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28 February 2003

The Secretary
Senate Select Committee on Superannuation
Parliament House
Canberra ACT 2600

Dear Ms Morton

Re. Inquiry into Planning for Retirement

Thank you for your letter of 21 February inviting me to lodge a submission in response to this inquiry.

I will restrict my comments to the 'financial' aspects of planning for retirement. Such planning can be divided into two parts:

1) the part which determines the quantum of retirement savings available to the individual at the 'time' of retirement (this 'time' being defined as the point at which the individual's income from personal exertion shifts to a level significantly below their normal current expenditures on living expenses as a result of a reduced amount of remunerated 'personal exertion' performed, and with no expectation of that situation being reversed).

2) the part which determines the way in which the individual's retirement savings are deployed at the time of retirement, and the way(s) in which the individual expects/plans to access those monies during their years in retirement.

Of these two parts, it is 1) which has received the greatest attention in Australia in recent decades. For workers who are not within 'striking distance' of their retirement ages, it is quite logical to focus heavily on 1). For workers who are close to their retirement ages, except where their retirement savings are so inadequate that a major last-minute surge of saving-effort is warranted, it is part 2) which deserves more attention. The focus of your

Location: Sturt Road, Bedford Park, South Australia.

inquiry therefore suggests that this submission should be mainly concerned with part 2) issues. But let me first make a few brief points re. part 1):

The number of workers who find themselves getting close to retirement age without adequate retirement savings would be reduced:

(a) if the SGC minimum were increased to a rate above 9 per cent;

(b) if the mandatory saving requirements of the SGC were to be extended to cover workers in self-employment status, on an appropriate basis (see attachment for elaboration);

(c) if persons in receipt of government income-support payments during periods of involuntary unemployment were to have government payments of superannuation contributions credited to their preserved superannuation savings at the same time.

Where workers do find themselves getting close to retirement age with demonstrably inadequate retirement savings, it would seem reasonable that a major last-minute surge of saving effort by them into appropriate retirement savings vehicles not be penalized by the operation of the superannuation surcharge in the way it is at the moment.

Turning now to the deployment of retirement savings from the time of retirement onwards, it is clear that there is a major deficiency in Australia's current superannuation policy framework in terms of the requirements it imposes for adequacy of insurance cover against longevity that is greater than the individual anticipates, and for the prudent deployment of the funds.

Up to the point of retirement, our current framework of superannuation law arrangements places a major barrier against the individual accessing any of their tax-advantaged retirement savings for current period living expenses. Once the clock ticks past the 'point' of 'retirement' for the individual, severe restriction gives way to total individual discretion.

Also, up to the point of retirement, our current framework of superannuation law arrangements places major constraints on how much risk is taken with the deployment of an individual's tax-advantaged retirement savings (whether deliberate or unwittingly). Once the clock ticks past the 'point' of 'retirement' for the individual, there is no constraint on the funds being shifted into high-risk forms (whether deliberately or because the individual has fallen prey to misinformed or self-serving 'financial advice').

The only tangible 'encouragement' our current framework provides for an individual to put retirement savings money into a vehicle that provides prudent deployment of funds and longevity insurance (i.e. a prudently managed life annuity) is via the two-tier RBLs. And this policy is itself sadly deficient in that those who are most at risk of running out of their retirement savings before they die are almost certainly over-represented among those who fall below the lower RBL, and therefore receive no 'encouragement' from the current policy. The people our policy's 'encouragement' actually applies to (those above the lower RBL) are unlikely to be in greater need of such 'encouragement' than those below it.

The taxation (and social security means-testing) advantages currently provided to so-called 'allocated pensions' may be perceived by less-well-informed retirees (and workers approaching retirement) as providing these products with some sort of stamp of government approval as prudent means of deploying one's retirement savings. These products typically provide zero longevity insurance. These products are available across a broad spectrum of capital-risk. It is madness for public policy to provide no significant 'encouragement' for 'below lump-sum RBL' retirees to deploy their monies into true prudently managed life annuities as compared with putting the same monies into so-called allocated pensions with significant capital-risk properties.

I attach some pages from my recent book *Policies to Boost Australian Saving: How? and Why?*, which amplify some of the points I have tried to set out succinctly above. If further explanation re any of those points is desired, please do not hesitate to get in touch with me.

