



ACCI POLICY STATEMENT

RETIREMENT INCOMES POLICY

PRINCIPLES OF RETIREMENT INCOMES POLICY

Developing a new approach to retirement incomes and savings is one of the most important policy issues facing Australia, in common with most other developed countries. The majority of Australians who have reached retirement age rely upon public funds for survival. A reduction in the importance of the Age Pension and a greater focus on self funding of retirement incomes will assist in achieving a decline in the level of public expenditure in the future as well as an increase in the level of national savings.

Over the next forty years the proportion of the population that is eligible to receive the Age Pension will double as a result of the ageing of the population. Unless methods to promote lower reliance on the Age Pension are developed, the taxation system will be faced with an increased burden that is likely to prove unsustainable over the longer term.

The considerations involved in determining an appropriate retirement incomes policy are extremely complex and interwoven. It is essential that retirement incomes policies are thoughtfully developed, comprehensive and designed to achieve strategic, long-term objectives. Many policy changes made to date have unfortunately been piecemeal and ad hoc. This approach to Australia's retirement incomes and savings system has been unsatisfactory.

POLICY OBJECTIVES

The last twenty years have seen employers increasingly forced to shoulder the burden of the retirement incomes problem facing the Australian population. Employers are now compelled to provide a Superannuation Guarantee of 9 per cent of the notional earnings base of employees, while also contributing around 40 per cent of general tax revenue that in turn is used to fund the Age Pension. The proper focus of the next stage of retirement incomes policy should be on increasing the self-reliance of employees and enhancing their capacity to adequately plan for retirement. Any increase in the Superannuation Guarantee should be made through the introduction of employee contributions rather than further demands made on already over-burdened employers.

Successive governments have already recognised that significant change is needed if the retirement incomes system is to be able to meet future needs, be fair, sustainable and compatible with our social goals. It is unfortunate that this recognition has not been translated into determined and significant policy reform. The changing economic, social and demographic environment provides an imperative for reform of current policies. In summary the key features of that environment are as follows:

- major population and labour force change. The ageing of the population means that the proportion of retirees will continue to increase substantially and the demand for pensions, health care and aged care will also increase. In 1976 Australia had 1.3 million people over the age of 65 years - 9 per cent of the population. By 2022 it will be 19 per cent or 4.3 million people. In addition, labour force participants are spending less time in the workforce and are less likely to be full-time employees - resulting in more pressures on the existing system. The tax base will come under greater pressure as Australia's age dependency ratio (the ratio of those of working age to those not of working age) declines;
- consequently, the sustainability of the current system of superannuation, tax funded pensions and subsidised aged care is in question. This is particularly significant, given that 82 per cent of Australians over 65 currently rely, to some

degree at least, on the pension or an equivalent government payment;

- the level of household savings in Australia has been dropping steadily for 20 years and shows no sign of recovery. In comparison to many overseas nations, our level of household savings is low. This is reducing the level of domestic capital available for investment, forcing increased borrowing from overseas and having an adverse impact on our international competitiveness;
- present taxation of superannuation contributions and earnings should be abolished and gradually replaced with equivalent levels of taxation at the point of benefit only. Because superannuation funds experience real compound growth over the life of their investment, the transfer of taxation to the benefit stage will mean a higher level of retirement savings and a larger tax base. Taxation at one point will also help to simplify a retiree's tax planning;
- shifting taxation away from the contribution and earnings stage to the point of benefit will defer large amounts of Commonwealth taxation revenue from current to future budgets. The effect would be to offset some of the fiscal pressure projected to arise in the next forty years using current tax revenues;
- the Superannuation Guarantee legislation, which requires Australian employers to accept partial responsibility for retirement incomes, has had an adverse effect on voluntary schemes. Employers should be encouraged to contribute their fair share towards Australia's superannuation needs and it should also be remembered that, at present and historically, employers have voluntarily contributed to superannuation on behalf of their employees. However this must be balanced by appropriate contributions from both government and employees themselves. A system which places onerous obligations on employers will produce negative economic effects in areas such as employment and international competitiveness;
- ad hoc changes continue to be made to the superannuation system by governments of varying political persuasions. The complexity of the system is discouraging increased voluntary contributions to superannuation - as such it has a detrimental effect on efforts to increase the level of household savings; and
- many other countries are experiencing an ageing of the population and similar problems. Retirement incomes and savings reforms are being considered or have been taking place throughout OECD countries, including changes designed to counter the increasing trend toward early retirement. Australia must accept that, unless it engages in a process of reform, it runs the risk of being saddled with an out-of-date retirement incomes and savings system in the next century. This will hamper Australia's future social and economic wellbeing.

