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Implications of the Retirement Income Review: Public advocacy of private profligacy?

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Contents

Introduction.........1

The superannuation system.........1

Chart 1: Fall in proportion of those age-eligible receiving any Age Pension.........2

The Retirement Income Review.........2

Changing official attitudes to saving?.........3

Saving and the growth of saving.........3

Box 1: The superannuation guarantee and savings: the FitzGerald Report.........4

Income adequacy in retirement.........5

Spending in retirement.........5

Future increases in the Superannuation Guarantee rate?.........5

Box 2: Higher SG rates likely add more to costs than to benefits.........6

The Review's key retirement income 'facts'.........6

Chart 2: Superannuation 'tax expenditure' costs are allegedly too high and rising.........7

Chart 3: Age Pension reduces inequality, superannuation concessions allegedly increase it.........8

Imaginary tax benchmarks are not facts.........8

The alternative expenditure tax benchmark for tax expenditures.........9

Table 1: Is the 'tax expenditure' on superannuation high and rising, or modest and flat?.........10

Hoarding in retirement?.........11

Income adequacy in self-funded retirement.........11

Policies have to be robust against shocks.........12

Conclusion.........12

Endnotes.........13

Introduction

The 2020 *Retirement Income Review* implies policy directions that, if adopted, would:

- limit retirement superannuation balances by more heavily taxing the compound growth of saving within the super fund;
- apply that new, higher tax to income in the retirement phase;
- encourage purchase of currently non-existent longevity protection products but encourage more rapid spending of saving in retirement;
- encourage spending of equity in the family home; and
- through all these measures, minimise any bequests.

In effect, preferred policy directions would incline each generation towards consuming fully its own lifetime savings. Policies would be shaped by the idea that retirement income of 65% to 75% of the average of post-tax income earned in the last 10 years of work is adequate for the final 30-or-so years of life. By that standard, the Review claims current retirement saving is more than adequate for most, with the main exception of renters.

How did we arrive at this odd juncture, with ideas for reducing retirement saving and increasing retirees' spending in a threatening economic and strategic climate?

The superannuation system

Superannuation emerged in the 19th century as a benefit mostly for select white-collar employees. From the introduction of the Commonwealth income tax in 1915, superannuation has had specific income tax treatment to account for its compulsory preservation for the saver's working life.

In the decade commencing in 1983, the Hawke Government increased tax on superannuation in the drawdown phase and imposed taxes on the contribution and accumulation phases. But it 'grandfathered' the tax increases to avoid significant adverse impact on those close to retirement or already retired, thus avoiding the unfairness of reducing retirement living standards for those unable to adjust to the higher tax levels by changed work or saving. The downside of repeated grandfathering was a build-up of complexity in the system. By the 1990s, lump sum retirement benefits could have up to eight different components taxed in seven different ways.[1]

Since the growing complexity of the 1980s, two major developments have shaped modern retirement income policies: the introduction of the Superannuation Guarantee (SG) in 1992 and the Simplified Superannuation measures of 2007.

- The SG mandated saving at the legislated uniform rate from entry to the workforce for the duration of an employee's typical 40 year career. (The rate at introduction was 3% of ordinary time earnings; it is now 9.5% and is scheduled to rise to 10% on 1 July 2021 and in stages to 12% on 1 July 2025.)[2] Since those on career-long lower incomes or with punctuated employment may not have saved much if at all without the SG, there has been a net increase in household saving.[3]
- Simplified Superannuation was introduced to "improve incentives to work and save" by:
  - — reducing the very high effective marginal tax rate on additional savings over the range of the Age Pension's means testing;
  - — simplifying taxation of superannuation; and
  - — conditionally removing income tax during retirement on life savings from previously taxed superannuation funds, provided savings were consumed in the form of drawdowns from allocated pensions at mandated minimum rates which rise with age to ensure capital is gradually run down.[4]

These two major packages can be seen as complementary, but the balance between them seems an almost daily debate. The one constant is change: Jeremy Cooper's Charter Group enumerated in 2013 incessant changes to superannuation law and tax, of which 30 legislative changes from 2005 to 2013 had revenue impact of $50 million or more over the forwards estimates period.[5]

The SG inculcated the mindset of long-term, patient saving and laid a foundation for compounding returns from super fund investment of compulsory savings over a working lifetime.

The Simplification package encouraged voluntary additional retirement savings as individuals' circumstances and preferences permitted, to facilitate achieving the retirement living standards they were prepared to save towards, and thus to reduce Age Pension reliance. It also secured a tax structure relieving long-term saving from cumulative income taxation of nominal returns at rising marginal tax

rates in the presence of variable but sometimes high inflation and interest rates.[6]

Thanks to these two key packages, the coverage of superannuation and the value of funds under management have grown strongly. The proportion of employees with super assets has risen from less than a third in the early 1970s to over 90% today, and the stock of assets in super funds has risen from the equivalent of about a third of annual GDP to about 175%.[7]

