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Standing Committee on
Economics, Finance &
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SUBMISSION 29

House of representatives Standing Committee on
Economics, Finance and Public Administration

Submission No: 29

Date Received: 1/8/05

Secretary: [illegible]

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PRESIDENT
Sharan Burrow

SECRETARY
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28 July 2005

Ms Sharon Bryant
Inquiry Secretary

Dear Sharon,

Re: ACTU Submission

As promised, please find attached the ACTU submission. We appreciate the time extension we were given.

We are happy to meet with the Committee when it comes to Melbourne.

Yours sincerely

N Nixon apple

Nixon Apple
ACTU Industry and Investment Policy Adviser

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STANDING COMMITTEE ON ECONOMICS, FINANCE AND PUBLIC ADMINISTRATION

INQUIRY INTO IMPROVING THE SUPERANNUATION SAVINGS OF PEOPLE UNDER AGE 40

ACTU SUBMISSION

July 2005

Introduction

The most important determinant of the superannuation savings of people under age 40 is whether or not Australia makes the changes that are needed to the existing Retirement Income System for the benefit of all Australians.

While there is wide-spread agreement about the need to increase the amount of superannuation saving, there is no consensus about how this should be achieved.

In previous inquiries the ACTU has considered the issue in relation to both increasing the funds going to superannuation and reducing the erosion of superannuation savings through taxation and fees.

This ACTU submission sets out ACTU policy and then addresses:

a) The best options for improving income adequacy so that the retirement incomes system delivers workers a retirement income equating to at least two thirds of their gross pre-retirement income. This is the existing community consensus level of adequacy that emerged during the Senate Inquiry into super in 2002.

b) The need for both sides of politics to develop more appropriate long term policies for health care including prescription medicines. This issue looms large with the ageing of the population as the major threat to retirement income adequacy. It can only be managed through long-term planning and co-operative federalism.

c) The specific problems confronting those under 40, and their ability to save for retirement; and how this can partly be addressed through the existing co-contribution scheme.

d) Conclusions and Recommendations

ACTU Policy

At its 2003 congress, the ACTU adopted the following policy on superannuation.

Superannuation and Retirement Incomes

Principles

1. *Congress is committed to a retirement income system based on:*

   a) *the retention of the current age pension, including its level and eligibility; and*

   b) *the development of superannuation to the point where, together with the age pension, it delivers workers a retirement income equating to at least two thirds of their gross pre-retirement income.*

Adequacy

2. *Congress is concerned at clear evidence that the 9% SG is insufficient to fund an adequate retirement income for average workers.*

3. *Congress also notes the particularly poor retirement income prospects of workers who have not had access to superannuation for the whole of their working lives, together with women, casuals and part-time workers.*

4. *The issue of providing adequate retirement incomes can be addressed in a number of ways. Congress advocates the following as a minimum:*

   a) *increasing minimum contributions to a goal of 15%, which could be achieved through one or more of bargaining, legislation or changes to the taxation of superannuation;*

   b) *reducing the contribution tax;*

   c) *restructuring superannuation taxes to provide greater equity;*

   d) *extending the entitlement of SG to all workers, irrespective of age or minimum earnings, possibly through changes to award provisions;*

   e) *fully disclosing all fees and charges, together with a ban on entry and exit fees and commissions charged on SG contributions; and*

   f) *equal treatment of same sex couples in the allocation of superannuation benefits.*

5. *Congress adopts, as an objective, the achievement of a minimum of 10% contributions over the next three years, achieved through bargaining.*

6. *Congress completely rejects those Federal Government proposals which it is claimed will assist in achieving adequacy, but which are aimed at assisting those on the highest incomes and transforming superannuation into a mere tax shelter, such as reducing the surcharge and establishing children's accounts.*

7. *Congress is opposed to any attempt to increase the preservation age to claim superannuation benefits, and pledges to initiate a vigorous campaign of workers and the community if the Federal Government decides to do so.*

a. Improving Adequacy

Following the 2002 Senate Committee Report on "Superannuation and the Standards of Living in Retirement" there was a broad consensus on what constituted an adequate retirement income for Australians. As that Senate Committee stated:

"...the committee notes the high degree of consensus expressed by witnesses at the roundtable that the desirable target for a person on average earnings is a replacement rate of 70-80 per cent of pre-retirement expenditure (which equates to approximately 60-65 per cent of gross pre-retirement income), a target which would need to be higher for those on less than average weekly earnings, and lower for those on high incomes."[1]

The Committee also found that:

"There is a shortfall in the ability of the nine per cent superannuation guarantee (SG) contribution, together with the age pension to deliver appropriate retirement incomes for many representative groups of Australians.... The Committee notes that the current available evidence demonstrates that SG and age pension alone will not provide an adequate income in retirement for most people."[2]

Clearly as the Treasury submission pointed out to the 2002 Senate inquiry, there are a wide range of factors that will influence retirement incomes including:

- *"superannuation; which is influenced by salary level and length of time in the workforce, interest rates, and fees and charges;*
- *other private savings;*
- *the effect of taxation, including the Senior Australians Tax Offset;*
- *home ownership;*
- *access to Government benefits;*

  and

- *family relationships and social contact.*

[1] The Senate: Select Committee on Superannuation: *Superannuation and Standards of Living in Retirement.* Dec 2002 pg xv.
[2] Ibid, pg 31 and pg 40.