The major policy objective must be to bring about fundamental change in Australia's system of retirement incomes and savings. Change must be directed towards the goal of providing all Australians with the fairest and most sustainable system of retirement incomes and savings, consistent with the constraints of prudent economic management.

The guiding principles that will lead to the achievement of these objectives are:

- consistent and comprehensive policies - long-term objectives and strategies should be developed and adhered to;
- any policy must have two fundamental aims. The first is to limit the level of public expenditure on retirement incomes in recognition that the ageing of the population places significant strains on the social security purse. The second is to raise the level of national savings;
- employers must not be forced to accept an inordinate amount of the cost of retirement incomes. To do so would cost jobs and reduce investment, which would put pressure on resources in other parts of the social security budget and on the economy. Placing onerous obligations on employers must therefore be rejected as being counter-productive to the fundamental aims of the policy;
- all initiatives for change must be directed towards developing policies which are sustainable in the long term. Consistent

with this approach, individuals must be encouraged to save for their own retirement with confidence in the stability of the system. Haphazard change represents a disincentive for individuals who may wish to contribute more for their own retirement needs; and

- taxation of retirement income savings should be simple to understand and consistent. The system must encourage and reward saving. Retirement savings must not be treated as a current revenue device for government via excessive taxation burdens. This does not assist in creating a greater pool of savings for Australia's long-term needs - it simply shifts the burden of savings back towards the public sector.

THE POLICY FRAMEWORK

Australia's system of retirement savings is based on a multi-pillared approach that includes government-funded pensions, compulsory superannuation and voluntary savings. This three pillar approach is an appropriate way of achieving retirement incomes and savings policy objectives. It should be retained, whilst reforming aspects that discourage saving and/or are inconsistent with fundamental policy objectives. A policy framework, driven by the guiding principles explained above, is set out below:

Government-Funded Pensions

Access to tax-funded pensions should ensure that funds drawn from tax revenue are directed towards those most in need. In other words, legislators should ensure that taxation revenue being directed into retirement incomes is spent as effectively as possible and encourages people to prepare and save for their own retirement.

The question is not whether public moneys should be spent, but rather how to spend them most effectively. Means testing is a necessary part of such a system and should be conducted in such a way as to ensure that individuals are not discouraged from saving for self-funded retirement. Public moneys should aim to fulfil social obligations to those in need, who do not have the resources to provide for themselves in retirement.

A system of means testing should not result in those who did not save for their own retirement getting the same amount as those who did. Saving for retirement must be rewarded. However, at a certain level of wealth it is appropriate for access to public funds to be restricted, consistent with the intention of directing public moneys towards those most in need.

The demographic scenario described above means that it is essential that individuals are encouraged to fund their own retirement to the greatest extent possible. The more individuals are encouraged to save for their own retirement, the better off they and the economy will be.

Further means of encouraging ongoing employment or gradual retirement past the retirement age should be introduced.

The tax system should not discourage individuals from working after the pensionable age is reached. ACCI supported the introduction in 1996 and extension in 2000 of a special tax schedule for persons over the pensionable to provide an incentive for individuals to remain in the workforce.

The 'Pension Bonus Scheme' that has operated since July 1998 is an example of a way to reward individuals who choose to partly fund their retirement through continuing to work. For each year that an eligible age pension recipient defers taking up the Age Pension they are rewarded with a lump sum payment made when they eventually do take up the Age Pension. However, the Bonus Scheme must be more highly publicised and made more attractive if it is to provide sufficient incentive for individuals to stay in the workforce.

