

DEFENCE FORCE WELFARE ASSOCIATION



NATIONAL OFFICE

PO Box 4166, KINGSTON ACT 2604

Telephone: 02 6265 9530

Facsimile: 02 6265 9776

rdfwanat@ozemail.com.au

www.rdfwa.org.au

Patron: His Excellency Major General Michael Jeffery AC CVO MC (Retd)
Governor-General of the Commonwealth of Australia

File: 51.01

19 July 2007

The Secretary
Senate Community Affairs Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Elton,

Our thanks to the Committee for its invitation to our association to make a submission to its inquiry. I should introduce myself. I am Colonel David Jamison AM (Retd), the new National President following the death in April of our long serving National President, Commodore Harry Adams AM RAN (Retd).

The Committee may also care to note that our association is in the process of changing its name, by dropping the word "Regular", to reflect the changed composition of the Australian Defence Force, and our acronym has, similarly, shrunk to just DFWA.

DFWA Submission

Inquiry into the cost of living pressures on older Australians

This submission addresses primarily item (d) of the Terms of Reference: "The adequacy of current tax, superannuation, pension and concession arrangements for older Australians to meet these costs" with a view to proposing a more appropriate measure of cost of living pressures than that currently used by the Government to index military and public service pensions.

CPI as a reflection of standards of living

As the Committee will be aware, military as well as public service pensions have, since the 1970s, been indexed to the Consumer Price Index. The CPI was selected by the then government at a time of rampant inflation when real wages were falling. In those circumstances the CPI was an adequate method of indexation to maintain the living standard of the government's former employees in their retirement. As the Committee will be aware, economic circumstances have since changed radically.

For over 15 years DFWA has experienced difficulty in convincing successive governments that the CPI, by itself, is no longer a suitable measure of cost of living pressures on older Australians who are trying to maintain their standards of living over, in many cases, decades of living on their military pensions.

DFWA contends that its position on this issue is supported by the Australian Bureau of Statistics (ABS), which compiles the CPI. The ABS says, at the bottom of page 3 of its publication 6440.0 - A Guide to the Consumer Price Index: 15th Series, 2005, that “**CPI is not a purchasing power or cost-of-living measure**” and then explains why! (This reference can be accessed at www.abs.gov.au/ausstats/abs@.nsf/525a1b9402141235ca25682000146abc/eca69414ad9af3fbca256888001f2467!OpenDocument)

In days gone by, when consumer choices were limited and the ingredients of life were simple – food on the stove, a roof over the head, clothes on one’s back, and access to drinking water - it may have been possible to maintain a reasonably realistic index of the costs of living of a particular socio-economic group of people. There are many reasons why no index, which relies on a “basket” of expenditure items, like the CPI, can now reflect the costs of maintaining living standards, even for a particular group, when community standards are changing rapidly. For example:

- **Items that were luxuries may become community norms.** Who at the ABS can judge when that may occur? Is a car with air conditioning still a luxury? When did mobile phones become essential? Broadband?
- **Elasticity of demand will almost certainly change expenditure patterns,** although it may not change the total amount spent on the item in the basket. If a pensioner has insufficient money, they might give up the item altogether, which the ABS should be able to detect, but most pensioners will probably seek cheaper alternatives, in which case their financial outlay on, say, peanuts, may not fall, but the *quality* of their purchases might. That would probably be invisible to any index of expenditure.
- **Changes in markets may require different expenditure patterns.** For example, the advent of Pay-TV may require expenditure on a new range of subscriptions in order to enjoy what was previously free-to-air entertainment – rugby, ballet, etc. Alternatively, reductions in public transport services in a particular local area may necessitate a retired couple’s running two cars where one may have been adequate previously.

Wages as a reflection of standards of living

DFWA believes that, *if operating without distortions*, the most realistic index of standards of living is one, which is based on wages across the community. In general, people will spend not much more than their earning capacity. Such a community-wide constraint then determines the rate at which all items of expenditure become community norms, thus reflecting the community’s living standards.

There will still be transient anomalies in wages - the mining industry may pay more this year than, say, the construction industry - and there will always be individual variations, but a wage-based index like Male Total Average Weekly Earnings (MTAWE) seems to show a suitably broad picture of the movement of wages, and hence living standards, across the community.

Problems arise with any wage-based index of living standards when artificial distortions or constraints are introduced, eg when wages were suppressed during the period of the Hawke Government’s Wages Accord, or when non-wage remuneration has to be taken into account.

The introduction of the Superannuation Guarantee Charge (SGC) in the early 1990’s saw a temporary slowing of the recorded increase in monetary wages, although in reality employers had started to pay an additional 5% (initially) on their wages costs and their employees were gaining a monetary asset in their super funds. Fringe benefits are another example of non-monetary benefits available to those in paid employment. Likewise, it is probable that work-life

choices over the next decade or so will see a trade-off between wages and non-monetary benefits which will not be registered in MTAWWE but will, nevertheless, represent a benefit to the lifestyle, ie standards of living, of those who can participate.

Thus it can be seen that, due to transient anomalies in wages growth, a simple MTAWWE-based index may not reflect the real growth in community living standards in a particular period, any more than a simple CPI-based index will.

The higher of CPI or MTAWWE

DFWA has figures which indicate that, since 1 January 1990, CPI-indexed pensions have almost always lagged wages-based community living standards, although, as indicated above, there may be periods when MTAWWE growth has been less than CPI, particularly when alternative, non-wage, benefits were provided to wage earners. The **solution** seems to be the same composite index measure that was adopted by the government itself in 1997 for most social welfare payments and for components of many other government pensions, ie “the higher of CPI or MTAWWE”.

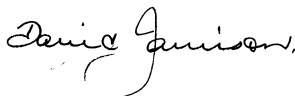
The difference between military pensions that have been indexed at CPI and if they had been indexed at MTAWWE/CPI is now about 29% since 1990. In other words, a CPI-indexed military pension started in 1990 and now worth \$20,000 pa in 2007 (which is about the average military pension) should have been increased to \$25,800 pa over that period if it was to make the same contribution to the pensioner’s living standards in 2007 as it did when the pension was started in 1990.

As an example of the inadequacy of simple CPI indexation to maintain the relative value of military pensions, DFWA has a member who survived being sunk in World War II, then went through the Korean and Vietnam Wars to retire as a Rear Admiral in the early 1980s, and whose CPI-indexed pension is now worth no more than that of a Commander retiring today! Others, who may not have risen to such high ranks, suffer the same relative disadvantage.

Recommendation

DFWA recommends that the Committee advise the Government that:

- a. CPI indexation should be discontinued as the sole mechanism for adjusting military pensions to reflect changes in living standards; and
- b. “The higher of CPI or MTAWWE” be adopted as a better index to reflect changes in community living standards.



David Jamison
National President