In view of all these factors Treasury indicated that different replacement rates will be optimal for different individuals. A number of other submissions from industry peak bodies supported this approach."[3]

However, the bottom line is that 9% SG plus the pension is not enough. The essential question therefore is how to improve income adequacy.

When considering this issue in 2002 the Senate Committee noted:

"The Committee notes that there is no consensus among the major groups about the level to which these compulsory SG contributions should go, nor the source of the additional compulsory contributions to fill the identified shortfall.

The Committee considers that the current economic and employment climates are difficult ones in which to contemplate additional compulsory employer contributions. The Committee is also reluctant to propose compulsory member contributions because of the immediate reduction in living standards that would result. Against that background, the Committee is not satisfied that employers or individuals could afford or support additional compulsory contributions in the current economic circumstances. Accordingly the Committee supports incentives to save in superannuation through voluntary tax effective contributions as the means to fill the adequacy gap."[4]

From the vantage point of the second half of 2002 it is perhaps understandable to some why the Senate Committee arrived at this conclusion.

- 2002 marked the final SG increase from 8% to 9% and some would argue that a pause in any further contributions by employers was warranted.
- Economic growth in 2000-2001 was only 2.1% and in 2001-2002 unemployment had increased to 6.7%.[5]
- After 4 consecutive budget surpluses, the underlying cash balance went into deficit by nearly a billion dollars in 2001-2002.[6]

However, with the benefit of hindsight we now know that the economic environment was far stronger and more capable of absorbing change then the Senate Committee or many of the inquiry participants imagined.

- Australian economic growth surged from late 2001 and unemployment fell to nearly 5%
- Employer's capacity to pay higher contributions had rarely been better. As the ABS pointed out:

[3] Ibid, pg 11.
[4] Ibid pg 41.
[5] ABS: *Australian Economic Indicators,* June 2005 ABS 1350 pg 8 & pg 68.
[6] Budget Paper No. 1: *Budget Strategy and outlook 2005-2006* pg 13-4.

"The profits share of total factor income of 26.7% in 2003-2004 is the highest share recorded since 1959-60. The profit shares recorded since the early 1990's are at a distinctly higher level than those at any time since 1959-60."[7]

In fact the profit share in the past 2 financial years was higher than when the first 3% super was won in the mid 1980's, and higher than when compulsory SG contributions began in the early 1990's and concluded in 2002. **Simply put the entire 9% super was paid for out of national productivity with low inflation and an increasing profit share.**

- The actual and projected budget surpluses beginning in 2002-2003 through to 2008-2009 totalled nearly $60 billion (almost $8.5 billion a year); and this was after 2 rounds of tax cuts totalling $35 billion (each round costed over 4 years) going mainly to high income earners and $2.5 billion to high income earners with the abolition of the super surcharge tax .As ANZ's economist Saul Eslake has pointed out the increase in additional Government spending over this period will total $104 billion and still leave the large surpluses already mentioned.[8]

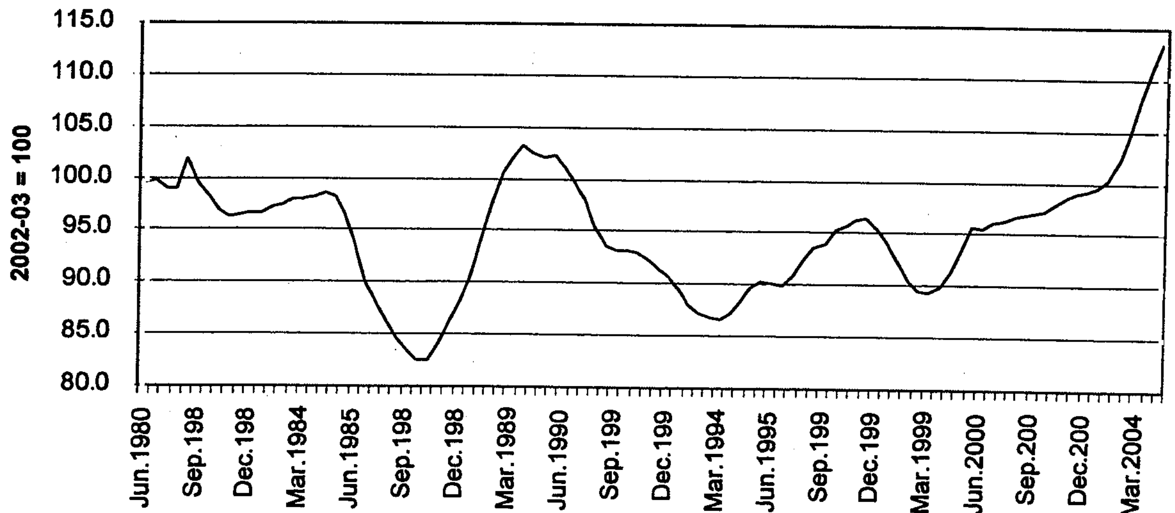
Record terms of trade (highlighted in the graph below) amongst other factors provided the fiscal circumstances for a once in a generation opportunity to:

- Increase the SG contribution paid by employers from 9% to 12% over 3 to 5 years;

- Phase out the 15% tax on super contributions.

