From the desk of Saxon Davidson, Research Fellow
[redacted]

Institute of Public Affairs

24 September 2024

Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Committee Secretary

Federal government must address immigration, superannuation, and international investors to expand home ownership

The Institute of Public Affairs welcomes the opportunity to provide this analysis to the Senate Standing Committee on Economics as it conducts its inquiry into the financial regulatory framework and home ownership.

Home ownership is central to the Australian way of life and gives Australians a stake in the nation. Ensuring the right policies are in place to enable and encourage Australians to become homeowners should be a key focus of the federal and state governments.

Australia's housing affordability and availability challenge is a consequence of supply and demand issues. On the supply side, the construction of new housing is constrained by restrictive planning laws and regulations applied at the state and local level. On the demand side, Australia has experienced an unprecedented surge in its migration intake in recent years, and this is straining the housing market.

The policy levers available to the federal government have significant influence over the demand side pressures on the housing market. These include:

- Dramatically reducing the intake of net migration to reduce housing demand.
- Allowing Australian buyers to access their super to help purchase their first home.
- Strengthening the restrictions on foreign property investors.

Immigration intake must be reduced

The latest data from the Australian Bureau of Statistics revealed that a new migrant is arriving in Australia every minute on a net basis. Despite projections in the federal budget that the full 2023-24 net overseas migration intake would be 395,000, the federal government has overseen actual net overseas migration from July 2023 to March 2024 of 388,241, with another three months' worth of arrivals still to be counted.

Unprecedented immigration is compounding record-high housing and rental prices by increasing demand. Previous analysis by the IPA found that the cumulative housing shortage between 2023 and 2028 is set to be as high as 252,800 homes.

In the 2023 financial year, the federal government oversaw the largest ever net intake of international students, of more than 250,000 people. This was more than twice the previous high of 122,000 net arrivals in 2009 and overcompensated for the decline caused by the COVID-19 pandemic by more than 85,000 net arrivals. Previous IPA research found that international students in this period occupied the equivalent of 70 per cent of the new housing units supplied to the market across the nation.

The unprecedented trends in migration are not in line with community expectations. In polling commissioned by the IPA, 60 per cent of respondents believed immigration should be paused until more economic and social infrastructure, such as schools, roads, hospitals, and houses, are built.

The federal government should immediately review its immigration policy, and adjust the number of arrivals to levels commensurate with housing supply to ensure Australians already here can purchase their own homes.

First-time buyers should be allowed to access their super to help them purchase a home

Often the largest asset an Australian will ever own is their home. However, due to compulsory superannuation, a significant proportion of employment income earned by Australians is not available for immediate use to invest in a family home.

First-time homebuyers who are struggling to afford the deposit to purchase a home should be allowed to draw from their compulsory superannuation, their earned income, to help purchase their own home. In addition, Australians who are homeowners should be able to use their supernnuation to pay down their mortgage, especially given rising interest rates and current inflationary pressures.

This is important because those who retire without owning their own home are significantly disadvantaged compared to those who do, with retirement income having to cover rents and without the option of drawing additional income from their home asset.

The use of superannuation now to help meet the cost of living is a popular policy: a survey from 2023 by Australian Broker found that more than half of Australians would access their superannuation early if they could, including 15 per cent who would use their super to buy a home for themselves, 8 per cent who would put it towards an investement property, and 4 per cent who would use it to help buy a home for their children.[1]

The restrictions on foreign residential property investors should be strengthened

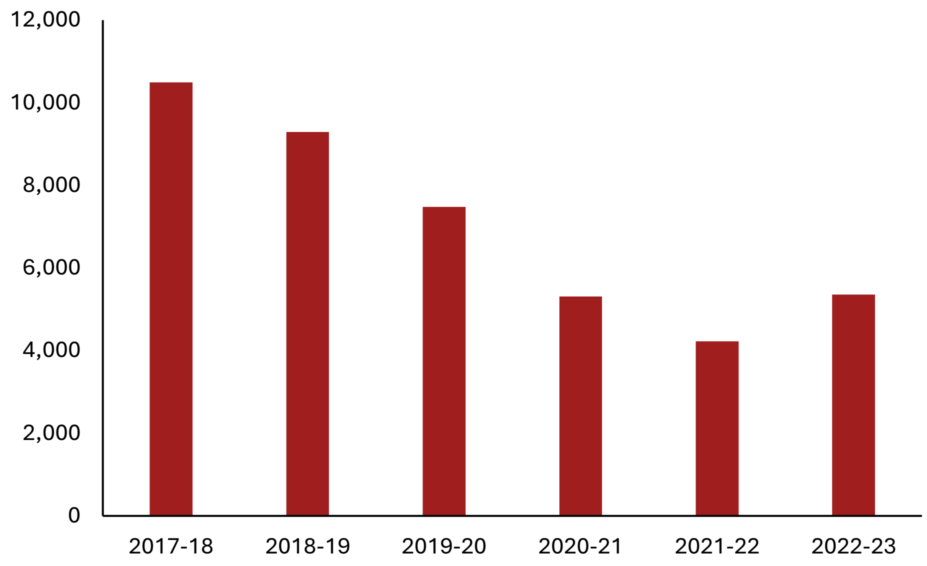
The principle position of the federal government should be that Australians have the opportunity to purchase a home and achieve the Australian dream of owning their own home without competing with international investors.

Whilst the number of dwellings being purchased annually by international investors is down on what it has been in the past, the shortage of new dwellings built since the pandemic has seen an increase in the number of established dwelling being bought by international investors (chart 2), even as the total number of residential dwellings being bought have stagnated (chart 1).

The number of established dwellings being purchased by international investors reached a five-year high in the 2022-23 financial year (chart 2), and the proportion of established dwellings being purchased by international investors has increased dramatically since the pandemic (chart 3).

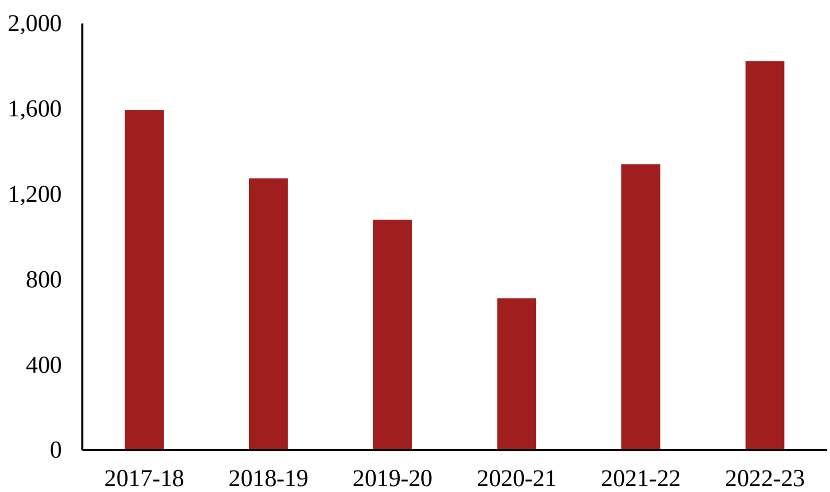
[1] Ryan Johnson, *Should Australians be allowed to tap into their super for homeownership?* (Australian Broker Poll, September 2023).

Chart 1: Number of residential dwellings purchased by international investors by financial year



Source: Australian Taxation Office

Chart 2: Number of established residential dwellings purchased by international investors by financial year



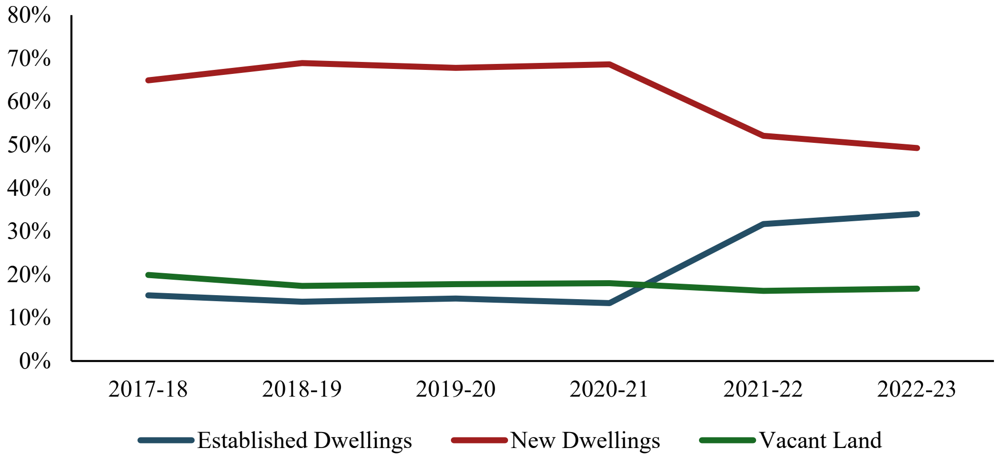
Source: ATO

Rather than largely purchasing new housing, international investors are increasingly diluting the amount of available housing that already exists, and this is reflected in the decreasing proportion of newly built housing being purchased by international investors (chart 3).

This has occurred at the same time as declining building approval rates,[2] putting further pressure on the housing market through decreased supply of new housing, and increased international investment in established housing.

[2] Daniel Wild, *Building Approvals Crash To 1980's Levels* (Institute of Public Affairs Media Release, April 2024)

Chart 3: Proportion of international investment purchases of residential property, by dwelling type by financial year



Source: ATO

Recommendations

Based on the analysis outlined above, the IPA recommends that:

- The net overseas migration intake be dramatically reduced.
- Australians seeking to purchase their first home be allowed to access their superannution to help address the issue of affordability.
- The restrictions on international investors in the domestic residential real estate market should be strengthened to help ensure Australians are given priority in the housing market.

I thank the Committee for the opportunity to provide this submission. Please do not hesitate to contact me at [redacted] for further consultation or discussion.

Kind regards,

Saxon Davidson
Research Fellow

Enclosed IPA Research

*Strangling The Goose With The Golden Egg: Why we need to cut superannuation taxes on Middle Australia (*IPA, September 2016)

There is a better home for superannuation (Australian Financial Review, March 2017)

Mass Migration Induced Housing Shortage (IPA, June 2023)

Australia's Housing Shortage: International Student Intake Exacerbating Nationwide Housing Supply Shortfall (IPA, July 2023)

IPA Poll: Attitude Towards Mass Migration In Australia (IPA, December 2023)

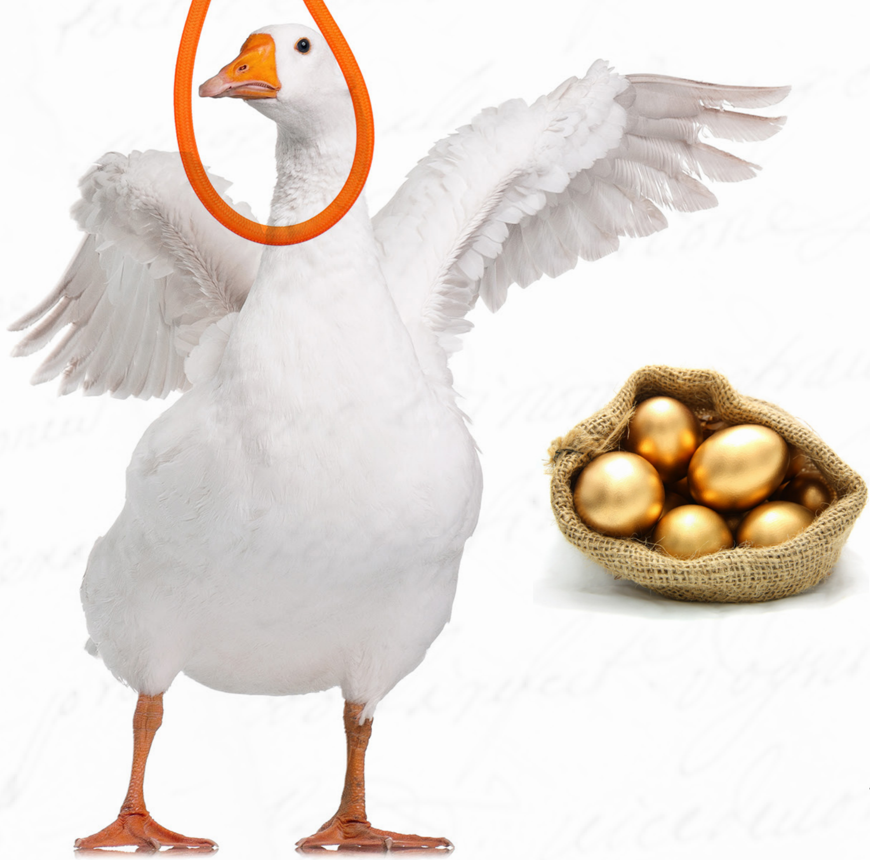
Australia's Declining Standard Of Living (IPA, May 2024)

Strangling THE GOOSE WITH THE GOLDEN EGG

Why we need to cut superannuation taxes on Middle Australia

Rebecca Weisser
in collaboration with Henry Ergas

September 2016



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Research Essay

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Note

The author of this research paper acknowledges the very generous contributions of Professor Henry Ergas, Professor Jonathan Pincus, and Brett Hogan. Nevertheless, the author takes full responsibility for the information contained in this research paper. This research paper draws on the submission of the Menzies Research Centre to the National Reform Summit.

Rebecca Weisser

Sydney, 8 September, 2016

1 Introduction

One wonders whether Phillip Larkin would have shouted 'Stuff your pension!', as he famously wished to do in his poem 'Toad', had he experienced the twists and turns, the dashed hopes and deceptions, of Australia's superannuation system. Even he, who despaired of aspirations he saw as profoundly middle class, recognized 'that's the stuff dreams are made on'. It's those dreams of funding a decent retirement—with the cost they impose in terms of submitting to Larkin's 'toad' of daily hard work—that are dashed when governments renege on promises.

Nowhere are promises more important than in retirement incomes. Saving for retirement involves making sacrifices today for the sake of the distant future; and once retirement occurs, those living on their savings no longer have the cushions—such as choosing to work longer hours—that might help them absorb the income losses governments can so easily inflict. Governments therefore have a duty to provide a stable and predictable framework in which individuals can save for retirement; and the greater the degree to which they can do so encouraging self-reliance, the more they will entrench the sense of independence that is at the heart of human dignity and that underpins a free society.

Australia has long struggled to meet that goal. Having introduced a means-tested age pension relatively early, so providing for some degree of poverty alleviation in old age, we then lagged in developing a comprehensive retirement income system that could ensure reasonable financial security for middle income Australians once they had ended working life. Proposals for a contributory defined-benefit scheme were repeatedly considered and several times advanced; but concerns about their fiscal implications and political divisions prevented their adoption.

Instead, a dual structure was eventually adopted which combined the Age Pension with a defined contribution scheme that had both a compulsory component and allowed for some supplementary contributions.

That choice, which was largely driven by the politics of the moment, was questionable from the outset. Since it came into effect, the problems it creates have only become more acute. As it stands, the scheme shifts complex financial and longevity risk on to savers who are poorly placed to bear it, has stubbornly high transactions costs, and is taxed in such a way as to further stymie its effectiveness.

Adding to the woes, successive governments have fiddled with the scheme's parameters, almost always with the goal of securing short-term revenue gains. They have, of course, invariably claimed that the latest fiddle would be the last: whether they believed those assurances is questionable; certainly the hapless contributors no longer do.

Unfortunately, the debate about the scheme, and the retirement income system more generally, has not focused on whether it is capable of meeting its objectives despite the damage wreaked on it. Rather, it has been hijacked by claims that the scheme is 'unfair', allowing higher income earners to avoid taxes they should have paid. Enveloped in rhetorical claims about 'rorts' and the super-rich, the debate has entirely ignored the 'forgotten people' - the middle income Australians who neither have incomes so low as to be adequately replaced by the Age Pension nor are so wealthy as to own large and diversified portfolios of tax-optimised financial and real assets.

That Labor, with its redistributionist agenda, would pay scant attention to this broad swathe of the population is perhaps understandable; that the Liberals would do so verges on the incomprehensible. Yet the most recent round of changes—introduced despite repeated promises to the contrary—suggests that is exactly what has happened.

To say that is not to deny that the architecture the Coalition's changes would introduce has a degree of coherence and is more readily implemented than the options advanced by Labor and the Greens. But even putting aside the manner in which it was introduced, its design, when viewed in more detail, seems severely flawed.

For example, the $1.6 million ceiling on the amount that can be held in the untaxed fund of the withdrawal phase is only indexed to the consumer price index; that means the maximum post-retirement income it can provide will decline over time compared to pre-retirement incomes, as wages growth comfortably exceeds the rate of increase in the CPI. To make matters worse, the Age Pension is indexed—and seems certain to remain that way—to the higher of CPI or nominal wages growth; as a result, the replacement rate provided by the age pension must rise compared to that which will be available from the ceilinged amount.

In other words, over time, those on the Age Pension will do steadily better compared to self-funded retirees. And compounding insult with injury, it is of course those self-funded retirees who, during the course of their working life, will have paid the taxes that finance the age pensions they are excluded from enjoying. If our concern is with fairness, that outcome—which reduces the allowed income replacement level available to those who save for themselves, relative to that assured to those who live on the income of others—should surely be objectionable.

However, it is not only fairness that is at stake; it is also efficiency. The economic purpose of a superannuation system is to facilitate the transfer of consumption from working life to the post-working years. It serves, in other words, as piggy-bank, allowing what economists call 'consumption smoothing' over the life-cycle. Ideally, taxes should be neutral as to when that consumption occurs: there is no sensible reason for taxing the same amount of consumption more heavily because it occurs tomorrow rather than today. Achieving that neutrality requires that the risk-free return on savings (which merely compensates savers for postponing consumption) be untaxed – so that $1 of consumption today is not taxed differently from consumption of the same present value at some point in the future.

Our tax system is far from achieving that neutrality, instead taxing the risk-free return to most forms of savings, excepting the family home, at positive rates, with the fact that those rates vary as between forms of savings adding to the inefficiency. Moreover, in the case of superannuation, the effective tax rate on private savings is increased by the (ever more) aggressive taper on the age pension, which can create effective tax rates on private savings that are well above the highest rate of personal income tax.

The government's proposed changes will only aggravate those distortions. Calculating the precise extent of the impacts—and their distribution among taxpayers—is complicated by the sheer number of changes and the multiplicity of moving parts, including the interaction with the Age Pension means test; it is made all the harder by the need to properly take account of volatility in incomes and of differences in starting point (as most Australians facing retirement have only had access to superannuation for a couple of decades). However, the Treasury has invested heavily in developing modelling tools that can do this; assuming it retains its traditional professionalism, it will undoubtedly have calculated the extent and pattern of the changes the package causes in effective lifetime tax rates on superannuation.

Transparency would have been well served had the government released those estimates. It hasn't, preferring to rely on data which is superficial when it is not seriously misleading.

For example, the government has greatly over-stated the income which can be derived from the capped $1.6 million by assuming it earns each and every year the rate of return that has historically characterized relatively risky portfolios, thus treating those returns as if they were a 'sure thing'. And as if that were not enough, it then routinely compares the resulting income stream to the age pension, which is far closer to a 'sure thing' then superannuation will ever be, especially given incessant government attempts at raiding it for revenue. It is easy to understand why it has chosen to do so, instead of evaluating the income stream from the $1.6 million using the bond rate and taking account of fees, as would be demanded by a like-for-like comparison: the calculated amount would be far closer to the age pension, undermining the government's claim that it is generous.

Ultimately, whatever one might make of the specifics of its plan, the government's claim is that an increase in the tax take on superannuation is needed to address the budget deficit. That the budget deficit has to be tackled is clear; however, even were it to be tackled through higher taxes, surely it is important to ensure that the taxes that are increased are those which impose the lowest economic costs. It hardly needs to be said that increasing taxes on savings, which are already taxed inefficiently heavily, does not meet that criterion.

Rather, the reason the government proposes to increase those taxes is because it can: they mainly hit middle-class and better-off Australians, and so are enthusiastically endorsed by the industry superannuation funds, the welfare lobby, and most of all, the ALP and the Greens, along with their noisy chorus of fellow-travelling think tanks. In contrast, durably changing the dynamics of public spending would require real political courage and ability; so too would serious tax reform.

But there is a price to be paid for taking the path of least political resistance. As Schumpeter put it, a country's fiscal structure is the best indicator of its real constitution—who has power and who doesn't, which citizens are genuinely important and which are confined to second class. Seen in that light, the lesson of these changes is that Australia's 'forgotten people' are as forgotten as they have ever been: their values, including that of self-reliance, derided; the confidence they have historically placed on the Liberal Party's sincerity and good faith mocked.

The long term damage to Australia's social fabric—the fabric the Menzies and Howard governments did so much to create—remains to be seen. But the damage to the Liberal Party's reputation, most notably among its historic constituency, has been as immediate as it risks proving enduring.

Combining analysis and passion, Rebecca Weisser brings these issues and many others to the forefront. Superannuation is a minefield of technical complexities; there will always be scope to argue about precisely what they imply. But ignoring the branches through an obsessive focus on the twigs is merely a way of avoiding the questions that really matter. The great virtue of this paper, which deserves a wide audience, is that it tackles those questions head on, putting into sharp focus the increased dangers our already flawed retirement incomes system now faces. Rather than kow-towing to the self-images of the day, it pierces through the rhetoric of 'fairness talk'; most importantly, it adopts the perspective, and champions the cause, of that middle class whose strength has always been the bedrock not only of this country's prosperity but also of its freedom.

Over a 1000 years ago, the great Muslim merchant and traveller, Akhbar al-Shin wal Hind, was amazed to find in Canton a system where all men paid a poll tax from when they turned 18. In return, he was told by high authorities:

"... when he reaches 80 years of age, no poll-tax is collected from him. He is then paid a pension from the Treasury. They say, 'We took from him when he was a youth, and we pay him a salary when he is old'."

Middle Australia, as it digests this latest blow to our system's credibility, can only share Akbhar's wonder at what he rightly regarded as the surest sign of a civilized society.

Professor Henry Ergas

2 Foreword

Almost a quarter of a century after the introduction of compulsory superannuation, four out of five Australians face not having enough savings to fully fund their retirement.

Yet rather than identify new ways to encourage people to put more money into their retirement accounts, the bipartisan approach of national policy makers is to treat this $2 trillion worth of private funds as just another source of taxation revenue.

In *Strangling the Goose with the Golden Egg*, Rebecca Weisser and Henry Ergas powerfully capture how this short term desire for revenue puts Australia at a disadvantage, and how the changes proposed by both the Government and the Opposition will make it unlikely that middle income earners will ever be free of the Age Pension.

High transaction costs, a lack of individual control, and rules that continually change are also contributing to a lack of trust and confidence in the current system.

But there is a better way.

Instead of citing ‘fairness’ to criticise people who attempt to provide for themselves, policy makers should acknowledge that private funds put aside for retirement represent deferred consumption, so flat and low superannuation takes on contributions and earnings for everyone is actually good public policy.

Instead of proposing that the goal of the superannuation system is merely to ‘substitute or supplement the Age Pension’ the aim should be to ensure as many Australians as possible take personal responsibility to save for their own retirement.

Instead of making the rules of the system ever more complex, simplicity and neutrality should be guiding principles.

Rebecca and Henry propose moving towards an ‘EET system’ where instead of taxing contributions and earnings, only end-benefits in retirement are taxed at an individual’s marginal income tax rate. They also suggest prioritizing the reduction of fees and charges and facilitating the purchase of private, defined-benefit pensions.

Superannuation lies at the heart of important national policy questions about taxes, spending, personal responsibility and the role of government. The Institute of Public Affairs will continue to conduct and support quality research on these topics.

Brett Hogan

Director of Research
Institute of Public Affairs

3 Executive summary

The purpose of the retirement income system should be to enable Australians to maintain in retirement the living standards they achieve during their working lives.

While our system largely achieves that goal for low and high-income earners, middle-income Australia is poorly served.

High effective tax rates on superannuation are a critical factor contributing to a retirement savings deficit for middle-income Australians, increasing their reliance on the age pension.

Moreover, the current system imposes unacceptably high transactions costs and risk on middle-income Australians.

Unfortunately, proposed changes to superannuation from both the Government and the Opposition worsen, rather than fix the system's myriad weaknesses.

Superannuation reforms should be judged by the effect that they have on helping each individual to accumulate sufficient funds to maintain their living standards in retirement.

The Government should:

- ensure that the Objective of the superannuation system is to allow people to maintain their living standards in retirement;
- task the Productivity Commission to review the whole retirement income system, considering the interaction of the age pension, superannuation and the taxation of savings;
- phase in a return to an EET system over time, where taxes are levied on benefits in retirement, not contributions or earnings,
- put out a tender for a low-fee default superannuation scheme and allow people to switch to it when they submit their tax return.
- facilitate the provision of defined benefit pensions to those who wish to purchase them.

If however the Government continues with its current policy approach, then it should allow income generated from assets outside superannuation to count as part of the $1.6 million asset base for tax-free retirement income and also allow the carry forward of unused concessional caps from 2007.

4 The architecture of Australia's retirement savings system

4.1 How the system evolved

National retirement systems are often classified according to a framework of pillars established by the World Bank. While variously categorized, three elements are commonly identified as pillars. The first pillar is a pension, funded from general taxes, which alleviates poverty and is either universal or means-tested. The second pillar mandates contributions to defined benefit or defined contribution schemes and aims to replace working income. The third pillar consists of tax arrangements that encourage voluntary contributions to defined benefit or defined contribution schemes.[1]

For most of the 20th century, Australia's retirement income system had two of these pillars and a third critical element. The first pillar was the Age Pension, which was introduced in 1909 and intended to alleviate poverty and therefore subject to an income and asset test. The second pillar was voluntary superannuation in which an employer made regular payments on behalf of an employee toward a future pension. These arrangements dated back to schemes offered by banks and state governments in the 19th century. From 1914, employer contributions and investment earnings were taxed differently to income tax and in 1936, different tax arrangements were put in place for benefits taken as a lump sum, introducing the EET system of taxation of superannuation[2]. A third critical element to the retirement system was the exemption from taxation of the family home, which was introduced in 1912 and remains central to the retirement strategies of the majority of Australians.

All these arrangements remained largely unchanged for around half a century [3] but the missing element was - and still is - a compulsory, contributory, earnings-related public pension, which would provide a defined benefit pension in retirement.

It is one of the great ironies of Australian public policy that between 1913 and 1938 two unsuccessful attempts were made by centre-right governments[4] to introduce just such a European-style, compulsory, contributory, earnings-related public pension and were blocked by the Labor Party, amongst others, which opposed it because it wanted, instead, to strengthen the Age Pension[5].

1 World Bank, *Averting the old-age crisis: policies to protect the old and promote growth*, (World Bank, Washington, DC, 1994), p.15

2 Superannuation can be taxed at three points: on contributions; on investment income; and when benefits are drawn down in retirement. Whether taxation occurs at each of these points and whether is at full or concessional rates is indicated using the symbols: E – exempt from tax, T – taxed at full rates, and t – taxed at concessional rates. An EET system exempts contributions and investment earnings but taxes final benefits. There are many permutations i.e.TEE, TET, ttE, ttt, TeT etc....

3 H. Bateman, "Retirement Incomes for an Ageing Australia", *Economic and Labour Relations Review*, January 2005, Vol. 15, Issue 2

4 "Towards Higher Retirement Incomes for Australians: a History of the Australian Retirement Income System since Federation" [online]. *Economic Round-up*, Centenary 2001, 2001: pp75-76.

5 Adam Creighton, "We are all capitalists now", *Only in Australia – the History, Politics, and Economic of Australian Exceptionalism*, ed. William O. Coleman, Oxford University Press, 2016, p.194.

Then, when the centre-right had given up, the Labor Party, together with the trade union movement, introduced a privately managed retirement scheme based on individual accounts, which incidentally, through the control of superannuation funds, offered a lucrative way of boosting the economic and therefore political power of the union movement, which was suffering a rapid decline in membership.[6] As a result, productivity award superannuation was introduced in 1986 and compulsory superannuation was introduced in 1992.