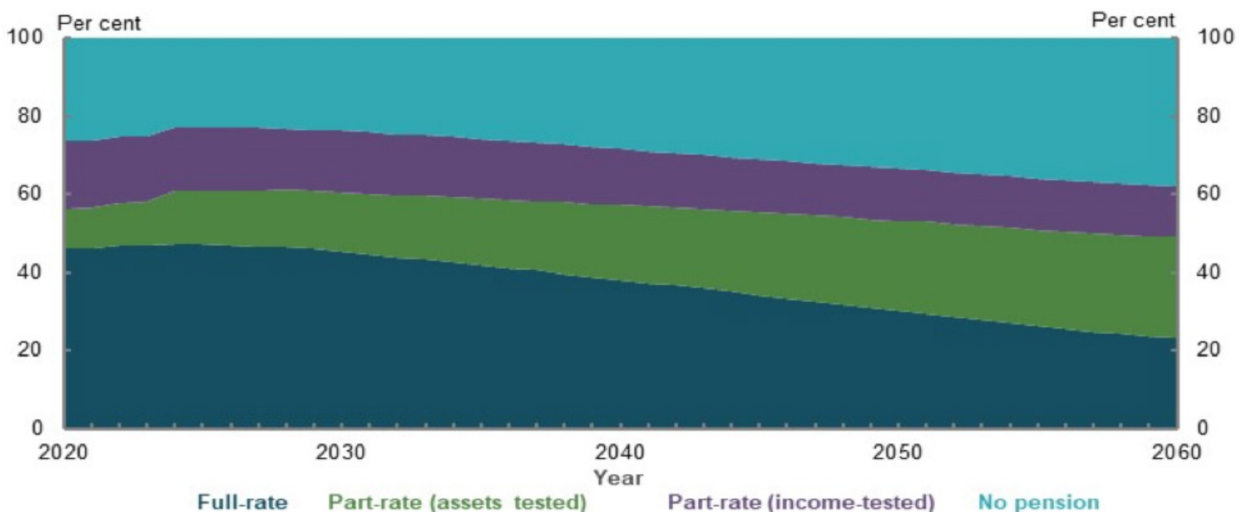
With an ageing population and rising real pension rates, Age Pension expenditure approximately doubled over the past 20 years, to reach $46 billion and almost 10% of the Commonwealth budget in 2018-19.[8] But as funds available from superannuation to top up or completely self-fund retirement have risen, projections of Age and Service Pension expenditure as a share of GDP are no longer rising. Contrary to projections in the first three *Intergenerational Reports*, they are now projected to fall significantly.[9]

The proportion of the age-eligible population receiving any Age Pension is also projected to decline (Chart 1). Since the Age Pension is indexed in a way that generally lifts its real value with the growth in real wages, and since those in self-funded retirement are *prima facie* better off than if they had spent their savings in order to access the Age Pension, projections now imply retirement living standards will continue to rise, at less cost to the diminishing proportion of the working age population whose taxes fund the Age Pension.

But in apparent offset of this good news, the Review worries that Treasury's annually estimated 'tax expenditures' on super are very high and rising, approaching the annual amounts actually spent on Age and Service Pensions. (A 'tax expenditure' is (broadly speaking) an estimated revenue gap between the actual legislated tax treatment and some hypothetical benchmark tax treatment chosen by the analyst. It may be either positive if the chosen benchmark is higher, or negative if the chosen benchmark is lower.)

Chart 1: Fall in proportion of those age-eligible receiving any Age Pension

Retirement Income Review Chart 4A-15, p 391



Note: Includes service, carer and disability pensioners. Source: Treasury estimates for the review using MARIA.

The Retirement Income Review

Does Treasury's chosen tax expenditure approach make sense? Are future SG rate increases necessary or desirable? To help answer these and related questions, and with the Commonwealth Budget apparently firmly on the path back to imminent sustainable surplus, Treasurer Frydenberg set the *Retirement Income Review* an important task in September 2019: to "…establish a fact base of the current retirement income system that will improve understanding of its operation and the outcomes it is delivering for Australians. The Retirement Income Review will identify … [among other things] …the impact of current policy settings on public finances."[10] Such a review had been a recommendation of the

Productivity Commission in 2018, for completion before any further increase in the Superannuation guarantee.[11]

The Review reported to the Treasurer in July 2020. Its report was released in November 2020, to a different economic and strategic world than the one into which it was born.

The Review's central finding is that the retirement income system is "effective, sound and its costs are broadly sustainable."[12] It concludes that the structure of the super system "broadly supports intergenerational equity", as superannuation saving reduces the burden on those of working age to pay for the Age Pension of the generation before them.[13] But note the repeated qualification: "broadly".

Changing official attitudes to saving?

A positive view of saving as deferred consumption that provided both the real resources and the finance for rising living standards, used to be a bedrock Australian value. In 1942, Robert Menzies praised the virtues of thrift and homeownership, arguing that "frugal people who strive for and obtain the margin above … materially necessary things [means to "fill his stomach, clothe his body and keep a roof over his head"] are the whole foundation of a really active and developing national life." Such attitudes illustrate what Henry Ergas has termed "the uniquely Western sacralisation of hard work, thrift and aspiration".

The *Retirement Income Review* seems to have arrived at a rather different view. Although not asked to make recommendations, the Review's 640 pages carry many policy implications, of which the most prominent are:*

Saving and the growth of saving

- The role of superannuation in national saving may safely be disregarded (p 4), even though raising national saving was one of the explicit objectives of the Super Guarantee (p 100).
- The compulsory Super Guarantee contribution rate need not rise (pp 170-181), as savings will already be more than enough for most at the current rate.
- Tax on the annual earnings from savings within super funds should be significantly raised, perhaps doubled. (This is by far the most commonly cited issue in the Review: for a non-exhaustive list, see pp 49-53, 235, 237-248, 251-256, 366, 372, 375-376, 379-382, 388-389, 393-395, 407-409 and 593. The Review calls for this tax to be "changed" (p 53), but it is absolutely clear from its analysis that 'changed' means 'increased').
  - The 15 per cent tax rate on earnings in a super fund (and its conditional removal on earnings in the fund for retirees) is repeatedly highlighted as driving the rising cost of claimed super 'tax expenditures', to the point where they are projected to exceed actual expenditures on the Age Pension around 2047.
  - The preferred higher tax rate is left unspecified, but the Review's analysis implies it would ideally mimic the taxation of income from a savings account outside superannuation – that is, interest income taxed at the individual's marginal rate. The Review claims this is the 'normal' way to tax saving, and so it uses it to estimate claimed 'tax expenditures' (p 81).† We judge the Review's benchmark could be approximated by applying to the return on savings within a super fund the average taxpayer's top marginal tax rate, which is 32.5% (and legislated to become 30% in 2024), instead of the current 15%.[14] (See also the comments by Professors Ergas and Pincus on this point quoted below.)
- There is no need to revisit the increase from 1 January 2017 of the Age Pension asset test taper, which reversed the 2007 Costello *Simplified Superannuation* reduction in that rate. The Review believes the recreation in 2017 of very high effective marginal tax rates on saving doesn't matter much.[15]

* Bracketed page references are to the pagination of the .DOCX version of the Retirement Income Review.