Had this been done the retirement income system would have been very close to providing the community consensus goal of a replacement rate of nearly two thirds of workers pre-retirement income.

Terms of Trade 1980 - 2004



Source: RBA data

[7] ABS: *Annual National Account 2003-04*, ABS 5204 pg 5.
[8] Sourced from: *2005-2006 Budget Paper Number One .and Saul Eslake: Reform remains crucial task. AFR May 12 2005.*

The most immediate beneficiaries of this would be those under age 40 who would reap the full benefits of the new system.

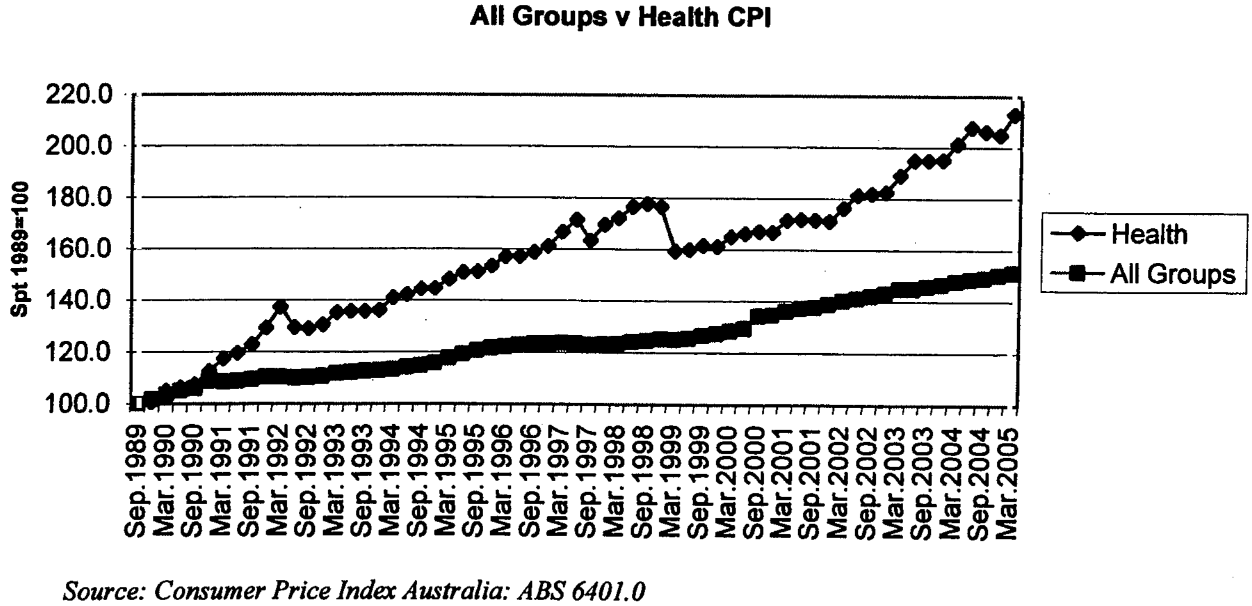
We will return to the adequacy issue when our submission concludes with specific recommendations. First, however, it is necessary to consider the issue most likely to reduce the future purchasing power of the pension – namely the rising cost of health services and the interface between the health and retirement incomes system.

b. Retirement Income Adequacy and the Long Term Costs of Health Services

Many Australians are concerned that their retirement income will not be adequate and that the purchasing power of their pension will be eroded by unforeseen additional costs. This is particularly the case with health services and prescription medicines. This problem is most pressing today for nearly two million Australians who are already in receipt of the age or service pension. It is also of concern for those over 40 and under 65 who have not had the benefit of accumulating the 9% SG contributions for a sufficient period of time.

It is also a significant issue for those under 40 in two important respects. First, many of the under 40's are starting a family, trying to find ways to save to purchase a home while at the same time saving and meeting the additional costs of health services. And secondly, the under 40's are faced with the uncertainty of who will pay the rapidly escalating national health care bill with the aging population and retirement of the baby boomers.

As suggested in the graph below rising health costs (up 112.9% since September 1989) have far outstripped the overall increase in cost of living as measured by the all groups consumer price index (up 51.4% since September 1989) over the past decade and a half.



Source: Consumer Price Index Australia: ABS 6401.0

But the ageing of the population holds even more challenging problems for how the nation pays for health services. As a number of official reports have demonstrated:

- Over the next 40 years the proportion of the Australian population over the age of 65 will double to around 25%;
- Over the same period the ageing of the population will (on unchanged policies) be associated with a reduction in the proportion of the workforce that has a job or is looking for one from close to 64% today to around 56%;
- The average expenditure per year on health and age care services for people over 65 is almost four times more than for those under 65 and six to nine times higher for older groups;
- As a result health care spending by Government could rise from 5.7% of GDP in 2003 – 2004 to 10.3% in 2044-45.