4.2 The system today

This has given Australia the broad architecture of the retirement system that it has today, which uses of all three of the World Bank's pillars.

The most substantial is the means-tested Age Pension, which has evolved from bare poverty alleviation to providing a quarter of average, male weekly earnings.

The second pillar is compulsory saving through private superannuation accounts, comprising employer contributions which are tax deductible, employee contributions which are not tax deductible but receive different tax treatments, fund earnings which are taxed differently, and benefits which are not currently taxed in recognition of the taxes that have already been paid and the bias against saving in the Australian taxation system.

The third pillar is the different taxation of voluntary saving through superannuation[7] and other forms of long-term saving through property and shares, which are also central to an effective retirement system.

In addition, the family home operates as a de facto fourth pillar since it is the single largest asset for most Australians and serves as the centrepiece of their retirement strategy. Paying off the family home is a tax effective way of reducing retirement expenses by obviating the need to pay rent or a mortgage. As well as reducing income needs in retirement, it also serves as a means of transferring consumption from working life to the retirement years, as home equity is a store of wealth that can be accessed through reverse mortgages or downsizing. Estimates show that without this 'fourth leg,' income replacement rates for those on middle-incomes would be very low for many years.

6 Union membership fell from 60 per cent of the workforce in the 1960s to 45 percent in the 1980s, and then to 17 percent (12 in the private sector) today. See Adam Creighton, 'We are all capitalists now', Only in Australia – the History, Politics, and Economic of Australian Exceptionalism, edited by William O. Coleman, Oxford University Press, 2016, p.194.

7 Ken Henry et al. "*Australia's Future Tax System*", December 2009, http://taxreview.treasury.gov.au/content/StrategicPaper.aspx?doc=html/Publications/Papers/Retirement_Income_Strategic_Issues_Paper/Chapter_2.htm, Viewed 26 August 2016

5 Problems with Australia's Retirement Savings System

5.1 Goal of superannuation to maintain income standards in retirement

Like most advanced economies, the Australian retirement system faces a major demographic challenge.

In 1901, 4 per cent of Australians were 65 years or older. Now, more than 13 per cent are 65 or older and by 2041 nearly a quarter of Australians (23 per cent) are expected to be 65 or older.[8] A boy born today can expect to live to 92 and a girl to 94[9]. Australians therefore face the challenge of financing what may be 30 or more years of living expenses beyond the normal end of working life[10]. Longer life expectancies, better health and higher levels of education should postpone retirement. Indeed, the labour force participation rate of people 65 and older has already nearly doubled, from 6 per cent in 2004-05 to around 12 per cent today[11].

However, while Treasury expects half the men aged 65 to 70, and 35 per cent of women, to still be in the labour force in 2055, the proportion of over-70s working is unlikely to rise much above 10 per cent, so that virtually all of the 'older old' will have little or no employment income and will have to rely on pensions and accumulated savings[12].

The introduction of compulsory superannuation was meant to respond to that demographic challenge by making it mandatory for all working Australians to put aside sufficient funds to be able to support themselves comfortably in retirement.

In 2007 former Prime Minister Paul Keating, the architect of compulsory superannuation, said the goal of superannuation was to allow employees 'to enjoy in retirement an income equal to 70 per cent of their earnings before retirement.'[13]That is an admirably clear and worthy goal yet almost a quarter of a century later, it is only those on the lowest pre-retirement incomes who are able to enjoy an income in retirement equal to 70 per cent of their pre-retirement earnings, let alone the 80 per cent or more achieved in many OECD countries (Figure 1).

8 Australian Bureau of Statistics, *4102.0 - Australian Social Trends March 2011*, http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/4102.0Main+Features10Mar+2011, Viewed 26 August 2016

9 Henry Ergas, The Australian, "As Budget Nears, Retirement Income System Faces Crisis Point", 11 April, 2015, http://www.theaustralian.com.au/opinion/columnists/henry-ergas/as-budget-nears-retirement-income-system-faces-crisis-point/news-story/2d3eea6ebecd176f795bb43474fc8ad1 ,Viewed 6 September 2016

10 Ibid.

11 Ibid.

12 Ibid.

13 Paul Keating, "The Story of Modern Superannuation", Speech to the Australian Pensions and Investment Summit, 31 October 2007, http://www.keating.org.au/shop/item/the-story-of-modern-superannuation-31-october-2007, Viewed 26 August 2016

Figure 1 Net Pension Replacement Rates by Earnings. Source: OECD[14]

OECD members	Individual earnings, multiple of mean for men (women where different)			
	Pension Age	0.5	1.0	1.5
Australia	67	88.6 (84.6)	58.0 (53.4)	45.9 (40.9)
Austria	65	92.1	91.6	88.9
Belgium	65	64.2	60.9	49.1
Canada	67	58.5	47.9	34.1
Chile	65	48.7 (45.3)	37.7 (33.1)	38.0 (33.4)
Czech Republic	68	93.1	63.8	51.9
Denmark	67	103.2	66.4	57.2
Estonia	65	76.1	59.8	53.5
Finland	65	66.6	63.5	65.0
France	63	66.9	67.7	62.0
Germany	65	53.4	50.0	49.0
Greece	62	82.9	72.9	73.3
Hungary	65	89.6	89.6	89.6
Iceland	67	90.5	76.7	76.3
Ireland	68	70.1	42.2	32.5
Israel	67-64	85.7 (77.4)	68.8 (61.9)	50.3 (45.2)
Italy	67	82.2	79.7	81.6
Japan	65	53.3	40.4	35.5
Korea	65	64.3	45.0	34.4
Luxembourg	60	98.4	88.6	83.7
Mexico	65	35.5	28.4 (26.2)	28.1 (26)
Netherlands	67	101.3	95.7	94.1
New Zealand	65	80.8	43.0	30.4
Norway	67	80.1	60.2	48.6
Poland	67	54.0	52.8	52.4
Portugal	66	87.7	89.5	88.4
Slovak Republic	67	84.0	80.6	79.4
Slovenia	60	57.6 (60.6)	57.4 (60.4)	55.1 (57.6)
Spain	65	89.1	89.5	89.3
Sweden	65	56.7	55.8	70.1
Switzerland	65 (64)	61.4 (60.7)	46.9 (46.5)	31.5 (31.2)
Turkey	65	98.0	104.8	109.9
United Kingdom	68	51.7	28.5	20.3
United States	67	54.3	44.8	38.9
OECD34	**65.5 (65.4)**	**74.1 (73.7)**	**63.2 (62.7)**	**58.5 (58.0)**
Other major economies				
Argentina	65 (60)	96.4 (104)	87.5 (87.3)	80.8 (78.4)
Brazil	55 (50)	105.9	76.4 (58.1)	76.4 (58.1)
China	60 (55)	102.2 (94)	80.5 (75)	73.6 (69)
India	58	109.7 (103.8)	109.7 (103.8)	109.7 (103.8)
Indonesia	55	13.8 (12.5)	13.8 (12.5)	13.9 (12.6)
Russian Federation	60 (55)	86.4 (73.7)	86.4 (73.7)	86.4 (73.7)
Saudi Arabia	45	65.4	65.4	65.4
South Africa	60	21.7	11.8	8.3
EU28	65.2 (65)	80.7 (80.4)	70.9 (70.7)	66.4 (66.2)

14 Organisation for Economic Co-operation and Development (OECD), *Pensions at a Glance 2015, OECD and G20 indicators*, (OECD Publishing, Paris), p.145

A retirement income stream that replaces 80 per cent of a person's working income is broadly considered sufficient to maintain real living standards, given that expenditure needs fall with age (for instance, older people are more likely to have paid off a mortgage and no longer have dependent children).

The measurement of retirement income as a proportion of working income is called the replacement rate and can be calculated using a range of methodologies.[15] Broadly, net retirement income is divided by net final pre-retirement income to calculate the net replacement rate. The OECD gathers information about mandatory and voluntary private and public pension schemes and the taxation treatment of workers and pensioners and uses this to calculate the net replacement rate[16].

5.2 Low-income earners achieve high replacement rates

OECD data shows that contrary to the view that the Australian retirement system favours the rich, net replacement rates secured through the pension and superannuation system are high only for people on low incomes and are lower than the OECD average for people on average and above average incomes.

Additionally, although Australians have relatively high rates of home ownership, and imputed income from housing means actual consumption replacement rates are somewhat higher than OECD estimates suggest, home ownership is very widely distributed, so imputed housing income does not greatly alter the replacement rate relativities between middle and lower income groups.

The Age Pension however is not particularly generous and low income earners achieve a high replacement rate, above 88.6 per cent, in part because some welfare recipients improve their living standards when they move from other welfare benefits to the Age Pension.[17] The OECD estimates that the incomes of people 65 and older in the advanced economies are, on average, 14 per cent below those of their respective populations; however, older Australians have average incomes 35 per cent lower than the Australian population as a whole[18]. Adding the benefit of home-ownership doesn't close the income gap but does halve it[19].

15 Commonwealth of Australia, *Australia's Future Tax System – Retirement Income Consultation Paper, Appendix D, 2008*, http://taxreview.treasury.gov.au/content/downloads/retirement_income_consultation_summary/Retirement_Incomes_Consultation_Paper.pdf, Viewed 6 September 2016

16 OECD, *Pensions at a Glance 2015, OECD and G20 indicators*, (OECD Publishing, Paris,), pp. 135-151

17 The single pension rate is $794.80 whereas the single rate for unemployment benefit for a person aged over 60 is $570.80 after 9 continuous months of unemployment. The single rate for a person on a disability pension is identical to the rate of the pension, so moving to the Age Pension represents a continuation of the same standard of living for the disabled but an improvement in the standard of living for the long-term unemployed.

18 Henry Ergas, The Australian, "As Budget Nears, Retirement Income System Faces Crisis Point", 11 April, 2015, http://www.theaustralian.com.au/opinion/columnists/henry-ergas/as-budget-nears-retirement-income-system-faces-crisis-point/news-story/2d3eea6ebecd176f795bb43474fc8ad1 ,Viewed 6 September 2016

19 Ibid.

Yet, even taking account of taxes, transfers and household size, 80 per cent of older couples are in the bottom two income quintiles[20]. That low-income earners rely on the pension is neither surprising nor unreasonable. The consumption sacrifice they would have to make during their working life makes it difficult if not impossible to accumulate savings. Further, the cost of managing small savings in a private savings scheme would take such a large share of annual earnings that it would also prevent accumulation.

5.3 High income earners fund their retirement despite high taxes

At the other end of the income spectrum, high-income earners (defined for OECD purposes as those earning one and a half times average earnings) have a low replacement rate of 45.9 per cent[21] in terms of income provided by the pension and superannuation, so the system delivers less for them in terms of replacement rates than for low income earners. Yet very high income earners are likely to have incomes in retirement from sources not covered by the OECD estimates, and a greater capacity to manage their resources to fund their retirement as they can accumulate large and diversified portfolios of financial and real assets.

But Australia's high income earners do this after paying an effective average tax rate on top income earners that is three percentage points higher than that in Canada, five percentage points higher than that in Sweden and 10 percentage points higher than that in the US[22].

Our highly progressive tax and transfer system also ensures that the poorest 20 percent of Australians get more than 40 percent of income transfers and 12 times more in cash benefits than the richest 20 percent which get less than 3 percent, by far the highest ratio in the advanced economies[23].

5.4 Stuck in the Middle - average Australians' sharp drop in retirement incomes

It is middle-income earners in Australia, on replacement rates of 58 per cent, that have a problem. The system compresses the distribution of income among older Australians to the disadvantage of middle-income earners who experience a sharp drop in their absolute and relative position in society.

In 2011-12, for instance, a typical middle-income couple aged 45 to 64 had almost twice the income of a couple of similar age in the two lowest income deciles whereas for those aged 65 and over, a middle income couple was only 25 per cent better off than its poorer counterparts[24].

20 Ibid.

21 OECD, *Pensions at a Glance 2015, OECD and G20 indicators*, (OECD Publishing, Paris,), p.147

22 Henry Ergas, The Australian, "Apocalyptic Claims Need To Be Put In Perspective", 24 May, 2014.

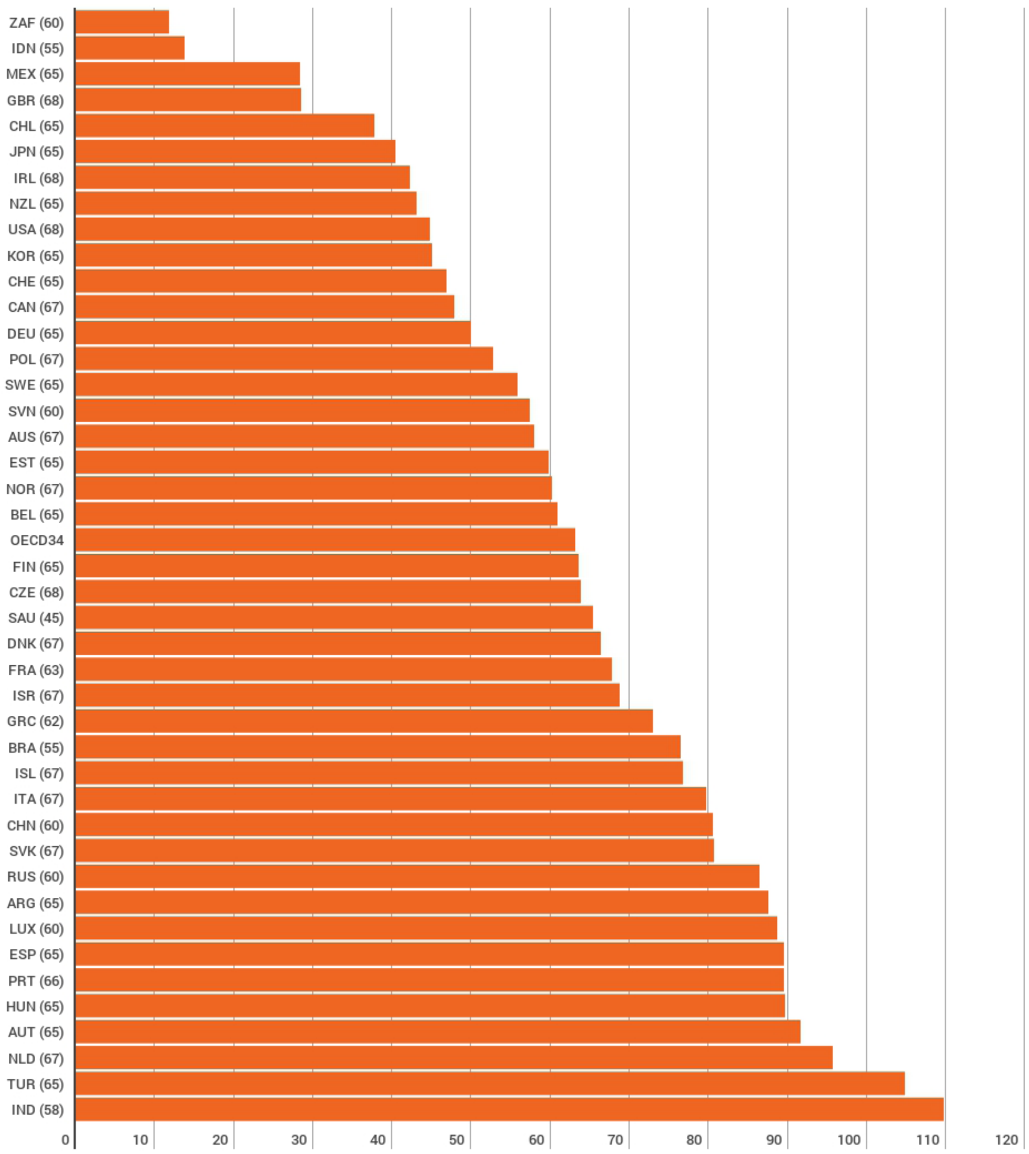
23 Ibid

24 Henry Ergas, The Australian, "That's Right Treasurer: Superannuation is Our Money Not Yours", 7 December 2015, http://www.theaustralian.com.au/opinion/columnists/henry-ergas/thats-right-treasurer-superannuation-is-our-money-not-yours/news-story/8145d79d8353e6b59bff7a749eee14ea, Viewed 6 September 2016

And despite earning relatively high wages and making compulsory savings throughout their working lives, they achieve significantly lower replacement rates than do their counterparts in many other countries in the OECD and lower than the OECD average. While average yearly worker earnings are higher in Australia than the OECD average ($79,689 compared with $48, 901),[25] the net replacement rates for average workers in Australia (58 per cent for men and 53.4 per cent for women)[26] is lower than the OECD average (63.2 per cent) and much lower than the EU28 average (70.9 per cent)[27] (See Figure 2 and Figure 3).

Figure 2 Australia's below average replacement rates for average earners. Source: OECD[28]

Net pension replacement rates: Average earners



25 OECD, *Pensions at a Glance 2015, OECD and G20 indicators*, (OECD Publishing, Paris), p.207

26 Ibid p. 210

27 Ibid p. 145

28 Ibid p.145

Figure 3 Australia's above average replacement rates for low earners but not high earners. Source: OECD[29]

The OECD average for the net replacement rates of an average earner, including mandatory and voluntary public and private schemes, is higher still at 71 percent[30].

29 Ibid p. 145

30 Ibid p. 146

The situation is even less positive when one compares the average Australian retiree with those OECD countries with the highest net pension replacement rates for people on average incomes such as:

• Austria	91.6
• Hungary	89.6
• Iceland	76.7
• Italy	79.7
• Luxembourg	88.6
• Netherlands	95.7
• Portugal	89.5
• Slovak Republic	80.6
• Spain	89.5
• Turkey	104.8

Some of these countries deliver high replacement rates for all income groups, allowing people across the income spectrum to maintain the income levels they achieved pre-retirement. For instance, in Austria net replacement rates are 92.1 per cent for low-income earners, 91.6 percent for average income earners and 88.9 percent for above average income earners. In Spain, replacement rates are almost identical for low, average and above average income earners at 89 percent[31].

Looking ahead to 2061, the OECD projects that net replacement rates will continue to be skewed in favour of low-income earners, based on projections which model scenarios using current legislation and 2014 data.

31 OECD (2015), Pensions at a Glance 2015: OECD and G20 indicators, OECD Publishing, Paris. P. 207 Ibid P.207

Figure 4 OECD pension modelling results – Baseline scenario. Source: OECD[32]

Baseline scenario: Legislation scenario (current policy indexation of safety-net schemes)						
Men	Individual earnings, multiple of average					
Women (where different)	*0.5*	*0.75*	*1*	*1.5*	*2*	*3.0*
Gross relative pension level	39.6	42.1	44.5	49.3	61.9	74.6
(% average gross earnings)	*37.9*	*39.4*	*40.9*	*43.9*	*54.7*	*65.9*
Net relative pension level	51.8	54.9	58	64.3	80.7	97.3
(% net average earnings)	*49.4*	*51.4*	*53.4*	*57.3*	*71.4*	*86.1*
Gross replacement rate	79.3	56.1	44.5	32.9	30.9	24.9
(% individual gross earnings)	*75.7*	*52.5*	*40.9*	*29.3*	*27.3*	*22.0*
Net replacement rate	88.6	69.6	58	45.9	44.8	38.5
(% individual net earnings)	*84.6*	*65.1*	*53.4*	*40.9*	*39.6*	*34.0*
Gross pension wealth	14.0	9.9	7.8	5.8	5.5	4.4
(multiple of individual gross earnings)	*15.1*	*10.5*	*8.2*	*5.8*	*5.5*	*4.4*
Net pension wealth	14.0	9.9	7.8	5.8	5.5	4.4
(multiple of individual gross earnings)	*15.1*	*10.5*	*8.2*	*5.8*	*5.5*	*4.4*

"Assumptions: Real rate of return 3%, real earnings growth 1.25%, inflation 2%, and real discount rate 2%.
All systems are modelled and indexed according to what is legislated. Transitional rules apply where relevant. DC conversion rate equal 85%. Labour market entry occurs at age 20 in 2014. Tax system latest available: 2013."

Figure 5 OECD pension modelling results – Alternative Scenario. Source: OECD[33]

Alternative scenario: full wage scenario: wage indexation of safety-net schemes						
Men	Individual earnings, multiple of average					
Women (where different)	*0.5*	*0.75*	*1*	*1.5*	*2*	*3.0*
Gross relative pension level	41.5	43.9	46.3	51.2	61.9	74.6
(% average gross earnings)						
Net relative pension level	54.2	57.3	60.5	66.8	80.7	97.3
(% net average earnings)						
Gross replacement rate	83.0	58.6	46.3	34.1	30.9	24.9
(% individual gross earnings)						
Net replacement rate	92.8	72.7	60.5	47.7	44.8	38.5
(% individual net earnings)						
Gross pension wealth	14.7	10.3	8.2	6.0	5.5	4.4
(multiple of individual gross earnings)	*15.9*	*11.0*	*8.5*	*6.1*	*5.5*	*4.4*
Net pension wealth	14.7	10.3	8.2	6.0	5.5	4.4
(multiple of individual gross earnings)	*15.9*	*11.0*	*8.5*	*6.1*	*5.5*	*4.4*

"Assumptions: Real rate of return 3%, real earnings growth 1.25%, inflation 2%, and real discount rate 2%.
All systems are modelled and indexed according to what is legislated. Transitional rules apply where relevant. DC conversion rate equal 85%. Labour market entry occurs at age 20 in 2014. Tax system latest available: 2013."

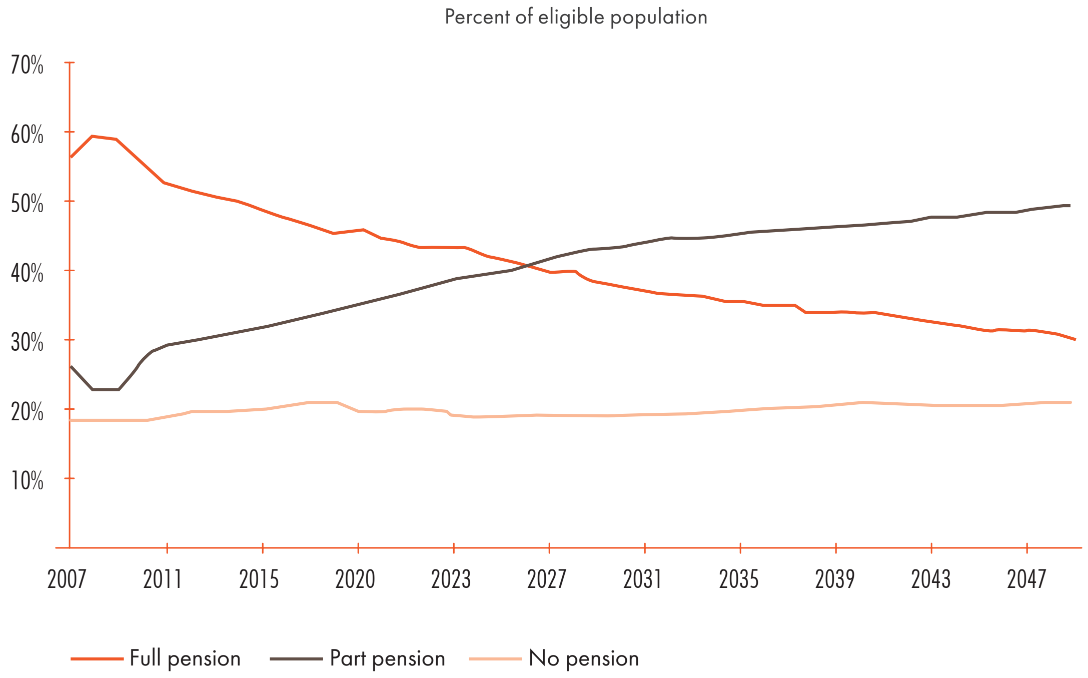
32 Ibid, p.210.

33 Ibid, p. 211.

That is not to say government should guarantee high replacement rates at any cost. There is no doubt that many countries have pursued the goal of pension adequacy in ways that are fiscally irresponsible, though there are also those where that objective has been achieved without compromising long term fiscal sustainability. For example, Defined Benefit Pension Funds in Belgium, Finland, Germany, the Netherlands, Norway Portugal and Spain had an average funding ratio around or above 110 percent in 2013, the most recent year for which figures are available[34].

So despite the fact that Australians have been forced to save ever more of their income in superannuation, starting at 3 per cent in 1992 and rising to 9.5 per cent today, 80 percent of Australians still rely to a greater or lesser extent on the age pension, funded out of general revenue (Figure 6).[35]

Figure 6 Projected proportion of eligible persons receiving an Age Pension. Source: National Commission of Audit[36]



And although the number of people receiving the full pension is set to decline, the number of part pensioners is forecast to increase by the same amount. In short, although the fall in the number of full pensioners will reduce the pressures on the Aged Pension, there is no prospect of a significant increase in the number of entirely self-funded retirees over the next 40 years. [37]

34 Ibid, p.197

35 The National Commission of Audit wrote 'on current projections there is unlikely to be an increase in the proportion of individuals who are completely self-sufficient and not reliant on the Age Pension despite the significant investment in superannuation over time. Even allowing for a decline in the proportion of people receiving the full pension, a rise in the number of people receiving the part-rate of pension will see the proportion of older Australians eligible for the Age Pension remaining constant at 80 per cent over the next forty years or so.' Source: *National Commission Audit*, 7.1 Age Pension, http://www.ncoa.gov.au/report/phase-one/part-b/7-1-age-pension.html

36 Ibid.

37 Ibid.

Indeed, Treasury modelling in 2009, cited in the Harmer Report, noted that the maturing of the Superannuation Guarantee in 2042 was only estimated to reduce the total value of pension spending by some 6 percent.[38]

This is hardly a satisfactory outcome. It seems even more curious when one considers that average earnings in Australia are high by international standards, which should allow reasonable levels of savings.

All other things being equal, Australians on average incomes should be able to look forward to maintaining the same consumption income they achieved in their working lives during their retirement. Yet for the majority this goal is elusive and the reality is that their living standards decline.

5.5 Shortsighted taxes, long-term damage

Former Prime Minister Paul Keating's ex post-facto explanation for this retirement savings deficit is to blame his opponents for not increasing compulsory contributions to 15 per cent of wages.[39]

But increasing mandated contributions has a steep economic cost, as it can force employees and their families to reduce consumption at times when doing so imposes a substantial sacrifice. Even putting that aside, his criticism ignores the impact that the Hawke Labor Government's restructure of superannuation taxation arrangements in 1988 had on savings in superannuation funds. Facing a shortfall in revenue in 1988, the government imposed a tax of 15 per cent on contributions and earnings but reduced taxes on benefits to zero for lump sums up to a certain moderate amount.[40] This represented a dramatic departure from the status quo ante as until then, an employer's contributions to superannuation were tax deductible, earnings were exempted from taxation and benefits were taxed at an individual's marginal income tax rate.[41]

This previous approach is broadly the approach followed in most OECD countries and confers a number of important benefits. First, it maximizes an individual's accumulation of savings and taxes income only when it is consumed. As well as being more equitable in terms of taxing like incomes alike, it ensures that the risk associated with generating a retirement income is spread between the individual and the government rather than being borne solely by the individual. Second, by taxing retirement income as ordinary income it provides an incentive to smooth consumption out over the anticipated retirement period since the larger the withdrawal the higher the marginal tax rate that would be paid. Third, it maintains the breadth of the income tax base regardless of changes in the demographic profile of a country.

38 Jeff Harmer, *Pension Review Report*, 27 February, 2009, p.9, https://www.dss.gov.au/about-the-department/publications-articles/corporate-publications/budget-and-additional-estimates-statements/pension-review-report, Viewed 6 September 2016

39 Paul Keating, "The Story of Modern Superannuation", Speech to the Australian Pensions and Investment Summit, 31 October 2007, http://www.keating.org.au/shop/item/the-story-of-modern-superannuation-31-october-2007, Viewed 26 August 2016

40 Adam Creighton, "We are all capitalists now", *Only in Australia – the History, Politics, and Economic of Australian Exceptionalism*, ed. William O. Coleman, Oxford University Press, 2016, p.197.