Yours faithfully,

Owen E. Covick
Associate Professor in Business Economics
(and Deputy Head, Faculty of Social Sciences)

Att: copy pp.168-173 of book and title page

C/Papers/Inquiry into retiremt memo

10 Concluding Comments

Owen Covick

Australia's National Saving level had been an issue of economic policy debate before the FitzGerald Inquiry of 1993. The *Australian Financial Review* had devoted its editorial of 2 April 1992 to a call for a federal government White Paper on the issue. Successive Commonwealth Budget and *mini*-Budget documents in the second half of the 1980s repeatedly stressed the objective of lifting the level of national saving, and the role of a tight Commonwealth fiscal policy in furthering that objective. But the FitzGerald Inquiry clearly brought focus to the debate. And it is useful to conclude this book by considering some of the main points arising from preceding chapters in the context of the recommendations made by FitzGerald nine years ago.

When the then Treasurer John Dawkins announced that he had commissioned former senior public servant Dr Vince FitzGerald to produce a national saving strategy for Australia, he did so in his first major speech after the Australian Labor Party had won the March 1993 federal election. At the centre of that federal election campaign had been the two 'plans': the Coalition's *Fightback* offering major personal income tax cuts to be funded by the introduction of a broad-based consumption tax of the European VAT type (GST) and substantial cuts in government spending; the ALP's *One Nation* offering almost as generous personal income tax cuts, divided into two tranches, without the discomforts of a GST or substantial cuts in government spending. The ALP won what had been widely described as an *unwinnable* election for the party. Treasurer Dawkins was left with the challenge of putting together a Budget which combined responsible economics and compatibility with the election promises. Announcing the commissioning of the FitzGerald Report, Dawkins stated it would focus on four issues in particular:

(a) the factors affecting household saving over the medium term;
(b) the ability of retirement incomes policy to further contribute to national saving;
(c) the factors affecting the ability of the business sector to generate additional internal funds to help meet its investment needs; and
(d) the scope for the Commonwealth and State governments' fiscal strategies to provide an improved level of national saving.[1]

When he presented his report Dr FitzGerald argued for a national saving goal of 22 to 23 per cent of GDP and advised the Treasurer: 'The more immediate and major part of the further lifting of national saving clearly must come from the public sector ... Essentially, of course, a medium term lift in public sector saving means reducing the

[1] Speech by the Treasurer, the Hon. John Dawkins, MP to the Australian Society of Certified Practising Accountants, Friday 2 April 1993. Treasurer Press Release. No 23, p. 1 and pp. 7-8.

general government budget deficit nationally (Commonwealth and State combined).[2] Of the ten concrete policy proposals Dr FitzGerald put forward to the Treasurer the first four were recommendations for ways Australian governments could directly increase their contribution to national saving by raising additional tax revenues. The four can be summarised:

- postpone or cancel the second round of personal income tax cuts from *One Nation*;
- consider measures to broaden the income tax base and/or reintroduce inheritance taxes;
- through negotiation with the States, and in conjunction with reducing *vertical fiscal imbalance*, seek to broaden the payroll tax base and the base of services taxation, and to consider also increasing the tax rates in areas where Australia's tax effort is relatively low (e.g., fuels); and
- introduce a temporary personal income tax surcharge.[2]

The Government made public FitzGerald's list of recommendations on Budget night of 1993 when it was able to announce also that it had rejected the fourth proposal and much of the second and third. The Budget as set out on 17 August 1993 adopted proposal one, announced some fairly modest income tax base-broadening and a program of increases in sales tax rates, petrol excise and tobacco excise. To sugar the pill, the first round of *One Nation* tax cuts was brought forward. When the pill still proved unpalatable to the minority parties in the Senate (and to some in the ALP Caucus) some of its components were negotiated down or out and partly offset by still higher tobacco excise increases.

FitzGerald's remaining six recommendations can be summarised as follows:

- reinforce the SGC arrangements by a series of measures including: introducing an additional employee 3 per cent requirement on top of the employer 9 per cent; bringing forward the increase in the preservation age; setting as an ultimate goal an SGC contribution rate of 18 per cent;
- allow banks and other financial institutions to offer superannuation saving vehicles directly, without the requirement for a separate trust structure, or life insurance subsidiary;
- resist proposals to allow people early access to their compulsory superannuation saving for use towards house purchase;
- increase the tax rate on compulsory superannuation contributions so as to finance increased taxation concessions for voluntary contributions;
- introduce a new type of tax-advantaged saving vehicle 'applicable to a range of life-cycle purposes' (i.e., not just retirement income); and
- actively pursue information and education programs to promote saving.