Not surprisingly many Australians are wondering how this will be paid for particularly since the cost to Government of the age pension will rise from 2.9% of GDP to 4.6% of GDP in the four decades to 2044-45.[9]

Of course policies to increase workforce participation, stronger productivity growth and other factors can help to cushion the impact of the ageing population. Nevertheless a substantial challenge remains.

This scenario has significant consequences for all Australians in terms of the future purchasing power of their pension. It also raises profound economic, social and moral issues, not just about paying for health services but for access to such services. In the future new technologies, drugs, and medical procedures will offer the hope for treatments and cures unimagined by previous generations. But who will pay for them and how will access be rationed? What can Government promise to its citizens and how can it deliver on that promise? What will people be expected to pay out of their pension in retirement, or will paying more today, if that is required, ensure and protect the future purchasing power of the pension?

It's not just about income adequacy, important as that is. It is also about nation's citizens having a sufficient degree of certainty to plan and make provision for the future.

Today Australians are experiencing unacceptably long waits for elective surgery, and the consequences of the gutting of the Government's "iron clad, rock solid" guarantee to protect the Medicare Safety Net thresholds.

In addition they face increased costs of prescription drugs, uncertainty about access to such drugs through PBS and there are lengthy queues faced by the elderly and the disadvantaged for dental care since the abolition of the Commonwealth Dental Program in 1997.

[9] These facts / projections are taken from: *Productivity Commission Research Report: Economic Implications of an Ageing Australia,* March 2005.

The challenges for both sides of politics at the State and Federal level as well as the broader community will intensify in the decades ahead. Already we are seeing worrying trends such as the rise in the out of pocket expenditure by individuals on health care, which increased by 8.3% per annum over the 1997-98 to 2002-2003 period.[10]

In addition, as highlighted in the table below more than 150,000 people aged 20-40 dropped out of private health insurance during the September 2000 to March 2005 period. Again this indicates the volatile generational pressures that exist in the system. These pressures and those discussed earlier call into question the systems capacity to cater for the requirements of an aging population.

Private Health Insurance Coverage by Age Group

	Age Cohort	Sept 2000	March 2005
	20-24	349,718	426,700
	25-29	390,575	355,101
	30-34	659,864	578,033
	35-39	753,604	643,522
Total	20-40	2,153,761	2,003,356
Total All Age Groups (Excluding 20-40)		6,637,512	6,703,011

Source: PHIAC Web site for March 2005 and Brian Hanning: "Some Demographic issues affecting Private Health Insurance", Australian Health Review, Vol 27 No.1 2004. Similar findings on the high drop out rate from PHI by the 20-40 age group over the December 2001-December 2004 period is found in R Deniss: Demographic Trends in Private Health Insurance Australian Institute February 2005

That is why the interface between the nation's retirement income system and its health care system is one of the most important issues for public policy.

And that is why the ACTU is concerned about current notions of income adequacy and the future purchasing power of the pension.

c. Specific problems confronting those under 40

It is sometimes suggested that those under 40 will have the advantage of fully accessing the 9 per cent SGC throughout their working life. Accordingly, as a group, the under 40's are sufficiently provided for and policy should focus on those over 40.

In our view this assessment is not an appropriate response to the system wide inadequacies that exist. There are three major reasons why the ACTU believes this to be the case.

[10] AIHW: *Health Expenditure Australia 2002-2003*

First and foremost, amongst the under 40's are a very substantial group of employees who are part-time, casual and low paid. This is particularly the case amongst women, migrant workers, those who left school early before completing their HSC, the unemployed, as well as those who move off other social security benefits and participate in the low paid end of the labour market.A significant proportion of this group is likely to have labour market experiences over their working life that will prevent them accumulating enough super savings to meet the target of two thirds of pre-retirement income at age 65, even with the pension.

A major factor explaining this situation is the nature of employment creation in Australia. As Borland, Sheehan and Gregory demonstrated in their study "Work Rich, Work Poor' and as highlighted in the table below:

- Of the 1.13 million jobs created in the 1990's, 87 per cent had average earnings of less than $26,000 a year and nearly half had an income of less than $15,000 a year.

Table 1: Australian total increase in employment by salary range 1990-2000 (thousands)

Annual earnings (year 2000 prices)	
More than $72,800	130
$52,000 - $72,800	-51
$36,400 - $52,000	-162
$26,000 - $36,400	230
$15,600 - $26,000	438
Less than $15,600	543
Total	**1 130**

Source: Derived from J. Borland, R. Gregory and P. Sheehan, "Work Rich, Work Poor: Inequality and Economic Change in Australia". Centre for Strategic Economic Studies, University of Victoria, Melbourne,3001

Despite more encouraging trends in the last several years, the engine of job creation has, over the longer term, tended to generate a disproportionate share of low paid, part time and/or casual jobs. Even amongst those under 40 who are full time in their main job, there is a significant number (as shown in the following table) who earn less than $600 a week. For many of these workers this situation is unlikely to change.