41 Five per cent of a lump sum taken on retirement was taxed at an individual's marginal tax rate. Source: K. Henry et al. "Australia's Future Tax System", December 2009, http://taxreview.treasury.gov.au/content/Paper.aspx?doc=html/publications/papers/report/section_4-01.htm, Viewed 26 August 2016

The taxation of superannuation in Australia is very complex, particularly considered over time, but broadly speaking Labor's restructure under the Hawke and Keating governments brought forward the receipt of tax revenue, transforming the taxation of superannuation in Australia from an EET system to a TTE system.[42] Australia is one of the few advanced economies to tax retirement incomes in this way. Almost all other OECD countries use the EET system, including most of the countries that outperform Australia on retirement replacement rates for average income earners. Countries that achieve high retirement incomes and use the EET system include Canada, Chile, the Netherlands, Sweden, Switzerland, the UK and the USA.[43]

Paul Keating's decision to adopt an approach that increased immediate taxation on superannuation was shortsighted and dramatically reduced retirement savings, particularly for middle-income earners. It should be a lesson to those who want to further increase taxes on retirement savings today. Australians are compelled to use superannuation to save for their retirement, yet from the outset, taxation has threatened to strangle the goose that should lay the golden nest egg.

42 See Footnote 2

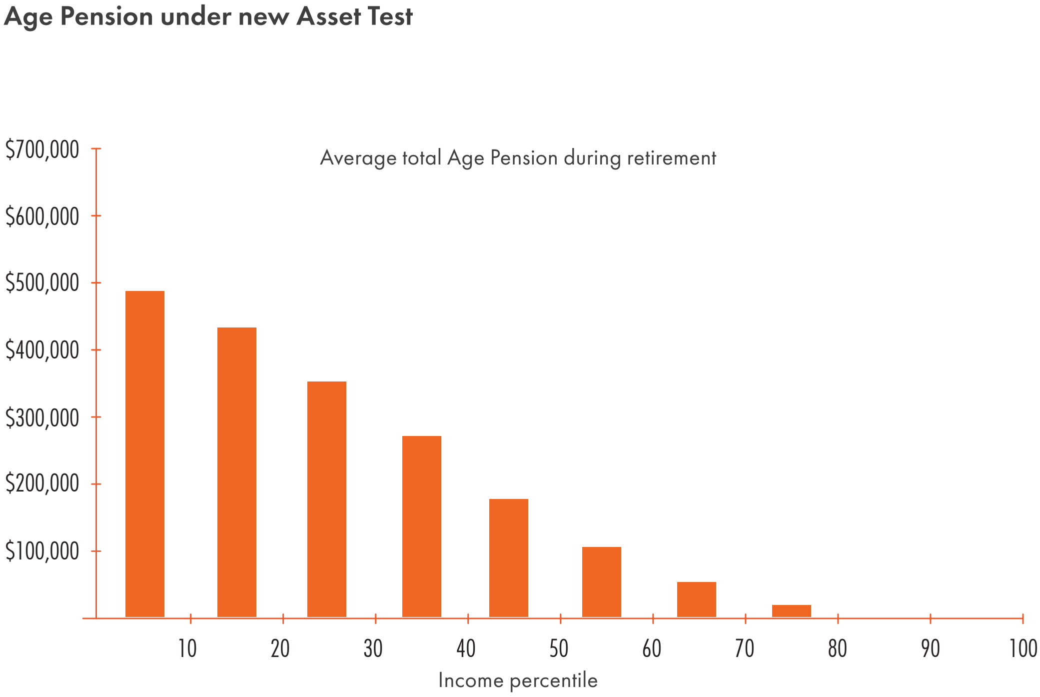
43 Mercer, Tax & Superannuation: Benchmarking Australia Against the World's Best Retirement Savings Systems, February 2013, p.6. http://www.mercer.com/content/dam/mercer/attachments/asia-pacific/australia/News/130208_Global_Tax_Benchmarking_Final.pdf

5.6 Correctly estimating the value of the age pension

Middle-income earners receive much less government support than those on low-incomes (Figure 7 [44]) and although their savings rise, the average superannuation balance for a 60 year old in 2017-18 is estimated to be $240,000[45], with women's balances less than half those of the average man[46].

This is not sufficient to maintain living standards or indeed to achieve the replacement rates of low income earners who rely on taxpayers to fund their retirement.

Figure 7 Reduction in direct assistance for middle-income earners[47]



It hardly seems fair that those who work and save for retirement should be relatively less well-off than those who save nothing for their retirement but Figure 7, which values the Age Pension at around $500,000 in life-time payments in today's dollars, can be misleading as it doesn't indicate how much it costs a self-funded retiree to safely and reliably generate the same income.

44 Mercer Australia, AIST Mercer Super Tracker – How the super system stacks up on fairness, adequacy, and sustainability, March 2016, p.7

45, The Hon Scott Morrison MP Treasurer, The Hon Kelly O'Dwyer MP Minister for Revenue and Financial Services, 'A More Sustainable Superannuation System,' Budget 2016 Briefing Note, p.5

46 In 2013-14 Australian women had on average $138,000 in super savings, less than half of the average male account balance at that time. Source: Australian Securities and Investment Commission, Money Smart Website, "Superannuation and Women", 19 April 2016. https://www.moneysmart.gov.au/life-events-and-you/women/superannuation-and-women, Viewed 31 August 2016.

47 Mercer Australia 2016, "AIST Mercer Super Tracker released: Government urged to revise Age Pension Asset Test", 17 March, 2016 http://www.mercer.com.au/newsroom/2016-aist-mercer-super-tracker-released.html, Viewed 31 August 2016.

As Jeremy Cooper, Chair of the Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System and chairman of retirement income at Challenger Sydney wrote in April, 2015:

"The brutal reality is a fair price for an age pension in today's interest rate environment is about $1 million. For that amount, a couple will get $1,297 a fortnight, or $33,717 of income a year. That's right; the full age pension (including supplements) would cost a 65-year-old couple a surprising $1,022,000 to buy today. For a 65-year old single woman, an age pension-equivalent income stream of $860 a fortnight for life, including supplements, or $22,365 a year, would cost $666,000."[48]

To calculate the value of future Age Pension cash flows one has to 'discount' them to today's dollars. Given the Age Pension is guaranteed by the government, the appropriate discount rate is the 10-year government bond rate of 2.30 per cent, the closest thing to a long-term, risk-free rate in Australia[49].

Those who think a couple will need less than $1,022,000 to retire on to generate the Age Pension, are assuming either a higher 10-year bond rate, and/or higher returns from investing in riskier asset classes[50]. But riskier asset classes cannot safely and reliably generate an income stream. Of course bond rates have been higher in the past. For instance, a bond rate of 6 per cent was around the average for the two decades to December 2013. At that rate, the capital value of the age pension would be around $410,000 for a single person[51]. Unfortunately, 10-year bond rates indicate that higher returns are unlikely this decade.

So a couple with their own home and no savings are entitled to an Age Pension which is the equivalent of a fully indexed defined benefit pension for life[52] that could be purchased for $1,022,000[53]; a couple with their own home and $814,250 in assets are ineligible for the pension and therefore seemingly worse off. Of course, after running down their assets, they will eventually qualify for the part pension and for the full pension but the example illustrates the bias against saving and the complex and contradictory incentives and disincentives that make it difficult to plan for retirement securely, efficiently and effectively.

48 Jeremy Cooper, Australian Financial Review, "Before super tax changes, remember the pension is worth $1 million," 15 April, 2015. http://www.afr.com/opinion/columnists/before-super-tax-changes-remember-the-pension-is-worth-1-million-20150419-1mo76p, Viewed 3 September 2016.

49 Ibid.

50 Ibid

51 Ibid

52 The pension for a single person including the pension supplement and the energy supplement is worth $867.00 per fortnight or $22,542 a year. The combined pension for a couple (including both supplements) is worth $1,307 per fortnight or $33,982.

53 A 65-year old man will, on average, live to 83.7 and a 65-year old woman will live to 86.8

5.7 Correcting for the bias against saving

The taxation treatment of superannuation savings is frequently spoken of as if it were a generous, or indeed an overly generous handout from the government, and the equivalent of a taxpayer-funded pension. In reality its purpose is to address the 'bias in the current taxation system against long-term saving, particularly lifetime saving such as superannuation[54].'

The bias discourages saving in a number of ways.

First, Australia's highly progressive taxes on income reduce the disposable income that people have to save.

Second, the Australian taxation system treats the earnings generated by savings as income and taxes it at an individual's marginal rate. This disadvantages savers in a number of ways compared with those who consume their earnings immediately:

- savers face additional taxes, every year, on their nominal earnings, even though these earnings must cover inflation simply to retain their present value;
- the tax on the earnings of capital at the individual's marginal tax rate reduces those earnings by more than the progressive taxation of wages since only a portion of a wage is taxed at the marginal tax rate; and
- the longer the savings are held the more they are eroded by annual taxes on earnings and inflation, creating a wedge between pre- and post-tax earnings which compounds over time.

It is in recognition of this punitive taxation of saving that most governments don't tax saving in the same way as income that is earned and immediately consumed and particularly long-held savings that are intended to provide income in retirement.

It is also why most governments run income-related pension schemes that are almost always sheltered from taxes and provides the rationale for not taxing capital gains in the same way as wages. The means-tested pension and other means-tested benefits also represent further effective income taxation in retirement and a disincentive to save.

54 Ken Henry et al, *Australia's future tax system – Final Report: Detailed Analysis, Chapter A: Personal Taxation, A2-2 Taxing Retirement Incomes.* http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/publications/Papers/Final_Report_Part_2/chapter_a2-2.htm, Viewed 7 September 2016

5.8 Correctly costing the tax treatment of superannuation

The equity and fairness of the tax treatment of superannuation is also contested, because it is said to cost taxpayers more than the pension[55]. In fact, it doesn't.

In 2015-16 assistance to the aged was estimated by Treasury at $60.734 billion[56]. In its Tax Expenditure Statement for 2015, issued on January 29, Treasury estimated the value of superannuation concessions at $30.610 billion comprising $810 million for concessions on personal contributions, $16.250 billion for concessions on employer contributions and $13.550 billion for concessions on earnings in funds[57].

But even this overstates the cost because of the way in which the value of the tax treatment of superannuation is estimated. That estimate is based on comparing the tax rate on superannuation to the income tax savers would pay were the superannuation contributions of employers and employees made from after-tax income which was taxed at their marginal income tax rates and if the earnings in funds were also taxed at the individual's marginal rate. This is known as a comprehensive income benchmark.

But no advanced country taxes long held retirement savings at standard income tax rates because it would result in cripplingly high effective tax rates[58]. For example, for an Australian taxpayer facing a 45 percent marginal rate, applying standard income tax rates to retirement savings would lead to a situation in which each $1 of retirement consumption would cost savers nearly $5 in taxes over a lifetime of saving, implying a consumption tax rate of a staggering 465 per cent.[59]

If those tax rates were imposed, voluntary superannuation savings would plummet, so the revenue raised by the government would fall far short of the amount reported by Treasury. And the consequences for the living standards of retirees would be so dire that the system would be politically unsustainable. Punitive taxes on savings also impose a substantial cost in terms of economic efficiency, as they distort patterns of consumption over time.

The tax treatment of superannuation must further the system's purpose which is to facilitate the efficient transfer of consumption from working life, when employment and other income is earned, to retirement, when the opportunity to work is materially reduced.

Since the purpose of retirement savings is to fund future consumption, tax rates on savings should

55 So-called superannuation 'concesssions' are projected by Treasury to cost $51 billion in 2018-19 and the Age Pension is projected to cost $50 billion in the same year. Deloitte, *Shedding light on the debate – Mythbusting tax reform*, 26 October, 2015, p. 8-9

56 Department of the Treasury, *Expenses and Net Capital Investment, Budget Statement 5*, www.budget.gov.au, Viewed 1 September 2016.

57 The Treasury, *Tax Expenditures Statement, 2015, C. Retirement Savings* http://www.treasury.gov.au/PublicationsAndMedia/Publications/2016/TES-2015/Tax-Expenditures-Statement/Chapter-2/Retirement-Savings, Viewed 7 September 2016

58 Henry Ergas, "Super changes? Let's take a hard look at the facts",The Australian, 25 May, 2015.

59 Henry Ergas, "National Reform Summit: super tax changes need proper analysis", The Australian, August 24, 2015. There are a number of different ways of calculating consumption tax rates and assumptions need to be made about earnings and the real discount rate but whatever variant you use, you get 300 – 600 percent tax rates, in the sense that you pay at least $3 of tax to get $1 of final consumption. This calculation assumes 46.5 percent tax on contributions, 46.5 percent tax on earnings each year throughout working life and also allows for the extent to which savings are eroded by inflation. http://www.theaustralian.com.au/opinion/columnists/henry-ergas/super-changes-lets-take-a-hard-look-at-the-facts/news-story/baacd8dba288ea62384f8d322c0b0960, Viewed 8 September 2016.

be measured in terms of their impact on the cost to savers of shifting consumption from their working life to retirement. This is all the more the case as savers are required to lock their savings away for up to 47 years (assuming they start working at 20 and retire at 67), with a substantial share of those savings being compulsory.

The tax treatment of superannuation should therefore be assessed using a consumption or expenditure tax benchmark, which measures the tax rate on consuming in the future as compared to consuming today. Using such a benchmark, tax rates in Australia on long held superannuation are already high.

5.9 Correctly costing the means-tested pension

Treasury's estimates of the implied tax rates on superannuation also take no account of the pension and aged care means tests. So although in the current system superannuation is notionally untaxed in the drawdown retirement phase, in reality, retirement income is taxed as it leads to benefits or transfers being reduced or withheld altogether.

These 'claw-backs' or taper effects, which are ignored in Treasury's modeling, imply that even on a comprehensive income benchmark, effective tax rates on long held superannuation are probably above current income tax rates, particularly for middle income earners.

Worse, the government's reduction of eligibility for the pension, effective from January 2017, will further hit middle Australia hardest (since those at the bottom of the income scales will still qualify while those at the top would not have qualified in any event).

Instead of losing $1.50 of Age Pension for each $1,000 over the full Age Pension asset threshold, retirees will lose $3.00 of Age Pension for each $1,000 over the threshold. As many as 300,000 retirees are expected to lose some or all of their pension entitlements although they will retain the Commonwealth Seniors Health Card, and the assets-test free threshold will increase from $202,000 to $250,000.[60]

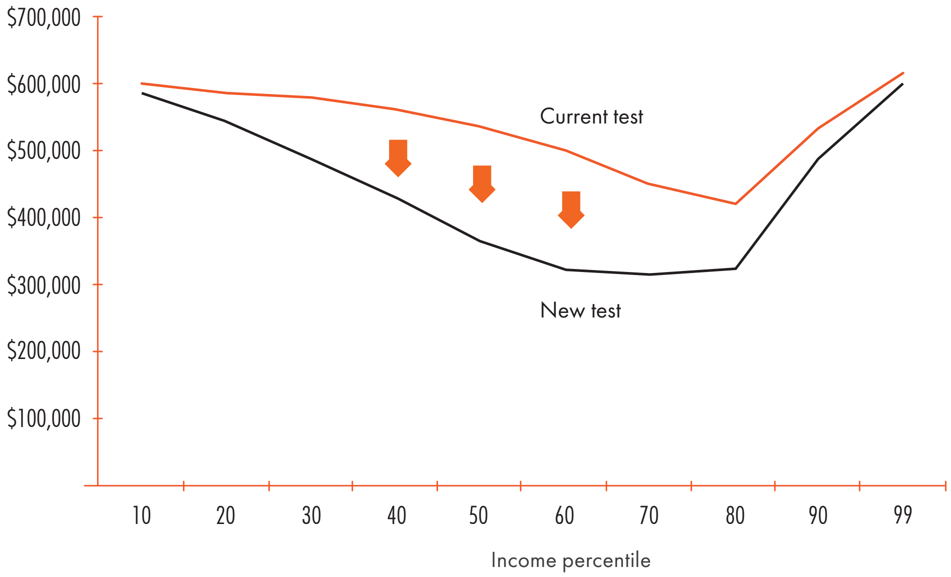
The result will be a substantial increase in the effective tax rate on private retirement savings. The Australian Institute of Superannuation Trustees (AIST) and Mercer estimate that under the new Age Pension Assets Test, effective tax rates for retirees on part pensions could rise by up to 40 percent, due to reductions in Age Pension payments. [61]

Figure 8 shows how sharply the position of middle-income earners will deteriorate under the new provisions.

60 Superguide website, "300,000-plus Australians Lose Entitlements from January 2017", http://www.superguide.com.au/smsfs/300000-retired-australians-to-lose-some-or-all-age-pension-entitlements, Viewed 6 September 2016

61 Mercer Australia, "2016 AIST Mercer Super Tracker released: Government urged to revise Age Pension Asset Test", 17 March, 2016 http://www.mercer.com.au/newsroom/2016-aist-mercer-super-tracker-released.html Viewed 31 August 2016.

Figure 8 Impact of effective tax increase on middle-income earners under new asset test. Source: AIST Mercer[62]



Yet high income tax and high taxes on investment earnings in superannuation don't leave middle-income earners with enough to maintain their living standards in retirement. As Professor Jonathan Pincus put it at a recent Roundtable on Retirement Incomes[63], since 1992 Australia has been forcing current taxpayers to finance their own retirement as well as that of the previous generation. Traditionally in Australia each generation financed the pensions of the previous generation and had their public pensions paid by the succeeding generation. Since 1992 however workers have not only funded the Aged Pension of those who are currently eligible but funded the reduction in their own future eligibility for the Aged Pension, through the Superannuation Guarantee Levy.

Reduced access to the pension should be prospective and accompanied by reduced taxes on superannuation savings so that middle and upper income earners can boost saving. Without the possibility of increasing savings or income, these measures will create strong incentives for retirees to restructure their assets so that they can still access the pension. The measures are therefore unlikely to raise the revenue anticipated.

62 Ibid.

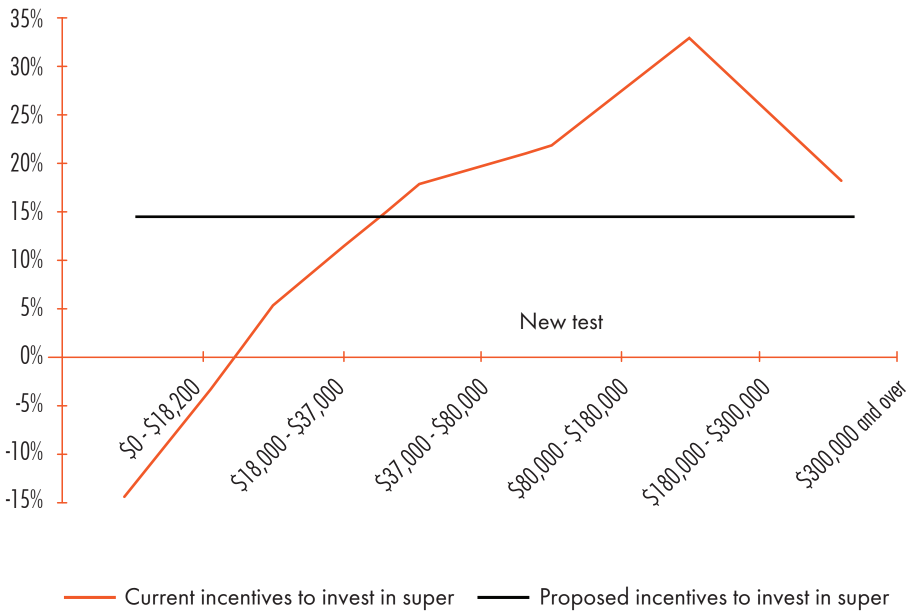
63 Academy of the Social Sciences in Australia/Committee for Sustainable Retirement Incomes ASSA/CSRI Roundtable on Retirement Income Adequacy and Interactions with Aged Care and Health Care, Canberra, Wednesday 6 April 2016

5.10 Flat taxes on contributions – heart break for whom?

Another alleged inequity of the system is that superannuation contributions are taxed at a flat rate of 15 cents per dollar contributed so that that low-income earners pay relatively more tax when a dollar of their earnings goes in to superannuation rather than when they receive wages (since they pay little or no tax on their income), whereas middle and high-income earners get bigger marginal tax benefits from measures to combat the bias against saving (because they save more and because they pay more tax).

Deloitte calls this the 'Heartbreak Hill,' though this analysis takes no account of the benefit that low-income earners receive from the Age Pension. When the Age Pension is added into the equation it is middle-income earners who are left in 'Heartbreak Hollow' (see Figure 8) unable to achieve the income replacement rates in retirement of low-income earners.

Figure 9 Deloitte's 'Heartbreak Hill' looks at the tax treatment of superannuation but ignores the Age Pension
Source: Deloitte[64]



5.11 How does our tax treatment of superannuation compare globally?

In February 2013, global human resources company Mercer benchmarked the Australian superannuation system against the taxation treatment of retirement savings in eight developed countries considered to have world-class retirement savings systems – Canada, Chile, Denmark, Netherlands, Sweden, Switzerland, the UK and the US[65].

64 Deloitte, *Shedding light on the debate – Mythbusting tax reform*, 26 October, 2015, p. 14.

65 Mercer, Tax & Superannuation: Benchmarking Australia Against the World's Best Retirement Savings Systems, February 2013, p.6. http://www.mercer.com/content/dam/mercer/attachments/asia-pacific/australia/News/130208_Global_Tax_Benchmarking_Final.pdf

Mercer's study did not consider the effective tax rate implied by withdrawal of the pension and other benefits, but even without that, the study showed that in six of these eight countries the tax regimes were less punitive towards retirement savings than in Australia.

In particular, Mercer found that Australia's concessional contribution caps fell significantly short of all other countries. Mercer measured the caps as a percentage of average earnings. Whereas Australia's cap was 34.6 percent of average earnings, the UK cap was 127 percent, Switzerland was 255 percent and there was no limit for Denmark.

Australia's parsimonious caps are even more problematic given that, unlike some of the other countries, Australia's Age Pension is means-tested and thus privately-funded savings are even more important. When Mercer wrote the report in February 2013, the cap was $25,000. It rose to $35,000 for those over 50 in July 2014 under measures introduced by the Gillard government.[66] This threshold was not indexed and was intended to expire when the indexed cap of $25,000 for those under 50 reached $35,000.

Instead, three years later, the Coalition government is proposing to reduce the cap back to $25,000 for everyone, which means that Australia's concessional caps fall even further short than those of the comparator countries in 2016 than they did in 2013. In addition, Australia was the only country that taxed employer contributions (paid by the fund). Australia was also the only country that taxed investment income that didn't also have either a universal pension or an earnings-related publicly supported scheme.

In view of this Mercer wrote that on the global stage, the taxation of Australia's retirement savings was not overly generous. The report noted that Australia had below average results for both the average and the above-average income earner. It concluded that the results of the benchmarking raised the question as to whether the arrangements provided Australians with the best opportunity to save for a comfortable retirement, while also reducing future reliance on the Government. Three years later, the government has reduced access to the pension for middle-income Australians and is proposing to make it even harder for them to save for their retirement.

5.12 Australia more redistributive than Sweden

Proposals to increase taxes on superannuation savings are justified by the supposed 'unfairness' of the system, which allegedly provides too many benefits to the well-off at the expense of the taxpayer and of the poor.

66 On 5 April 2013, then Minister for Financial Services and Superannuation Hon. Bill Shorten MP announced that the government would increase the cap for concessional contributions from $25,000 to $35,000 cap for anyone over 50 because older people had not had the benefit of the Superannuation Guarantee for their entire working lives and should be given a chance to increase contributions as they approached retirement. Source: Hon. Bill Shorten MP Joint Media Release with Treasurer Hon. Wayne Swan MP, 5 April 2013, http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2013/020.htm&pageID=&min=brs&Year=&DocType=0 Viewed 6 September 2016

In reality, the Australian tax and transfer system is highly redistributive. The share of taxes paid by individuals in the lowest quintile – the poor – is lower in Australia than almost anywhere else in the OECD.[67]

A comparative study by AC Stahlberg (2007) estimated that in Australia 62 percent of lifetime benefits received by individuals were financed through redistribution between the rich and the poor and only 38 percent were financed through taxes they paid at another stage of their life-cycle. In comparison, in Sweden, lauded as a paragon of the welfare state, 18 per cent of lifetime benefits involved redistribution between individuals and 82 per cent involved redistribution over different phases of the life-cycle of an individual.

The authors concluded that with a relatively small tax and welfare system Australia achieved the same redistributive impact as countries characterised by much higher taxes and transfers (such as Germany) because Australia relies more on income taxes, which are more progressive than other taxes, and on means-tested cash transfers.[68] Indeed, cash transfers in Australia are also more strongly targeted toward the poor than in most other countries in the OECD and although expenditure on the Australian pension - fixed at 27.7 per cent of Male Total Average Weekly Earnings and rising to 28 per cent average weekly earnings - is relatively low, publicly provided services for the elderly enhance retirement incomes by 35 per cent for those who qualify for a pension.[69]

5.13 Too much tax is never enough

Complaints that '10 per cent of Australians received 38 per cent of all superannuation tax concessions'[70] rarely note that 'the top 10 per cent of working age persons pay 50 per cent of personal income tax.'[71]

In 2012/13, the most recent year for which the ATO provides these calculations, individual income tax returns showed that the top three per cent of income earners paid 27 per cent of all net tax and the next six per cent paid 20 per cent of all net tax. So, the top nine per cent paid 47 per cent of all net tax. The next 30 percent paid 42 per cent of all net tax, meaning that the top 39 per cent paid 89 per cent of all net income tax.

67 Mauro Pisu, *Income inequality in OECD Countries: What are the Drivers and Policy Options?*, Peter Hoeller, Isabelle Joumard, Isabell Koske, (eds) p.137

68 Isabelle Joumard, Mauro Pisu and Debbie Bloch, *OECD Journal: Economic Studies - Volume 2012*, p.6

69 Patricia Pascuzzo, 'An International Comparison of Pension System Performance in Delivering Adequate Retirement Incomes,' Super Research and Advisory for Challenger Limited., http://www.challenger.com.au/group/Documents/Attachment_A_ChallengerInternationalComparisons.pdf Viewed 6 September 2016

70 Hon Bill Shorten MP, Media Release, April 22, 2015, http://www.billshorten.com.au/labors-plan-for-fair-sustainable-superannuation, Viewed 6 September 2016

71 Ben Phillips, fact, The Conversation on July 28, 2015, https://theconversation.com/factcheck-is-50-of-all-income-tax-in-australia-paid-by-10-of-the-working-population-45229 Viewed 6 September 2016

Thus less than 40 per cent of taxpayers paid almost 90 per cent of all income tax. [72]

Those statistics are not an anomaly. The Henry Tax review found, using figures from 2005-06, that the top 20 per cent of taxpayers paid 59 per cent of all net tax[73]. Since 2005-06 this distribution is likely to have been further skewed with the introduction of Temporary Budget Repair levy of 2 per cent in 2014 on taxable incomes of $180,000 and the increase in the Medicare levy from 1.5 per cent to 2 per cent in July 2014, especially considering that the bottom 20 per cent of adults are exempted from the Medicare levy.

'Fair is obviously in the eye of the beholder, but fair, I think, for Australians, means that the burden of tax is best borne by those able to pay it' said Prime Minister Malcolm Turnbull[74]. In fact the bottom 26 per cent of income earners don't pay any net income tax and the next 35 per cent pay only 11 per cent of net tax, so the bottom 61 per cent of people paid only 11 per cent of all net income tax.[75] The question might therefore be asked whether it is fair that many who could afford to make some contribution make virtually none.

