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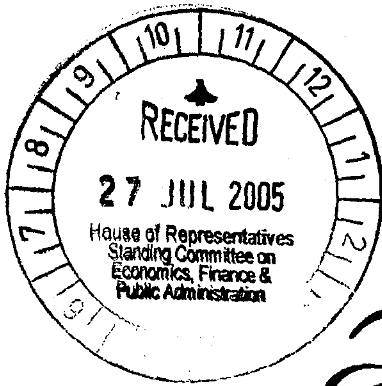

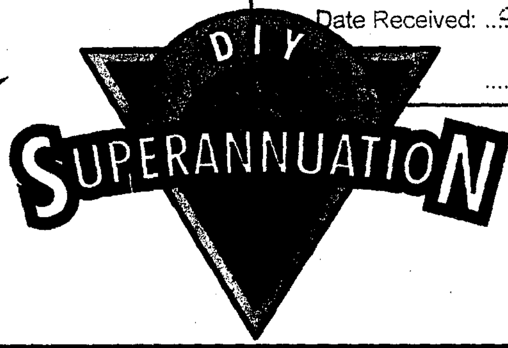

Submission

Re: Inquiry into the superannuation savings of the people under 40

From Taxpayers Australia Inc. and Superannuation Australia

TO: The Standing Committee on Economics, Finance and Public Administration

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Superannuation savings of the people under 40

This paper is Taxpayers Australia's submission to the inquiry into the superannuation savings of the under 40s falling behind for adequate future retirement incomes.

Summary

We are not privy to the studies that have highlighted the extent to which there is a shortfall in the aggregate under 40's contribution balance to superannuation or of the benchmarks that are used to support this contention. But it seems that there is limited history in relation to SG that commenced in July 1992 albeit at a low 4% rate and now other opportunities are available for superannuation contributions. Whilst the focus is on the current level of superannuation savings for this pre-retirement group, clearly what is relevant is the amount that is available at retirement. In discussing this matter it should be recognised that there are other acute demands for the available resources for this demographic. Our paper touches on a number of factors that would contribute to low superannuation account balances for the under 40s. The main ones are the near term imperatives that allocate resources to consumption ahead of superannuation. The superannuation contribution life cycle of commitments identifies this phenomenon. Others include the difficulty of quantification of projections made over several decades, uncertainty in incomes, longer working lives and the suggestion that greater opportunities exist to make good early shortfalls in super at a future point in the life cycle. Any benchmarking exercises used should also reflect these issues. A lack of understanding of superannuation in the community may also be a contributing factor.

The superannuation contribution life cycle

Relatively lower incomes during the early working life imply lower contributions to super. This situation continues as family formation occurs and despite rising incomes, increasing commitments to family, child rearing and other responsibilities limits the availability of spare resources for extra superannuation savings. Many argue that it is better to "have a life" and err on the side of possibly not enough super than to forego "having a life" and having too much in super! Appeals to the under 40s to accelerate their superannuation savings instead of directing them to increasing the size of the deposit for their first home would fall on deaf ears. Most objective observers would also question the sense of such appeals and competent financial planners would advise against this as the greater benefit would come

from initially focusing resources on the purchase of a home and bringing down the mortgage level to long-term manageable amount before contemplating additional superannuation contributions. This position may of course be clouded by issues of the housing aspirations of the individuals as well!

In later years as commitments are lessened and incomes are potentially higher, those in their 40s and 50s see the prospect of retirement looming and are motivated to address their retirement funding issues. They are also likely to make use of some or all of the opportunities that currently exist to increase their contributions to superannuation. Salary sacrifice and the elimination of the surcharge potentially help this situation as will the introduction of spouse contribution splitting in the future. In addition, many would agree that the level of super they could aim at is better assessed at a time closer to retirement, rather than 25 years earlier. The result is more important than the journey, so it would matter little if the account balance was relatively low at less than 40 years but that it increased to meet the necessary amount when retirement commenced. Education programmes should stress that it is not too late at 40 to begin to address future retirement savings. Any measures intended to change the current situation would require significant incentives. This is likely to be expensive for Treasury if they are to succeed in achieving greater contributions by the under 40s.

Uncertainty

For individuals attempting to make rational decisions about superannuation and retirement savings the quantification of projections into the distant future is fraught with difficulties. In particular, future earnings of investment funds or the economic conditions prevailing at some time, decades into the future, cannot be made with any degree of certainty. Hence the amount of retirement income required, the appropriate level of retirement savings that should be targeted, and the level and profile of contributions over the individual's lifetime are tempered by these uncertainties.