† For the way Treasury generates tax expenditure numbers, see p 393, note to Chart 4A-17: "The value of superannuation tax concessions is estimated by adding contributions and earnings to taxable income in two stages and applying the progressive income tax rates at each stage."

Box 1: The superannuation guarantee and savings: the FitzGerald Report

Detailed debates about Age Pension and Superannuation policy settings have been framed by several broader analyses of demographic trends, savings and fiscal policy trends and tax system design.

Fiscal deficits exacerbated by demographic ageing and rising life expectancy loomed large in debate from the early 1990s. (To highlight a retirement income angle, the number of working age people for every person aged 65 and over had fallen from 7.3 in 1975 to about 6.1 by the start of the 1990s. The most recent *2015 Intergenerational Report* projects that by 2054-55, it would more than halve to 2.7 people.)

Treasurer Dawkins' founding statement in 1992 on the purposes of the Super Guarantee observed, "the increased self-provision for retirement will permit a higher standard of living in retirement than if we continued to rely on the age pension alone. …. Lastly, self-provision will increase the flexibility in the Commonwealth's Budget in future years, especially as our population ages, and will increase our national savings overall, thus reducing our reliance on the savings of foreigners to fund our development."

The SG's creation was more formally set into a fiscal and savings context in 1993's *National Saving: A report to the Treasurer*, the FitzGerald Report. It set out a path to stronger national savings and less exposure to dependence on foreign lending and investment based on:

- the return of the Commonwealth budget from deficit of about 4% of GDP to "persistent surplus";
- the reduction of commonwealth net debt (then about 15% of GDP) to reduce the risk of risk premia in debt service; and
- the effect of the SG in gradually making a net addition to the household sector's saving and slowly reducing Age Pension liabilities.

The FitzGerald Report bears rereading now that Australia's Commonwealth post-Covid deficit is 11% of GDP and its net debt about 44% of GDP – in both cases, more than double the levels (relative to GDP) that rang alarm bells in the Hawke-Keating era.

FitzGerald was cautious in estimating the impact of SG contributions at scheduled rising SG rates. His 1993 projections suggested the SG would:

- *have little impact on age pension outlays for the next twenty years, then reduce their cost by amounts rising to about one half of one per cent of GDP …. by the middle of next century;*
- *increase the cost to the Budget of the superannuation tax concessions over the next decade by about 0.2 per cent of GDP (relative to the pre-Superannuation Guarantee situation continuing), declining very slowly towards 0.1 per cent of GDP beyond;*
- *accordingly, reduce public saving slightly over the next 20 years, then by a diminishing amount as pension savings come in; reach a crossover 30 years from now* [2023]*; then by rising amounts add to public saving – by almost half a per cent of GDP by the middle of the next century* [2050].

As we have seen, Age Pension expenditures are topping out about now and are then projected to decline ahead of the FitzGerald projections as the rapid growth of savings in superannuation move retirees towards partly or wholly self-funded retirement at higher living standards, even without some of the originally-scheduled increases in the SG rate.

In May 2009 the *Australia's Future Tax System Review* released a separate, early report on the retirement income system. It was notable for addressing many of the design issues the 2020 *Retirement Income Review* has wrestled with, including the fate of scheduled SG increases. It recommended:

> The superannuation guarantee rate should remain at 9 per cent. The Panel has considered carefully submissions proposing an increase in the superannuation guarantee rate. Such an increase could be expected to lift the retirement incomes of most workers. However, the Panel considers the rate of compulsory saving to be adequate. The Age Pension and the 9 per cent superannuation guarantee (when mature) can be expected to provide the opportunity for people on low to average wages with an average working life of 35 years to have a substantial replacement of their income, well above that provided by the Age Pension. This strikes an appropriate balance for most individuals between their consumption opportunities during their working life and compulsory saving for retirement.

Income adequacy in retirement

- An adequate retirement income living standard for all, including self-funded retirees, would be 65-75% of average annual after-tax income in the last 10 years of working life (pp 167-168, 511).
- With current policies (including the current Superannuation Guarantee rate), most people will have enough funds in retirement to meet the Review's judgement of "retirement income adequacy' (pp170-181).
- It should not be "an aim in itself" for more people to achieve a higher retirement income than the Age Pension through lifetime saving in superannuation.[16] Instead, the Age Pension should remain (as it is now) a permanent option for all to supplement retirement income, especially if savings are exhausted over lengthening life spans through the faster, earlier expenditure of less saving that the Review favours, or rising medical or age care costs, or unforeseen economic shocks.[17]

Spending in retirement

- The higher earnings tax rate implied above should also be applied to any earnings from savings accruing in the retirement phase (typically some 30 years), reversing the Costello reform of 2007 (p 53).
- Retirees should be encouraged to spend their superannuation capital faster than already required; any shortfall in savings should be met initially by a 'longevity product' (so far, practically non-existent) to be purchased at retirement, supplemented as necessary by a reverse mortgage of the family home or recourse to the Pension Loans Scheme.[18] Uptake of unpopular reverse mortgages could be induced by treating homeowners less generously relative to renters in the Age Pension asset test (pp 44-45, 289-290).
- If an individual's life savings were nonetheless exhausted by longevity, an economic downturn or a health shock, retirees could revert to the Age Pension and publicly funded age and health care (pp 188-191, 383-388).
- Were the above changes in play, bequests would become much smaller (or disappear – see p 36 for the illustrative, most 'efficient', 'central case'), and we would no longer see people dying with more wealth than they had at the end of their working life.

The *Review* reverses a 30-year concern with inadequate national saving and the need to raise self-sufficiency for richer, longer retirements in the face of demographic ageing.