5.14 High transaction costs

Australia's compulsory superannuation also suffers from high transaction costs.

A study in 2003 found the system to be inefficient, with low returns and high cost due to the fragmentation of accounts, lack of competition and the existence of severe principal-agent problems, as trustees didn't appear to act in the interests of members. [76]

A 2014 paper found that Australians on average, pay fees of 1.2 percent on their superannuation balances, three times more than the median OECD rate, that reducing fees by half could save account holders $10 billion a year and concluded it was the largest single opportunity for micro-economic reform in Australia. [77] Author Jim Minifie wrote, 'Two main reforms will reduce the cost of superannuation. Government should establish a tender for the right to run the best-priced default fund for new job starters, and the tax return process should allow taxpayers to match their fund with the low-cost winners of the default tender – and to switch on the spot if they choose.'

72 Australian Taxation Office, *Australian Taxation Statistics 2012-13*, https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Taxation-statistics/Taxation-statistics-2012-13/ Viewed 6 September 2016

73 Ken Henry et al. "Australia's Future Tax System", December 2009, http://taxreview.treasury.gov.au/content/Paper.aspx?doc=html/publications/papers/report/section_3-03.htm, Viewed 6 September 2016

74 The Guardian,"Malcolm Turnbull: 'burden of tax is best borne by those able to pay it," 5 November 2015, https://www.theguardian.com/australia-news/2015/nov/05/malcolm-turnbull-burden-of-tax-is-best-borne-by-those-able-to-pay-it, Viewed 6 September 2016

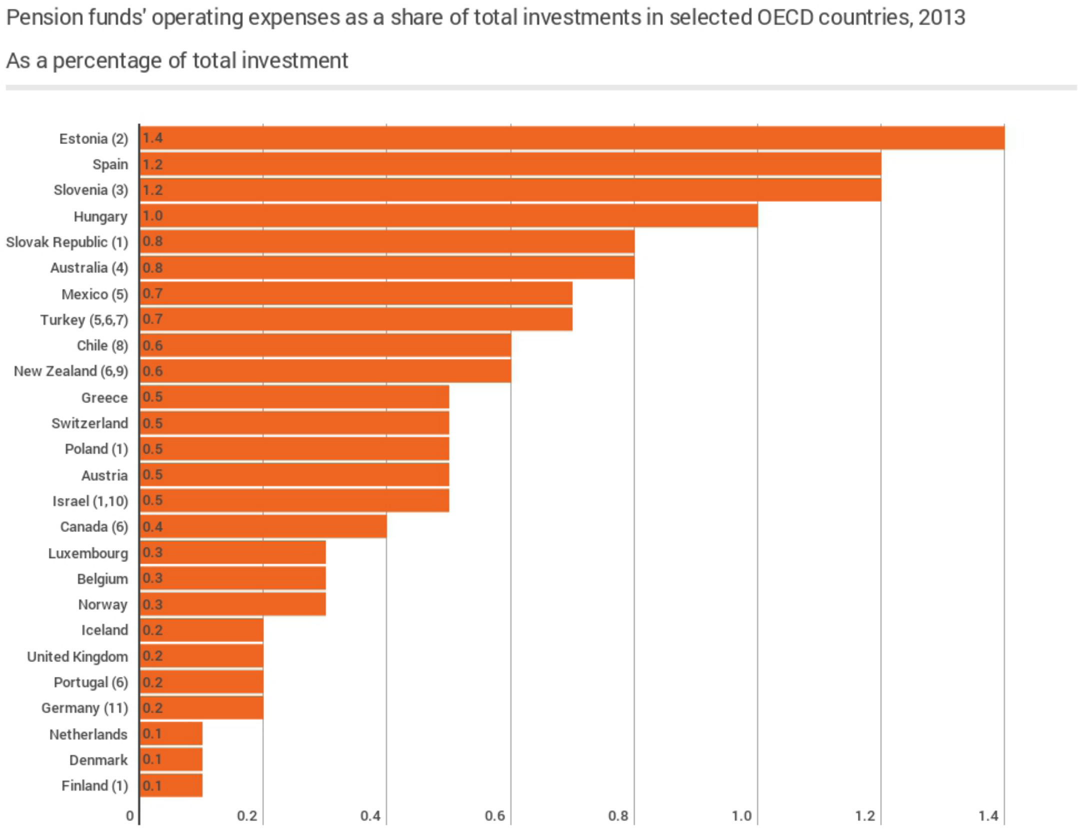
75 Australian Taxation Office, *Australian Taxation Statistics 2012-13*, https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Taxation-statistics/Taxation-statistics-2012-13/ Viewed 6 September 2016

76 Michael Drew and Jon Stanford, *A Review of Australia's Compulsory Superannuation Scheme After a Decade,* March 2003. The study found that around 50 per cent of people are members of retail funds, which were characterized by low investment returns relative to a standard benchmark and high cost with a total expense ratio exceeding two per cent of assets under management, and entry and exit fees accounting for 3.5 per cent of funds under management. Further, members of industry funds tended to have low accumulated balances, which added to the cost of the system.

77 Jim Minifie, *Super Sting: How to Stop Australians Paying Too Much for Superannuation*, Grattan Institute, 27 April, 2014. https://grattan.edu.au/report/super-sting-how-to-stop-australians-paying-too-much-for-superannuation/, Viewed 6 September 2016

In 2015, the OECD reported operating expenses as a share of total investments were found to be eight times higher in Australia than in countries where those expenses were lowest (Figure 10). In the Netherlands, Denmark and Finland operating expenses were only 0.1 per cent as a share of total investment compared with 0.8 per cent in Australia.[78]

Figure 10 Australia's operating expenses eight times higher than Netherlands, Denmark, Finland.
Source: OECD, 2015[79]



These high expenses, incurred each year, impede accumulation and waste resources.

The 2014 Financial System Inquiry (FSI) found that superannuation fees had not fallen by as much as expected, given the massive increase in funds under management, which should have translated into substantial economies of scale[80]. Rather the benefits of any cost reductions appear to have been captured by trustees managing the funds at the expense of members' retirement incomes.

78 OECD, *Pensions at a Glance 2015 – OECD and G20 indicators*, December 2015, p. 197

79 Ibid.

80 David Murray AO et al, *Financial System Inquiry Final Report*, November 2014, Recommendation 10. http://fsi.gov.au/publications/final-report/chapter-2/improving-efficiency/, Viewed 6 September 2016

The OECD notes that countries such as Australia with defined contribution systems and a large numbers of small funds do have higher operating costs than countries with only a few funds offering either defined benefit, hybrid, or collective defined contribution pension arrangements [81] but even allowing for that the FSI reported that system growth and scale could have reduced fees by 45 basis points and that two-thirds of the estimated benefits from scale and lower margins over the past decade had been offset by increases in fund costs[82].

Treasury's submission to the FSI said the sector needed to continue to improve its technical efficiency – for example by reducing the use of costly manual, paper-based systems – to reduce fees.[83]

High costs are not just driven by inefficiency. A major part of the problem, according to Treasury, is the separation of ownership of funds from those who manage the funds, which opens up the risk that managers maximise their own interests at the expense of those whose funds they are managing. It warned that, 'these risks rise when there is a potentially complex decision to be made, with possible asymmetric information and disengaged members.'[84]

5.15 Retirement roulette

This risk is part of a broader problem. A consequence of making superannuation compulsory, barely noted at the time, was the transfer of risk from the employer to the employee. Under earlier defined benefit schemes, the retiree knew exactly how much they would receive in retirement and the risk was largely borne by the employer, who could spread it over time and through financial markets. In the 1970s, about 40 per cent of workers had superannuation coverage predominantly in defined benefit schemes rising to 62 per cent in 1988.[85] However, between 1985 and 2000 almost all defined benefit schemes were closed. Under the new defined contribution schemes, the risk and the uncertainty, as well as the responsibility for managing retirement savings was shifted to individuals.[86] Trapped in a complex system that is constantly changing, many feel daunted by this prospect.[87]

The goal of the system was to achieve reasonable replacement rates in the long term through individual savings; but the process of establishing private superannuation has largely eliminated the legacy defined benefit schemes, which despite their obvious deficiencies (including limited

81 OECD, *Pensions at a Glance 2015 – OECD and G20 indicators*, December 2015

82 David Murray AO et al, *Financial System Inquiry Final Report*, November 2014, Recommendation 10. http://fsi.gov.au/publications/final-report/chapter-2/improving-efficiency/, Viewed 6 September 2016

83 The Department of Treasury, *Submission to the Financial Services Inquiry*, 3 April 2014, p.52 http://www.treasury.gov.au/~/media/Treasury/Publications%20and%20Media/Publications/2014/The%20Department%20of%20Treasurys%20submission%20to%20the%20Financial%20System%20Inquiry/Documents/PDF/Treasury_submission_to_FSI.ashx Viewed 30 August 2016

84 Ibid.

85 Adam Creighton, 'We are all capitalists now', Only in Australia – the History, Politics, and Economic of Australian Exceptionalism, ed. William O. Coleman, Oxford University Press, 2016, p.190.

86 The exception was workers under awards, which directed contributions to industry super funds. While this reduced the burden on individuals, it also eliminated competition and choice, which were intended to be the guardians of the system, and created serious principal-agent problems.

87 ABC News, "Australia's Super System is a National Disgrace", 31 October 2012, http://www.abc.net.au/news/2012-10-31/kohler-australia-super-disgrace/4343108, Viewed 26 August 2016

coverage) met that goal reasonably well. Now, only a few still survive, notably those covering Commonwealth public servants and federal parliamentarians, and most are closed to new entrants. The vast majority of superannuation savers shoulder the risk of managing their superannuation accounts.

Ironically, the politicians and Treasury officials who designed the retirement roulette that retirees are obliged to play, are loath to play it themselves. Instead they continue to enjoy the security of a generous defined benefit pension, worth up to 75 percent of their highest salary, for life, courtesy of the taxpayers[88]. The scheme closed in 2004 but the value of the total accrued liabilities for the 501 contributors and pensioners is $833 million, with an average liability of $1.663 million per member.[89]

Middle-income earners also need to accumulate high savings early in their working careers so those savings can compound over time. Yet those are the years in which Higher Education Contributions Scheme debts accrue and need to be paid off, followed by family formation and child rearing which make other, often more pressing, demands on incomes.[90]

Traditionally, these problems were mainly addressed by defined benefits schemes. Employers effectively contributed a higher share of the accumulating fund in the early years of an employee's career, with that share decreasing as the employee's income rose, while the whole structure was tax-sheltered. It is no coincidence that the high replacement rates achieved in other OECD countries all involve some form of earnings-related, defined benefit scheme. The Mercer study which benchmarked Australia against high-performing economies, looked at the retirement income for an average salary earner in Australia and estimated that they would be 20 per cent better off in Canada, 11 percent better off in Switzerland, 18 percent better off in the UK and 11 percent better off in the US.[91] Moreover, there is a great deal of evidence that middle-income earners prefer the income security and low transactions costs of defined benefit schemes rather than the retirement roulette of defined contribution schemes.

The move to a defined contribution model in Australia, which coincided with the introduction of compulsory superannuation, eliminated the defined benefit solution without putting in place an effective alternative. Rather, it shifted substantial, difficult-to-diversify risk on to savers, along with high transactions costs, and compounded the problem by taxing earnings at quite high rates, impeding accumulation.

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88 Australian Government Department of Finance, *Parliamentary Contributory Superannuation Scheme Handbook, April 2016* https://www.finance.gov.au/sites/default/files/parliamentary-superannuation-handbook.pdf?v=1, Viewed 26 August 2016

89 Australian Government Department of Finance, *Parliamentary Contributory Superannuation Scheme Cost Report 2014* https://www.finance.gov.au/sites/default/files/PCSS%20LTCR%202014.pdf, Viewed 26 August 2016

90 Negative gearing has made it possible for some people with relatively low incomes to make a leveraged investment early in their career, which will compound over a lifetime to provide income in retirement. A fair retirement savings system should endeavor to treat retirement savings made outside the superannuation system neutrally, particularly if they are provide a supplement to inadequate savings within superannuation.

91 Mercer, Tax & Superannuation: *Benchmarking Australia Against the World's Best Retirement Savings Systems, February 2013*, p.9., http://www.mercer.com/content/dam/mercer/attachments/asia-pacific/australia/News/130208_Global_Tax_Benchmarking_Final.pdf

5.16 High capital gains tax

For a number of reasons including the inflexibility of the system, the fact that it is still maturing, and the constant tinkering with the rules which increases complexity and reduces confidence, many middle-income earners have saved outside the superannuation system, for example by purchasing negatively geared investment properties. Labor's policy is to change the tax treatment of negative gearing which is seen by many as an evil tax loophole that should be closed[92]. In reality, the ability to deduct expenses incurred in earning revenue is an accepted principle in our tax system[93] which offers middle-income Australians who have little knowledge of investing a way of leveraging their savings. Now that it is possible to make such investments within the superannuation system, it is proving popular with middle-income Australians.

But for those who have saved for their retirement outside the superannuation system, the taxation of capital gains in Australia, which is high by international standards, also erodes their retirement savings. New Zealand, for example, has no capital gains tax. Nor does Belgium, Czech Republic, Korea, Luxembourg, Netherlands, Slovenia, Switzerland or Turkey and the OECD simple average tax rate on capital gains is only 18.4 per cent.

In contrast, in Australia capital gains are treated as income for taxation purposes. This can result in very high effective tax rates on long-term savings, particularly on assets such as real estate where the gain can only be realised in one tax year; not only is the nominal gain far higher than the real gain because of inflation but additionally the gain cannot be retrospectively smoothed out and added to actual taxable income in each year. The Capital Gains Tax Discount does not fully address this problem for long-held assets.

The annual caps on concessional contributions to superannuation also constrain the ability of individuals to transfer capital gains into superannuation. The caps limit the amount that can be contributed and take no account of the fact that an individual may not have had sufficient disposable income to make concessional contributions in earlier years and may have accumulated very little in superannuation over a lifetime, for a variety of reasons including low income, unemployment, self-employment, part-time employment or unpaid employment working in the voluntary or charity sector or caring for children or disabled or elderly relatives.

92 Deloitte, *Shedding light on the debate – Mythbusting tax reform*, 26 October, 2015, p. 15

93 Ibid, p.2

5.17 The Middle Income Retirement Deficit

Bodies such as the World Bank have often praised Australia's compulsory superannuation [94] but in reality middle-income Australians have been poorly served by the post-defined benefits arrangements.

The interaction of high progressive income taxes, high capital gains tax, high fees and charges in the superannuation system, low caps on contributions and the high taxation of superannuation by international standards make it difficult for middle income earners to achieve the superannuation balances they need to fund their retirement.

Since middle-income earners are inefficiently constrained by taxation from fully funding their retirement, the rational option is to structure their affairs to qualify for a part pension.

The transition to compulsory, private, individual, defined contribution superannuation was always going to impose relatively high costs and create significant problems by shifting almost all risk and high transactions costs on to retirees, and especially those on middle incomes. It has also raised an obvious problem of transition, that is, what would happen to Middle Australia while the system matured, assuming it would ultimately mature.

Those problems have now come home to roost. Middle Australia faces high taxes on its savings, low income replacement rates in retirement and greater risk and uncertainty than under the old defined benefits pension schemes.

94 World Bank, *Averting the old-age crisis: policies to protect the old and promote growth*, (World Bank, Washington, DC, 1994), p.153

6 Proposed changes to superannuation

6.1 Defining the purpose of superannuation

On Budget night, 3 May 2016, the government announced its tax reform agenda for superannuation. This consisted of setting out, for the first time, a clear objective for superannuation – to provide income in retirement to substitute or supplement the Age Pension – as well as a range of measures that flow from the new objective.

That definition seems no more sensible than claiming the purpose of work is to 'substitute or supplement' the dole, and to set income taxes accordingly[95]. Superannuation serves a social purpose as well as an economic one. It should enhance efficiency by allowing us to transfer income earned while working to retirement, preserving living standards in old age[96]. It should also encourage self-reliance and reward hard work, promoting the seemingly forgotten virtue of thrift which underpins a society in which people take responsibility for their future[97].

Private savings shouldn't be seen as just an add-on to the social safety net; it is the public pension that ought to be seen as the backup, assisting those who have not been in a position to save for their retirement[98]. For superannuation to play its intended role as a lifetime savings vehicle that allows people to maintain their living standards in retirement, it needs to be easier to access and appropriately taxed so that middle-income Australians who achieve a comfortable standard of living through work can maintain their living standards in retirement.

6.2 Measures which make it harder to save

The government says several existing measures in the tax treatment of superannuation are inconsistent with its new objective because they benefit people who will never depend on the age pension and can save outside the superannuation system. The new measures make it harder to contribute to the superannuation system but will, the government claims, only affect the wealthy. Treasurer Scott Morrison says the changes are 'appropriately targeted' to allow people to secure an 'adequate retirement income' and prevent superannuation from being used as 'an open-ended savings vehicle for the wealthy to accumulate large balances underpinned by tax breaks far more than required for an adequate retirement.'[99]

95 Henry Ergas, "Super Should Serve Economic and Social Goals", The Australian, 9 May, 2016

96 Ibid. http://www.theaustralian.com.au/opinion/columnists/henry-ergas/super-should-serve-economic-and-social-goals/news-story/b08ae7dd1f5d330e56fe7bcb10093420, Viewed 8 September 2016

97 Ibid.

98 Ibid.

99 Phillip Hudson and David Uren, "Support for cut to super tax breaks: Newspoll", The Australian, 3 February 2016.

In reality all contributions to superannuation are capped and provisions that allowed people to build up very large balances no longer apply, so it is impossible for superannuation to be an 'open-ended savings vehicle.' Far from only affecting high-income earners who are gaming the system, the measures will significantly affect Middle Australia, which is already poorly served by our complex retirement income arrangements [100]. These measures are discussed below.

6.2.1 Taxes on earnings in retirement above $1.6 million

The government will introduce a $1.6 million superannuation transfer balance cap, putting an upper limit, from July 1, 2017, on funds that can be transferred into, or retained in, a pension fund. Only earnings in pension funds will be tax-free in retirement. Funds above the $1.6 million cap will have to be returned to an accumulation fund and taxed at 15 per cent or withdrawn from superannuation. Retirees who do not fully utilise the $1.6 million transfer balance cap when moving assets into pension phase will be able to move in additional funds up to the transfer balance cap at a later date or dates and the amount will be calculated as a percentage of whatever the cap is at that date. However, this is the only reason that funds can be transferred into the pension fund. If the pension balance drops due to poor investment returns and the transfer balance cap has already been reached, there is no possibility of putting more money in, even if the retiree's pension fund savings have been wiped out. On the other hand, if the pension account generates strong returns they can be retained in the pension fund.

Critically, the cap is only indexed to CPI (in increments of $100,000) not to average weekly earnings, so its value will be eroded over time in relation to wages and the pension. And the value of the cap will fluctuate dramatically in real terms because of the volatility of assets. For example, the Government has greatly over-estimated the value of the cap by assuming a 5.5 percent rate of return in the retirement phase; since the funds have to generate income with the same reliability as the Age Pension, the appropriate risk-free rate of return, the 10-year government bond rate, which reached a record low of 1.82 percent in August 2016. This implies that $1.6 million would generate an income stream that is far lower than $88,000 that the Government assumes. The government says the balance cap will affect fewer than one per cent of fund members and will raise $2.0 billion over the forward estimates period. That has been questioned since high net worth individuals may switch their funds out of superannuation into other savings vehicles including investment companies, annuities, franked income, geared property insurance bonds, family trusts, or adopt a downsizing the family home strategy,[101] all of which may reduce revenue raised. It has been estimated that around 140,000 persons have more than $1.5 million in superannuation, 100,000 in excess of $2 million and about 70,000 in excess of $2.5 million[102]. In 2012-13 24,000 retired members with account balances in excess of $2 million received around $5.2 billion in income stream payments and a further 51,700 retired members with account balances between $1 million and $2 million received around $4.9 billion in payments[103] Those income streams would presumably be far lower today and in the future in current interest rate environment.

100 Henry Ergas, The Australian, "As Budget Nears, Retirement Income System Faces Crisis Point", 11 April, 2015, http://www.theaustralian.com.au/opinion/columnists/henry-ergas/as-budget-nears-retirement-income-system-faces-crisis-point/news-story/2d3eea6ebecd176f 795bb43474fc8ad1, Viewed 6 September 2016. http://www.theaustralian.com.au/national-affairs/newspoll/support-for-cut-to-super-tax-breaks-newspoll/news-story/6a5d57884729d5cf36396e1452d4b30d, Viewed 8 September 2016

101 Australian Financial Review, "High Income Workers Must Revisit Super Strategy Urgently", http://www.afr.com/personal-finance/superannuation-and-smsfs/highincome-workers-must-revisit-super-strategy-urgently-20160501-gojp6d, Viewed 6 September 2016

102 Association of Superannuation Funds of Australia, *Superannuation and high account balances*, April 2015, p.3

103 Ibid, p.3

6.2.2 Labor's policy – taxes on earnings above $75,000

In April 2015, Labor announced its superannuation policy. The centrepiece was a proposal to impose, from 1 July 2017, a 15 percent tax on superannuation pension earnings of more than $75,000.[104] This was a harsher version of the superannuation policy that Labor announced in April 2013 when it proposed a 15 percent tax on earnings of more than $100,000[105]. Labor said its policy was designed to affect only fully independent self-funded retirees since the income test for the Age Pension (singles and partnered) is under the $75,000 threshold. The measure was intended to affect approximately 60,000 people with superannuation balances in excess of $1.5 million although the research paper Labor cited said around 140,000 people had balances of more than $1.5 million in superannuation [106].

Labor maintains its changes will only affect superannuants with balances over $1.5 million. In reality, volatility in rates of return mean much lower balances will generate earnings that exceed $75,000 in good years[107]. As a result, very large accounts may contribute barely a third of the revenue Labor hopes to raise[108]. For example, if Labor's policies were already in place, retirees with balances below the cut-off point for the part pension would have had to pay tax on their superannuation income in five of the last 11 years[109].

And as inflation erodes the $75,000 threshold in real terms and increases the nominal value of accounts, more superannuants will exceed Labor's threshold, shifting an ever greater share of the tax burden on to retirees whose savings are little more than half the actuarial value of the full age pension[110].

Thus, Labor's proposal will become an increasingly significant tax on the middle class, which is already harshly treated by our retirement income system[111]. That is all the more likely as the well-off will be better placed to switch assets from superannuation to other forms of savings if it is tax-effective to do so[112] . That switching means Labor's hopes of raising $9bn in net revenue are likely to be dashed[113]. In addition, taxing relatively small balances, even infrequently, will deplete them more rapidly and push people on to the Age Pension sooner and for longer, particularly since there is no symmetrical offset when returns are poor[114]. A rough estimate of the impact is that part pension eligibility for initial balances in the $350,000 to $500,000 range could be 5 to 10 per cent greater, with broadly similar effects for means-tested age care payments, both reducing net

104 Australian Labor Party, "Labor's Fairer Super Plan", http://www.alp.org.au/fairer_super_plan, Viewed 26 August 2016

105 Hon Bill Shorten, MP Media Release, "Reforms to make the Superannuation System Fairer", 5 April 2013

106 Association of Superannuation Funds of Australia, *Superannuation and high account balances*, April 2015

107 Henry Ergas, 'Federal Election 2016: super debate deserves better than polemics' The Australian, 16 May 2016.

108 Ibid.

109 Ibid.

110 Ibid.

111 Henry Ergas, "Chris Bowen reheats discredited, soak-the-rich super policy", The Australian, 27 April, 2015, http://www.theaustralian.com.au/opinion/columnists/henry-ergas/chris-bowen-reheats-discredited-soaktherich-super-policy/news-story/81c5d204cf098793139bb0f2c08fcdcf, Viewed 7 September 2016

112 Ibid.

113 Ibid.

114 Ibid.

revenues[115]. There would also be broader efficiency costs as some non-compulsory savings were diverted into assets such as owner-occupied housing, further distorting markets and increasing vulnerability to property price bubbles[116].

6.2.3 Lifetime non-concessional caps and reduced annual caps

From Budget night, 3 May 2016, subject to passage through the parliament, the cap on concessional contributions will be reduced to $25,000 a year for all contributors, regardless of age. Currently, concessional contributions are capped at $30,000 for those under age 50 and at $35,000 for those aged 50 and over. The government claims that capping concessional contributions at $25,000 per year will still allow individuals to accumulate significant amounts of tax advantaged concessional superannuation but in fact that capacity is significantly reduced.

From 1 July 2017, the government will also introduce a lifetime cap of $500,000 for non-concessional contributions, which will be indexed to average weekly ordinary time earnings. This cap will take into account all non-concessional contributions made on or after 1 July 2007. This eliminates the possibility of making non-concessional contributions for anyone who has already made non-concessional contributions of $500,000 or more since 1 July 2007. Contributions made from 7.30pm AEST on 3 May 2016 that exceed the cap (taking into account all previous non-concessional contributions) have to be removed or will be subject to the current penalty tax arrangements of 49 per cent. However, contributions made before 7:30pm on Budget night would not have to be removed and would not be subject to penalty tax arrangements.

This replaces the existing annual cap of $180,000, or $540,000 every three years under the bring-forward rule. This meant that in a relatively short space of time individuals including those who, for a variety of reasons had very low superannuation balances – due to low income employment, unemployment, self-employment, part-time employment and unpaid employment in the voluntary or charity sector or caring for children or disabled or elderly relatives - could substantially improve their financial security as they approached retirement, if they had the means to do so.[117]

No detailed modeling of the impacts on savers has been released but the new caps seem harsh. The reduced concessional caps make it harder for everyone to increase their superannuation balances even though most superannuation balances are not sufficient to allow people to maintain their living standards in retirement.

The threshold of the lifetime cap on non-concessional contributions seems arbitrary. Someone who has made $500,000 in non-concessional contributions since 1 July 2007 may still have a balance well below the $1.6 million that the government has said retirees may rely on to generate a tax-free income in retirement.

115 Ibid.

116 Ibid

117 There is overwhelming evidence that most people are only in a position to make substantial contributions to superannuation as they approach retirement.

Many countries have caps they periodically revise on retirement savings or on the income that can be derived from public and private pension schemes. To that extent, even when revising existing caps, or imposing new ones is undesirable, it is not unheard of. Yet given how crucial superannuation is to the living standards of older Australians, changes to the caps deserve the most utmost scrutiny. They must, in particular, be assessed in terms of their impacts on what our superannuation system is trying to achieve.

The questions the government needs to address are:

1. With interest rates low and returns volatile, will the new caps allow middle income Australians to achieve acceptable replacement rates in retirement?[118]
2. Can savers in their late 40s or 50s, their peak earning years, whose superannuation balances are too low to make them financially secure in retirement, catch up?[119]
3. Can middle income families in which a spouse with an interrupted work history was planning on catch up, perhaps by selling an investment property and placing the proceeds into superannuation, still do so?[120] And if not, why not?

In each case, the answer appears to be that the government's proposed changes will make it even more difficult for Australians on middle incomes to achieve acceptable replacement rates in retirement, making a system that is already inadequate worse.

6.2.4 Doubling taxes on high-income earner contributions

The government will double the tax on contributions to superannuation for those earning more than $250,000 (which will include those earning $225,000 who wish to make a voluntary contribution up to the limit of $25,000). It will also apply to members of defined benefit schemes but exclude State higher-level office holders and Commonwealth judges. Up to now, only people earning over $300,000 pay 30 cents in the dollar on contributions. The government appears to have copied this proposal from Labor, which announced it in April 2015. Labor estimated around 110,000 people would be affected by the new arrangements and that the measure would raise $5.1 billion over a decade [121]. The government estimates that the measure will raise around $2.5 billion over the forward estimates. The Greens want to go even further doubling the tax on superannuation contributions for everyone earning more than $150,000 and increasing the tax from 15 cents to 22 cents for those earning between $100,000 and $150,000.[122] They say their proposal would raise around $10 billion over four years.

