Retirement Incomes Review

Submission February 2020

Who we are

ACOSS is the peak body of the community services and welfare sector and the national voice for the needs of people affected by poverty and inequality.

Our vision is for a fair, inclusive and sustainable Australia where all individuals and communities can participate in and benefit from social and economic life.

What we do

ACOSS leads and supports initiatives within the community services and welfare sector and acts as an independent non-party political voice.

By drawing on the direct experiences of people affected by poverty and inequality and the expertise of its diverse member base, ACOSS develops and promotes socially and economically responsible public policy and action by government, community and business.

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Summary

For a decent, secure retirement people need enough income to cover essentials. They also need good-quality universal health and aged care services, as well as secure and affordable housing.

The present Review is an opportunity to set clear goals and benchmarks in each of the **five foundations for a decent retirement**:

1. **Adequate social security payments to prevent poverty**
   All income support payments, including pensions and Newstart, should be benchmarked to the costs of essentials and indexed to wage movements, as well as inflation, so that people on the lowest incomes don't fall behind.

2. **Universal compulsory superannuation to help people on low and middle incomes smooth their incomes through life, topping up the modest pension payments:**
   This should be benchmarked to the contributions required for a median fulltime wage-earner and their partner (if any) to attain a living standard in retirement that is within reach of – but not greater than – their average pre-retirement living standard.

3. **Tax concessions to support compulsory and voluntary saving through superannuation to reach up to an 'average living standard' in retirement, not to support wealth accumulation for other purposes:**
   The community should not be required to subsidise a retirement living standard above that of an 'average fulltime wage-earner' and their partner (if any).

4. **Universal, good quality, affordable health, aged care and community services**:
   These should be guaranteed for all, and predominantly funded through progressive taxation rather than user charges.

5. **Housing that is secure and affordable for all:**
   People with low incomes who are renting should receive adequate Rent Assistance, and those who cannot meet their housing needs in the private rental market should have access to social housing.

We have made much progress in improving the living standards and quality of life of older people.

- The increase in the single pension rate a decade ago reduced poverty among older people by almost 10%.Universal compulsory superannuation has lifted the retirement living standards of people with low and middle incomes significantly above pension levels, closer to (and sometimes above) those attained during working life.

- Medicare and the public health system have made essential health care more affordable for people with low and modest incomes.

There are also yawning gaps in the system of public support for older people.

- the impoverishment of older people relying on the Newstart Allowance or renting their homes, along with growth in homelessness among older people;
- complex, inequitable and expensive tax concessions that hark back to a time when superannuation was a privilege largely confined to those on high income;
- a superannuation system that reproduces and amplifies income inequality, including between men and women:
  In 2017, average superannuation savings for a woman aged 60-to-64 were \$227,800 compared with \$336,360 for a man of the same age.[1] This inequity is due to the superannuation system itself, as well as women's lower earnings from employment. Women receive only one third of the benefit of all superannuation tax concessions.
- the regulatory failures of our residential aged care system exposed by the Royal Commission, along with high out-of-pocket costs for residential care and long waiting lists for home care;
- a health care system poorly designed and resourced to support people with chronic or complex illness, with high out-of-pocket costs for specialists and a dental health system that is manifestly failing people with low incomes.

These problems are inter-related.

Governments expect people to remain in the paid workforce longer and to transition to retirement gradually, yet the default social security payment for people making those transitions – Newstart Allowance – is \$183pw less than the Age Pension. One in four Newstart recipients is 55 years or over.

While the original intention of the superannuation system was to ensure everyone had a decent income in retirement, in practice it remains a very generous wealth management system for people with high incomes, despite recent reforms. In stark contrast, people with low incomes but receive little or no benefit from the tax concessions.

[1] Myer R (2019), Why the figures on women's superannuation are not always what they seem. New Daily 19/12/2019 https://thenewdaily.com.au/finance/superannuation/2019/12/19/super-women-gender-gap-surprise/

In the absence of fundamental reform of the tax concessions, further increases in compulsory super contributions would be of doubtful benefit to people with low incomes who face greater financial pressure during working life, and are more likely to have already achieved income replacement in retirement at the present 9.5% contribution level.

Government policy changes and under-resourcing of aged care and many public health services means there has been a shift towards user charges, which make older people wary of drawing down their super to enjoy retirement while they are still healthy. At the same time, growth in the cost of tax concessions for people after they retire comes at exactly the time when governments will need more revenue to guarantee decent affordable health and aged care for all.