Future increases in the Superannuation Guarantee rate?

The *Review's* preference for halting the rises in the SG rate at the present 9.5% is sound, principally because the SG is uniform over a saver's working life when saving circumstances and saving capacities vary widely. Low income workers or those with punctuated careers may have to sacrifice more highly valued options (such as buying a house) than they will get back in additional retirement income (above the Age Pension) at any plausible rate of SG. That and other problems with saving compulsion become worse the higher the SG rate (see Box 2). The achievement of higher retirement income is better met through a tax regime that does not penalise additional voluntary long-term saving, than by higher compulsory saving at a constant rate.

However, one of the arguments the Review uses — that retirement income will already be 'adequate' for most at the current SG rate — is inappropriate because the notion of a Government endorsement of any particular level of self-funded retirement as 'adequate' is itself wrong in principle. Government should not define acceptable living standards for the final third its citizens' lives, and such prescription is unnecessary. As all who have reviewed the issue have concluded, a modest SG rate provides a desirable foundation for retirement saving. Beyond that, people ought be entitled to whatever self-funded retirement they want to work and save for, over the lifetime savings pattern that suits them best. The higher the SG, the less the choice to do that.[19]

Box 2: Higher SG rates likely add more to costs than to benefits

At a modest SG rate that does not cut in at too low an income level, compulsory super may arguably create more benefits than costs.

It may alert young workers to the desirability of building retirement living standards of their choosing, rather than leaving them to be determined by Age Pension conditions applying 40 years hence. It may attune them to the virtues of thrift and the power of compounding returns from steady saving over a long period. Such possible benefits from compulsion may not increase much with the SG rate: the issues are not whether more saving is desirable and if so, how much, but whether more saving can be better achieved more flexibly and voluntarily in a stable, tax-effective framework.

Against such possible benefits from compulsion, any chosen SG rate applies at a constant rate over a working life, while workers often have to wrestle with the changing priorities of financing their studies, establishing their own household, buying a house, raising a family and educating children. Compulsory saving comes at a cost to such other objectives.[20] Citizens denied the spending prioritisation of their own income by savings compulsion become a target for ever-larger government spending interventions of questionable efficacy (eg for childcare or housing assistance), raising the risks of 'voting for a living'.[21]

Guaranteed rising compulsory superannuation savings also adversely affect the performance of the superannuation industry itself: some conscripted customers may be disengaged rather than inspired, and they are prey to lazy fund management, wasteful fund advertising, excessive fees or 'fees for no service', fragmented accounts and so on. Governments can attack these problems directly, but they are battling against a powerful and affluent industry largely freed from the chore of attracting customers by service.

Over a wide political spectrum, most not connected directly or indirectly with the super industry itself who have attempted to weigh these issues have concluded that higher SG rates are undesirable.[22] They raise marginal costs more (and faster) than they raise marginal benefits.

The Review's key retirement income 'facts'

The Review advances two central propositions as if facts. They underpin most of its analysis and many implied recommendations.

First, it hypothesises 'tax expenditures' on superannuation that it believes are too high and rapidly rising, particularly because of the 15% earnings tax rate on the income compounding within the superannuation fund during the typical 40-year accumulation phase. It also excoriates the (conditional) exemption from that tax of any further earnings on life savings over the typical 30 years of retirement (see Chart 2). The specific legislated tax treatment of superannuation is said to be 'costing' over $40 bn a year and growing at some 10% a year, compared to the asserted 'normal' but hypothetical alternative tax Treasury imagines.

Every extra dollar saved into super is 15 cents to the government, and every extra dollar earned by a fund lending or investing super saving yields another 15 cents to government. Since super balances are growing faster than GDP and since returns to super investments are also usually higher than GDP growth, tax receipts from super must actually be rising as a share of GDP, a fact not drawn out by the Review.

Second, these 'tax expenditures' are claimed to be unduly weighted to the rich, who are said to get more lifetime assistance from them than the poorest get from the Age Pension (see Chart 3).

Even though voluntary savings in super are now about 40% of inflows (p 76) and would presumably cease if taxed like a savings account, the Review argues tax increases wouldn't damage saving much, because the SG would continue to compel 60% of superannuation fund flows.[‡] Rich people are said to be unable to stop saving, merely reallocating savings that would have been made anyway (p 422). However any such reallocation would likely largely be into housing, so not generating the revenue the Review imagines.

‡ About half of voluntary contributions into superannuation are non-concessional, so already taxed on contribution at the saver's top marginal rate. But they nevertheless benefit from the current tax treatment of earnings compounding within the fund, and the conditional tax exemption on drawdown. They would lose those benefits under the Review's implied policies.

Drawing on extensive work by the ANU's Tax and Transfer Policy Institute (TTPI), Andrew Podger concludes:

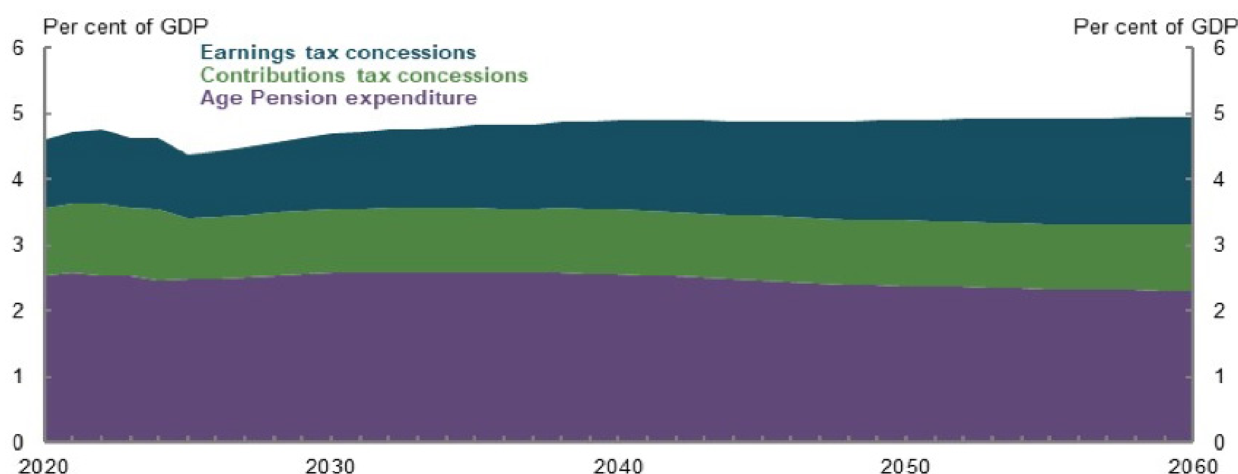
> *The Report* [ie, the Retirement Income Review] *argues that the concessions should be benchmarked against 'what is' rather than 'what should be', where 'what is' refers to the existing 'comprehensive income' tax treatment of other savings i.e. taxing both contributions and earnings at the individual's marginal rate of tax but exempting any tax on final spending ……*
>
> *For good reason, however, superannuation could never be taxed this way. The Henry Report, like previous studies, argued that the* [approach taken in the Review] *taxes savings excessively, discouraging savings. Just because super is largely compulsory is surely no justification for over-taxing it. The degree to which* [the approach taken in the Review] *is excessive increases with the length of time the savings are held, as a recent report by TTPI demonstrates, because the tax on earnings is effectively a wedge that compounds.*[23]

The Review believes remaining compulsory saving would be more than enough for retirement, provided we:

- accept retirement income should be no more than 65-75% of a saver's after-tax annual income, averaged over the last 10 years in the workforce (pp 488-541);
- buy imagined longevity protection products at the start of retirement to provide some income if we live beyond age 92 (p 36);
- consume superannuation capital faster than presently required;
- consume more of the equity in our home (pp 44-45); and
- leave smaller bequests (or ideally, none – p 36).

Chart 2: Superannuation 'tax expenditure' costs are allegedly too high and rising

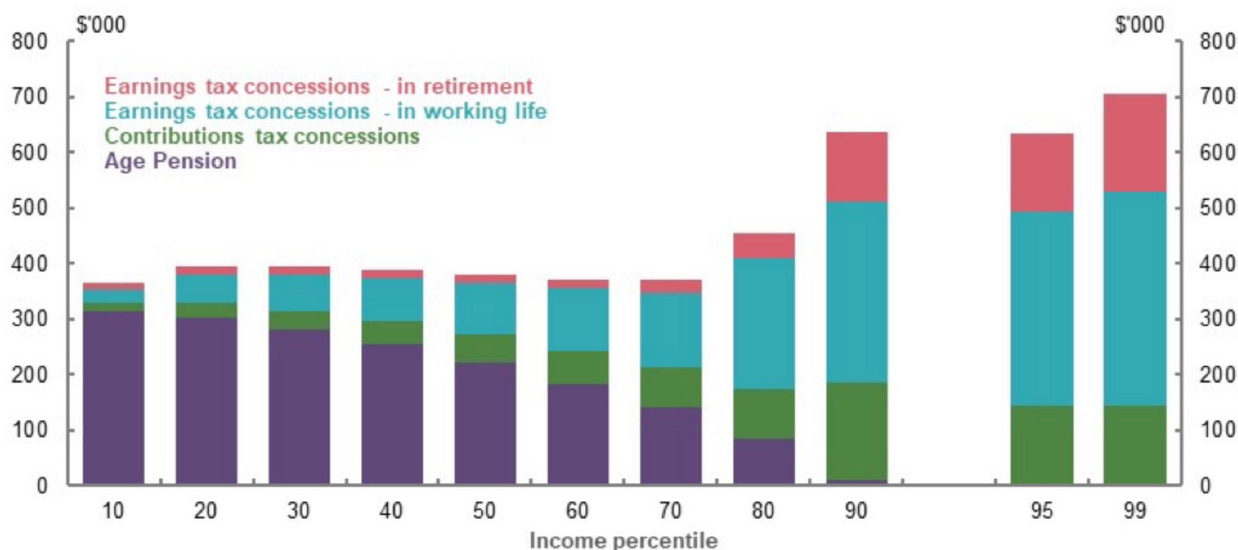
Retirement Income Review Chart 4A-12, Total projected system cost (p 387)



Note: Includes service pensioners. The tax concessions time series is presented to illustrate the general trend. The cost of tax concessions is estimated independently each year (i.e. there is no dynamic impact of the removal of concessions over time). Earnings tax concessions includes the concessional taxation of superannuation earnings and capital gains tax discount for superannuation funds (broadly C1 and C4 in the Tax Benchmarks and Variations Statement). Contributions tax concessions includes the concessional taxation of employer and personal contributions (broadly C2 and C3 in the Tax Benchmarks and Variations Statement). Projections in MARIA broadly follow the methodology of the Tax Benchmarks and Variations Statement but have been calculated on an additive basis. The value of superannuation tax concessions is estimated by adding contributions and earnings to taxable income in two stages and applying the progressive income tax rates at each stage. The value of the earnings tax concession is the difference between the total value of concessions and value of contributions tax concessions. Personal income tax thresholds are also indexed for movements in wages beyond the mediumterm period. Source: Treasury estimates for the review using MARIA. [Emphasis added]

Chart 3: Age Pension reduces inequality, superannuation concessions allegedly increase it

Retirement Income Review Chart 7: Projected lifetime support from the retirement income system, p 42.



