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Chris Bowen reheats discredited, soak-the-rich super policy

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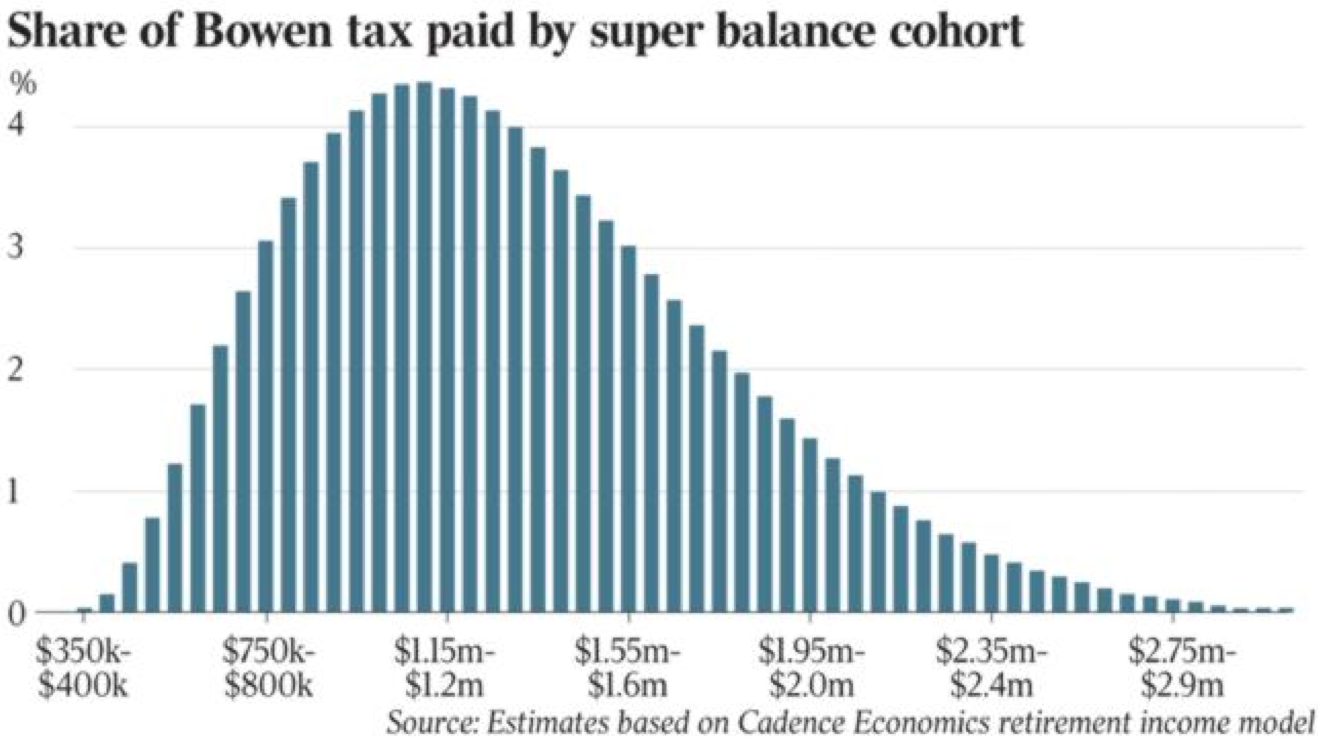

You can't step into the same river twice. But the bathwater is a different matter. It just gets colder and nastier each time.

If Chris Bowen knows that, it hasn't stopped him diving in. Voters presumably thought they had killed off Wayne Swan's proposal to tax retirees' superannuation income whenever it exceeded $100,000.

Well, the baby may have gone but the bathwater is back, and with an even lower threshold of $75,000. Nor is it alone in returning from the crypt. For the misleading statements are back too. In this case, it's the claim the tax, which Bowen expects to raise $9 billion in a decade, will only hit the 60,000 or so retirees with super balances greater than $1.5 million.

