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That’s right, Treasurer: superannuation is our money, not yours

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Illustration: Eric Lobbecke

Speaking in Brisbane 10 days ago, the Treasurer called for a national conversation about what needs to be done to “ensure our superannuation system can provide higher standards of living for retirees”.

By all means, let’s have that discussion. But let it start from the facts. Here they are.

First, most advanced economies have public pension schemes that guarantee average income earners around 40 per cent of their pre-retirement earnings. In contrast, the OECD estimates that our age pension replaces just 13.5 per cent of the

average income earner's pre-retirement income.

As a result, middle class Australians are almost uniquely dependent on their private savings for income security in retirement, which makes the tax treatment of savings a key factor determining living standards in old age.

Second, until the Costello reforms in 2006-07, our tax rates on private retirement savings were far above those in comparable countries, even ignoring the implicit tax imposed by the means-testing of the age pension.

It was therefore unlikely middle-income earners could or would build up the balances needed to finance their retirement years unless compulsory savings were increased to inefficiently high levels.

Third, the Costello reforms — which critics such as the Grattan Institute's John Daley now want to reverse — helped move our system towards a more rational tax structure.

No one put it more forcefully than the then treasury secretary. "As an exercise in policy leadership", Ken Henry said in a speech delivered behind locked doors to treasury officials in 2007, "the (Costello) superannuation reform is as good as anything I've seen the department produce in the 20-odd years of my treasury career".

Describing the package as an "outstanding achievement", Henry went on to praise it for "advancing all five elements of (treasury's) wellbeing framework", including social equity and fiscal sustainability.

Fourth, despite those reforms, our retirement income system is still far from providing middle-class Australians with reasonable financial security once they leave working life.

For sure, the age pension gives low-income earners replacement rates that, on an after-tax basis, are close to 90 per cent; but it will be many decades before those retiring on average incomes have super balances that come anywhere near financing the 70 to 80 per cent replacement rates the Treasurer has raised as possible targets.

With high replacement rates for low incomes, and low replacement rates for middle incomes, the result is to compress the distribution of income among older Australians.

In other words, as they move into retirement, middle-income earners experience a sharp drop in their absolute and relative position.

For example, in 2011-12, the typical middle-income couple aged 45 to 64 had nearly twice the income of a couple of similar age in the lowest two income deciles; however, for the population aged 65 and over, the middle income couple was only 25 per cent better off than its poorer counterparts, which implies a replacement rate of less than half.

Fifth, the insecurity that creates is exacerbated by the sheer extent of the risk we impose on those seeking to fund their own retirement. With the virtual disappearance of defined-benefit schemes, middle-class Australians are far more exposed to financial risk, including that which comes from uncertainty about longevity, than their equivalents in other countries, where defined-benefit pensions generally remain an important part of retirement incomes.

Yes, the age pension partly cushions those risks; but as well as being limited by its low level, the insurance the age pension provides has been eroded by the progressive tightening of the assets test.

And constant tinkering with the superannuation rules, as well as with the age pension itself, makes financial certainty ever more elusive.

Given that most retirees have little ability to offset falls in their real income by returning to work, it is difficult to see an equity or efficiency case for placing so much financial risk on older Australians, who can only manage it by saving more than they ideally would, especially in the form of (tax advantaged) housing.

Sixth, reverting to the high tax rates on superannuation that were in place before the Costello reforms would merely compound the problems.

Even the Grattan Institute, which used to claim tax rates on super are derisory, now accepts that effective tax rates are above those that would prevail under the approach most economists recommend: that is, one in which contributions and earnings are untaxed, while withdrawals are taxed as ordinary income.

The result is obvious unfairness: taking two people with equal incomes, we tax the person who saves for his or her own retirement more heavily than the person who does not, which is hardly consistent with the Liberal commitment to self-reliance.

And it is inefficient to boot: $100 of consumption in 20 years’ time is taxed by 15 to 30 per cent more than exactly the same $100 of consumption today — which is as harmful as would be having one GST rate for apples and another for their substitute, oranges.

Increasing those tax rates further, be it directly or by reducing the caps on concessional contributions, would add to that inefficiency. As for imposing a 15 per cent tax on all earnings in the retirement phase, as Grattan recommends, it would hit millions of Australians who have made their plans on the basis of the current arrangements, and who could not realistically save enough between now and when they retire to make up for the damage to their future living standards.

Seventh and last, but perhaps most important: as Scott Morrison rightly emphasised, “Above all else, we must remember superannuation belongs to those who have earned it over their working life. It is not my money, nor the government’s money. It is your money”.

Well said; let him now show he means it.