Note: Values are in 2019–20 dollars, deflated using the review's GDP deflator and uses review assumptions (see Appendix 6A. Detailed modelling methods and assumptions). Income percentiles are based on the incomes of individuals (whether they are single or in a couple).
Source: Cameo modelling undertaken for the review. [Emphasis added]

Imaginary tax benchmarks are not facts

The Review's central concern of high and rising 'tax expenditures' rest entirely on its choice of an unjustified hypothetical 'comprehensive income tax' benchmark to generate its 'tax expenditure' numbers. In theory, the comprehensive income tax is the Schanz-Haig-Symons tax — in effect a tax on the annual accrual of wealth plus expenditure, minus the costs of earning income.[24] This benchmark has never been explicitly adopted by any government and is biased against all saving, but particularly against long-term saving. Since it is also impractical, it is replaced in practice by the tax treatment preferred by the analyst and claimed to be 'normal'.

The Review claims the way of taxing savings accounts, with deposits from income taxed at full marginal rates and nominal interest also taxed at the taxpayer's top marginal rate is the 'normal' way to tax savings in Australia. (Withdrawals from savings accounts are unconditional and tax-free.) But the 2009 Henry Report estimated that this taxation treatment produced effective marginal tax rates of up to 80%.[25] This is because nominal interest returns, in part merely covering inflation, are taxed as if they were an increase in 'capacity to pay').

Because superannuation savings compound over a uniquely long period – some 40 years of accumulation and 30 years of drawdown – this problem makes a huge difference between the nominal tax rate of 15% that the Review focusses on exclusively and the effective tax rate. Henry Ergas and Jonathan Pincus illustrate the problem with an example using just 20 years compounding:

> *Consider a person who earns $50,000 a year and is planning to retire in 20 years. As things stand, she will be required to put $4750 into superannuation this year, paying a 15 per cent contributions tax on that amount. If her fund earns 3.5 per cent a year — also taxed at 15 per cent — those savings will grow to $7300, spendable in 2041.*
>
> *However, in the absence of taxes on contributions and on earnings, steady compounding would have increased today's $4750 to about $9500. As a result, the actual tax rate, which reduces $9500 to $7300, is not the notional or statutory 15 per cent but, at 30 per cent, twice that.*
>
> *Moreover, every dollar of superannuation reduces our saver's entitlement to the Age Pension and to aged-care subsidies. And just as marginal effective tax rates on an additional dollar of income from working are properly calculated taking reductions in transfer payments into account, so must the reductions*

in eligibility be included in the effective tax rate on superannuation.

> *Factoring the means testing of those payments into the calculation pushes the effective tax rate on compulsory superannuation towards 40 per cent or more, which no one could sensibly describe as unduly low.*[26]

The related claim that tax expenditures are inequitable is built on the first error, so it is highly exaggerated and contestable. Andrew Podger observes:

> *… the Report's figures highlight the 'concession' on how earnings are taxed in particular, revealing that those on the highest incomes and who are the oldest (and hence have held their superannuation savings the longest) are gaining the most 'concessions'. In terms of any reasonable counterfactual, that is misleading.*[27]

For these reasons among others, most of the Review's implied policy preferences are unsound.

The Review generates an overall fiscal cost for retirement income by adding hypothetical 'tax expenditure' dollars measured off a biased benchmark that could never be obtained from superannuation to actual dollars spent on the age pension. It does not so much add 'apples and oranges', as add 'unicorns and oranges'. The Review mistakes a biased approximation of an abstract concept of hypothetical revenue forgone (unicorns) as comparable to, and additive with, the actual fiscal cost of the Age Pension (oranges). Logicians call this a reification fallacy — a 'fallacy of misplaced concreteness'.[28]

While the Review asserts that the taxation of savings accounts is the 'normal' way of taxing savings in Australia, superannuation marshals three times as much saving as currency and deposits (such as in savings accounts).[29] Super has had specific lower taxation treatment than savings accounts for the entire 105 year history of the Commonwealth income tax,[30] to account as fairly and efficiently as possible (by the Parliamentary judgements of the day) for its restriction on access until retirement and its long-compounded returns

So one could as well (or better) argue that the taxation of savings accounts is the exception and that the lower taxation of superannuation and owner-occupied housing is the normal benchmark, at least for long-term saving.

The other major form of long-term household saving is owner-occupied housing, which also has specific tax treatment lower than the 'comprehensive income tax' benchmark. Indeed, Treasury's tax expenditure estimates on the principal residence are the only ones higher than estimated tax expenditures on superannuation — almost $50 billion in 2020-21, compared with almost $40 billion on superannuation.[31]

The alternative expenditure tax benchmark for tax expenditures

Estimating any 'tax expenditure' on superannuation is more sensibly scaled by a benchmark that does not discriminate against saving, as was argued in the 1993 FitzGerald and 2009 Henry reports. Treasury has in fact estimated 'tax expenditures' on superannuation by this alternative 'expenditure tax' benchmark for 8 years to 2021 (Table 1). Instead of some $40 billion a year and rising , 'tax expenditures' by this alternative measure are about $7.5 billion a year and steady. Under an expenditure tax benchmark, contributions are taxed at marginal tax rates, while earnings and benefits are exempt from tax. The point of difference between the comprehensive income tax benchmark and the expenditure tax benchmark is the taxation of superannuation earnings.

The Review does not mention the existence of a parallel stream of Treasury tax expenditure estimates for superannuation; nor does it offer any insights from comparing the two benchmarks or associated estimates, nor mention Treasury's acknowledgement that there are reasonable arguments for both.[32]

These alternative expenditure tax based estimates are about one-fifth or less of those estimated from the savings account benchmark. By the expenditure tax benchmark, real expenditure on the Age Pension is, and will remain, much higher than the imaginary 'tax expenditure' on superannuation. If a benighted commentator could not resist the urge to add (improperly) 'tax expenditures' by that benchmark to actual expenditures on the Age Pension, the total would continue to decline as a share of GDP, notwithstanding an ageing population and rising real living standards in retirement. That looks like a triumph of policy, not a problem.

Table 1: Is the 'tax expenditure' on superannuation high and rising, or modest and flat?