Nine years on, what is the situation? The general government sector's direct contribution to the national saving position, as we saw in Chapter One, has been dramatically improved over that period. This has been the result of three forces:

[2] Treasurer Press Release No. 97, 17 August 1993, *Release of Dr FitzGerald's Policy Proposals and Government Response*.

restraint in government spending programmes at both Commonwealth and State levels; restraint in providing reductions in overall real taxation levels (the 1998-2000 Commonwealth tax reforms involved little real change in overall revenue raising, strident publicity suggesting the opposite notwithstanding); and the impact of eight years in the non-recessionary part of the economic cycle. As has been discussed in Chapters Seven, Eight and Nine the first of these three factors has been playing a diminishing role over the last four years. The third factor is now largely responsible for the general government sector's bottom line continuing to look so good in national saving terms. Until one can enjoy the wisdom of hindsight (in combination with the discomforts of the next major economic recession) it is very difficult to distinguish how much of that overall government saving performance is *structural* and how much *cyclical*.

Turning to private sector saving: the clock on the SGC minimum contribution requirements has ticked on and the hand now points to 9; there have been some tightenings of preservation requirements; what might be described (if one was being very kind) as an attempt at providing a FitzGerald type broad-based tax advantage for saving, the 'savings rebate' scheme, was terminated after one year of being 'phased-in'; early access to super for housing purposes has been successfully resisted; and banks (and other deposit taking institutions) have been authorised to offer retirement savings accounts (RSAs) which provide the same tax advantages as the more traditional forms of superannuation. Apart from that, the picture is still pretty much the same as it was in 1993 and the private sector's contribution to national saving continues to look 'low' (see Chapters One and Two).

If it is accepted that Australia's national saving level is *still* not as high as could reasonably be considered to be in the overall best interest of the Australian community, the discussion of the issue in the preceding chapters of this book would suggest that the following points may be useful in considering the various approaches that might be viewed as available policy options:

- Legislating for the SGC minimum standard to be increased to a level greater than the current 9 per cent, by one percentage point stages set to take effect on two-yearly intervals commencing on 1 July 2004 ought to be fairly straightforward for the community to digest. It should also require minimal *additional* compliance costs (and compliance-ensuring costs) compared with the present situation. Since the actual incidence of the additionally required superannuation contributions would be likely to be the same whether the legal obligation to contribute was on an employee's employer or on the employee themselves (see Chapter 5), it would not seem worth the effort of finding an appropriate Commonwealth Constitutional power, drafting a whole new body of legislation, and setting up a new set of payment arrangements simply to mollify some of the least mentally-alert employer-interests in the country that the new requirement was for 'employee contributions'.

- The issue of extending compulsory retirement-saving arrangements to Australia's self employed should *not* be ignored. But nor should it be treated as a simple matter. Where a self employed person is demonstrably building up personal net wealth for their retirement at a rate above the SGC prescribed minimum, and on a basis that inspires reasonable confidence that the 'prescribed-minimum' element is not at too much risk of disappearing prior to preservation age being reached, there would seem to be sense in giving this appropriate recognition (see Chapter 3). But the mere fact that *some* self-employed persons are behaving so commendably should not be used to argue that self-employed persons who *choose* to save little for their retirement should be treated differently from equivalent-income wage/salary earners who would prefer to do the same. Similarly there should be some reasonable equivalence of preservation requirements as between the two categories of workers' retirement savings. More work is required in designing how to extend compulsory minimum saving requirements to Australia's self-employed.

- Instead of worrying further about the appropriate level of the preservation *age* for superannuation in Australia (currently 55, but to rise to 60 by the year 2025), the focus should be shifted to the broader issue of requiring that a defined minimum of each person's superannuation savings be accessed as a retirement income stream which includes compulsory longevity insurance. Policy-makers would need to take steps to ensure that life annuities (and appropriate variants thereof[*]) were available for purchase at actuarially justified prices before making such purchase mandatory. But the whole *raison d'etre* of compulsory saving for retirement would seem to be confounded by maintaining a system of rules which, once a citizen has reached a prescribed age, removes *all* requirements for the prudent marshalling of the monies thus far accumulated to see the citizen through their remaining years of life? This issue is discussed more thoroughly in Bateman, Kingston and Piggott's *Forced Saving: Mandating Private Retirement Incomes*, Cambridge University Press, 2001.