Key Recommendations

1. Adequate social security payments to prevent poverty

The $32pw increase in single pension rates in 2009 substantially reduced poverty among older people, but 55% of people relying on Newstart Allowance – including the 25% of recipients (184,000 people) who are 55 years or older – live in poverty.

Among people aged 65 years and over, there is a stark difference in living standards between those who own their home and those who rent. While the poverty rate among older home-owners (12%) is slightly below the overall poverty rate (13%), the risk of poverty is three times higher (43%) for older tenants.

All of the evidence points to these two groups of older people – those on Newstart and those pensioners who rent – facing the greatest risk of poverty and deprivation.

We propose a $95pw increase in single rates of Newstart Allowance, and an immediate 30% increase in maximum rates of Rent Assistance to ease the most severe poverty, with a broader review to determine appropriate payment benchmarks and indexation arrangements, noting that others, including COTA Australia and the Grattan Institute, are calling for a higher increase in Rent Assistance and that the payment takes no account of large regional differences in rents.

2. Compulsory superannuation that's sufficient, but not too much, to maintain living standards after retirement

When the superannuation system matures, universal compulsory superannuation at its present (9.5%) contribution level will enable the majority of workers to reach a living standard in retirement close to that which they had during working life.

Grattan Institute research indicates that across all income levels, older people who were previously employed fulltime currently receive at least 70% of their previous disposable income after retirement, without taking account of the lower housing and child related costs faced by people after they retire, or the higher replacement rates that will apply once the superannuation guarantee fully matures.[2] This is a major achievement.

For people with low and modest incomes, the cost of increasing the super guarantee (i.e. reduced take home pay) during their working lives would likely exceed any benefit derived in retirement, noting that the age pension will continue to be the primary source of income for many of these households.

Any increase in compulsory retirement saving above 10% of wages should be based on a careful assessment of the needs of low and middle-income workers before and after retirement, which we hope the Review will undertake.

Further, the superannuation guarantee should not rise above this level until tax breaks for super contributions are reformed to make them fair for people with low and modest incomes.

3. Reform of inequitable and costly tax concessions

The flat 15% tax on employer superannuation contributions means that a cleaner earning $20,000 (who normally does not pay tax on earnings) receives no taxation support for compulsory employer contributions, yet a fund manager on $200,000 receives a tax break of 32 cents per dollar contributed.

Thirty years after the super guarantee was introduced, these inequities should finally be removed, before compulsory contributions are increased further.

We propose a revenue-neutral reform of tax concessions that would equalise tax breaks for every dollar contributed on behalf of people at different income levels:

All super contributions (regardless of source) should attract a uniform 20% refundable tax credit up to a modest annual cap of around $15,000 in contributions. Other tax concessions for contributions should be removed.

In addition, the first $500 of contributions should attract a dollar for dollar tax credit to boost the retirement savings of people with very low earnings, most of whom are women.

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[2] Daley J & Coates B (2018), Money in retirement, more than enough. Grattan Institute.
While most partnered women with children are predominantly employed part-time, they are also likely to be partnered on retirement. Those people at greatest risk of poverty in retirement (including many single women) are less likely to be able to forego more of their wages for superannuation during working life.

4. Guarantee quality, universal aged care and health services

The Aged Care Royal Commission has exposed serious flaws in the system, especially in residential care. In addition to the poor quality of services (due in large part to insufficient skilled staff and high turnover), and long queues for at-home care, older people worry whether they can afford increasing out-of-pocket costs of residential care, including large lump-sum deposits. Older people already pay almost 30% of the cost of residential care.[3]

This is undermining the purpose of superannuation, as people's anxiety about future out-of-pocket health and aged care costs mean they are reluctant to draw down on their savings to fund a decent retirement. One outcome is that retirement savings are not used for their intended purpose, and instead pass to the next generation. A stronger universal health and aged care system would ease this anxiety and keep superannuation focussed on its main purpose: ensuring an adequate living standard in retirement.

Preventive health care, dental care, and support for people with chronic illness are also under-resourced. The government will not be able to 'guarantee' quality health care for all as long as growth in Commonwealth health expenditure is held at 0.7% per year over the next four years, as the Budget projects.[4]

Given that population ageing is expected to increase the cost of health and aged care by approximately $8 billion a year in a decade's time (along with $8 billion more for pensions), future governments will need a more robust public revenue base.[5]

People of all ages should contribute to these costs according to their capacity to pay, yet only 16% of people over 64 years pays income tax even though many can afford to do so.[6]

We propose that approximately $5 billion a year in additional public revenue should be raised from 2021-22 (much more in later years) to guarantee quality, affordable aged care and help close the gaps we have identified in health care by:

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[3] Aged Care Financing Authority (2019), Seventh report on the Funding and Financing of the Aged Care Industry.