			Estimate 1: Tax expenditures on superannuation				Estimate2: Tax expenditures on superannuation				Expenditure tax estimate as % of Comprehensive income tax estimate
			Comprehensive income tax benchmark				Expenditure tax benchmark				
Source			Revenue forgone, $ Million				Revenue forgone, $ million				
		Age Pension	**Superannuation Contributions tax**	**Superannuation Earnings tax**	**Total**		**Superannuation Contributions tax**	**Superannuation Earnings tax**	**Total**		**%**
Tax Expenditure Statement 2013	2013-14	39390	16000	16100	32100		16000	-5800	10200		32%
	2014-15	41370	17800	18450	36250	13%	17800	-6570	11230	10%	31%
	2015-16	43230	19150	21700	40850	13%	19150	-7450	11700	4%	29%
	2016-17	44220	20700	24100	44800	10%	20700	-8300	12400	6%	28%
Change in tax ependiture over estimate period					40%				22%		
Avearage annual change					9%				5%		
Tax Expenditure Statement 2017	2017-18	44802	16900	19250	36150		16900	-9450	7450		21%
	2018-19	46444	17750	23250	41000	13%	17750	-10800	6950	-7%	17%
	2019-20	50078	19400	26050	45450	11%	19400	-12200	7200	4%	16%
	2020-21	53000	20900	28950	49850	10%	20900	-13450	7450	3%	15%
Change in tax ependiture over each 4-year estimate period					38%				0%		
Avearage annual change					8%				0%		

Note: Tax expenditure assumptions differ between the 2013 and 2017 Tax Expenditure Statements, so the estimates should be read as for two separate four-year periods, not one continuous eight-year period.

Sources: Age pension outlays: Department of Social Services, Annual Reports, various issues. 2020-21 expenditure is an estimate. Superannuation tax expenditures: *Tax Expenditure Satement 2013* for 2013-14 to 2016-17 estimates; *Tax Expenditure Statement 2017* for 2017-18 to 2020-21 estimates

The reputable alternative estimate of 'tax expenditures' on superannuation is so much lower than the Review's choice, that the 'inequity' the Review claims in assistance over the income distribution disappears.[§] The poorest 10% still receive lifetime support over $300,000 in (mostly) actual Age Pension expenditures and small superannuation 'tax expenditures'. But the richest 10% (and even the richest 1%) get no Age Pension (rightly so, of course) and less than $150,000 in lifetime 'tax expenditures'.

The Review's choice of a benchmark biased against saving in preference to a savings-neutral one reveals a more general point: 'tax expenditure' analysis operates in practice as a high-tax charter. It is used to argue that lower tax treatments (e.g. on superannuation) should be raised, never that higher tax treatments (e.g. on savings accounts) should be lowered.

As Andrew Podger notes,

> *… it plays into the hands of those interest groups who believe there is a magic pudding of tax revenues available for redirection from the wealthy to their particular priorities.*[33]

Professors Ergas and Pincus observe that the approach favoured in the Review (taxing super as if a savings account) would produce an effective tax rate 93% in the case they illustrate. They conclude of the Review's approach:

> *Given how distorting, unreasonable and politically unsustainable such a tax rate would be, its use as the standard for evaluating the current arrangements is indefensible.*

Andrew Podger has arrived at a similar assessment of the Report's drive to raise the tax on accumulation within super funds and apply that new higher rate to the drawdown phase:

> *….. the Report's view that 15% represents a 'concession' (and really should be increased) is inappropriate. If anything, I suspect the tax on earnings should be lower – perhaps a revenue neutral move to around 10% should be phased in for both the accumulation and pension phases.*[34]

§ As a first approximation in terms of chart 3, the aqua and salmon coloured blocks disappear from the diagram, leaving only the green contributions tax blocks. More precisely, the aqua and salmon coloured blocks become smaller and negative, subtracting from the contribution tax 'tax expenditure', as can be seen in the Table 1 contrasts between the income and expenditure tax benchmarks for 'tax expenditure' estimates.

Hoarding in retirement?

The Review is concerned about some people dying with more wealth than they retired with, and presents that as a problem of retirement income policy (pp 23,56).

But 40% of the average household's wealth is equity in the family home and only about 20% is in superannuation.[35] With such a split, retirees' wealth might well increase in periods of fiscal and monetary stimulus and asset price inflation. Capital city residential property prices have increased by 45% in the last 8 years alone (p369). Over 30 years of retirement, appreciation of equity in the family home could easily outpace even an aggressive drawdown of superannuation income and capital.

The Review also worries that superannuation balances, taken alone, do not decline much with age (pp 436, 437). But that is a misleading citation of data only for superannuation balances that are still positive for each age cohort. Jim Bonham has shown that, when a paper the Review relies on is correctly examined over all superannuation balances that existed for each cohort, roughly 80% of males and a higher proportion of females have exhausted their accounts by age 80.[36] (Eighty is significantly short of recent life expectancy at retirement age.)[¶][37]

Income adequacy in self-funded retirement

Convincing itself by its selection of a biased benchmark that produces a very high estimate of 'tax expenditures' on superannuation, the Review seeks a guide to help lower those imagined 'expenditures'. To that end, the Review judges that a self-funded retirement income of 65-75% of the average after-tax income over the last 10 years of working life would be "adequate". Such benchmarks have been widely discussed in the retirement industry itself (p 35). But for the industry, such guidelines are rules of thumb offered to individuals trying to scale their voluntary retirement saving to their aspirations. The Review's approach would likely use them to steer taxation to make it more difficult to exceed the defined adequate income range.

People today spend some 30 years of their life in retirement. Government specification of an 'adequate retirement income' for the self-funded retiree makes no more sense than directly specifying an 'adequate working income' over the preceding 40 years they are working. Government has never so far attempted either, because people have different capacities, productivity and aspirations, and different attitudes to calculable risks (like having to be treated in retirement for cancer or nursed with dementia) and incalculable uncertainties (like Covid). Individuals express those differences, in part, by working and saving differently. Society is more robust for a diversity of judgements about such matters.