Table 2:Weekly Earnings of Employees Who Were Full Time in their Main Job: August 2004

	% of this Age Group that earned less than $600 per week	Median Earnings of this Age Group
Males		
15-19	81%	$399
20-24	42%	$615
25-34	15%	$850
35-44	12%	$961
Females		
15-19	88%	$400
20-24	43%	$600
25-34	21%	$767
35-44	23%	$785

Source: Calculated from ABS 6310.0 August 2004.

From a policy perspective, the large number of employees with several part time and/or casual jobs calls into question the $450 a month earnings threshold for SG contributions. This may have made sense when SG was 3%. However in a choice environment with 9% SG, employees are in a better position to nominate an account for small payments. A number of ACTU affiliates covering a diverse range of occupations from nurses to cleaners have emphasised this point. The time has come to remove the threshold of earnings of $450 a month for SG contributions.

The second reason why many of the under 40's are unlikely to meet the consensus retirement savings target is related to the first reason. Namely, the labour market experience of many workers, particularly in their 30's and early 40's is such that they have very low super account balances to begin with. And this is the group that has had greater access to SG contribution. As shown in Table 3:

- 55 per cent of women (who had super) aged 25-34 had a super account balance of less than $10,000 in 2002; for those aged 35-44, almost 40 per cent had an account balance of less than $10,000.
- Amongst males, 34 per cent of the 25-34 age cohort (who had super) had an account balance of less than $10,000 and almost 20 per cent of the 35-44 age group was in the same situation.

Table 3: Superannuation Savings of the Under 40's in 2002

	Average Account Balance for those with Super	% of those with Super in each Age Group with Account Balances below $10,000
Males		
15-24	$6,800	88%
25-34	$27,200	34%
35-44	$65,000	19%
All Ages	$78,700	30%
Females		
15-24	$4,300	88%
25-34	$20,800	55%
35-44	$37,600	39%
All Ages	$61,800	44%

Source: Calculations derived by ACTU from the unit record file data in the 2002 HILDA Survey reported in the paper: Ross Clare. Why Can't a Woman Be More Like a Man – Gender Differences in Retirement Income. Paper delivered to the 2004 ASFA Conference.

From a policy perspective, the low super balances, particularly for those in the 35-44 age group raises the issue of the fees and commissions charged by superannuation funds and financial planners. The ACTU maintains its position that the charging of entry and prohibitive exit fees (for example where the exit fee is designed to prevent a member from leaving the fund rather then being designed to meet the administrative cost to the rollover to another fund) by superannuation funds should be banned. The payment by superannuation funds to financial planners and accountants of up front or trail commissions should also be prohibited. Research by Super Ratings demonstrates that such fees and commissions have substantial consequences for retirement income adequacy which would be even more the case for those under 40 given the longer period they will have in the workforce.

The third reason that many of the under 40's are unlikely to achieve the retirement goal of two thirds of pre-retirement income relates to the particular life cycle needs of this age group. In particular:

- As pointed out by the Productivity Commission, the majority of first home buyers are in their twenties and thirties. Saving for a home is a major challenge at the best of times and even more so today given asset price inflation in the property market in the last 5 years.[11] It is even more challenging for those who are also budgeting for the repayment of their HECS debt.

- Women have higher rates of part time and casual work and along with the primary child rearing role will remain disadvantaged in terms of accumulating an adequate super account balance.

- As mentioned earlier, the under 40's face the challenge of paying for rising health costs and getting timely access and quality care today, as well as the uncertainty of who will pay the nations rising health bill as the baby boomers retire.

For all of the reasons mentioned, a significant proportion of those under 40 today will struggle to achieve a modestly comfortable retirement income without significant changes to the system.

Given the situation described in this submission, the ACTU supports the concept of a superannuation co-contribution scheme for all age groups .We support the existing scheme highlighted in Table 4.

Table 4: Current parameters of the superannuation co-contribution

Income level (assessable income plus reportable fringe benefits) per annum	Maximum co-contribution currently applying to contributions in 2004-05 and later years	Amount of personal contribution needed to achieve maximum co-contribution
$28,000	$1,500	$1,000
$30,000	$1,400	$934
$40,000	$900	$600
$45,000	$650	$434
$50,000	$400	$267
$55,000	$150	$100
$58,000	0	

[11] Productivity Commission Draft Report: First Home Ownership December 2003

We also supported the improvements in the scheme recommended by ASFA in its 2005-2006 budget submission and shown in table 5.As data provided in the press release of February 2005 from the Minister for Revenue and the Assistant Treasurer Mal Brough indicates the co-contribution scheme has been of assistance to low and middle income earners across all age groups since its inception. Approximately 40% of co-contribution payments have gone to those under 40.However, the take up rate of the scheme is still low relative to the eligible population. While an incidence analysis of the co-contribution scheme has not been undertaken, it most certainly is accessed by less then 10% of those eligible. By contrast well over 90% of those eligible receive the compulsory SG contributions.