Doubling the tax on superannuation contributions for those earning over $250,000 will increase taxes on lifetime incomes and undermine incentives to work, save and invest, particularly in superannuation. While it is not clear just how high effective tax rates on superannuation will be,

118 Henry Ergas, "Super Should Serve Economic and Social Goals", The Australian, 9 May, 2016, http://www.theaustralian.com.au/opinion/columnists/henry-ergas/super-should-serve-economic-and-social-goals/news-story/b08ae7dd1f5d330e56fe7bcb10093420, Viewed 8 September 2016

119 Ibid.

120 Ibid.

121 Australian Labor Party, "Labor's Fairer Super Plan", http://www.alp.org.au/fairer_super_plan, Viewed 26 August 2016

122 Australian Greens, "Progressive Superannuation, a System for Everyone, Not Just the Rich," http://christine-milne.greensmps.org.au/sites/default/files/150225_progressive_superannuation.pdf, Viewed 26 August 2016

what is certain is that it will lead back towards the situation prior to the Costello reforms, when the OECD found Australia's effective tax rates on superannuation were among the highest in the advanced economies.

6.2.5 Tax exemption removed for transition to retirement earnings

The government has dealt a grave blow to the Transition to Retirement (TTR) provisions by removing the tax exemption on earnings of assets supporting Transition to Retirement Income Streams from 1 July 2017 (income streams of individuals over preservation age but not retired). The current TTR tax regime encourages people approaching retirement to keep working, either full-time to boost their superannuation or with reduced hours, in which case the policy softens the drop in income. If workers choose to boost their superannuation they can salary sacrifice up to the current annual cap of $35,000 into an accumulation account while moving the rest of their funds into retirement phase, which allows earnings on investments to be tax free and while drawing down between 4 and 10 per cent of their superannuation as a tax free income stream (not a lump sum) so that they don't suffer an equivalent drop in disposable income. Essentially, they get the benefits of moving into retirement phase while still be able to work and contribute to superannuation.

The purpose of these provisions is to reduce the disincentives to work of people who have reached preservation age and could therefore retire. There is strong evidence internationally that as people approach retirement, their labour force participation decisions become highly sensitive to tax rates. One disincentive to work is that earnings on investment in retirement are tax-free. These provisions increase the incentive to work, albeit at a modest cost. That is advantageous not just because these people are at peak earning capacity but because the longer people work, the greater their savings, and the less likely that they will need to draw, in part or full, on the Age Pension. The introduction of TTR provisions was followed by a substantial increase in participation rates. The government has said that there are currently 115,000 people on a TTR income stream but it may be double that and many are on average incomes[123]. Preventing these people from boosting their superannuation balances seems to contradict the government's claim that only wealthy people will be adversely affected by its proposed changes. What the government has not done and ought to do is to show that the social benefits in terms of additional revenue raised by the measure exceed the social costs in terms of reduced participation and lower superannuation balances.

The measure is meant to raise government revenue of $640 million over the forward estimates period but will not raise that sum if it discourages older people from working and boosting their superannuation before retirement. Indeed, if it does that, it may increase demands on the Age Pension and thus on the taxpayer in the long run.

123 Rachel Baxendale, The Australian, "Kelly O'Dwyer Explains Superannuation", 1 June, 2016 http://www.theaustralian.com.au/federal-election-2016/federal-election-2016-kelly-odwyer-explains-superannuation/news-story/9e3343fb5582d60bf8564096a75d905f, Viewed 6 September 2016

6.2.6 Who will be affected

The government says its changes will adversely affect only a very small number of wealthy, high-income individuals who have large superannuation balances, well in in excess of $1.6 million. It bases this on aggregate ATO data over the last decade which it says shows that these are the only people who, in the past, have made substantial concessional and non-concessional contributions.

But the past behaviour of taxpayers is not necessarily a reliable indicator of the future retirement income plans and aspirations of individuals, much less their needs. The ATO data of the last decade may be skewed by the following factors.

First, most large balances in superannuation owe their existence to features of the system that no longer exist.

Second, people who have defined benefit pensions don't need to save as much in superannuation. As the proportion of people on defined benefit pensions declines, the proportion of people who will rely on superannuation to maintain a reasonable standard of living in retirement will grow.

Third, tax laws treat income from capital gains as income for tax purposes. Thus, people who have low or no income appear to the ATO to be high-income earners in the year that they realize the capital gain.

On the other hand, as the government reduces access to the pension, individuals need to save more in superannuation, not less. And it will be many years until everyone in the system has had the chance to make the compulsory and voluntary contributions over 45 years that should, if the system is properly designed, allow people to achieve reasonable retirement rates.

OECD data shows that average income earners are not achieving reasonable replacement rates. The government's data seems to confirm this in that at present the average superannuation balance of a 60 year-old is expected to be $240,000 in 2017-18. This would generate an income of around $28,000 for 25 years including the Age Pension[124], around a third of full-time adult average weekly earnings, which are just under $82,000.

Clearly, there is a need for average Australians to be able to save more for their retirement and that need will grow. It seems highly probable that measures that may have only affected the wealthy in the past will adversely affect middle-income Australians who simply want to maintain their standard of living in retirement.

124 Figures calculated using Unisuper Pension Calculator., https://super.towerswatson.com/unisuper/apphtml/pensionincome.html#/calculator/pensionincome/start

6.3 Measures to make the system more flexible

Despite making it harder for middle and upper income people to contribute to superannuation, the government says it also wants to make the system more flexible to align with the changing work-life patterns of modern Australia. This is a commendable intention but it is largely stymied by the measures that make it harder to save as discussed below.

6.3.1 Catch up concessions

Individuals with superannuation balances under $500,000 who don't reach their concessional cap in a given year will be able to carry forward their unused cap amounts over up to five consecutive years. The government says this is intended to benefit women with low superannuation balances that have broken employment records due to childbearing and child-rearing responsibilities.

While the carryover provision does mean that people will be able to make a catch-up contribution of up to $125,000 at the end of a 5-year period, it is still substantially less than the $175,000 they could have contributed over a five-year period under the current system if they made the full concessional contribution each year and if they were aged over 50.

The government has given no explanation as to why the cut-off threshold for this provision is a superannuation balance of $500,000. As Jeremy Cooper has written, 'Assumptions and assertions that $500,000 or even $1 million in superannuation, in the current environment, will guarantee a comfortable retirement are suspect.'[125]

It would seem sensible for the government to allow people to accumulate sufficient assets so that they didn't require either the pension or the Commonwealth Healthcare Card. While determining what superannuation balance would achieve that goal is complex, there seems to be a strong case not to set caps which prevent people accumulating $1.6 million.

Indeed, it seems unfair that this measure prevents people who have a balance of $500,000 or more from carrying forward their unused caps to make catch up concessions as their superannuation balance may be lower than they would otherwise have been due to periods of low-income employment, unemployment, self-employment, part-time employment or unpaid employment in the voluntary sector or caring for children or disabled or elderly relatives.

Contrast this with those who are able to accumulate $1.6 million within superannuation (whether they use catch up concessions or not); they were probably able to do so because they were able to work without interruption and were sufficiently well remunerated that they could make voluntary contributions each year.

125 Jeremy Cooper, Australian Financial Review, "Before super tax changes, remember the pension is worth $1 million," 15 April, 2015. http://www.afr.com/opinion/columnists/before-super-tax-changes-remember-the-pension-is-worth-1-million-20150419-1mo76p, Viewed 3 September 2016.

Separately, since the lifetime cap on non-concessional contributions commences in 2007 because reliable records exist from that period, it seems only fair that the carry forward for unused concessional caps should also commence in 2007.

Finally, the government makes the case that a lifetime cap on non-concessional contributions is superior to an annual cap on non-concessional contributions because it allows people to make contributions when they are able to do so. The same principle should apply to concessional contributions – a lifetime cap on concessional contributions would allow people who had not been in a position to make contributions at an earlier period to contribute if they were able to later in their life.

6.3.2 Removal of the work test for contributions up to age 75

From 1 July 2017, people aged 65 to 74 will no longer have to satisfy a work test to be able to make contributions to superannuation and they will also be able to receive contributions from their spouse. This is a good idea but the contributions will be subject to the new lifetime cap limiting the extent to which middle-income retirees can attempt to make their superannuation last longer. The measure is estimated to have a cost to revenue of $130.0 million over the forward estimates period.

6.3.3 Low-income offsets

The low income superannuation offset is intended to avoid the situation in which low-income earners pay more tax on savings placed into superannuation than on income earned outside of superannuation. The measure is estimated to have a cost to the Budget of $1.6 billion over the forward estimates period. It will increase low-income earners' superannuation by up to $500. Most people on low incomes will still get the full pension.

From 1 July 2017, the Government will also increase access to the low-income spouse superannuation tax offset by raising the income threshold for the low-income spouse to $37,000 from $10,800. The low income spouse tax offset provides up to $540 per annum for the contributing spouse and the government says it will boost retirement savings of low income women. The measure is estimated to have a cost to revenue of $10.0 million over the forward estimates period.

Both of these measures seem misguided. The cost of managing small savings in a private savings scheme takes a very large percentage of annual earnings. Boosting the superannuation balances of low-income earners will therefore probably be of greater benefit to industry superannuation funds which hold most of these small funds than to the recipients. The main impact of these policies seems to be to shift expenditure from the pension to the offset, while increasing spending overall. It is therefore difficult to understand how this measure can be justified.

6.3.4 Tax deductions for superannuation up to age 75

The introduction of income tax deductions for personal contributions to a complying superannuation fund up to an individual's concessional cap and up to age 75 is a positive measure but is limited by the government's tight caps. This will impose a small net cost on the government.

6.3.5 Tax exemption on earnings for annuities

The extension of the tax exemption on earnings in the retirement phase to products such as deferred lifetime annuities and group self-annuitisation products is a positive measure that was also recommended in the Henry Tax Review but needs to go much further.

The Henry Tax Review also recommended a number of other measures that the government should undertake to support the development of a longevity insurance market.[126]

126 See Recommendation 21, Chapter 12: *Australia's Future Tax System.*, http://taxreview.treasury.gov.au/content/finalreport.aspx?doc=html/publications/papers/final_report_part_1/chapter_12.htm

7 Broader recommendations on the government's proposals

7.1 Review the retirement system and rethink reform

The government should heed the call of the Secretary of Treasury to undertake a proper review of the retirement income system considering the interaction of the age pension, superannuation and the taxation of saving[127]. It should give the task to the Productivity Commission.

The objective should be to move towards neutrality between current and future consumption and away from measures that penalize savings, as doing so imposes high efficiency costs and undermines living standards. Superannuation should not be seen as a source of revenue to fund other government programs. Its purpose is to generate retirement income. Governments that tinker with superannuation for budgetary reasons run the grave risk of seriously undermining the system[128].

The focus should be on ensuring that Middle Australia can save enough through superannuation to maintain its standard of living in retirement. The government should formulate its policies with these people in mind rather than the very small number of people who accumulated very high balances through provisions that no longer apply.

7.2 Revisit caps and taxes

From the point of view of securing acceptable replacement rates for middle-income Australians, the caps imposed by the government, both on concessional and non-concessional contributions and on the retirement balance, appear to be too low and the taxes on savings too high.

The government needs to calculate a retirement balance cap taking into account the capital requirements to safely and reliably generate replacement incomes, real interest rates, appropriate discount rates and volatility in asset values.

127 Peter Martin, Sydney Morning Herald, "Treasury boss John Fraser calls for a 'fundamental rethink' of superannuation, pensions", 9 April, 2015, http://www.smh.com.au/federal-politics/political-news/treasury-boss-john-fraser-calls-for-a-fundamental-rethink-of-superannuation-pensions-20150408-1mgqwq.html, Viewed 7 September 2016

128 "Dr. (Ken) Henry said the key risk to superannuation was overzealous regulation, and governments who tinkered with the system for budgetary means risked undermining the system," James Frost, Australian Financial Review, 18 March 2015 http://www.afr.com/news/policy/tax/ken-henry-says-increase-in-gst-inevitable-20150318-1m29xp#ixzz4JRVRtKzs, Viewed 8 September 2016

Any caps need to be set so that people can reach the maximum indicative balance through catchup contributions if they are unable to reach it simply by making the maximum annual contributions.

As recommended by the Henry Tax Review, the government should increase the effective rate of savings delivered by the superannuation system by reducing the tax on the earnings on savings, which erodes savings annually. The Henry Tax Review recommended reducing the tax on earnings to 7.5 percent. This should be considered as part of a longer-term transition to an EET (see below).

7.3 Make the system more flexible in other ways

The compulsory contribution to superannuation, the Superannuation Guarantee, is legislated to rise from 9.5 percent to 12 percent in 0.5 percent increments starting 1 July 2021, yet these mandatory contributions impose high costs, in terms of foregone consumption, on income earners at points in the lifecycle when they have many other commitments – tertiary education, family formation, purchasing a home.

Instead of heavy-handed compulsion, the priority should be to make saving attractive by reducing inefficiently high taxes on saving and increasing the flexibility in the system so that when people have additional funds to contribute, usually later in life, they are able to do so.

Allowing people flexibility to set their contribution levels below the mandated amount in specified personal circumstances, perhaps subject to them making up the difference later, is an option worthy of consideration. Similarly, imposing limits on superannuation concessional contributions constrains savers' capacity to make up for inadequate savings at earlier stages of their lives.

The caps need to be flexible enough to accommodate large one-off payments, as one of the key ways that people with interrupted earnings and low salaries could make a significant contribution might be through the sale of assets, such as an investment property.

7.4 Allow assets saved outside superannuation to contribute to the savings balance

Once the retirement balance that one can use to generate a tax free retirement income has been established, it would make sense to allow people to contribute up to the retirement balance.

It would also make sense to allow assets outside superannuation - for example shares or investment properties – to count as part of the $1.6 million asset base.

That would imply allowing taxpayers to combine those assets for tax purposes at the time of entry into the retirement phase, with all the earnings from those assets being treated as if they were derived from a balance being held in a superannuation account. In other words, at the time of transition, other assets could be contributed up to the amount of the $1.6 million cap.

The lifetime caps the government has proposed would need to be flexible enough to accommodate any such transfer.

This proposal raises issues of how any such asset transfer on retirement should be treated from the perspective of the taxation of contributions although it would seem reasonable that they be treated in the same way as other non-concessional contributions. These are issues that would need careful consideration, as would the fiscal consequences.

Nonetheless, if the government holds that, for example, $1.6 million is an appropriate cap on superannuation savings, why should different assets that could contribute to that $1.6 million balance be subjected to different tax treatment?

Rather, the various savings vehicles ought to be treated as neutrally as possible, minimizing the risk of distorting savings decisions. At the same time, such neutral treatment would ensure greater horizontal equity – treating those who are equally placed alike – as it would not be as discriminatory between savers whose savings were in superannuation, and those whose savings were in other assets, as would a cap that applied to superannuation alone.

There is, therefore, a case for moving to a more flexible concept of the 'savings balance' of retirees. Such a balance, all elements of which would be given the same tax treatment, would both ease the savings tax on middle Australia and make for a much efficient tax system.

7.5 Reduce fees and charges

Fees and charges in the Australian superannuation system are much higher than in many other OECD countries. This reduces retirement savings across all income levels but because some fees are flat, they have a bigger impact on smaller balances. Since contributions to superannuation are compulsory and the system is complex and opaque, choice alone has been insufficient to drive competition, with most people remaining in a default fund chosen by their employer.

It would be far better to reduce fees and charges for all savers by increasing the competitive pressure on funds. One way to do this would be for the government to tender for a low fee default scheme and give people the option of moving to that scheme when they submit their tax form. This would put greater pressure on funds to reduce fees.

7.6 Take the roulette out of retirement – defined benefit pensions from the Future Fund

It is inappropriate for the government to expect middle-income retirees to shoulder the risk associated with living on investment earnings of volatile assets, when individuals cannot diversify that risk in the way that an employer, the government or a pension fund can. An adverse event beyond an individual's control, such as the Global Financial Crisis, can wipe out an individual's savings and plunge them into penury.

Given that few retirees can offset falls in income by returning to work, it is hard to see an equity or efficiency case for placing so much financial risk on older Australians, whose only option to manage it is to save more than they ideally would, especially in the only tax advantaged vehicle open to most of them – their own house[129].

In addition to market and market timing risk, individuals face longevity risk. An individual can address the risks they face by purchasing an annuity but because the market in Australia is so small, the costs are very high.

The government provides a guaranteed, inflation-indexed income for life at high replacement rates to low-income Australians via the Age Pension. It also provides guaranteed, inflation-indexed income for life, at generous replacement rates to members of public sector defined benefit schemes, underwritten by the Future Fund. To reduce the risk facing retirees, the government should make it possible for middle-income Australians to purchase a defined benefit pension from the Future Fund, with benefits proportional to contributions.

This was discussed at some length in the Henry Tax Review which recommended that the government consider offering an immediate annuity and deferred annuity product that would allow a person to purchase a lifetime income. It recommended that this should be subject to a business case that ensures the accurate pricing of the risks being taken on by the government and added that to limit the government's exposure to longevity risk, it should consider placing limits on how much income a person could purchase from the government.

129 Henry Ergas, "That's right, Treasurer: Superannuation Is Our Money, Not Yours", The Australian, 7 December, 2015, http://www.theaustralian.com.au/opinion/columnists/henry-ergas/thats-right-treasurer-superannuation-is-our-money-not-yours/news-story/8145d79d8353e6b59bff7a749eee14ea, Viewed 7 September 2016

7.7 Move towards an EET system of taxation

The government should move towards an EET system for the taxation of superannuation, in which contributions and fund earnings are untaxed and end-benefits are subject to individuals' full marginal income tax rates in retirement. This is the system used in most of the OECD and with good reason.

The amount an average income earner would accumulate over a lifetime of saving under the current system is reduced by up to 45 percent by the current taxation treatment of superannuation[130]. All other things being equal, a move to an EET system could therefore result in superannuation saving balances that were substantially higher on retirement.

These increased savings would provide more adequately for retirement, giving dignity and independence to retirees while reducing the burden on government by reducing the demand for the Age Pension.

In addition, because withdrawals would be taxed at the marginal rate of income tax, they would reduce the distortion to individuals' ability to transfer income from working life to retirement, making it easier for individuals to smooth out their income over the lifecycle while ensuring that the government would have a more adequate source of revenue as the population ages.

A move to an EET system would also provide transparency and tax neutrality in retirement between savings acccumulated in superannuation and those saved outside of superannuation, as income from all assets would be taxed at the same rate and in the same way, except for owner-occupied housing, which is taxed on a pre-paid consumption basis.

Finally, it would reduce the burden of risk to the individual by not taxing volatile earnings in either the good or bad years but only taxing income once it was available for consumption.
It is often claimed that switching from ttE to EET, TEE or TET would require such complex transitional arrangements over 40 years, with such severe transitional implications for government revenue that it couldn't be done.

There is no doubt that there are transition issues however, they are entirely manageable and many countries reshape their retirement incomes systems over time (as Australia did not so many years ago). For example, a shift from the current TTE system to an EET system could be phased in by cohort, retaining the TTE for current savers but allowing subsequent cohorts to save on an EET basis. This would minimise the immediate cost in tax revenues. Indeed, a transition to EET would allow the government to continue to receive tax on the contributions and earnings of those in the current system and by the time the government was getting all of its tax from retirement income streams, retirees would make up a substantial share of the population. Alternatively, each cohort could be allowed to accumulate EET balances beginning at differing dates.

130 Henry Ergas, "Super changes? Let's take a hard look at the facts, 25 May, 2015, http://www.theaustralian.com.au/opinion/columnists/henry-ergas/super-changes-lets-take-a-hard-look-at-the-facts/news-story/baacd8dba288ea62384f8d322c0b0960, Viewed 7 September 2016

Proposals to move to a TEE system also have merit and whether the government taxes contributions or benefits, the single measure that will make the most difference to retirement balances is to reduce or eliminate the tax on superannuation earnings. Indeed, it would be better to accept higher taxes on either contributions or benefits in order to cut the tax on earnings.

Ultimately, what is important is ensuring that whatever form of taxation is adopted the goal of ensuring acceptable retirement incomes is achieved for all Australians and achieved in a manner consistent with fiscal sustainability and economic efficiency.

7.8 Assess equity looking at system as a whole

Equity and fairness need to be assessed viewing the Australian retirement income system as a whole. Given that the system provides income replacement rates for low-income earners that are high by international standards and relatively low for other income earners, the system is anything but biased to the better off. The fact that the tax treatment of superannuation benefits mainly higher-income earners arises because Australia has a highly progressive income tax system.

High income earners get more tax relief because they are carrying a greater share of the tax burden while low income earners get the taxpayer-funded age pension. Ken Henry commented last year that 'it was always understood that those who have the capacity to save, because they have higher incomes during their working lives, would benefit most from the tax concessions, with lower-income employees benefiting most from the pension.' [131]

It is misleading to consider individual components of a complex tax/transfer system in isolation - any equity issues arising in the tax system should be assessed viewing the system in toto. Fundamentally, the tax system is a poor way of achieving equity goals and piecemeal changes to the tax system made in the name of equity are likely to be costly and counterproductive.

7.9 Define, measure and regularly publish key benchmarks

The government should define, measure and regularly publish key benchmarks - such as target replacement rates, target retirement income streams and lifetime effective tax rates on savings - which show how the system is performing.

Most proposals to increase the taxation of superannuation do not estimate the effective tax rates they would impose on superannuation savings and take no account of the behavioural responses they will elicit. Typically, these proposals distort decisions both about the timing of contributions and about whether to retain savings in superannuation post-retirement or run them down.

131 Australian Financial Review, "Ken Henry Says Increase in GST Inevitable", 18 March 2015, http://www.afr.com/news/policy/tax/ken-henry-says-increase-in-gst-inevitable-20150318-1m29xp, Viewed 6 September 2016

7.10 Adverse changes should not be retrospective

Adverse changes should not be retrospective in effect, and should recognise that current participants have made long-term plans under the current and previous rules.

7.11 Don't increase complexity

Any changes should not add complexity and should preferably reduce it.

7.12 Stick to these principles

Virtually all the changes made in recent years and those currently proposed have flouted these principles. The result is that rather than improving our retirement income system, we are aggravating its deficiencies.

8 Conclusion - Repairing our retirement system

“We have talked of income from savings as if it possessed a somewhat discreditable character. We have taxed it more and more heavily. We have spoken slightingly of the earning of interest at the very moment when we have advocated new pensions and social schemes.” Robert Menzies[132]

Few in Australia are talking about how to reduce the savings deficit of middle-income Australians or the income risk and uncertainty they face as they age. Instead the debate is focused almost exclusively on increasing taxes on superannuation. An indicator of the focus of the debate in Australia is that different proposals are assessed according to the amount of revenue raised, largely without reference to the way in which increased taxes on superannuation will affect living standards in retirement.

Yet as Prime Minister Turnbull has rightly said, ‘If you want less of something you increase taxes on it.’ [133] Already, under the existing arrangements effective tax rates on superannuation are inefficiently high. Increasing them further and reducing the access to superannuation savings for middle-income Australians by reducing the caps for concessional and non-concessional contributions will almost certainly make a bad situation worse.

What is clear is that governments should not tax retirement savings at rates that make it difficult or impossible for savers to secure reasonable living standards in retirement based on the living standards they achieved during their working life. Nor should government taxes on retirement savings distort consumption decisions, undermining the quality of life in old age and reducing overall economic efficiency (an important component of which is the ability to efficiently smooth consumption over the life cycle). Yet in our current system, where it will be decades before a substantial share of the population have saved in superannuation for 35 years or more, that is what our taxes do.

Returning the budget to surplus is a matter of the utmost importance but doing so at the expense of retirement savings has very high welfare costs. As a result, taxes on those savings should only be increased if there are no less-costly ways of restoring fiscal balance. In reality, there are many such options, ranging from eliminating wasteful spending to increasing the tax take by reducing our very high tax-free threshold, which leads to many people making no contribution to the cost of the services they consume.

132 R. G. Menzies, “The Forgotten People”, 22 May 1942, R. G. Menzies Collection, National Library of Australia.

133 ABC 7:30, “Interview with Prime Minister Turnbull”, 26 April 2016 http://www.abc.net.au/7.30/content/2015/s4450761.htm, Viewed 26 August 2016

There seems to be no recognition by the government of the need to seriously rethink the system rather than tinkering with its parameters, which is essential if middle-income Australians are going to be able to enjoy income security and maintain their living standards in retirement.

The virtue of providing for oneself has been forgotten and the necessity of ensuring that the tax and transfer system doesn't make that impossible is not on the agenda. Instead, the Age Pension has become the cornerstone of retirement and everything else is portrayed as a 'concession,' as if the purpose of the system were to redistribute from rich to poor rather than to allow savers to smooth out their own income consumption.

On the day he became Prime Minister-designate, Malcolm Turnbull told Australians he would lead a 'thoroughly Liberal government.' It is therefore to be hoped that he will take to heart the words of Robert Menzies who criticized government policy designed not to 'help the thrifty' and 'encourage independence' but rather to harvest 'the votes of the thriftless...to defeat the thrifty.'[134]

This, after all, could be a tempting prospect. Australians have more than $2 trillion locked up in superannuation. So it is hardly surprising that governments and oppositions should hungrily eye those funds, driven by the desire to raise revenue for spending and giving little thought as to whether people will have sufficient savings to enjoy a reasonable degree of income security in retirement. An opinion poll published in The Australian on February 3 reported that 62 per cent of voters favoured raising tax rates on superannuation contributions by high-income earners, 27 per cent were opposed and 11 per cent undecided[135]. Pandering to this sort of populism however has dangerous consequences and will not solve the problems we face. Rather, precisely the same sentiments will lead to the revenues thus gathered being squandered, recreating the fiscal problems the tax changes were intended to address.

Moreover, even were the long run fiscal consequences less adverse, it is inefficient to distort the choice between current consumption and consumption in retirement – that is, to prevent income earners from managing their spending through the life course. Rather, the tax system should treat consumption as neutrally as possible over time. The harm those distortions impose, including the risk of hardship in old age, should weigh as heavily in public decision-making as the budgetary impacts.

'You do not expect much from conservative governments, but you do expect them to believe in thrift,' former Prime Minister Paul Keating said addressing a summit on Australian Pensions and Investment in 2007[136]. Unfortunately, neither side of politics seems to be focused on encouraging thrift.

Yet nowhere is thrift more important than in saving for our retirement. As Menzies said in his 'Forgotten People' speech: 'If the motto is to be "Eat, drink and be merry, for tomorrow you will

134 R. G. Menzies, "The Forgotten People", 22 May 1942, R. G. Menzies Collection, National Library of Australia. http://menziesvirtualmuseum.org.au/transcripts/the-forgotten-people/59-chapter-1-the-forgotten-people, Viewed 6 September 2016

135 The Australian ,"Support for Cut to Super Tax Breaks: Newspoll", 3 February 2016, http://www.theaustralian.com.au/national-affairs/newspoll/support-for-cut-to-super-tax-breaks-newspoll/news-story/6a5d57884729d5cf36396e1452d4b30d, Viewed 26 August 2016

136 Paul Keating, "The Story of Modern Superannuation" Speech to the Australian Pensions and Investment Summit, 31 October 2007, http://www.keating.org.au/shop/item/the-story-of-modern-superannuation-31-october-2007, Viewed 26 August 2016

die, and if it chances you don't die, the State will look after you; but if you don't eat, drink and be merry and save, we shall take your savings from you," then the whole business of life would become foundationless.'[137]

Menzies spoke in that speech, delivered in the dark days of war in May 1942, of a world that needed to have its sense of values "violently set right". "Have we realised and recognised these things or is most of our policy designed to discourage or penalise thrift, to encourage dependence on the State?"

No question could be more pertinent today, as an unholy consensus seems to be emerging that when it comes to retirement what is needed are more taxes on peoples' savings to pay for state pensions. The dangers in this approach were apparent even in Menzies' day.