Regulations should discourage taxpayer-funded early retirement.

Consistent with the principles outlined in the preceding point, disincentives for workers to remain in the labour force after a certain age must be eliminated. This will only occur if tax-funded early retirement is made less attractive and less feasible. Early retirement and double-dipping at taxpayers' expense can be limited by further raising the preservation age for superannuation entitlements to match the Age Pension eligibility age of 65 years.

In addition to this, the simplest means of discouraging tax-funded early retirement is to establish a system that discounts eligible government benefits for the years before the official eligibility age to an extent that early retirement based on social security payments is unattractive. If such a system were implemented together with the changes in preservation rules and an increase in the retirement age rules, early retirement should become less attractive.

Compulsory Superannuation

Given compulsory employer contributions are to continue, they must be supplemented by compulsory employee contributions.

Governments have periodically recognised the necessity of introducing compulsory employee contributions. Lamentably, short-term political considerations have been allowed to thwart significant economic and social policy objectives. Compulsory employee contributions are clearly necessary to extend and provide balance in the sources of superannuation contributions.

While the current level of the Superannuation Guarantee will have a sizeable impact on retirement incomes it is generally accepted that additional contributions will be necessary in order for individuals to achieve the standard of living they currently anticipate in retirement. As employees are the major beneficiaries of higher retirement incomes it is entirely appropriate that they should bear at least some of the costs associated with providing that additional support.

There should be minimal exemptions from coverage of compulsory superannuation.

A significant lift in the coverage of compulsory and voluntary superannuation contributions could be achieved by ensuring that the self-employed and those who work casually or part-time are brought within the compulsory pillar when they earn above a certain income band and that individuals who do not work but who have the capacity to invest (e.g. spouses not in work) are encouraged to invest in superannuation. In principle, no group of people, no matter what their source of income, should be exempted from the superannuation system. The self-employed and those relying on business and investment income should be included in the compulsory pillar where possible.

Choice of Funds

Choice is an important element of a sound retirement incomes system. ACCI supports the principle of fund choice in superannuation subject to the establishment of satisfactory mechanisms to ease the administrative burden on employers and provided the legislation to implement choice has appropriate safeguards to protect employers from litigation arising out of the transition to a choice regime.

Any choice legislation must be simple to understand and implement and be transparent, efficient and cost effective in any obligations it imposes. It must also be underpinned by a fund compliance regime which requires funds to disclose commissions, bonuses and fees paid and received for fund or membership promotion or investment decisions.

Any choice of funds policy should possess the following characteristics:

- it must minimise the compliance burden for business in implementing choice arrangements;
- it must give employers an opportunity to choose the most appropriate arrangements, including:
 - offering choice from a limited number of funds selected by the employer with arrangements properly drafted to

- protect employers against liability and to minimise the employer role and responsibilities; or
- offering unlimited employee choice, with no employer role except to pay to a fund as specified by the employee; or
- determining choice of fund arrangements through a statutory or common law workplace agreement.
- the special problems raised by Defined Benefit Schemes require that they be exempted from the choice legislation;
- there should be a statutory protection against employer liability;
- notional earnings bases must be retained in awards and superannuation removed;
- employers and employees must be adequately informed and educated on the new rules; and
- an appropriate phasing in or transition for any choice proposal including an educative rather than punitive approach to employer compliance.

In principle, the system should encourage income streams as opposed to lump sum payments.

Income streams must be encouraged in order to assist national savings and avoid the undesirable social consequences that can be caused by unwise financial choices being made on receipt of a lump sum for retirement. It is much easier to design a comprehensive tax and social security system when individuals mainly have access to an income stream form of payment.

The management and administration of superannuation and retirement savings funds must be transparent, efficient and cost effective. Competition will assist in the achievement of these objectives.

For the greatest benefits to be obtained from a retirement incomes policy it is necessary that retirement incomes funds be operated in the most cost effective way possible. In particular the administration and management of these funds must be efficient, must avoid excessive charges on contributors' funds and must enable the tracking of lost members, using technology to reduce imposts on employers. It is important that the governance and administration of funds be conducted in a manner that allows for transparency and member scrutiny. Review and evaluation arrangements must be improved. By the same token, excessive regulation of funds should be avoided. The introduction of competition is the most efficient way of achieving these objectives and maximising the efficiency and accountability of schemes.