It is the assessment of the ACTU that a major barrier to a higher uptake is the problem low and middle income earners have in coming up with a thousand dollars of post tax income to participate. We would suggest that the scheme be reconfigured to allow it to be taken through $20 per week deductions from an employees pay for 50 weeks as salary sacrifice. That way the cumbersome paper work to apply for the co-contribution by the employee would be avoided, the weekly payments of $20 would be more manageable, and as salary sacrifice the payments would be more tax effective. In addition the Government is likely to find a willingness of employer associations, unions and super funds to provide a high level of workplace communication to advise employees and employers of the opportunities and benefits for those who are eligible to participate.

We have asked a leading superannuation administrator, SuperPartners, to give consideration to the logistics of such a system and the administrative implications for government, employers and employees. We will request that the information available on this issue is brought before the Committee during its public hearing sessions.

Table 5: ASFA proposed parameters for the superannuation co-contribution[12]

Income level (assessable income plus reportable fringe benefits) per annum	Proposed maximum co-contribution currently applying to contributions in 2005-06 and later years	Amount of personal contribution needed to achieve maximum co-contribution
$40,000	$1,500	$1,000
$45,000	$1,125	$750
$50,000	$750	$500
$55,000	$375	$250
$60,000	0	

[12] The Association of Superannuation Funds of Australia (ASFA) Pro Budget Submission 2005-2006 p. 5

Conclusions and Recommendations

This submission has agued that improvement in superannuation savings for those under 40 is best achieved through improvements in the system of retirement incomes for all Australians.

There is broad based support and well established precedence for considering the circumstances of different groups (age, gender etc) in the context of improvements to the retirement income system as a whole. As the 2002 Senate Committee Report on "Superannuation and Standards of living in retirement" put it:

"The Committee considers that a number of its recommendations for change which apply to the wider community will also assist baby boomers to achieve an adequate income in retirement...

The Committee considers that by implementing the [system wide] measures outlined in this report, there is scope to improve the ability of individuals, such as women and others with broken working patterns and baby boomers, to increase their retirement incomes."[13]

In addition the ACTU agrees with the 2002 submission of ASFA, which rejected changes to the system based on age. As ASFA put it in relation to a question from the Senate Committee about introducing special arrangements to help boost the savings of those over 45.

"This would introduce a whole new layer of complexity to record keeping and accounting. It also needs to be kept in mind that funds do not have records of the age of some fund members, and there is no independent validation of the birth dates that are recorded. In addition not all persons aged over 45 are relying on compulsory superannuation alone. Around 40% of the population had superannuation prior to the SG, with a fair proportion of these in relatively generous defined benefit schemes and/or have a substantial proportion of their superannuation benefits payable as a lump sum of which only 5% forms part of their taxable income in the year the benefit is taken."[14]

As this submission has argued the most important changes required to the retirement income system for all Australians involves:

- Increasing super savings so that workers can expect a retirement income of at least two thirds of their gross pre- retirement income;
- Focusing public policy on the interface between the retirement incomes system and the health care system so rising costs of health services including prescription medicines do not seriously erode the future purchasing power of the pension, or

[13] The Senate: *Select Committee on Superannuation:* Superannuation and Standards of Living in Retirement: December 2002 pg xvi – xvii

[14] IFSA Submission to the 2002 Senate Committee pg 18.

cause unnecessary uncertainty for citizens to plan for their future retirement provision.

Clearly the desired outcomes need to take into account the economic consequences of the ageing population. It is also clear that:

- **Employers, Governments and employees will each be required to make a contribution if a sustainable and affordable outcome is to be achieved. The real debate should focus on the best division of labour in terms of what each group can and should contribute.**

To explain this proposition we provide the following example. The ACTU neither supports nor opposes the division of labour highlighted in the example. Rather it highlights what we mean by each of the three groups (government, employers and employees) making a contribution. In this example we assume it was implemented in 2002-2003 which was the best circumstances in a generation for a major reform initiative given employer profitability and a favourable government fiscal position.

- The employers contribution could have been through further increases in the compulsory SG contributions such that 12% contributions was mandatory before 2010 and the first step to 10% achieved in 2004. Employer's capacity to pay has rarely been better and it had been more than 2 years since the last SG increase. In addition, previous NATSEM modelling showed long term savings to Government on the age pension from 2030 onwards for additional contributions before 2010.With the ageing of the population and strong budget surpluses today the savings would accrue in several decades time when they are needed most.

- The Governments contribution could have been to phase out the 15% front end taxation of super contributions. As the Investment and Financial Services Association (ISFA) argued in its 2002 submission to the Senate Committee:

"We also note that the 1988 changes to the taxation of superannuation represented a bring-forward of future taxation revenues from retirement savings. As the IGR shows, there is a greater need for taxation revenues out into 2030 and beyond than there is in 2002 and the current forward estimates period. Unwinding some of the tax bring-forward achieved by the current rules, and returning that revenue to future years would ameliorate some of the future fiscal drain outlined in the intergenerational report.