[4] ACOSS (2019), The uncertain future of essential services. https://www.acoss.org.au/wp-content/uploads/2019/06/ACOSS_future-of-services_briefing-note_updated.pdf

[5] Parliamentary Budget Office (2019), Population ageing – understanding the fiscal impacts over the next decade. https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Budget_Office/Publications/Research_reports/Australias_ageing_population_-_Understanding_the_fiscal_impacts_over_the_next_decade

[6] Daley J et al (2016), Age of entitlement, age-based tax breaks, Grattan Institute.

- *Extending the standard 15% tax rate for the investment income of superannuation funds to funds paying a pension, whose investment income is presently untaxed (superannuation benefits would remain tax-free);*
- *Reducing age-based tax breaks such as the Senior Australians and Pensioners Tax Offset (SAPTO);*
- *Strengthening the Medicare Levy by including income from negatively geared investments, private trusts and fringe benefits in the definition of income used.* [7]

5. Housing security for older people who rent

Experts estimate there is a shortage of 400,000 affordable dwellings for people who are homeless or on very low incomes.[8]

Older people are not immune from this problem. In 2016, 11% of people aged 65 and over were renting. This is likely to increase in future years, since the share of people aged 50-54 years who own or are purchasing their home declined from 85% in 1996 to 80% in 2014. [9] Almost 20,000 people over 55 years were homeless in 2016, a more than 25% increase since 2012. [10]

To close the housing affordability gap, governments will need to support the construction of affordable homes through improved urban planning, incentives for investment in housing rented at below-market rates, and above all to stem the decline in social housing, which has fallen from 5.1% of all homes in 2001 to 4.2% in 2016.[11]

Due to its security of tenure and the capping of rents by income, social housing offers the best protection against homelessness for financially or otherwise vulnerable people.

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[7] ACOSS (2019), Budget priorities statement 2020-21

[8] Lawson J et al (2018), Social housing as infrastructure: an investment pathway, AHURI Final Report 306, Australian Housing and Urban Research Institute.

[9] ABS (2016), Census of population and housing; Yates J et al (2017), Housing as a fourth pillar of Australia's retirement income system. Discussion Paper for CSRI roundtable 6-7 April 2017. https://www.abs.gov.au/ausstats/abs@.nsf/Lookup/by%20Subject/2071.0~2016~Main%20Features~Ageing%20Population~14

[10] AHURI (2019), Supporting older Australians experiencing homelessness, AHURI Policy Evidence Summary. https://www.ahuri.edu.au/__data/assets/pdf_file/0023/52916/PES-322-Supporting-older-Australians-experiencing-homelessness.pdf

[11] AIHW (2019), Housing assistance in Australia. https://www.aihw.gov.au/reports/housing-assistance/housing-assistance-in-australia-2019/contents/summary

As a first step to improve security and affordability of housing for people at risk of homelessness, we propose a social housing investment package to build 20,000 homes over the next three years. [12]

This package would complement the increase in Rent Assistance and broader review of rates and indexation arrangements outlined above.

Data required to properly evaluate the retirement income system

The attachment to this submission lists data which we suggest the Review release publicly to inform policy discussion of the effectiveness of the retirement incomes system.

Given the very tight timeframe for this Review, and the imminent release of the next Intergenerational Report in April 2020, a month's extension of time for the Panel to report may be needed.

Introduction: Five foundations of a decent retirement

The scope of the Review

The Review's Terms of Reference include the following goals:

> ''It is important that the system allows Australians to achieve adequate retirement incomes, is fiscally sustainable and provides appropriate incentives for self-provision in retirement.''[13]

The Terms of Reference refer to the roles of the Age Pension, compulsory superannuation, and voluntary retirement saving (including through home ownership) in meeting these goals.

In our view, the adequacy of retirement incomes cannot be divorced from:

- the other social security payments on which older people rely, including allowances;
- universal, good quality and affordable health, aged care and community services; and
- secure and affordable housing.

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[12] ACOSS (2019), How to reduce homelessness and boost incomes and jobs: Social housing as infrastructure. https://www.acoss.org.au/wp-content/uploads/2019/08/ACOSS-Brief-Social-Housing-Investment-as-Infrastructure.pdf

[13] Retirement Income Review (2019), Consultation paper.