In reality, 70 per cent of the tax's take is likely to come from older Australians whose super balances are below $1.5m. Indeed, accounts with balances of less than $1m would pay nearly a third of the tax, while accounts holding $2m or more would not even contribute 10 per cent of the total.

The difference between these estimates and Bowen's is readily explained. Super accounts, like most other investments, earn incomes that vary greatly: one group of investors with small balances could have a standout year, lifting their income above the threshold, while others with much higher balances suffer large losses.

As a result, figuring out whose ox the tax will gore requires taking that variability into account.

Whether the Parliamentary Budget Office did so in assessing the proposed tax isn't known, as Bowen has refused to release its report.

What is certain, however, is that Bowen, when he says the tax merely affects savers with very large balances, is ignoring that variability entirely. Rather, Bowen assumes that balances secure a fixed 5 per cent return each and every year, so that only accounts with $1.5m or more exceed the threshold. But that assumption is absurd.

Luckily, a model developed by Bob Scealy from Cadence Economics can be used to correct Bowen's mistake. Starting from the initial distribution of super balances, Scealy's model simulates their evolution over time, with the spread in the returns they earn reflecting historical patterns of variability.

That allows an estimate to be derived, for each opening balance, of the probability that its income in any year will exceed the $75,000 threshold, as well as of the amount that can be drawn from the account over the saver's remaining lifetime.

The results suggest that far from generating the bulk of Bowen's $9bn, very large accounts will contribute barely a third. Moreover, as inflation both erodes the threshold in real terms and increases the nominal value of accounts, the likelihood of earnings on even quite small balances exceeding the $75,000 threshold will rise sharply, shifting a rising tax burden on to retirees whose savings are far below the actuarial value of an entitlement to the full age pension (which Mercer estimates at $1m).

Bowen's proposal is therefore not a tax on the rich; rather, it is a tax on the middle class, which is already harshly treated by our retirement income system. And that is all the more the case as the well off are likely to have greater opportunities for switching assets from super to other tax-advantaged forms of savings.

That switching, which is sure to be pervasive, is not just crucial to understanding the tax's incidence; it also means the claimed $9bn net revenue increase, which does not seem to take any switching into account, is likely to be a serious over-estimate.

And other factors could make that over-estimate all the greater. In particular, taxing relatively small balances, even if it is only once or twice in a decade, causes savings to be exhausted more rapidly.

Their owners therefore qualify for the age pension sooner and for more years. Adding to the problems, that effect is especially pronounced as the tax would hit incomes in the occasional very good year (when excess earnings might have been reinvested) without providing any offset in low-earning years.

While quantifying the resulting impacts is complex, a rough estimate is that pension eligibility for initial balances in the $350,000 to $500,000 range could be 5 to 10 per cent greater under the Bowen tax than without it, with broadly similar effects for means-tested age care payments. As those increases in eligibility translate into greater public expenditure, the promised gains in net revenues will melt away. And there will be broader efficiency costs to boot.

For example, non-compulsory savings will be diverted into assets such as owner-occupied housing, further distorting housing markets while increasing our vulnerability to property price bubbles.

As for compulsory super contributions, raising the effective tax rate they face is equivalent to increasing taxes on lifetime incomes, which undermines the incentives to work and invest. That the proposal involves formidable administrative complexities merely makes its costs greater.

Nor will Bowen’s proposal correct any of our superannuation system’s myriad weaknesses, which, in addition to high fees and charges, include placing risks on individual savers they are poorly placed to manage.

And the alleged unfairness in the taxation of super would be better addressed by the Henry review’s recommendations, which, whatever their problems, were at least more sensibly targeted.

But that doesn’t mean the proposal won’t strike a chord. There are, after all, fashions in confusion, and Labor’s “soak-the-rich” rhetoric admirably suits the Newspeak lexicon that Daniel Hannan, a British Member of the European Parliament, recently diagnosed.

It goes as follows: “Greed: Wanting to keep your own money. Need: Wanting to be given someone else’s. Compassion: A politician arranging the transfer.”

With more tax grabs looming, expect compassion to get a serious workout in the months ahead.