What makes this more problematic is that often standard projections carried out by different reputable organisations produce results that can be of dubious value because there are few if any official standard parameters for such long term projections and hence comparisons by ordinary members of the community are often not possible. Standards must be set in place for this purpose.

What level of contribution?

How does the average person achieve some understanding of the adequacy or otherwise of their current level of contribution and what retirement income would it provide 25 years into the future? Does the 9% SG provide an adequate base for funding one's retirement? If not would it in combination with the, albeit means tested and not necessarily fixed, social security entitlement provide an adequate retirement benefit stream? Is there a need for additional contributions and if so what should they be or what should one reasonably aim for? Appropriate benchmarking that lends itself to universal application is therefore necessary.

Longer working lives

Since the 25+ year, time horizon for a current 40 year old to access super means that there is still much time left to contribute for retirement needs. In addition as the concept of working until one is older becomes entrenched, clearly individuals believe that this additional period will offer them new opportunities to save for retirement. Each additional year of employment yields:

a) one additional year of contribution
b) one less year of drawdown
c) one additional year of earnings by the fund

These three factors reinforce each other strongly and could create some comfort for those under 40 who currently hold inadequate levels of superannuation.

Employment uncertainty

The new workplace realities and current employment contracts mean that security of employment income is a thing of the past. This inevitably means that individuals will put aside resources in a contingency fund to fall back on during periods when they are between jobs. Since superannuation is designed for retirement incomes and not accessible until preservation age or a condition of release is met super cannot fulfil the role of a contingency fund into which spare cash could be "parked" and accessed when needed as is now possible for the over 55s but not for the under 40s.

Defined benefit schemes discouraged

Retirement was potentially simpler when defined benefit pensions (DBPs) were more widely available; but they were not universal. These schemes provided certainty for retirees. They guaranteed members a lifetime pension that was proportional to their final salary and indexed in some measure to the cost of living. With a strong

move away from DBPs, including the unjustified constraint on the payment of new DBPs from self managed super funds after December 2005; the consequent increase in the reliance on accumulation funds, with non-lifetime retirement benefits and the transfer of mortality and market risk to the retiree have added to the complexity of superannuation. They detracted from super being the preferred venue for additional savings for some.

Contribution taxes

Contribution taxes on super at 15% are likely to be a deterrent for lower income individuals with a marginal tax rate of 15% (up to an income of $21,600). Those on a 30% marginal tax rate (up to $63,000) might also feel that the additional 15% tax may be worth paying for immediate access to cash instead of having to put it away in super. This tax rate might determine whether additional contributions to super are made by such groups who are likely to be the ones most in need of raising their aggregate superannuation account balances. Higher income earners on the other hand do not have the same problem because salary sacrifice is equated as a saving against higher personal marginal tax rates making super contributions more palatable.

Disincentives to superannuation contribution

***Taxation of contributions, earnings and tax on the receipt of benefits would discourage contributions.**
***The inaccessibility of assets until retirement is another disincentive for contributions.**
***Deciding between competing demands for resources and trying to determine future needs in a changing world encourages a focus on the near term.**
***While making rational decisions about savings, contributions will not be forthcoming where quantification is not meaningfully!**

Current incentives in place for voluntary superannuation contributions

***The low tax environment is an incentive, but more attractive to top marginal tax rate individuals.**
***Tax deductibility for employers, self employed and substantially self employed is attractive.**
***Salary sacrifice is an incentive.**
***Small business retirement concessions are appealing.**
***Tax free earnings in the fund upon retirement is a winner.**

***Potentially rebatable income streams in retirement and tax free draw downs of UPP for life are very appealing.**
***The elimination of the Surcharge is hugely popular.**
***The future introduction of spouse splitting will be strongly embraced.**
***The co-contribution scheme for low income taxpayers is an incentive but this should be widened so as to somehow include the unemployed.**

Increasing the awareness for saving early for retirement

Whilst this would seem to be an appropriate area to focus on, the fact remains that many of the points raised in this paper suggest that there are other forces that potentially enable greater contributions at a later phase in one's working life. Thus although many may be unaware of the power of compounding or the importance of consolidating and growing their superannuation accounts over the long term, the problem of low account balance individuals relates as much to income as anything else and additional resources will only be available once the tension between competing needs for resources can be eased.

Conclusion

Fewer available resources can be devoted to super by the under 40s and the period in the fund is lower so it is not surprising that the sub-40 age group has a preponderance of low superannuation account balances. A possible freeing up of funds as other commitments diminish enables this age group to redirect its resources to retirement savings and as the demographic reaches the 50s with retirement starting to loom on the horizon there is potentially a greater focus on the effective use of the opportunities available to increase super including deductibility or salary sacrifice, surcharge elimination and the proposed spouse splitting.