"This review isn't simply about one or two issues, like whether 12% superannuation guarantee is adequate or excessive, or whether the pension asset test taper is correct. These individual issues need to be viewed within a more comprehensive, outcomes focused framework." (COTA Australia, COTA welcomes Retirement Incomes Review, Media Release 27/9/19)

'Retirement' can no longer be narrowly defined as a fixed point in time at which people leave the paid workforce permanently. Retirement is now a continuum between reduced participation in the paid workforce (for example, through reduced working hours and temporary employment) and leaving it altogether.

This is the logic behind a pension income test that facilitates part-time employment, and 'transition to retirement' arrangements in the superannuation system. Encouraging a 'staged' departure from paid employment, to improve health and wellbeing and raise paid workforce participation, is now a key public policy objective.

It is therefore appropriate for the Review to consider the adequacy of the incomes of older people (above superannuation preservation age) who have reduced their paid workforce participation, as well as those well as those who are no longer in the paid labour force.

In December 2018, 541,000 people aged 55-64 years received an income support payment, including 270,000 receiving Disability Support Pension (DSP), 173,000 on Newstart Allowance and 79,000 on Carer Payment. [14] They comprised 20% of all people in that age group. The vast majority of this group had reduced paid workforce participation, for reasons beyond their control such as disabilities and caring roles.

Reduced paid workforce participation places them at greater risk of poverty once they reach pension age at 65 years, as they are less likely to have accumulated the assets – including liquid assets, outright home ownership and adequate superannuation – that could shield them from poverty in retirement. Many have been forced to draw down their already modest superannuation to survive until they reach pension age.

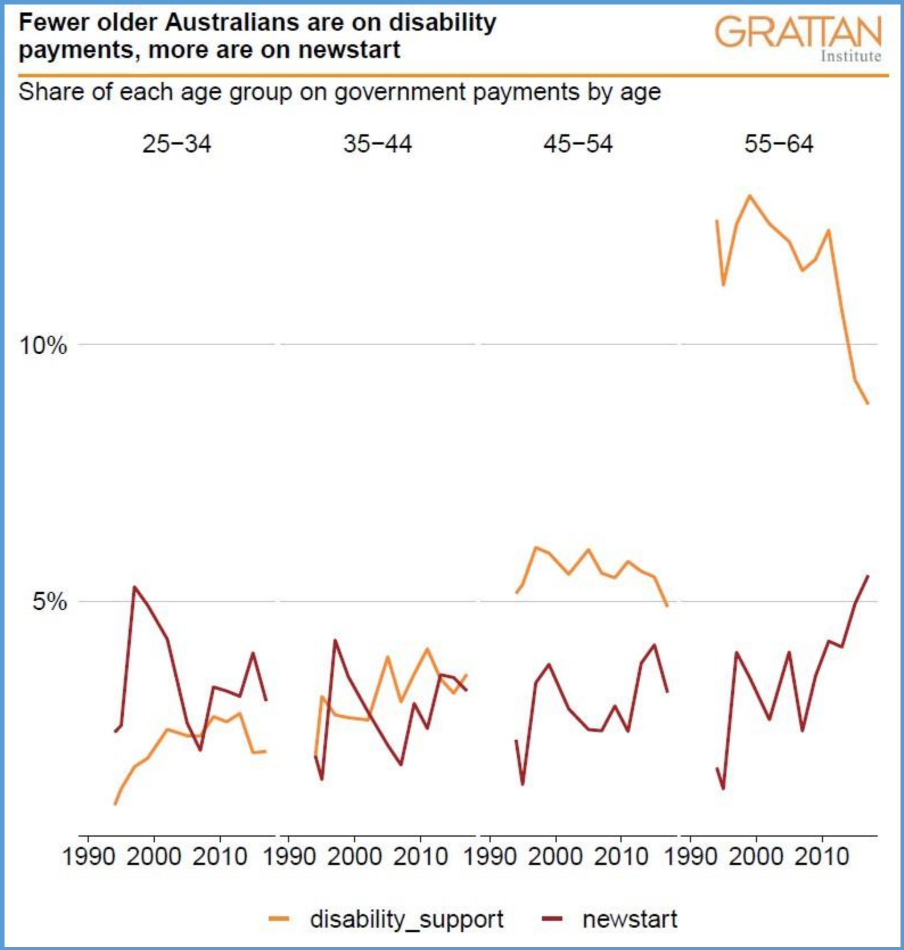
Over the last two decades, as access to pension payments such as DSP and Parenting Payment Single has been restricted, Newstart Allowance has become *the default payment* for people of working age who do not qualify for another income support payment, rather than just an unemployment payment.