"We have hastened to make it clear that the provision made by man for his own retirement and old age is not half as sacrosanct as the provision the State would have made for him if he had never saved at all," he observed.

While the provision of a means-tested pension is a non-negotiable responsibility of modern government, it is no less important for governments not to unnecessarily reduce individuals' incentive and ability to provide for themselves.

Unfortunately, our compulsory superannuation system has been undermined by the shortsighted determination of governments to constantly tinker with tax arrangements. Each year, the capacity of compound interest to grow people's savings has been damaged by these taxes. This is why, almost a quarter of a century after compulsory superannuation started, only 20 per cent of people fully fund their retirement and the other 80 per cent receive a full or part pension that is benchmarked at 25 per cent of average weekly earnings.

As the government prepares to take its superannuation reforms to the parliament, it should embrace its philosophical roots and put tax cuts for superannuation and saving at the centre of its retirement incomes policy.

137 R. G. Menzies, "The Forgotten People", 22 May 1942, R. G. Menzies Collection, National Library of Australia. http://menziesvirtualmuseum.org.au/transcripts/the-forgotten-people/59-chapter-1-the-forgotten-people, Viewed 6 September 2016

Opinion

There Is A Better Home For Superannuation

Written by: Simon Breheny

16 March 2017

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Giving people access to their own money is an uncontroversial idea. Young people trying to enter the housing market should be granted access to their own superannuation accounts to help make it happen.

One of the biggest hurdles young people have to clear in buying their first home is saving enough money for a deposit. It takes time, and with rising house prices, the dream of owning a home keeps moving into the distance.

There is a simple solution to this problem. Many young people already have a house deposit, or a partial deposit, set aside. They are just not able to access it because it is locked away in a superannuation account that they are not allowed to get their hands on until they retire.

There are many layers to the senselessness of this policy. The most obvious is that money in your superannuation account is yours. You have earned it, and you should be able to do with it what you like. If you want to use your money to buy a house you should be free to do so.

But even if one accepts the rationale for the current system of government-mandated savings there are a number of reasons why granting access to superannuation for first home buyers makes sense.

Money set aside in your superannuation account is invested in the expectation that the initial capital you have put into the account will grow over the long run until you are ready to retire. There are a range of investments that you can choose to make, but one of them is property. Including residential property.

In fact, according to the latest Russell Investments/ASX Long-term Investing Report that is the best investment your superannuation fund could have made over the last 20 years. Superannuation funds that invested in residential investment property in the 20 years to 2016 returned an average of 9.7 per cent per year, the highest of any investment class measured in the report. Australian shares returned 9.1 per cent, and Australian listed property gave returns of 6.9 per cent.

So your superannuation fund is very likely to be investing your money in residential property anyway. It is not much of a leap to allow for that money to be invested in your own home rather than someone else's.

The other thing to keep in mind is how important it is to own your own home in retirement. The disparity in outcomes between people that own their own home and those that do not is stark.

With house prices continuing to go up, and young people finding it increasingly difficult to get their foot in the door, this problem is set to explode over the coming decades.

The problem of not owning a home in retirement is that you have to keep paying rent right up until the day you die. Recent research from the Australian Housing and Urban Research Institute projects that by 2050 there will be 832,319 people over the age of 50 living in private rental accommodation, up from just over 420,000 today.

This is not just a problem for older Australians. Young people also risk depleting their savings during their working life as they continue to rent before buying a home, potentially offsetting any benefits of forced saving through compulsory superannuation.

We need to be clear about one aspect of this debate: allowing access to superannuation to buy a home is not going to bring down house prices. It is much more likely to have the opposite effect.

But this is not a policy aimed at housing affordability. Only releasing more land and relaxing density restrictions can bring house prices down over the long run. This is a policy aimed at helping young people to become members of the homeowners' club.

Treasurer Scott Morrison should be applauded for looking at creative solutions to break down the rigidity of the current superannuation investment model. Allowing individuals to access their own money held in superannuation accounts is not a radical proposal. Especially if the money is being used to invest. Giving young Australians the flexibility to use super to invest in their own home is just the kind of positive, forward-thinking policy a modern Coalition government should be championing.

Simon Breheny

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June 2023

MASS MIGRATION INDUCED HOUSING SHORTAGE

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Institute of Public Affairs

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Introduction

This research report estimates the shortfall in housing supply as a result of the expected increase to migration announced by the federal government.

The study was conducted by making adjustments to a net annual dwelling supply and demand forecast, modelled by the National Housing Finance and Investment Corporation.[1] The adjustments incorporate new data on overseas migration intake contained in the 2023-24 federal budget,[2] which estimates that net overseas migration could bring in up to 1.755 million new immigrants by the financial year ending 2028.

New net migration figures in the May 2023 budget represent an excess of 379,000 migrants over the initial estimates between 2022 and 2028, announced in the October budget last year.

Key findings in this report are as follows:

- Between 2023 and 2028, net overseas migration to Australia is expected to reach 1.755 million. This is the equivalent to 117,000 new households formed from immigration alone in search of housing every year.
- This will be in addition to the creation of 69,617 new domestic households every year, which will require 417,700 new housing units by 2028.
- Between 2023 and 2028, housing supply is forecast to increase by only 866,900 units.
- This will result in a net housing supply **shortfall of 252,800 housing units** from 2023 to 2028.[3] On a state and territory level, the expected housing shortage from 2023 to 2028 is as follows:
    - New South Wales: 70,889
    - Victoria: 62,168
    - Queensland: 54,591
    - Western Australia: 34,720
    - South Australia: 18,162
    - Tasmania: 8,922
    - The Northern Territory: 2,624
    - The Australian Capital Territory: 2,325

1 NHFIC (2023, April) *State of the Nation's Housing 2022-23*, National Housing Finance and Investment Corporation: Sydney.

2 Federal Government (2023, May) *Budget 2023-24: Budget Strategy and outlook: Budget Paper No. 1*, Federal Treasury: Canberra.

3 The expected shortfall of housing has increased from the IPA's initial estimate in May due to the higher number of expected migrant intake announced in the most recent federal budget.

- The **aggregated cost of the shortage from 2023 to 2028 will be approximately $142 billion or $24 billion per annum on average**, based on the cost of the extra housing which would need to be constructed in order to accommodate the expected increase to migration. On a state and territory level, the costs are as follows:
  - NSW: $50.36 billion
  - Victoria: $33.56 billion
  - Queensland: $27.16 billion
  - Western Australia: $15.75 billion
  - South Australia: $8.79 billion
  - Tasmania: $3.73 billion
  - The Northern Territory: $1.02 billion
  - The ACT: $1.48 billion

Research Methodology

This research report utilises data derived from: forecast modelling by the NHFIC's 2022-23 State of the Nation's Housing Report, the 2023-24 federal budget and the Australian Bureau of Statistics.

On Australia-wide net new supply and demand estimates

Specifically, data relating to projected net new dwelling supply between the years 2022 and 2028 were derived from the NHFIC's report. Data relating to net new household formation, which indicate annual increases in demand, were based on both the said report and the budget's updated migration forecast.

The NHFIC's report assumed the steady-state net overseas migration level to be 235,000 individuals per annum, in line with the Centre for Population's prediction in its 2022 Statement and pre-pandemic numbers.[4] Its modelling assumed that net migration would reach this level by 2023, up from 150,000 in 2022.

Data used for the NHFIC's modelling, however, has been superseded by subsequent government information releases. The May budget's forecast suggests that net migration intake will be considerably higher: at 715,000 individuals between 2023 and 2024, before falling to 260,000 individuals per year: an annual steady state over the forward estimate that is higher by 25,000 individuals than initially forecast in the October 2022 budget and the Centre for Population's initial estimate.

The housing supply and demand estimates, presented in this report, adjusts the NHFIC's initial assumption in light of the new and elevated net overseas migration numbers in the budget.[5]

To give context to the study, ABS data have also been collected to cover the five years before 2022, namely the period just prior to and during the pandemic.

New net dwelling supply for each year prior to 2022 was taken to be the equivalent to the year-by-year change in estimated stock of dwelling as reported in the ABS' national dwelling stock statistics.[6] Historical data on new net household formation is based on an analysis of ABS data on the change in Australia's population - attributable to natural increases and net overseas migration.[7]

4 Centre for Population (2022) *2022 Statement*, Commonwealth Treasury: Canberra.

5 For the purpose of this report, each financial year's migration intake is assigned to the calendar year in which the financial year ends.

6 ABS (2022, October) Estimated dwelling stock: Provides quarterly estimates of dwelling stock, additions and removals, *Australian Bureau of Statistics*, Available from: https://www.abs.gov.au/statistics/industry/building-and-construction/estimated-dwelling-stock/latest-release#:~:text=Australia's%20dwelling%20stock%20was%2010%2C879%2C349,additions%20and%206%2C987%20dwelling%20removals.

7 ABS (2023, March) National, state and territory population: Statistics about the population and components of change (births, deaths, migration) for Australia and its states and territories, *Australian Bureau of Statistics*, Available from: https://www.abs.gov.au/statistics/people/population/national-state-and-territory-population/sep-2022#data-downloads.

For each year, the net increase in housing supply is compared against the net increase in the number of households in Australia to arrive at either a surplus or a shortfall. Increased migration intake increases the number of new households and, therefore, demand for new housing units. The outcome is to reduce any surplus housing or exacerbate any shortage.[8]

For the purpose of this report, housing units can be detached homes, apartments and other forms of dwelling in which an individual or family lives. A household can consist of one or more people, related or otherwise, that lives in the same housing unit (e.g., friends sharing a home, a nuclear family or a single person living on their own).

The 2021 Census finds that Australia has an average household size of 2.5.[9] This is the average number of people throughout the country who occupy a dwelling unit. The number of people in Australia which constitutes a household has been somewhat stable since the year 2000.[10] In this report, therefore, the assumption is made that a new household is formed for every additional 2.5 new residents.

8 This report is concerned with the gap in housing availabilities for new households. Accordingly, new net dwelling supply and new net household formation are used as determinants of the gap in the analysis. This follows the methodology in the NHFIC's report in favour of utilising aggregate supply and demand data, which capture market and investor sentiments - among other factors - that have the potential to cloud the result.

9 ABS (2022, June) Snapshot of Australia: A picture of the economic, social and cultural make-up of Australia on Census Night, 10 August 2021, *Australian Bureau of Statistics*, Available from: https://www.abs.gov.au/statistics/people/people-and-communities/snapshot-australia/latest-release#:~:text=The%202021%20Census%20counted%20more,2016%20to%202.5%20in%202021.

10 Qu (2018, May) Population and Households: Population Growth, *Australian Institute of Family Studies*, Available from: https://aifs.gov.au/research/facts-and-figures/population-and-households; GlobalData (2022) Average Size of Households in Australia (2010 - 2021), *Data and Insights*, Available from: https://www.globaldata.com/data-insights/macroeconomic/average-household-size-in-australia-2096118/#:~:text=Size%20in%20Australia-,Australia%20had%20an%20average%20household%20size%20of%202.59%20people%20in,2021%2C%20between%202010%20and%202021.

On state by state net new supply and demand estimates

The NHFIC's modelling provides a state by state breakdown of the aforementioned new net dwelling supply and demand forecast.[11] But state-level data do not distinguish overseas migration-driven net demand increases from demand increases arising from other factors such as interstate migration and natural growth.

In this report, then, state and territory allocation of migration intake is extrapolated based on state and territory population data as follows:[12]

Table 1: State by state population breakdown

State	Capital City	Population	Share of Population
NSW	Sydney	8,193,500	31%
VIC	Melbourne	6,656,300	25%
QLD	Brisbane	5,354,800	21%
SA	Adelaide	1,828,700	7%
WA	Perth	2,805,000	11%
TAS	Hobart	571,900	2%
NT	Darwin	250,600	1%
ACT	Canberra	459,000	2%

This means that we assume migration pattern into different parts of Australia to follow the current state by state makeup of the overall population. This approach is preferred to apportioning migrant numbers based on state of arrival because the latter disproportionately allocate migrant intake to the states with the busiest international airports.

Since the focus of this report is on the impact of overseas migration, growth in state population arising from interstate migration are not distinguished from natural growth, namely births minus deaths. Consequently, domestic interstate movement is taken to be a part of an 'organic' change.

11 The individual states' data in the State of the Nation's Housing Report do not add up exactly to the national data, but the discrepancies are minor. No discrepancy, in any single year, add up to more than 1% of the sum.

12 ABS (2023, March) National, state and territory population: Statistics about the population and components of change (births, deaths, migration) for Australia and its states and territories, *Australian Bureau of Statistics,* Available from: https://www.abs.gov.au/statistics/people/population/national-state-and-territory-population/sep-2022#data-downloads; Centre for Population (2023, January) Centre for Population Projections, *Centre for Population*, Available from: https://population.gov.au/data-and-forecasts/projections.

Nationwide Housing Supply Gap

The baseline forecast, informed by the NHFIC's State of the Nation's Housing Report, estimates a cumulated housing supply shortfall of 114,800 units between 2023 and 2028, subsequent to which the annual supply of housing was meant meet and then exceed the demand for new housing every year.

This was anchored on the assumption that net overseas migration brought in 150,000 new residents last year before reaching a steady state of 235,000 per annum from this year onwards. This will be the equivalent to 94,000 households.

Table 2: Baseline forecast

Year	New Net Dwelling Supply	New Net Household Formation			New Dwelling Supply – Household Formation
		Total	Organic	Net Migration	
2017	189,609	153,440	56,800	96,640	36,169
2018	197,104	159,200	58,320	100,880	37,904
2019	178,597	154,640	55,600	99,040	23,957
2020	159,595	50,360	52,360	-2,000	109,235
2021	153,297	59,640	57,280	2,360	93,657
2022	143,800	132,400	72,400	60,000	11,400
2023	148,500	139,200	45,200	94,000	9,300
2024	138,200	150,400	56,400	94,000	-12,200
2025	127,500	176,400	82,400	94,000	-48,900
2026	134,600	173,700	79,700	94,000	-39,100
2027	155,700	171,100	77,100	94,000	-15,400
2028	162,400	170,900	76,900	94,000	-8,500

Housing supply is expected to decline from a high of almost 200,000 units annually, prior to the pandemic, to 127,500 in 2025 before picking up again in a belated response to increased demand. The decline has been due to a number of factors including: the rise in interest rates following an upsurge in inflation, the increasing cost of building materials, the increasing cost and scarcity of labour, and delays due to weather conditions and red tape.[13]

Demand for housing, on the other hand, is expected to strengthen - on the back of the expected return of migration intake to pre-pandemic levels and beyond. By 2024, household formation is expected to outstrip new net dwelling supply, meaning that – on balance – there will be more families looking for homes than there are homes being supplied to accommodate them.

13 Diana Mousina (2023, April) Australia's housing shortage, *EconoSights*, Available from: https://www.amp.com.au/content/dam/amp-au/documents/insights/econosights-housing-shortage.pdf; NHFIC (2023) *State of the Nation's Housing 2022-23*, National Housing Finance and Investment Corporation: Sydney.

New Treasury figures, revealed in the May budget, however, suggests that demand for housing has already outpaced supply on the back of higher than expected net migration intake.

Net overseas migration in the financial year ending 2022 was 23 per cent higher than expected in the October budget, at 184,000. Intake for this year is 70 per cent higher than anticipated, at 400,000. Intake for next year is expected to be 34 per cent higher than anticipated, at 315,000. And the steady state migration intake going forward will be 10 per cent higher than anticipated at 260,000 per annum, up from 235,000 per annum in accordance with the October budget and Centre for Population estimate.

May 2023's budget papers ambiguously note that net overseas migration is expected to "[fall] back towards historical trends of 235,000 per year", but only after "the temporary catch-up effect from the pandemic subsides" well beyond 2027. A counterpoint to the budget assertion of a return to pre-pandemic levels is the typical growth in net overseas migration in Australia in recent years. In the 15 years prior to the pandemic, the average annual growth in net overseas migration was 8.3 per cent. Net overseas migration falling, after 2027, to approximately half of today's level - and staying constant thereafter - is unlikely.

The furthest projected net overseas migration forecast is 260,000 in 2027. For simplicity, the present analysis assumes that the net overseas migration will stay at this level into 2028.

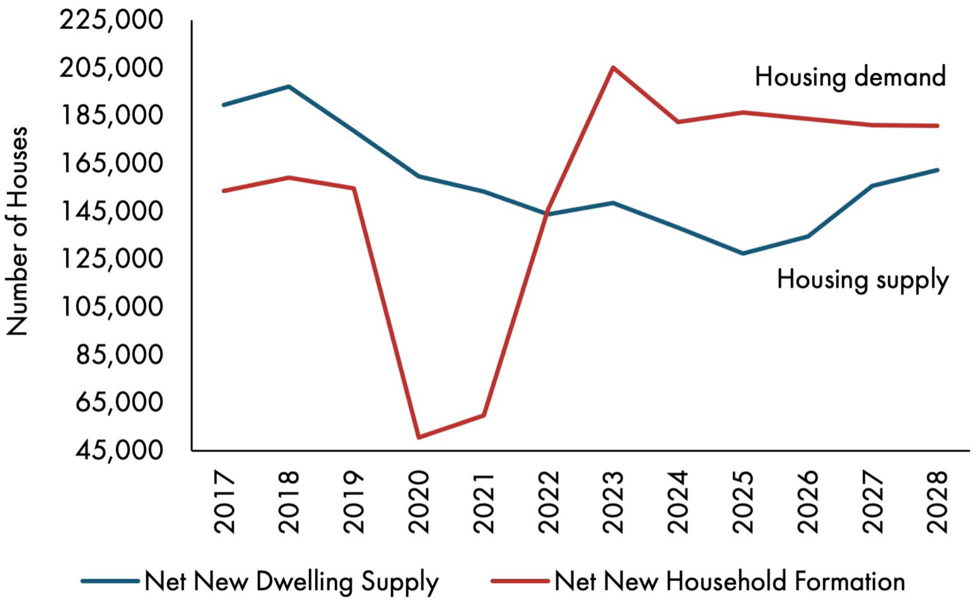
Table 3: Housing supply shortfall due to migration expansion

Year	New Net Dwelling Supply	New Net Household Formation			New Dwelling Supply – Household Formation
		Total	Organic	Net Migration	
2017	189,609	153,440	56,800	96,640	36,169
2018	197,104	159,200	58,320	100,880	37,904
2019	178,597	154,640	55,600	99,040	23,957
2020	159,595	50,360	52,360	-2,000	109,235
2021	153,297	59,640	57,280	2,360	93,657
2022	143,800	146,000	72,400	73,600	-2,200
2023	148,500	205,200	45,200	160,000	-56,700
2024	138,200	182,400	56,400	126,000	-44,200
2025	127,500	186,400	82,400	104,000	-58,900
2026	134,600	183,700	79,700	104,000	-49,100
2027	155,700	181,100	77,100	104,000	-25,400
2028	162,400	180,900	76,900	104,000	-18,500

As shown in Table 2 above, based on the updated figures, we estimate a housing supply shortfall of approximately 42,133 housing units each year between 2023 and 2028, for a total accumulated shortfall of 252,800 units. Over the course of the period, net migration intake is expected to increase by over 1.755 million people or the equivalent to 702,000 households.

The shortfall in housing supply is expected to continue into the foreseeable future, as shown in Chart 1 below.

Chart 1: Housing supply shortfall due to migration expansion



All else remaining constant, the increased migration intake will worsen Australia's housing shortage and lengthen the time needed for the supply side of the market to catch up with the increased demand in housing.

We estimate the cost of building a residential dwelling to be $516,314 – on average – across Australia's capital cities, where the bulk of the population lives, and where the majority of new migrants are expected to settle.

The estimate is derived from applying the median cost of land and building per m^2 on the average size of new homes in Australia, namely 195.8 m^2.[14]

Table 4: Cost of building a new home[15]

Capital City	Cost of Land per m^2	Building Cost per m^2	Total Cost
Sydney	$1,898	$1,730	$710,362
Melbourne	$1,087	$1,670	$539,821
Brisbane	$851	$1,690	$497,528
Perth	$607	$1,710	$453,669
Adelaide	$531	$1,940	$483,822
Hobart	$284	$1,850	$417,772
Darwin	$193	$1,800	$390,209
Canberra	$1,325	$1,930	$637,329

However, the total cost of addressing the aforementioned supply gap of 252,800 units will be more than simply multiplying the accumulated shortfall by the abovementioned unweighted average cost of building a residential dwelling. This is because the supply gap will be more prevalent in the most expensive states.

We estimate the cost of addressing the supply shortfall to be $141.85 billion over the six years to 2028, which is the equivalent to $23.64 billion per year between 2023 and 2028.

Our state by state analysis is presented in detail in the next section of the report.

14 Craig James and Ryan Felsman (2020, November) Australian houses are again the world's biggest, Economic *Insights*, CommSec: Sydney.

15 Estimates derived based on data from: Statista (2023, April) Price per square meter of land in selected cities Australia 2022, *Statista*, Available from: https://www.statista.com/statistics/736673/australia-land-price-per-square-meter-in-selected-areas/; Domain Research (2023, February) Housing affordability: The price per square metre, *Domain*, Available from: https://www.domain.com.au/research/housing-affordability-the-price-per-square-metre-1193910/; Newscorp (2018, February) Tasmanian land sales are up but prices are down, *Mercury*, Available from: https://www.realestate.com.au/news/tasmanian-land-sales-up-prices-down/; Koste (2023) Construction Cost Table, *Australian Building Construction Cost*, Available from: https://koste.com.au/construction-cost-table/ (Note that the construction figures used are based on the 'Standard House (Medium)' estimate); Platinum Pro (2023, January) How much does it cost to build a house in Tasmania?, *Platinum Pro Construction*, Available from: https://www.platinumproconstruction.com.au/blog/how-much-does-it-cost-to-build-a-house-in-tasmania; *Kitome* (2022, October) Calculating the Cost of Building a Home, *Kitome*, Available from: https://kitome.com.au/blog/calculating-cost-building-home/.

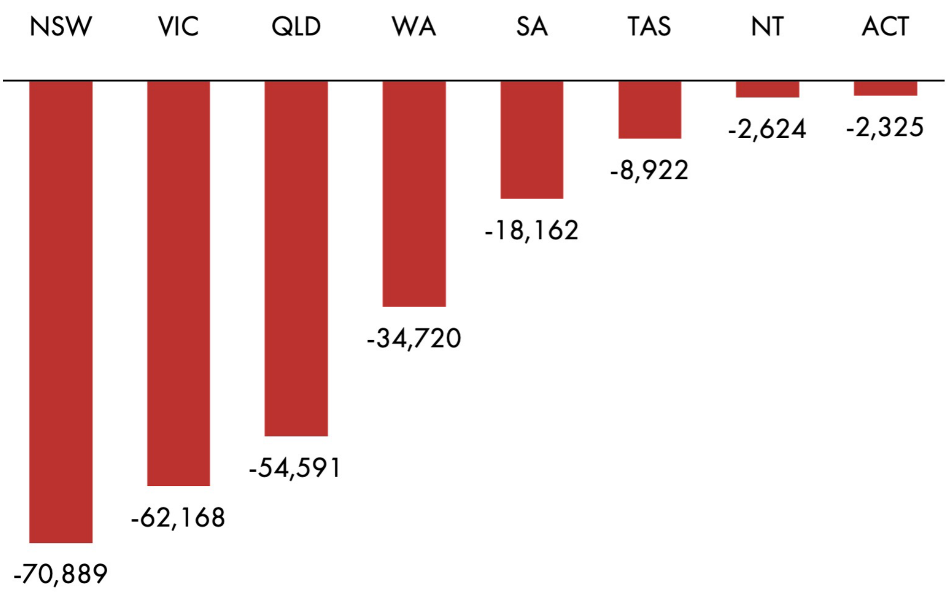
State by State Analysis

This section of the report estimates the state by state impact of the expected housing supply shortfall that Australia is experiencing and will continue to experience to 2028 and beyond.

Assuming that migration pattern matches the distribution of Australia's population among the eight states and territories, we expect each state and territory to suffer from housing supply shortages over the next decade. But the impact will not be evenly felt.

As Chart 2 below shows: NSW, Victoria and Queensland will bear the brunt of the housing supply shortfall – with the territories being the least affected.[16]

Chart 2: Cumulative housing shortage in each state and territory from 2023-2028



The Northern Territory is expected to benefit from both an increase in the housing supply and a slowing down in the rate of household formation.

The ACT will experience a slight pick up in the housing supply and a flatlined population growth, with overseas migration contributing to less than half of Canberra's new household formation.

16 The sum of the state by state supply shortfall estimates is 0.63% higher than the estimated nationwide shortfall as a result of the aforementioned slight discrepancy in the original state by state vs national data.

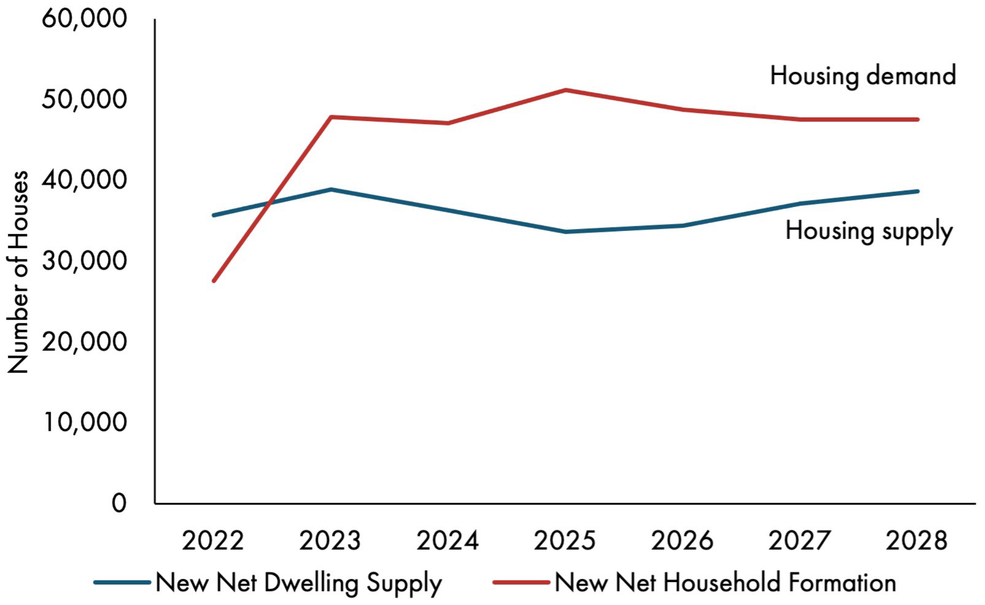
New South Wales

Table 5: New South Wales state estimates

Year	New Net Dwelling Supply Sydney	Rest of NSW	New Net Household Formation Total	Organic	Net Migration	New Dwelling Supply – Household Formation
2022	23,400	12,300	27,566	4,479	23,088	8,134
2023	25,900	13,000	47,803	-2,387	50,190	-8,903
2024	24,500	11,800	47,038	7,513	39,525	-10,738
2025	22,800	10,800	51,137	18,513	32,624	-17,537
2026	22,900	11,500	48,737	16,113	32,624	-14,337
2027	25,100	12,000	47,537	14,913	32,624	-10,437
2028	25,800	12,800	47,537	14,913	32,624	-8,937

Between 2023 and 2028, NSW will experience a shortfall of 70,889 housing units. During the same period, NSW will receive an estimated 550,525 net new migrants, the equivalent of 220,210 new households through migration alone.

Chart 3: Housing supply shortfall due to migration expansion in New South Wales



Assuming that the construction of a new unit of housing for each new household in NSW is $710,362, the total cost of the shortfall for the state will amount to $50.36 billion. This will be the equivalent to $8.39 billion per annum to 2028.