In contrast to the Review, classical economists viewed saving as the engine of rising community living standards, both within and between generations.[38] The voluntary deferral of consumption of real resources by savers has two effects: funding lending to, or investment in, those with greater need or more profitable opportunity, and indirectly providing the real resources for that expanded activity. Saving has those benefits even if done by a retiree.

Do voters want government setting income adequacy norms for retirement and then setting policies to produce them? It is clear from the Review's 'tax expenditure' analysis and its argument for capping the SG that the proposed guidelines would be used to redesign tax, welfare and compulsory saving systems to 'nudge' savings and living standards down to the endorsed range. That would be the consequence of raising tax to reduce compounding of savings net of tax within super funds (a very effective way of reducing super balances at retirement) and applying that higher tax to income from that balance once retired.

¶ Many now in the age 80 cohort would of course not have enjoyed SG contributions for much if any of their working lives.

Policies have to be robust against shocks

As 2020 reminded us, life is uncertain.[¶¶] Households should be prudent, and governments should pursue policies that are robust against shocks. In the time it took to prepare and release the Review (10 months and 4 months respectively), a pandemic and responses to it devastated our tourism, hospitality and educational export sectors, among others.[39] Australia's trade environment has deteriorated markedly.[40] Our energy exports and domestic energy costs face new threats from 'net zero' pledges.[41] Our strategic environment is more dangerous.[42] Our fiscal and public debt situation has taken extraordinary setbacks at all levels of government, so public dissaving (ie budget deficits at all levels of government) is now the worst it has been since WW II.[43] Population growth is projected to be lower than pre-Covid, crimping the growth in tax bases that would have helped wind back fiscal deficits.[44]

In this context, is it sensible to be discouraging long-term saving, encouraging profligacy in retirement spending and consumption of equity in the family home, on the assurance we can all fall back on the welfare system if necessary? We should beware of designing more fragile systems.

Those saving for, or living in, retirement deserve respect. They have 60-plus years of diverse and extensive life experience, have weathered earlier shocks, have 'skin in the game', and are prudent. They are not the ill-advised rubes the Review makes them out to be. They deserve better than policy 'nudges' from Canberra to make them more profligate. Review advice such as "If superannuation was consumed more efficiently in retirement, most people would have higher replacement rates" (p 437) simply misses the point of saving.

Moreover the Review uses the idea of 'efficiency' in retirement spending in a sense quite foreign to economics, where allocative efficiency relates to the ability to make at least one person better off and none worse off. For the Review, 'efficiency' means having less savings and spending faster so you have maximum living standards before dying broke. Such a view cannot properly cope with risk (since markets for longevity products are very limited) and still less with uncertainty.

Retirement saving changes very slowly after policy changes: the effects of the SG introduced almost 30 years ago have yet to have full effect on current savings and retirement patterns. Here's a thought experiment: imagine the Review reported 15 years ago, and its implied policy directions had been put into effect in 2005, displacing former federal treasurer Peter Costello's key 2007 *Simplified Superannuation* reforms which the Review clearly opposes and wants to reverse. By 2021, after 15 years application – a mere blink in retirement income terms – would the retirement income system, retirees' living standards, national saving, the Commonwealth budget and national debt have weathered the Covid shock better, or worse?

Conclusion

The Review's implied policy preferences amount to a public encouragement of private profligacy. Their logical endpoint is that ideally, each generation should consume its lifetime capital, leaving each new generation at a 'year zero' from which to build and in turn then consume their own capital. [45]

Seldom has any report's policy inclinations been so quickly challenged by events.

Earlier, we cited Menzies' old-fashioned views on the virtues of thrift, and will also give him a few concluding words apposite to the Retirement Income Review. He warned in 1942: "..If the motto is to be 'Eat, drink and be merry, for tomorrow you will 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."[46]

¶¶ Uncertain in the sense of lacking any knowledge of probabilities to assign to possible events.

Endnotes

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One of the simplification package's key strategic pro-saving measures, the reduction in the taper rate on the Age Pension means test, was reversed in the 2015-16 Budget.

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> *...... the proper mode of assessing an income tax would be to tax only the part of income devoted to expenditure, exempting that which is saved. For when saved and invested (and all savings, speaking generally, are invested) it thenceforth pays income tax on the interest or profit which it brings, notwithstanding that it has already been taxed on the principal. Unless, therefore, savings are exempted from income tax, the contributors are twice taxed on what they save, and only once on what they spend. p 490*

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"*Recommendation 30 Independent Inquiry Into The Retirement Incomes System*

The Australian Government should commission an independent public inquiry into the role of compulsory superannuation in the broader retirement incomes system, including the net impact of compulsory super on private and public savings, distributional impacts across the

population and over time, interactions between superannuation and other sources of retirement income, the impact of superannuation on public finances, and the economic and distributional impacts of the non-indexed $450 a month contributions threshold. This inquiry should be completed in advance of any increase in the Superannuation Guarantee rate. "

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16 *Ibid.* p 95, where a straw man is demolished by misrepresentation: "Some stakeholders proposed that the retirement income system should explicitly aim to reduce the share of retirees drawing on the Age Pension. This should not be an aim in itself. The system should prioritise individual outcomes above Government outcomes. If the system specifically aimed to reduce the share of retirees drawing on the Age Pension, optimal retirement outcomes would not necessarily be achieved. For example, such an objective could imply the Age Pension means tests be set so that as few people as possible would qualify."

17 *Ibid*, p 18, "The Age Pension is more than a safety net. It plays an important role in supplementing the superannuation savings of retirees and allowing them to maintain their living standards. It also provides a buffer for retirees whose retirement income and savings fall due to market volatility, and for those who outlive their savings."

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Terrence O'Brien, *Grandfathering super tax increases*, CIS Policy, Vol 32 No 3, pp 3-12 (Spring 2016)

Robert Carling and Terrence O'Brien, *Voting for a Living: A shift in Australian politics from selling policies to buying votes?* CIS Policy Paper 9 (September 2018)

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