- Policy-makers should resist special 'tax-breaks for saving' proposals (and government subsidies for saving proposals). The bottom line here is that *real* saving is about thrift. It has never been a particularly exciting or glamorous activity to participate in and is unlikely to become so. Any special new tax advantaged savings vehicles which are perceived by citizens as so attractive that they voluntarily and enthusiastically sign up for them, and then feel very pleased about having done so, almost certainly involve overall national saving going backwards as a result (when the full public sector saving consequences are considered as well as the full private sector consequences see Chapter 5).

- If governments allocate even a relatively modest amount of proceeds from major privatisations to additional government current purpose spending and/or additional low-return government 'investment' projects which do not satisfy reasonable social benefit to cost tests, the whole exercise is likely to

[*] It should be noted that the typical 'allocated pension' product available in Australia today is almost entirely devoid of any significant element of longevity insurance. Allocated pensions are thus little more than tax-preferred unit trusts. Paring back these largely unwarranted tax preferences might help encourage retirees to place their retirement savings in products which *do* guarantee an income stream for life.

worsen the nation's saving-investment imbalance rather than improve it (see Chapter 6).

- Governments should not ignore the capacity of public-education campaigns to help lift national saving. Professional economists have traditionally been skeptical about 'increased awareness' or 'moral suasion' campaigns. And the 'watering-can' television ads promoting the SGC in 1992-93 no doubt bolstered such skepticism. But it is truly stunning how poorly acquainted most Australians are in regard to how long an Australian adult currently of the same age as themselves, can expect to live for if 'statistically average'. Many seem to believe life-expectancy at birth is the only figure you need to remember to do this exercise, with you simply subtracting your current age from that figure. Helping people understand just how many years they are (if 'statistically average') likely to live for after retirement, is clearly a first step in helping people appreciate the likely value to them of current period saving. The work of Richard Thaler discussed in Chapter 3 provides additional reasons for supporting policies to increase awareness about personal saving. The Fitzgerald Report's recommendation on public education should not be confused with a recommendation for more 'watering-can' adverts.

- The nation's taxation system and the arrangements under which social security benefits (and other government services subject to means testing) are delivered influence the quantum and pattern of private sector saving. But assessing the precise nature of those influences is a very complex matter. At the present stage of knowledge it would be premature to conclude that the present Australian arrangements lead to overinvestment in owner-occupied housing or that heavier effective tax rates on housing would improve Australia's saving/investment performance. The same applies to propositions about bias as between debt financing and equity financing. Chapters 3 and 4 attempted to highlight where further research is needed in these (and similar) areas.

- Lastly there is the issue of what represent the appropriate longer-term guidelines (or 'objectives') for the stance of fiscal policy. Over the last twenty years there has been a significant shift in Australian public policy, away from single-year cash-focussed budgeting to a medium-term focus guided by published forward estimates and accruals-based accounting methodologies. That has occurred at both Commonwealth and State levels and has represented, overall, a significant improvement in the public policy framework. But the *medium* term framework, combined with our current *accruals* accounting methodologies may not have taken us far enough. The essence of the medium-term framework was spelt out succinctly in the 1999 Commonwealth Budget Papers (p 1.14).

  > The primary objective of the Government's medium term fiscal strategy is to achieve fiscal balance, on average, over the course of the business cycle. This will ensure that, over time, the Commonwealth general government sector makes no net call on private sector saving and therefore does not contribute to the national saving-investment imbalance (i.e., the current account deficit).

Thus, in the parlance of present day fiscal policy making, medium-term means 'over the course of the economic cycle' and the objective is no *direct* general government sector contribution to saving-investment imbalance over that time-frame. The three factors of a bulge of baby boomers moving along the age-spectrum, increasing life expectancy, and increasing community expectations of what represents a socially-acceptable minimum standard of living for the elderly (with the public purse called upon to underwrite that standard) may mean that the Australian public sector is accruing significant future expenditure liabilities, year-by-year, which are not being picked up by today's accruals figuring. We need a clearer picture of what represents *fiscal balance* in such a broader *accruals* framework. We need further debate on the consequences of simply allowing the 'missing' currently accruing expenditure liabilities to be unfunded and unrecorded

Policies To Boost Australian Saving:

How? and Why?

Edited by
Owen Covick
(For the South Australian Centre for Economic Studies)

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