The management and administration of funds will also be improved by requiring more frequent period payments of superannuation contributions by employers. Legislation has previously required that compulsory employer contributions only be paid once a year, which has led to a range of difficulties for employers and employees. Making payments more frequent, e.g. by requiring a periodic payment to be made every quarter, may provide greater security for employees whilst removing some of the administrative difficulties faced by employers. Recent Government decisions require most employers to pay money into super funds quarterly.

The proper role of employers in the administration of superannuation must also be minimal. Red tape and administrative burdens should be the responsibility of the parties that are best able to deal with them. With their high degree of specialisation it is the superannuation funds that possess the capacity to administer superannuation schemes at least-cost and it is appropriate that is where the duty should rest.

The taxation of retirement savings must be aimed at encouraging private contributions - not maximising current taxation revenue.

If Australia is to achieve the retirement incomes and savings policy objectives outlined above, a strategic, long-term

approach must be taken to the taxation of retirement income. Taxation measures applied as part of a retirement incomes policy must adopt the following aims:

- maximising retirement savings;
- encouraging private contributions for all members of the community;
- setting taxation at levels which do not inhibit a fund's capacity to grow; and
- minimising the compliance costs for business.

Further details on ACCI's retirement incomes taxation policies can be found in the Taxation Policy.

Voluntary Savings

National saving has two components - public saving as measured by the government's budget deficit and private saving by households. Australia's national savings performance has been poor, stemming from insufficient savings behaviour among households. A savings culture must be fostered amongst the population in order to reduce reliance upon foreign capital and provide greater levels of private funding of retirement.

It is important to recognise that the superannuation guarantee alone will not produce a fair and sustainable retirement incomes system. For those individuals who do not contribute voluntarily, the superannuation guarantee as presently structured will produce an entirely inadequate savings base for retirement. At minimum, therefore, a focus on measures to promote the self-funding of retirees beyond the compulsory arrangements currently in place will be essential in ensuring that the retirement incomes system in Australia is viable in the long term.

Private saving activity by Australian households has been steadily deteriorating throughout the introduction of compulsory retirement income savings. Superannuation contributions it seems have come at the expense of private savings for retirement. The clear message must be sent to households that even with the introduction of the Superannuation Guarantee they still need to save for their retirement. In order to motivate higher levels of saving it is necessary to clarify the level of benefits available to workers when they retire. If people were better educated about superannuation and their level of entitlements during old age, they would be able to determine an appropriate savings profile in their approach to retirement. A greater comprehension of the superannuation system is essential to motivate greater private savings.

Further, general reductions in the level of personal income tax and the re-introduction of the 15 per cent tax rebate on interest earnings would assist in boosting voluntary savings.

CONCLUSION

ACCI supports the three pillars foundation of Australia's retirement income system. However, reform of a number of its elements is necessary in order to improve the individual elements and its overall function. From a taxation perspective the key policy change that is needed is the gradual removal of taxation from superannuation contributions and earnings and replacement with taxation only at the point of withdrawal.

It is especially important to recognise that the Superannuation Guarantee alone will not produce a fair and sustainable retirement incomes system. For those individuals who do not contribute voluntarily, the Superannuation Guarantee as presently structured will produce an entirely inadequate savings base for retirement. At a minimum, therefore, a focus on measures to promote the self-funding of retirees beyond the compulsory arrangements currently in place will be essential in ensuring that the retirement incomes system in Australia is viable in the long term.

Australia's retirement incomes system should be comprehensive in nature, focusing on:

- reducing the importance of the Age Pension;
- encouraging voluntary superannuation and contributions;
- promoting private investments;
- increasing home ownership;
- supporting mature age employment; and
- funding a world standard health care system.

Only when each of these factors has been incorporated in the development of a retirement incomes policy will Australia be well positioned to manage the rapidly increasing number of people who will reach retirement age in the future.

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