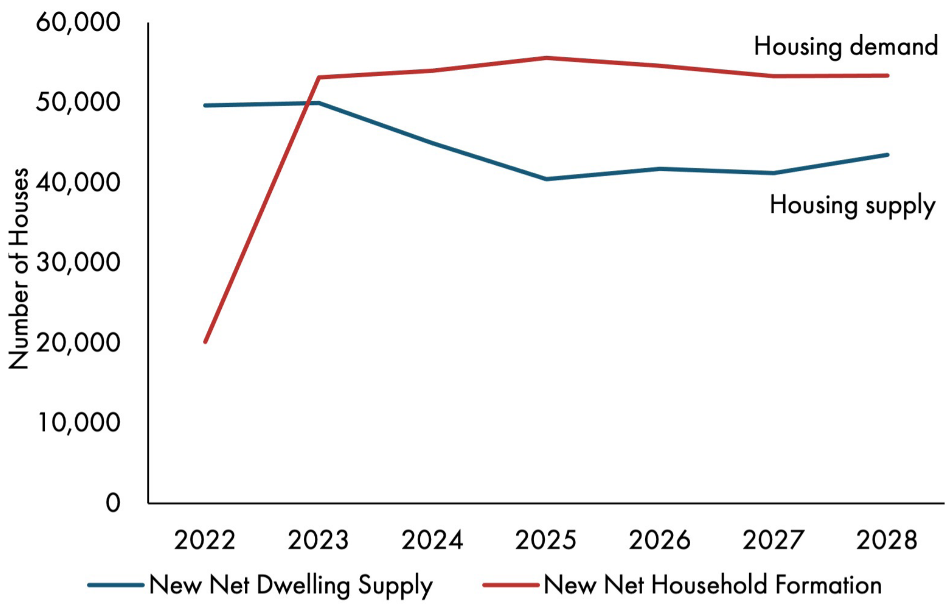
Victoria

Table 6: Victoria state estimates

Year	New Net Dwelling Supply Melbourne	Rest of VIC	New Net Household Formation Total	Organic	Net Migration	New Dwelling Supply – Household Formation
2022	36,000	13,600	20,166	1,410	18,756	29,434
2023	37,000	12,900	53,119	12,345	40,774	-3,219
2024	33,700	11,200	53,955	21,845	32,110	-9,055
2025	30,600	9,800	55,548	29,045	26,503	-15,148
2026	31,100	10,700	54,548	28,045	26,503	-12,848
2027	30,900	10,300	53,248	26,745	26,503	-12,048
2028	32,700	10,800	53,348	26,845	26,503	-9,848

Between 2023 and 2028, there will be an estimated shortfall of 62,168 housing units in Victoria. During the same period, Victoria will receive an estimated 447,240 net new migrants, the equivalent of 178,896 new households through migration alone.

Chart 4: Housing supply shortfall due to migration expansion in Victoria



Assuming that the construction of a new unit of housing for each new household in Victoria is $539,821, the total cost of the shortfall for the state will amount to $33.56 billion. This will be the equivalent to $5.59 billion per annum to 2028.

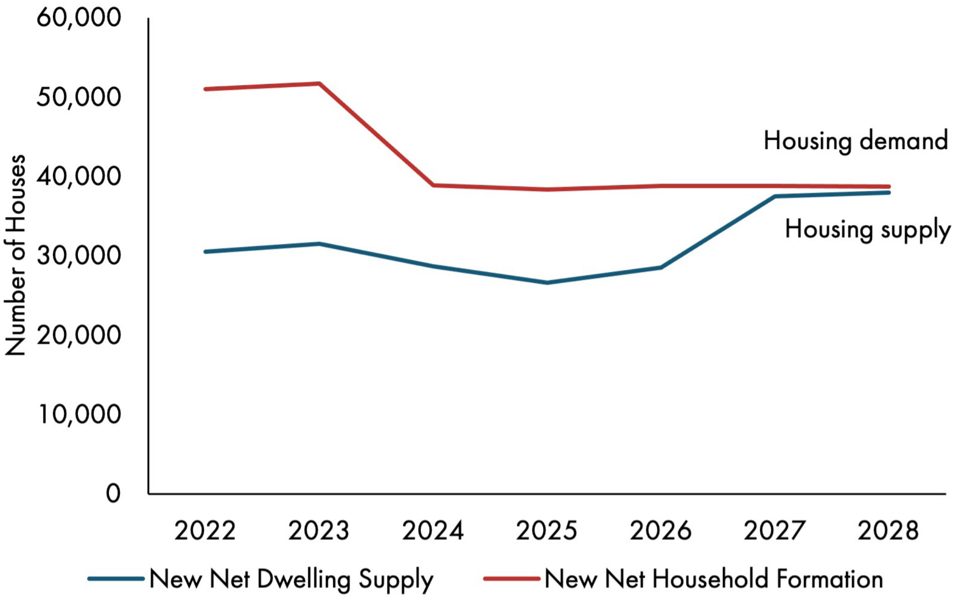
Queensland

Table 7: Queensland state estimates

Year	New Net Dwelling Supply		New Net Household Formation			New Dwelling Supply – Household Formation
	Brisbane	Rest of QLD	Total	Organic	Net Migration	
2022	16,600	13,900	50,988	35,899	15,089	-20,488
2023	17,300	14,200	51,731	18,929	32,801	-20,231
2024	15,900	12,800	38,860	13,029	25,831	-10,160
2025	14,800	11,800	38,350	17,029	21,321	-11,750
2026	15,800	12,700	38,850	17,529	21,321	-10,350
2027	17,300	20,200	38,850	17,529	21,321	-1,350
2028	16,900	21,100	38,750	17,429	21,321	-750

Between 2023 and 2028, there will be an estimated shortfall of 54,591 housing units in Queensland. During the same period, Queensland will receive an estimated 359,790 net new migrants, the equivalent of 143,916 new households through migration alone.

Chart 5: Housing supply shortfall due to migration expansion in Queensland



Assuming that the construction of a new unit of housing for each new household in Queensland is $497,528, the total cost of the shortfall for the state will amount to $27.16 billion. This will be the equivalent to $4.53 billion per annum to 2028.

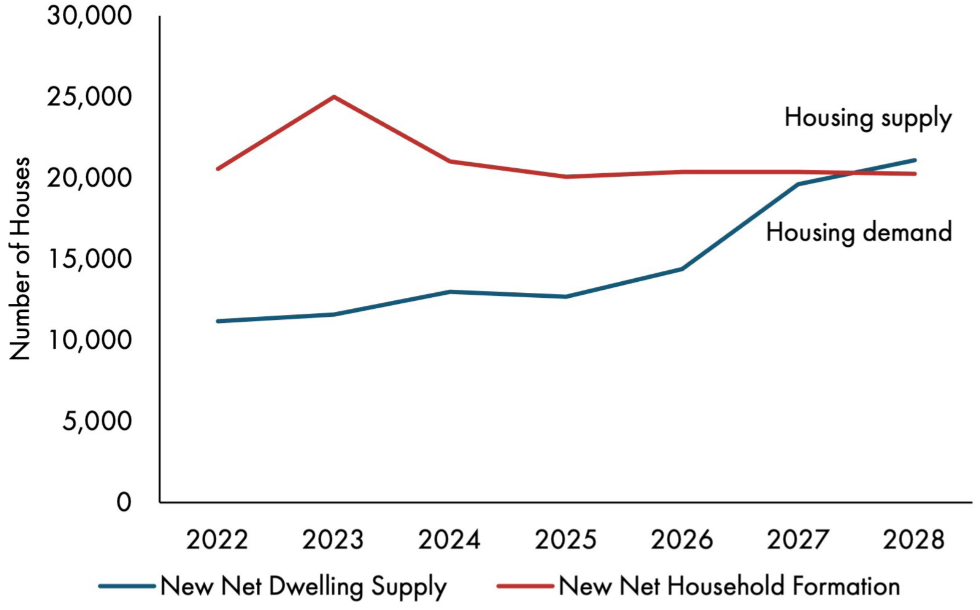
Western Australia

Table 8: Western Australia state estimates

Year	New Net Dwelling Supply		New Net Household Formation			New Dwelling Supply – Household Formation
	Perth	Rest of WA	Total	Organic	Net Migration	
2022	9,500	1,700	20,561	12,657	7,904	-9,361
2023	9,600	2,000	24,988	7,805	17,182	-13,388
2024	10,900	2,100	21,036	7,505	13,531	-8,036
2025	10,500	2,200	20,074	8,905	11,169	-7,374
2026	11,600	2,800	20,374	9,205	11,169	-5,974
2027	16,500	3,100	20,374	9,205	11,169	-774
2028	17,500	3,600	20,274	9,105	11,169	826

Between 2023 and 2028, there will be an estimated shortfall of 34,720 housing units in Western Australia. During the same period, Western Australia will receive an estimated 188,470 net new migrants; the equivalent of 75,388 new households through migration alone.

Chart 6: Housing supply shortfall due to migration expansion in Western Australia



Assuming that the construction of a new unit of housing for each new household in Western Australia is $456,669, the total cost of the shortfall for the state will amount to $15.75 billion. This will be the equivalent to $2.63 billion per annum to 2028.

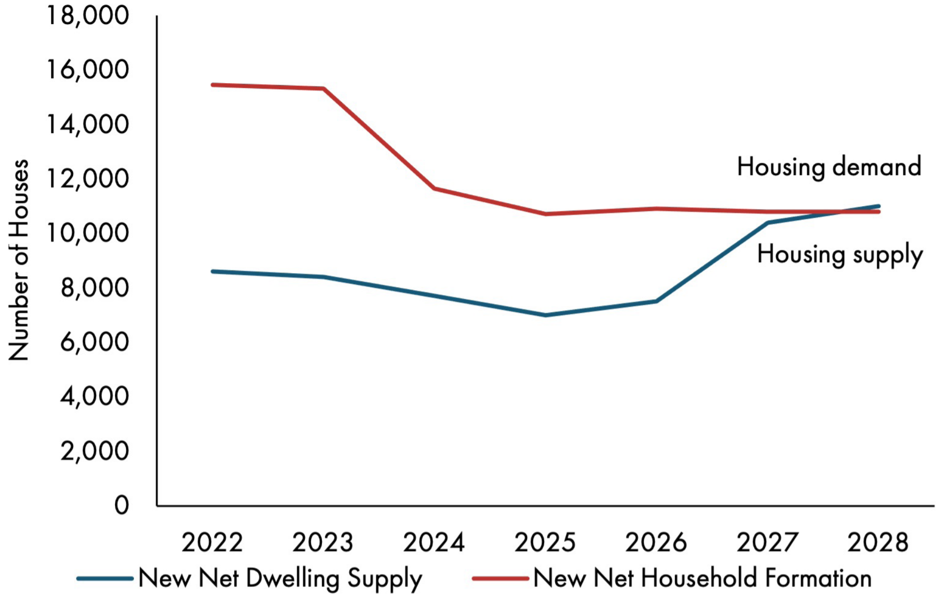
South Australia

Table 9: South Australia state estimates

Year	New Net Dwelling Supply		New Net Household Formation			New Dwelling Supply – Household Formation
	Adelaide	Rest of SA	Total	Organic	Net Migration	
2022	6,700	1,900	15,452	10,299	5,153	-6,852
2023	6,700	1,700	15,321	4,119	11,202	-6,921
2024	6,200	1,500	11,640	2,819	8,822	-3,940
2025	5,600	1,400	10,700	3,419	7,281	-3,700
2026	5,900	1,600	10,900	3,619	7,281	-3,400
2027	8,600	1,800	10,800	3,519	7,281	-400
2028	9,000	2,000	10,800	3,519	7,281	200

Between 2023 and 2028, there will be an estimated shortfall of 18,162 housing units in South Australia. During the same period, South Australia will receive an estimated 122,870 net new migrants, the equivalent of 49,148 new households through migration alone.

Chart 7: Housing supply shortfall due to migration expansion in South Australia



Assuming that the construction of a new unit of housing for each new household in South Australia is $483,822, the total cost of the shortfall for the state will amount to $8.79 billion. This will be the equivalent to $1.46 billion per annum to 2028.

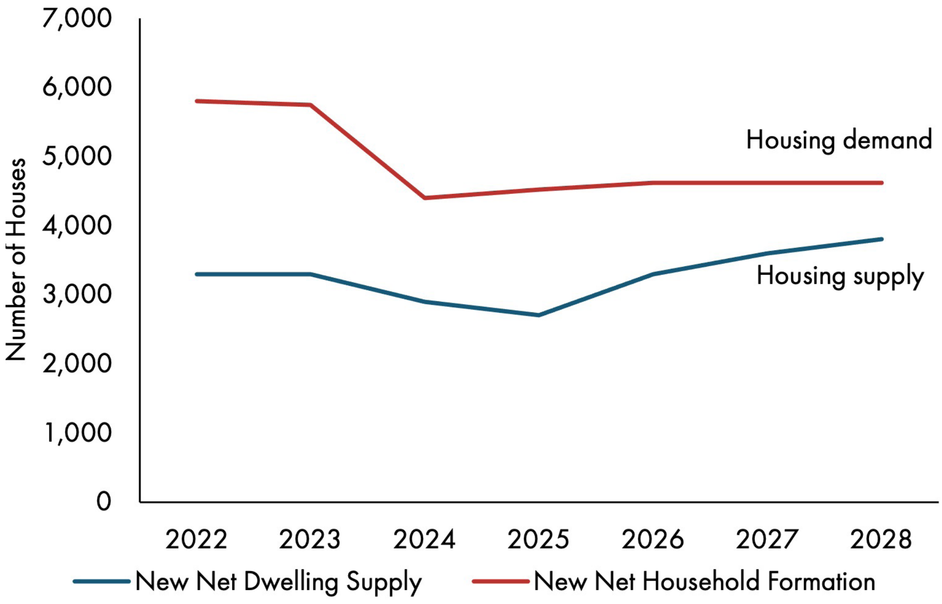
Tasmania

Table 10: Tasmania state estimates

Year	New Net Dwelling Supply			New Net Household Formation		New Dwelling Supply – Household Formation
	Hobart	Rest of TAS	Total	Organic	Net Migration	
2022	1,500	1,800	5,798	4,186	1,611	-2,498
2023	1,500	1,800	5,745	2,242	3,503	-2,445
2024	1,300	1,600	4,401	1,642	2,759	-1,501
2025	1,200	1,500	4,519	2,242	2,277	-1,819
2026	1,400	1,900	4,619	2,342	2,277	-1,319
2027	2,300	1,300	4,619	2,342	2,277	-1,019
2028	2,500	1,300	4,619	2,342	2,277	-819

Between 2023 and 2028, there will be an estimated shortfall of 8,922 housing units in Tasmania. During the same period, Tasmania will receive an estimated 38,425 net new migrants, the equivalent of 15,370 new households through migration alone.

Chart 8: Housing supply shortfall due to migration expansion in Tasmania



Assuming that the construction of a new unit of housing for each new household in Tasmania is $417,772, the total cost of the shortfall for the state will amount to $3.73 billion. This will be the equivalent to $621 million per annum to 2028.

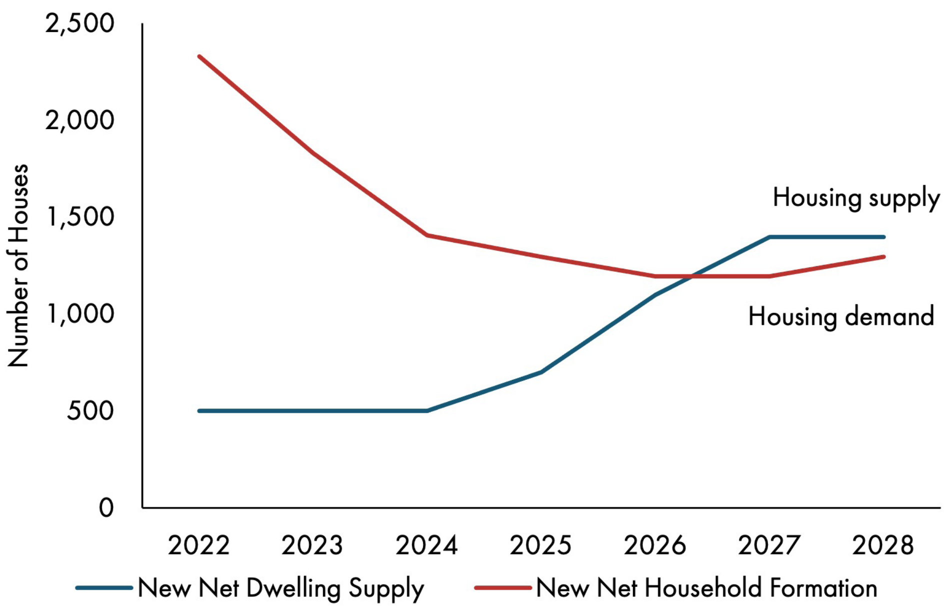
Northern Territory

Table 11: Northern Territory estimates

Year	New Net Dwelling Supply		New Net Household Formation			New Dwelling Supply – Household Formation
	Darwin	Rest of NT	Total	Organic	Net Migration	
2022	400	100	2,330	1,624	706	-1,830
2023	400	100	1,833	298	1,535	-1,333
2024	400	100	1,407	198	1,209	-907
2025	500	200	1,296	298	998	-596
2026	800	300	1,196	198	998	-96
2027	1,000	400	1,196	198	998	204
2028	1,000	400	1,296	298	998	104

Between 2023 and 2028, there will be an estimated shortfall of 2,624 housing units in the Northern Territory. During the same period, the Northern Territory will receive an estimated 16,838 net new migrants, the equivalent of 6,735 new households through migration alone.

Chart 9: Housing supply shortfall due to migration expansion in the Northern Territory



Assuming that the construction of a new unit of housing for each new household in the Northern Territory is $390,209, the total cost of the shortfall for the territory will amount to $1.02 billion. This will be the equivalent to $171 million per annum to 2028.

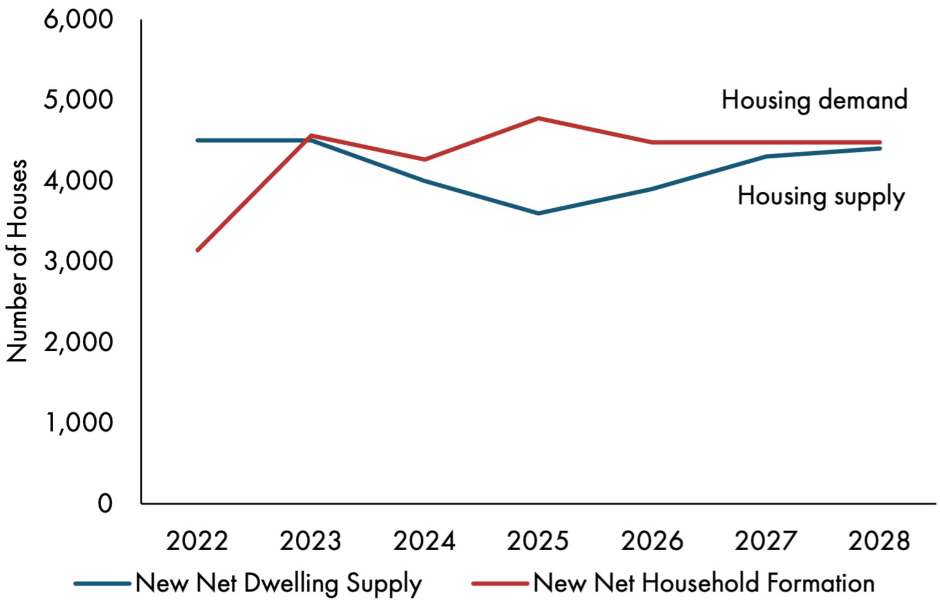
Australian Capital Territory

Table 12: Australian Capital Territory estimates

Year	New Net Dwelling Supply	New Net Household Formation			New Dwelling Supply – Household Formation
		Total	Organic	Net Migration	
2022	4,500	3,139	1,846	1,293	1,361
2023	4,500	4,560	1,748	2,812	-60
2024	4,000	4,262	2,048	2,214	-262
2025	3,600	4,776	2,948	1,828	-1,176
2026	3,900	4,476	2,648	1,828	-576
2027	4,300	4,476	2,648	1,828	-176
2028	4,400	4,476	2,648	1,828	-76

Between 2023 and 2028, there will be an estimated shortfall of 2,325 housing units in the ACT. During the same period, the ACT will receive an estimated 30,840 net new migrants, the equivalent of 12,336 new households through migration alone.

Chart 10: Housing supply shortfall due to migration expansion in the Australian Capital Territory



Assuming that the construction of a new unit of housing for each new household in the ACT is $637,329, the total cost of the shortfall for the territory will amount to $1.48 billion. This will be the equivalent to $247 million per annum to 2028.

Conclusion

This research report estimates the shortfall in housing supply as a result of the net inflow of immigrants following the Commonwealth Government's lifting of international borders after the pandemic and its decision to rely on increased migration as a solution to address Australia's worker shortage crisis.

The study was conducted by making adjustments to a net annual dwelling supply and demand forecast, modelled by the NHFIC. The adjustments incorporate new data on overseas migration intake contained in the 2023-24 federal budget.

Key findings in this report are as follows:

- Between 2023 and 2028, net overseas migration to Australia is expected to reach 1.755 million. This population increase will be in addition to the natural increase of the domestic population. This is the equivalent to 117,000 new households formed from immigration alone in search of housing every year.
- This will be in addition to the creation of 69,617 new domestic households every year, which will require 417,700 new housing units by 2028.
- Between 2023 and 2028, housing supply is forecast to increase by only 866,900 units.
- This will result in a net housing supply **shortfall of 252,800 housing units** over the course of the period.
- The **aggregated cost of the shortage will be approximately $142 billion or $24 billion per annum**, which will have to be borne by Australian families through higher rent, a higher barrier to home ownership, higher taxes, higher inflation and a more severe cost-of-living crisis.

MASS MIGRATION INDUCED HOUSING SHORTAGE

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Institute of
Public Affairs

JULY 2023

AUSTRALIA'S HOUSING SHORTAGE

International Student Intake Exacerbating Nationwide Housing Supply Shortfall

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Dr Kevin You
Research Fellow

Institute of Public Affairs

Contents

Key findings

- **Last financial year, the federal government oversaw the largest ever net intake of international students**, of more than 250,000 people, which was more than twice the previous high of 122,000 in the financial year ending 2009.
- Last financial year, on average across Australia, **new international students took up 70 per cent of the net new housing units supplied to the market,** leaving just 30 per cent for the rest of the nation, including other new migrants. The vast majority of students live in rental accommodation, and their entry into the rental market has been a major contributing factor to rental shortages and rapidly rising rental costs.
- Despite this, **the government is expected to bring in a further 187,000 net new international students this financial year**, with no apparent plan for where they will be housed, or how to absorb the extra pressure on infrastructure such as roads and public transport.
- This financial year, it is expected that international students will, on average across the nation, take up close to 55 per cent of net new housing supply.
- **From 2025 to 2028, it is expected that international students will take up approximately one-quarter of Australia's net new housing supply**, baking in housing shortages and rising rental prices.
- It was claimed that the increase to net international student intake compensates for the reduction in international student arrivals due to COVID-19. Yet the intake for the last, and expected intake for this, financial year **will result in more than 85,000 net arrivals above and beyond what would have been required to offset the COVID-19 decline.**

Introduction

Research by the Institute of Public Affairs (IPA) finds that over the six years to 2028, Australia is set to face a net housing supply shortfall of 252,800 units.[1] A key contributor to this housing crisis is the Commonwealth Government's inability to rein in the influx of migrants subsequent to the lifting of international borders after the COVID -19 pandemic. A net of 1.755 million new immigrants are set to call Australia home between 2023 and 2028.

The *Australian Financial Review* has attributed this steep rise in migration to 'a rebound in the number of people living in Australia on student visas'.[2] This was subsequently acknowledged in the May 2023-24 Budget:

> The reopening of international borders has seen a rapid recovery in the stock of international students, skilled temporary visa holders and working holiday makers in 2022-23. Second and third-year students who were studying online during the pandemic have been returning, in addition to those arriving in Australia to begin their studies.[3]

Almost two-thirds of the more than 400,000 net new migrants in the financial year ending 2023 have arrived in Australia on student visas. Another two thirds of the subsequent year's net migration intake will be made up of international students.

Many international students come to Australia for the primary purpose of working and seeking permanent residency rather than getting an education. Indeed, part-time work opportunities and a pathway to permanent settlement are the major selling points of educational and immigration agents, as well as tertiary education institutions, seeking to attract international students.

This research report studies the impact that the present volume of international student arrivals has, and will continue to have, on Australia's housing shortage. The consequences of the unprecedented influx of international students are not just felt by Australians but also the international students themselves, whose educational experience suffers as a result of issues associated with a lack of housing availability, especially in Australia's capital cities.

1 Daniel Wild, Kevin You and Morgan Begg, *Mass Migration Induced Housing Shortage* (Institute of Public Affairs Research Report, June 2023).

2 Michael Read, 'Migration to hit a record 400k this year amid a surge in students', *Australian Financial Review* (28 April 2023) <https://www.afr.com/policy/economy/migration-to-hit-a-record-400k-this-year-amid-a-surge-in-students-20230428-p5d3zw>.

3 Commonwealth of Australia, *Budget 2023-24: Budget Strategy and Outlook: Budget Paper No. 1* (Treasury, Canberra, May 2023).

Unprecedented international student arrivals to 2028

The Commonwealth Government began admitting fee-paying overseas students in 1986, prior to which only scholarship holders were permitted to study in Australia as international students.[4] Since then, student enrolment has risen rapidly. In 1987, there were 1,019 fee-paying international students enrolled in Australia's higher education institutions.[5] By 1993 this number had risen to 35,282 students.[6]

Between January and April 2023, there were 590,566 international students participating in 648,700 courses across the country.[7] Students from China and India alone make up close to 40 per cent of all international students in Australia.

The continued increase in the number of international students has been celebrated by universities awash with tuition revenues. Universities Australia, the peak body for Australian universities, boasted:

> [International] education added over $29 billion to the economy in 2022, with international students in Australia contributing $25.5 billion and students studying online adding a further $3.5 billion ... Education is our largest services export and the biggest product we don't source from the ground. [8]

However, this figure should be treated with scepticism. A large share of international students arrive in Australia with the expectation that much of their expenses and tuition will be paid for by working in Australia, not with money earned overseas.[9] Moreover, the calculation of education exports is a consequence of the Australian Bureau of Statistics (ABS) treating international students as residents of their home countries for the duration of their study. As economist and writer Dr Cameron Murray notes:

> Notice that for everyone *but* international students, if they are working and living in Australia the value of goods and services they consume is not an export. Only international students are treated this way, despite most of them working locally... This is the statistical trick at the heart of the education exports figure. [10]

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4 Colin Walters, 'International students – returning their investment: Australia's reform program for international education' (Paper presented at the Going Global Conference, Hong Kong, 2011); Alison Moodie, 'Australia: Long history of international higher education', *University World News* (6 March 2011) <https://www.universityworldnews.com/post.php?story=20110305121304874>.

5 No earlier data were available prior to 1987.

6 Australian Bureau of Statistics, 'Participation in Education: Overseas Students in higher education' (Australian Social Trends 1995, released 20 June 1995) <https://www.abs.gov.au/ausstats/abs@.nsf/2f762f95845417aeca25706c00834efa/de4fd4d0af435ad4ca2570ec007521f0!OpenDocument>.

7 Department of Education (Cth), *International Student Data: Monthly Summary*. Note that there are more enrolments than students since a student can study in more than one course in one calendar year. Many students enrol in English language and their main courses of study simultaneously.

