THE AUSTRALIAN

Grattan Institute call to increase taxes ignores sound public policy

THE AUSTRALIAN NOVEMBER 30, 2015 12:00AM HENRY ERGAS

Another week, another call from the Grattan Institute to increase taxes. And yet again it is superannuation in the crosshairs.

Grattan's tune is so familiar we could sing along. The tax treatment of super is a gift to the old and the rich; drastically narrowing the "concessions" could more than double the tax government extracts from super without any damage to efficiency; and as well as helping to balance the budget, this doubling in the tax take would make Australia a fairer place.

Of course, as with all workers' paradises, securing these gains would require breaking more than a few nest-eggs.

A new 15 per cent tax would be imposed on the currently untaxed earnings from super of anyone aged 60 or over; the cap on concessional contributions, which is now $30,000 a year (and $35,000 for those over 55), would be cut to $11,000; and even contributions to super from after-tax income would face a new lifetime limit of $250,000.

Overall, for many middle-income families, and virtually all upper-income families, the gates of super would become narrower than the eye of a needle.

Good thing, too, says Grattan: super heaven is no place for toffs.

Yet, as its class war proceeds, Grattan's world seems to be getting curiouser and curiouser, to the point where, just as Lewis Carroll's Alice "being much surprised, quite forgot how to speak good English", so Grattan has forgotten sound public policy.

It is, to begin with, strange to regard the proposed tax on the super earnings of all those age 60 and over as "fair". Its impact, including on savers with small balances, would be far from trivial: the effective tax rate on super earnings would rise nearly 10 percentage points, with today's 60 year olds suddenly facing an additional tax take that, over their remaining lifetimes, could be far higher than the taxes on super they had already paid, slashing the incomes they had planned on securing.

Nor do the proposed caps seem much fairer. Grattan claims, for example, that "most post-tax contributions are made by those who already have large super balances"; yet its own data shows two-thirds of those contributions come from savers whose balances are below $750,000, which is 25 per cent less than the amount required to secure an income comparable to the **Age Pension**.

Undeterred, Grattan simply denies that tighter caps would harm those who are trying to compensate, through greater contributions, for the inadequate amounts they have accumulated to date. Yet the reality is that both incomes and the rate of return on invested savings fluctuate considerably; and, even more important, **they tend to vary together**.

The probability an individual saver will never hit an extended period with both lower growth in incomes from working and below-average earnings on invested savings is consequently small; and when those periods occur they cause shortfalls that only much higher inflows in the good times can offset.

However, Grattan's caps would make it significantly harder for those affected by downswings to ever catch up, with impacts that, once again, are anything but trivial: on an admittedly rough estimate, Cadence Economics' superannuation model finds up to a quarter of savers might have to exceed Grattan's caps if they are to accumulate savings that allow a reasonable standard of retirement living.

That would matter less if our public system, like those in most advanced economies, guaranteed income-related pensions that replaced 40 per cent of **average pre-retirement income**. Instead, according to the OECD, the Age Pension pays barely 14 per cent of that amount, leaving the majority of Australians exposed to substantial financial risk in retirement. Shifting even more of that risk on to individual savers, who are less well placed to manage it than the community as a whole, is likely to be as inefficient as it is inequitable.

Yet Grattan baldly asserts its changes could be made at no harm to efficiency. That is all the more puzzling as Grattan itself now seems to accept that current tax rates are not as low as it had previously suggested.

For sure, understanding Grattan's estimates of effective tax rates is as easy as removing one's socks by energetically shaking one's feet. But, taken at face value, they imply tax rates are already materially above those that would be imposed under a system which taxed contributions as ordinary income while exempting earnings and eventual payments from tax; and higher still than the approach economists usually recommend, in which contributions and earnings are tax-free, with drawdowns taxed as ordinary income.

Given that starting point, raising taxes further should impose steep efficiency costs. That Grattan concludes otherwise is partly due to the fact that it gets its economic theory wrong. If total savings don't fall, it claims, that implies an increased tax rate on savings is not distortionary; but Harvard's Martin Feldstein, in a classic **article**, savaged that claim 40 years ago. However, it is also because Grattan ignores any adverse changes in behaviour its proposals could cause.

Grattan accepts, for example, that its recommendations would increase the effective tax rate on working, as both compulsory and voluntary savings out of labour income would be more heavily taxed. However, it then simply assumes away the consequences, even though its own data shows that the bulk of post-tax super contributions are made by older workers, whose labour force participation decisions are known to be **highly sensitive** to tax rates.

None of that inspires confidence; yet it is hardly likely to slow our Robespierres down. Their goal, after all, is not to expand the pie but to punish the rich. And with plenty of taxpayers' money funding their efforts, "peak tosh", as Judith Sloan has delightfully called it, may still lie some way ahead.