Gradual removal of front –end taxes could increase adequacy for future generations of retirees without sudden and significant fiscal impact on Commonwealth revenue."[15]

An alternative to this at roughly half the cost would be to have gradually phased out the contributions tax on low and middle income earners as a first step. In either option the Government recoups some of the revenue foregone through greater receipts from the tax on super fund earnings, and benefits from the compounding interest effect in

[15] ASFA Submission to the 2002 Senate Committee pg 80-81.

the long term with a larger tax take from end benefit taxation. Again this accrues in several decades time when it is needed most in the context of the ageing population.

- The contribution of employees could have been based on an agreed plan between the States and Commonwealth on the additional investment required in the Medicare System over rolling 5 year periods. If an increase in the Medicare levy was required then an MOU between the States and the Commonwealth would have spelled out how, under co-operative federalism, substantial savings were in the process of being realised by getting the division of labour right between the states and the commonwealth; and how a number of agreed measures such as an increase in the supply of doctors, nurses and other health service industry workers, cutting the queues for elective surgery etc would benefit all Australians. **This is important. It is unlikely that community support for change can be achieved until the savings from the current system are realised through co-operative rather then confrontational federalism and an agenda in place to achieve on going productivity gains. That way citizens can have confidence that additional investments in the system won't disappear down a black hole or be frittered away from entrenched inefficiencies.**

- In explaining how increases or cuts to the Medicare levy for different income groups would be made once every five years, the government would have explained:

    - what additional investment is required, how it is to be paid for, the promise of better more affordable and accessible health services that all Australians could expect and its impact in preserving the purchasing power of the pension.
    - every five years this MOU should be renewed so that all Australians had confidence in what they were paying for. Over time a culture would develop amongst citizens based on the realisation that paying today for Medicare would , amongst other things, greatly assist in preventing the erosion of the purchasing power of the pension in retirement and provide access to many new treatments for all Australians. An understanding would develop about 12% SG contributions from employers, the phase out of front end contributions tax by Government and employees responsibility to make their contribution through the Medicare levy. **Good public policy is greatly assisted by this understanding amongst citizens. It also helps to ensure bipartisan support and continuity with changes in government over time.**

Had such a division of labour been articulated in 2002 and implemented it would also have benefited fiscal policy given the environment of excess domestic demand as none of these measures would increase current disposable income. Had the agreed MOU between the States and the Commonwealth articulated a higher standard of health services requiring increases in the Medicare levy such increases could have been balanced by restructuring the tax cuts to offset the higher contributions from low and middle income earners. As shown in the two tables below there was considerable scope to make the May 2004 and 2005 tax cuts more equitable.

Table 6: Income Tax Cut From 30 June 04 to 1 July 06 - Single no dependents

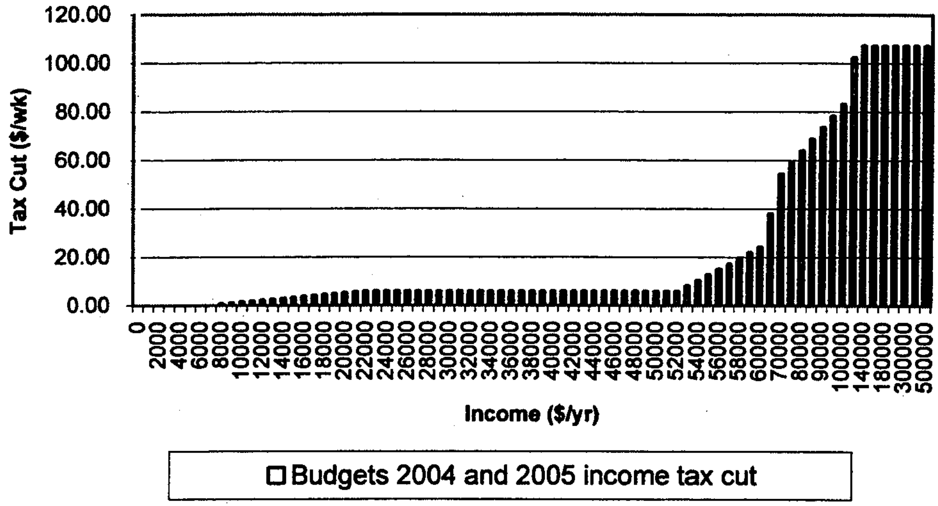
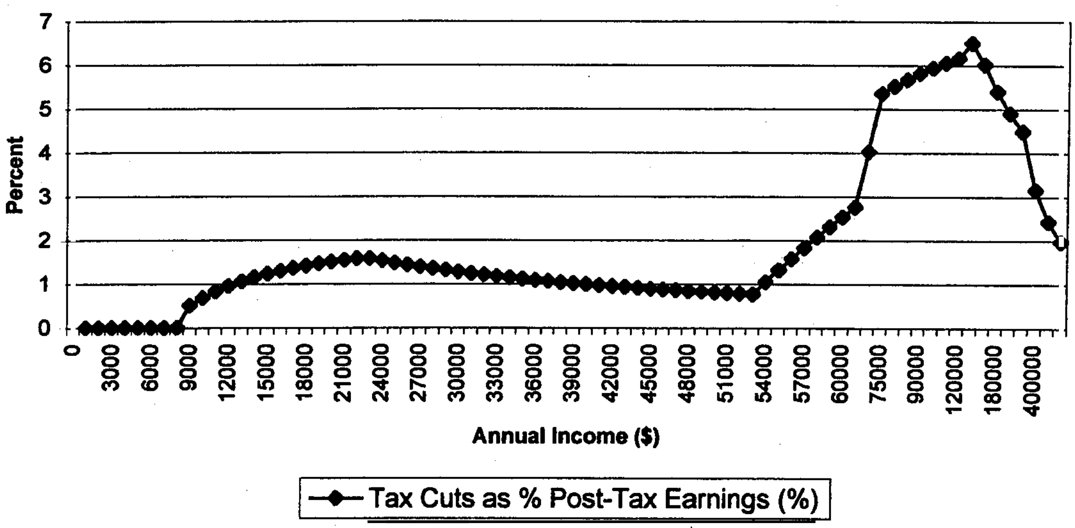