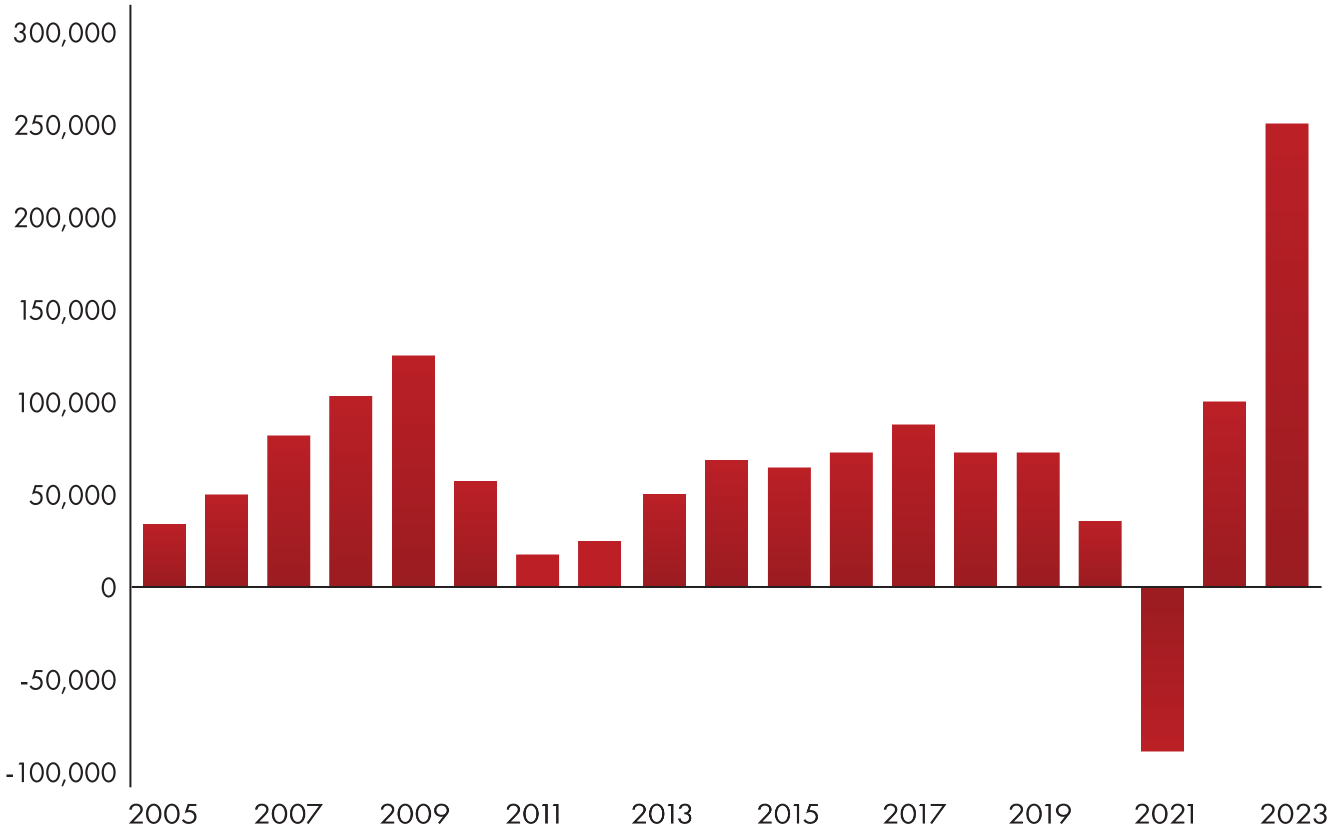
8 Catriona Jackson, 'International Education Adds $29 Billion to the Economy', *Universities Australia* (28 February 2023) <https://www.universitiesaustralia.edu.au/media-item/international-education-adds-29-billion-to-the-economy/>.

9 Leith van Onselen, 'International Education was never a genuine export', MacroBusiness (13 April 2023) <https://www.macrobusiness.com.au/2023/04/international-education-was-never-a-genuine-export/>. For instance, Census data from the ABS reveals that 78 per cent of students from India, 81 per cent from the Philippines, 87 per cent from Nepal and 88 per cent from Colombia undertook paid employment to support themselves.

10 Cameron Murray, 'Australia's $40 billion of education exports is a statistical trick', *Fresh Economic Thinking* (12 June 2023) <https://www.fresheconomicthinking.com/p/australias-40-billion-of-education>. See also Salvatore Babones, *The China Student Boom and the Risks it Poses to Australian Universities* (Centre for Independent Studies, Analysis Paper No 5, August 2019).

We have charted below, in Chart 1, the fluctuation in net international student intake since the financial year ending 2005.[11] It shows an increase to 2009, followed by a sharp two-year decline as a result of the global financial crisis, and then a gradual recovery between 2011 and the start of the covid-19 pandemic. Since then, net intake has risen sharply.

CHART 1: *Net international student intake*



Source: ABS, IPA

Our analysis of ABS data reveals that the financial year ending June 2023 saw the largest net international student intake on record, with a total of 253,940 new students settling in Australia.[12] This is the equivalent of 101,576 new households.

The average household in Australia – whether it be accommodated in an apartment, a detached house or any other type of housing – is made up of approximately 2.5 individuals. A household can consist of one or more people that live in the same housing unit, such as a nuclear family, a single person living alone or, indeed, a group of international students sharing an apartment.

In the financial year ending 2024, net student intake is estimated to reduce slightly from 2023, but will remain at an elevated level of 186,828 individuals, or the equivalent of 74,731 households.

11 Net intake of international students is defined as student visa arrivals minus student visa departures.

12 Australian Bureau of Statistics, 'Overseas Arrivals and Departures, Australia: Statistics on international travel arriving in and departing from Australia' (14 June 2023) <https://www.abs.gov.au/statistics/industry/tourism-and-transport/overseas-arrivals-and-departures-australia/latest-release#arrivals-international-students>.

This estimate is based on an average of the net student intake as a share of Australia's population increase in the two years following the pandemic (i.e., at just over 41 per cent) and Australia's expected population increase over the course of the year (i.e., at 454,300 people).[13]

Between the financial years ending 2025 and 2028, the net annual intake of international students is expected to stabilise to pre-pandemic levels. In the 15 years prior to the pandemic, between 2005 and 2019 (inclusive), net international student intake averaged approximately 18 per cent of overall population growth in Australia. We estimate that population growth between 2025 and 2028 to total 1,830,250 – or 457,563 per year.[14] The share of international students will therefore be 330,246 people or 82,561 people per year.

TABLE 1: *Estimated net international student intake to 2028*

FINANCIAL YEAR ENDING	NET STUDENT INTAKE	EQUIVALENT HOUSEHOLD
2023	253,940	101,576
2024	186,828	74,731
2025	82,561	33,024
2026	82,561	33,024
2027	82,561	33,024
2028	82,561	33,024

Source: IPA

Between the financial years ending 2023 and 2028, we expect 771,012 net new international students to settle in Australia, which will be the equivalent of 308,405 households.

13 Centre for Population, 'Budget 2023-24: Population projections, Australia, 2022-23 to 2033-34' (Centre for Population Projections, 17 May 2023) <https://population.gov.au/data-and-forecasts/projections>.

14 We have opted to base this estimate on the IPA's adjustment of modelling data from the National Housing Finance and Investment Corporation as opposed to directly on the Centre for Population's prediction because the Centre's longer term population forecast has not been reliable, as demonstrated in the considerable revision in net migrant intake numbers given to Treasury. The Centre's forecast for the financial year ending 2024, however, is comparable to the IPA's 2024 estimate.

Impact of international student arrivals on housing supply

In the years immediately prior to the pandemic, the share of new housing units claimed by international students averaged approximately 17 per cent. This is set to more than double to more than 36 per cent between 2023 and 2028 on the back of a continuing decline in housing supply and an increasing number of international students arriving in Australia.

TABLE 2: *International students' share of new housing units 15*

FINANCIAL YEAR ENDING	NEW NET HOUSING UNIT SUPPLY	NET ANNUAL STUDENT INTAKE	EQUIVALENT HOUSEHOLD	NEW STUDENTS TO NEW HOUSING PERCENTAGE
2023	148,500	253,940	101,576	68%
2024	138,200	186,828	74,731	54%
2025	127,500	82,561	33,024	26%
2026	134,600	82,561	33,024	25%
2027	155,700	82,561	33,024	21%
2028	162,400	82,561	33,024	20%

Source: IPA, NHFIC

The pressure put on the housing market following the surge in international student intake subsequent to borders re-opening has more than surpassed the supply recovery relief provided by the reduction in student intake in the midst of the pandemic.

Housing supply has declined, and is expected to continue to decline, from a high of almost 200,000 units annually, prior to the pandemic, to a low of 127,500 in 2025 before picking up again in a belated response to increased demand. The decline in supply has been attributed to a number of factors, including the inflation-induced rise in interest rates, the increasing cost of building materials, the increasing cost and scarcity of labour, and delays due to weather conditions and red tape.[16]

Moreover, the upsurge in housing demand attributable to the return of international students was unforeseen, with the Commonwealth Government having to make substantial revisions to its modelling between the October 2022 mini budget and May 2023 budget.

15 The new net dwelling supply estimates were derived from Wild, You and Begg, *Mass Migration Induced Housing Shortage* (Institute of Public Affairs Research Report, June 2023). For the purpose of this report, each calendar year's dwelling supply estimate is assigned to the financial year that ends on 30 June of that calendar year.

16 NHFIC, *State of the Nation's Housing 2022-23* (National Housing Finance and Investment Corporation Report, April 2023).

Net overseas migration in the financial year ending 2022 was 23 per cent higher than expected in the October budget. Intake for the financial year ending 2023 was 70 per cent higher than anticipated. Intake for the following year is expected to be 34 per cent higher than anticipated. And the steady state migration intake going forward will be approximately 10 per cent higher than anticipated. This constitutes a demand shock, for which the already struggling supply side of the housing market has failed to prepare.

The supply crisis has taken a toll not just on Australians but also on international students themselves. In May, *ABC News* broke a story about an international student experiencing insomnia and severe anxiety directly as a result of the stress associated with finding permanent accommodation upon arrival in Australia. Another student was forced to live in a hotel for almost a year before settling into a four-bedroom home with eight other migrants.[17] These are not isolated incidences.

At the start of the new financial year, *News.com.au* exposed a concerning trend of 'hot-bedding' among international students, whereby two or more strangers split the rent of a bedroom and rotate the use of a bed based on their study and work schedules.[18]

The consistent message from recent international students is that the housing crisis they encountered upon arrival in Australia was not at all what they had expected. Many were enticed by the promise of a better life in Australia by their agents and educational institutions – and they would have had second thoughts had they known they would face the prospect of homelessness upon arrival.

According to census data released in March 2023, there were already 122,494 homeless people in Australia on census night.[19] Given the continuing housing crisis, fuelled by the uncontrolled influx of migration and international student intake, this figure is likely to have increased since then.

17 Annika Burgess and Kelly Wu, 'International students faced with housing and cost-of-living stress say they were misled about Australia', ABC News (19 May 2023) <https://www.abc.net.au/news/2023-05-19/international-students-migrant-housing-crisis-living-costs/102355508>.

18 Georgina Noack, '"Hot-bedding" grows in popularity among international students in desperate move to beat rising rent', *News.com.au* (1 July 2023) <https://www.news.com.au/finance/real-estate/renting/hotbedding-grows-in-popularity-among-international-students-in-desperate-move-to-beat-rising-rent/news-story/40d9255bb3489c3056360bd10b9f83c7>.

19 Australian Bureau of Statistics, 'Nearly 1 in 200 people homeless on Census night in 2021' (22 March 2023) <https://www.abs.gov.au/media-centre/media-releases/nearly-1-200-people-homeless-census-night-2021>.

Compensating for the covid-19 decline

Claims have been made that the dramatic expansion to Australia's net international student intake is, in part, designed to offset the decline which occurred during covid-19. Yet, this claim is not supported by an analysis of the official figures.

Specifically, in the five years prior to the pandemic, net student intake averaged 76,524 per year. In the financial year ending 2020 that intake dropped to 30,750, and to negative 80,310 in 2021.

Had the intake across those two years been consistent with the pre-covid average, the total intake would have been 153,048.

The pandemic-induced student deficit over those two years was therefore 153,048, plus the total deficit during that period of 49,560, for a total of 202,608.

Yet, in the 2023 financial year, the government is estimated to have allowed a net of 253,940 international students to enter Australia – and is expected to allow a further 186,828 students this financial year, for a total of 440,768 students.

If the government had kept the intake of international students at the pre-covid average of 76,524, the intake for the financial years ending 2023 and 2024 would be 153,048.

The total number of net student arrivals in the current and previous financial years, which would have compensated for the pandemic related decline, in order to maintain the pre-covid average intake, is therefore 355,656 net new students.[20]

Given the expectation of a net intake of 440,768 students over this period, the notion that the influx of students in the last two financial years is merely to compensate for the covid-19 decline is unjustified.

By the end of this financial year, it is expected that there will be an excess of 85,112 international students over and above the net intake had the pandemic not taken place.[21] This is the equivalent to 34,045 new households or approximately 34 per cent of the housing supply shortfall over the course of the period.

In other words, 34 per cent of the housing supply shortfall in Australia over 2023 and 2024 is the equivalent to the excess of the net international student intake above and beyond pre-pandemic levels.

20 This number being equal to the two-year steady state average of 153,048 plus the 202,608 pandemic-induced decline in net student intake.

27 i.e., if net intake remained and continued to be at pre-pandemic volume.

Conclusion

Australia is in the midst of a housing crisis: a crisis that has been exacerbated by the unprecedented flow of migrants through Australia's borders.

Almost three-quarters of the 400,000 net new migrants in the financial year ending 2023 have arrived in Australia on a student visa. Almost two thirds of the subsequent year's net migration intake will be made up of international students.

Out of the 1.755 million new migrants expected to stay in Australia by the year 2028, close to half will enter the country on a student visa.

This IPA research report studies the impact that the current international student intake has and will continue to have on Australia's housing shortage. The consequences of the unprecedented inflow of international students are not just felt by Australians but also the students themselves, whose educational experience suffers from the housing shortage.

- **Last financial year, the federal government oversaw the largest ever net intake of international students**, of over 250,000 people, which is more than double the previous high of 122,000 in 2009.
- Last financial year, on average across Australia, **new international students took up 70 per cent of net new housing units supplied to the market,** leaving just 30 per cent for the rest of the nation, including other new migrants. The vast majority of these students live in rental accommodation, and their entry into the rental market has been a major contributing factor to rental shortages and rapidly rising rental costs.
- Despite this, **the government is expected to bring in a further 187,000 net new international students this financial year**, with no apparent plan of where they will be housed, or how to absorb the extra pressure placed on infrastructure such as roads and public transport.
- This financial year, on average across the nation, it is expected that international students will take up close to 55 per cent of net new housing supply.
- **And from 2025 to 2028, it is expected that international students will take up approximately one-quarter of Australia's net new housing supply**, baking in housing shortages and rising rental prices.
- It was claimed that the increase to net international student intake compensates for the reduction in international student arrivals due to covid-19. Yet the intake for the last financial year and the expected intake for this financial year **would result in more than 85,000 net arrivals above and beyond what would have been required to offset the covid-19 decline.**

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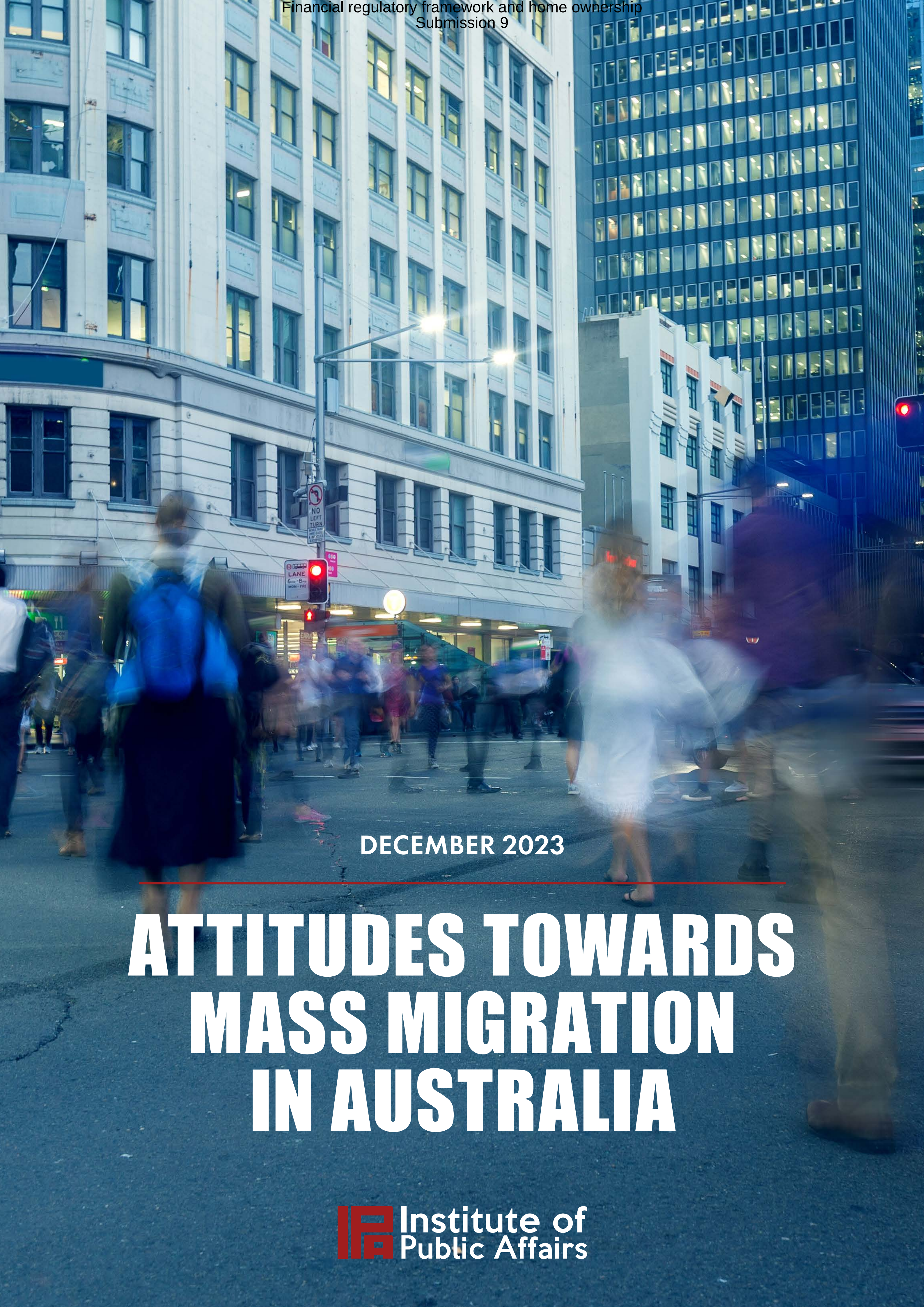

DECEMBER 2023

ATTITUDES TOWARDS MASS MIGRATION IN AUSTRALIA

Institute of Public Affairs

This poll of 1,000 Australians was commissioned by the Institute of Public Affairs. Data for this poll was collected by marketing research firm Dynata between 27 November and 1 December 2023 and rounded to the nearest whole number.

QUESTION 1

Australia should temporarily pause its intake of new immigrants until more economic and social infrastructure, such as schools, roads, hospitals, and houses, are built

COLUMN %	TOTAL	MALE	FEMALE
Agree	60%	61%	60%
Disagree	23%	26%	21%
Don't know	17%	13%	19%

COLUMN %	18-24	25-34	35-44	45-54	55-64	65+
Agree	50%	51%	65%	60%	63%	70%
Disagree	31%	32%	19%	23%	16%	20%
Don't know	19%	17%	16%	17%	21%	10%

COLUMN %	NSW	QLD	SA	VIC	WA
Agree	59%	65%	53%	63%	60%
Disagree	25%	20%	24%	23%	21%
Don't know	16%	15%	23%	14%	19%

QUESTION 2

The federal government is proposing to let in a further 650,000 migrants over the next two years. This is:

COLUMN %	TOTAL	MALE	FEMALE
Too many	62%	59%	65%
Not enough	5%	5%	4%
The right amount	33%	36%	31%

COLUMN %	18-24	25-34	35-44	45-54	55-64	65+
Too many	46%	45%	63%	65%	78%	74%
Not enough	7%	8%	4%	3%	3%	3%
The right amount	47%	47%	33%	32%	19%	23%

COLUMN %	NSW	QLD	SA	VIC	WA
Too many	61%	64%	62%	61%	64%
Not enough	5%	5%	4%	4%	5%
The right amount	34%	31%	34%	35%	31%

QUESTION 3

I am concerned the current migration intake is making it harder for young Australians to afford their own home

COLUMN %	TOTAL	MALE	FEMALE
Agree	71%	69%	73%
Disagree	12%	13%	10%
Don't know	17%	18%	17%

COLUMN %	18-24	25-34	35-44	45-54	55-64	65+
Agree	68%	65%	74%	68%	74%	77%
Disagree	11%	12%	11%	13%	11%	11%
Don't know	21%	23%	15%	19%	15%	12%

COLUMN %	NSW	QLD	SA	VIC	WA
Agree	70%	77%	65%	71%	68%
Disagree	12%	11%	13%	11%	11%
Don't know	18%	12%	22%	18%	21%

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IPA RESEARCH NOTE

Australia's Declining Standard of Living

MAY 2024

Dr Kevin You
Senior Fellow

- Real growth of gross domestic product per capita has been below trend (measured from 1990-2023) for the last eight consecutive years. This means per capita GDP was $14,700 lower than it would have been had per capita GDP growth rates remained on the long-term trend over the period.
- At the conclusion of the 2023 calendar year, Australia's per capita economic growth was 3.03 per cent below its long-term trend. This difference amounts to approximately $2,800 per person.
- To return to trend by the year 2030, real GDP per capita would need to grow at an annual average growth rate of 1.65 per cent each year for the next seven years. This compares with the long-run average annual growth rate of 1.54 per cent since 1990.
- In the decade prior to Covid, real GDP per capita grew by an average annual rate of 1.02 per cent.
- After a dramatic plunge in 2020 from the Covid response, real GDP per capita bounced back strongly in 2021 and 2022. Prior to Covid, the last time real GDP per capita was higher than trend was in 2012, when real GDP per capita grew by 2.1 per cent.
- There have been periods in Australia's economic history of prolonged per capita GDP growth. From the end of the 1990s recession (in 1993) to 2007, real GDP per capita grew by an annual average of 2.56 per cent. The past rates of real GDP per capita growth were attributable to productivity-led economic growth, which freed up the economy through lower taxes, deregulation, and privatisation.

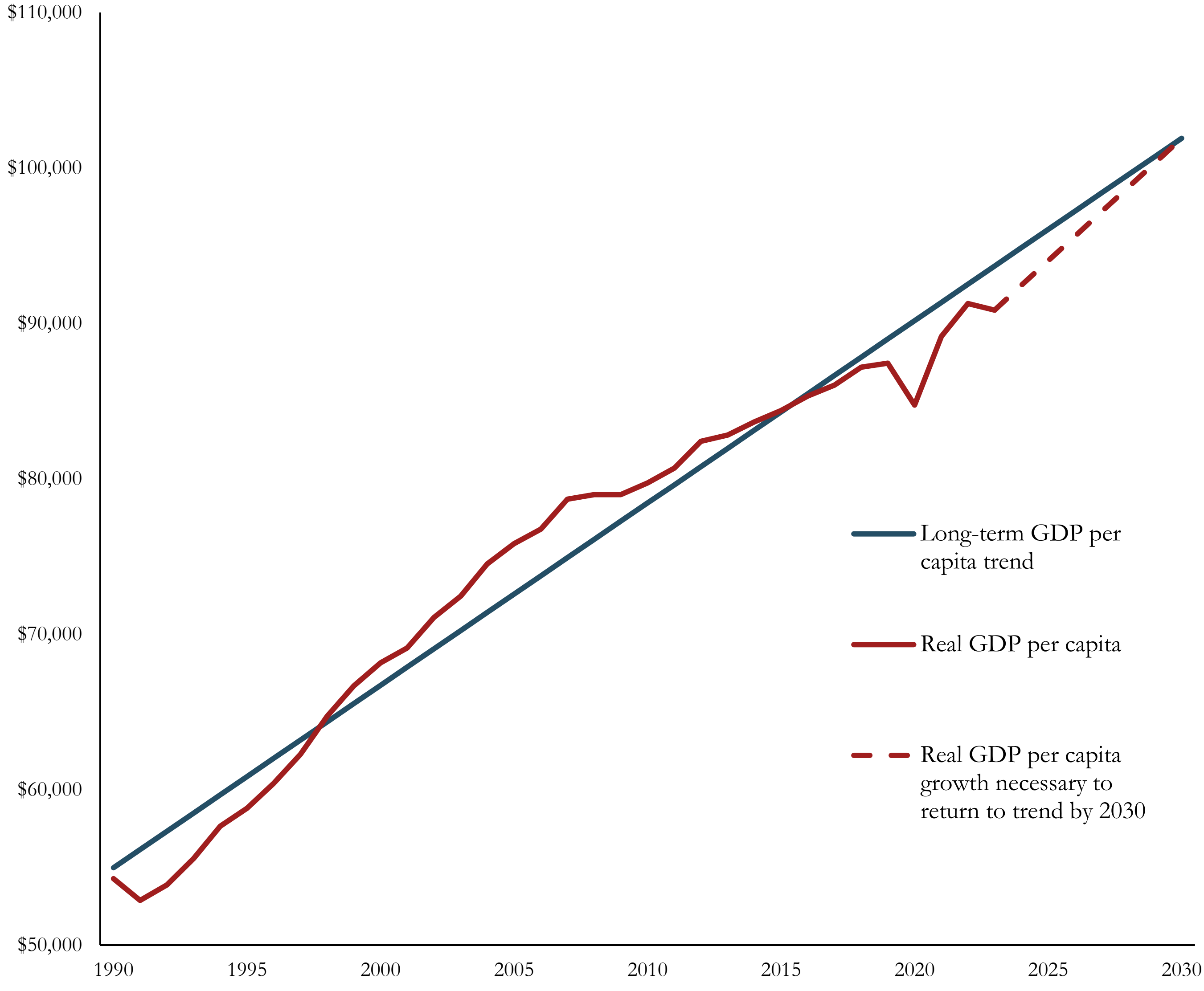
GDP per capita is a better measure of living standards than headline GDP, because the effects of population are accounted for. For the first time since the 1980s, Australia's per capita growth has declined for four consecutive quarters (under -0.1 per cent in the March 2023 quarter; -0.2 per cent in the June 2023 quarter, -0.5 per cent in the September 2023 quarter, and -0.3 in the December 2023 quarter.). A key difference between the current decline and that of the 1980s is that Australia was experiencing a fully-fledged economic recession in the 1980s, with headline GDP also declining for four straight quarters.

Today, the vast majority of economic growth is generated through population growth, which does not deliver faster per capita growth. Previous IPA research estimated that:

- From 1990-1999, population growth contributed approximately one-third of total economic growth.
- From 2000-2009, population growth contributed approximately one-half of total economic growth.
- From 2010-2019, population growth contributed approximately two-thirds of total economic growth.
- Population growth accounted for 85 per cent of total real economic growth in the 2023 financial year, the highest in any normal year on record.[1]

The population growth rate in 2023 of 2.4 per cent was driven by net overseas migration of 528,421—the highest annual level in Australia's history.[2] At the same time, labour productivity declined by approximately 3.6 per cent—the most severe productivity decline since at least 1980.[3]

Chart 1: *Historic and forecast GDP per capita growth ($ value)*



Source: IPA, ABS

For more information contact Morgan Begg, Director of Research at [redacted]

End Notes

1. Kevin You and Morgan Begg, *Addicted to Migration: Australia's Falling Productivity and the Cost of Relying on Migration for Economic Growth* (Institute of Public Affairs Research Report, December 2023).
2. Australian Bureau of Statistics, *National, state and territory population* (21 March 2024): https://www.abs.gov.au/statistics/people/population/national-state-and-territory-population/sep-2023.
3. Productivity Commission, *Annual productivity bulletin 2024* (PC Productivity Insights, 2024); You and Begg, *Addicted to Migration* (IPA, December 2023).