Table 7: Budget 2004 and 2005 Tax Cuts as % Post-Tax Earnings (%)



As emphasised previously, the example above of "what might have been" is neither supported or opposed by the ACTU. It is there to highlight what we mean by a division of labour between Government, employers and employees in getting better outcomes for both the retirement income system and the health system .It is also the case that any such proposed scheme would need to be costed on a forward estimates basis as well as being subject to a distributional analysis including through generational accounting to get the right balance between efficiency and fairness over time. Any such scheme can be fine tuned at the margin to get a better distributional outcome or to adjust the timing of the costs and benefits to the budget bottom line in the short and longer term.

The example above also provides the context for the conclusion of this ACTU submission.
We recommend the following six principles be used as the basis for a fundamental reform of the health and retirement income system.

Core Principles

a) The under 40's and all Australians will benefit most from a public policy focus that begins with the interface between the retirement income system and the health care system.

b) The economic and social consequences of an ageing population require a long-term policy focus that extends well beyond the traditional 4 year forward estimates period provided in the budget. To get the outcomes the nation needs from health services and the retirement income system we need to plan for the next 3 to 4 decades.

c) Employers, Governments and employees will each be required to make a contribution if a sustainable and affordable outcome is to be achieved. The real debate should focus on the optimal division of labour in terms of what each group can best contribute.

d) Public policy should ensure that citizens understand the goal of achieving superannuation savings of at least two thirds of pre-retirement income. This equates to super contributions over most people's working life of at least 15 per cent.

e) Low and middle-income earners have and will continue to struggle to achieve an adequate level of superannuation savings. During the period in which a move to higher contributions is being phased in there is an important role to be played by the co-contribution scheme. It should be reconfigured so that low and middle-income earners can, if they choose, access the scheme through modest weekly salary sacrifice contributions to earn the Government's co-contribution. This should continue to the end of the decade before being reviewed .In addition, the $450 a month earnings threshold for SG payments should be abolished and the government should prohibit excessive fees and the payment of up front or trail commissions through new forms of regulation.

f) The current co-operative approach to improving health services by the States and the Commonwealth through COAG should continue. At the appropriate time an MOU by the parties should be issued specifying the savings that will be achieved and how/when. This MOU should also lay out a long term plan for achieving a higher standard of quality, affordable and more timely and accessible health services (including prescription medicines) and what the additional costs will involve. Every five years this process should be repeated.

An Agenda to give effect to the Principles

What is required now is an agenda and a transparent consultation process to give effect to these principles. This should include amongst other things:

1. After the completion of this Committee's Inquiry, the Commonwealth should implement the changes proposed by the ACTU to make the co-contribution scheme more attractive to low and middle income earners across all age groups.

2. Under the guidance of the Productivity Commission and with the involvement of Federal Treasury and the Institute of Actuaries of Australia amongst others, a working party should be established to model the cost and benefits of different scenario's for Australians to increase contributions to retirement savings and the long-term generational consequences (particularly for Government taxation revenue).

3. The current COAG working party on health services should complete its work program. Over time its work program should be linked to the outcomes from the working party on retirement incomes.

4. By early 2006 the material generated from this process outlined above should be forwarded to the Productivity Commission. That Commission should conduct an inquiry based on the traditional submissions/public hearing process to ascertain:

    - The best long-term options for improving the interface and outcomes from Australia's health services and retirement income system and the best division of labour between Government, employers and employees in paying for it.

5. The recommendations from the Commission's Final Report should be fed into COAG and the consultation processes involving Governments and the community. A new set of policies, goals and funding arrangements for Australia's health and retirement incomes system should be put in place in 2007.

The ACTU believes the above process would be strongly endorsed by the Australian community. However if partisan politics interferes then arrangements should be made for the private sector to take over the process and undertake all the work required. Private sector participants would then in a non-political bipartisan way put the options and outcomes into the public arena in 2007.

One way or another this work should be done. It should be done through co-operative federalism and bipartisan support. If this cannot be achieved then it will most certainly be one of the two or three issues that will determine the outcomes in the next set of Australian elections.