[14] www.data.gov.au

In December 2018, 40% of people who were paid Newstart Allowance had no job search requirements, 25% were over 55 years old, and 41% had a partial work capacity (they were assessed as only able to undertake paid work of up to 15 hours a week due to a disability).[15]

For example, figure 1 shows how a decade of tightening of Disability Support Pension eligibility requirements has diverted people with disabilities from that payment to Newstart Allowance.

Figure 1: The diversion of people with disability to Newstart Allowance



Source: Coates B (2020), Submission to the Review of retirement incomes. Grattan Institute.

[15] www.data.gov.au ; Department of Social Services (2018), Labour Market and Related Payments; Senate Community Affairs Legislation Committee (2019), Estimates transcript, 24 October 2019.

As detailed later, Newstart Allowance is the weakest link in the income support system for older people.

The connection between the adequacy and sustainability of retirement incomes and *health and aged care services* is also clear:

- Affordable access to essential health and aged care services is vital to people's wellbeing in retirement.
- One of the reasons that older people are reluctant to draw down their super after retirement, consistent with the objectives of the superannuation system, is that they fear they will not have the resources to pay for quality aged care and health services later in life.[16]
- As we discuss later, the growing cost of post-retirement superannuation tax concessions, especially the tax exemption for the investment income of the funds, undermines the public revenue base that funds those services.

Further, there is a clear connection between the adequacy of retirement incomes and people's *housing status*.

- The adequacy of the Age Pension depends to a large degree on the modest housing costs that come with outright home ownership. Yet this assumption is coming into question. The share of people aged 50-54 years who own or are purchasing their home declined from 85% in 1996 to 80% in 2014, a trend which is likely to continue. [17]
- As detailed on the next page, older people renting their home face a far greater risk of poverty than those who own or are purchasing their home.

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[16] CEPAR (2018), Retirement income in Australia, Part 2: public support, CEPAR Research Brief November 2018.

[17] Yates J et al (2017), op cit.

Benchmarking retirement incomes and services

The retirement income system should be based on the following pillars:

1) Adequate social security payments to prevent poverty:
    - All income support payments, including pensions and Newstart, should be benchmarked to the costs of essentials and indexed to wage movements as well as inflation so that people on the lowest incomes don't fall behind.
    - The adequacy of all social security payments should be reviewed regularly by a statutory Social Security Commission which advises Parliament.
2) Universal compulsory superannuation to help people with low and middle incomes smooth their incomes through life, topping up the modest pension payments:
    - This should be benchmarked to the contributions required for a median fulltime wage-earner and their partner (if any) to attain a living standard in retirement that is within reach of – but not greater than – their average pre-retirement living standard (taking account of social security payments, housing costs and the costs of children).[18]
    - The appropriate superannuation guarantee rate to reach this benchmark would be reviewed from time to time but would not be reduced.
3) Tax concessions to support compulsory and voluntary saving through superannuation to reach up to an 'average living standard' in retirement, not to support wealth accumulation for other purposes*:*
    - The community should not be required to subsidise a retirement living standard above that of an 'average fulltime wage-earner' and their partner (if any) during working life.
    - Taxation concessions for retirement saving should not support wealth accumulation for other purposes such as bequests (apart from transfers to dependents).

[18] For the many people that had inadequate living standards *before* retirement, simply maintaining them after retirement is not sufficient. Adequate social security payments are vital here.

The retirement income system should be supplemented by:

1. Universal, good quality, affordable health, aged care and community services:
    - These should be guaranteed for all, and predominantly funded through progressive taxation rather than user charges.
    - Along with people of working age, retirees should contribute through the income tax system to the costs of these essential services according to their ability to pay, so that quality services are guaranteed and reliance on user charges is limited (Proposed reforms to taxation of older people are outlined below).
2. Housing that is secure and affordable for all:

- For people with low incomes who are renting, this should be underpinned by adequate Rent Assistance, and access to social housing (with rents tied to income) for those who cannot meet their housing needs in the private rental market.

Pillar 1: Income support to prevent poverty

Goals

The purpose of the *social security pillar* should be to prevent poverty.

This means that minimum rates of payment should be adequate to cover the costs of essentials, including for those who face the higher costs associated with renting privately.

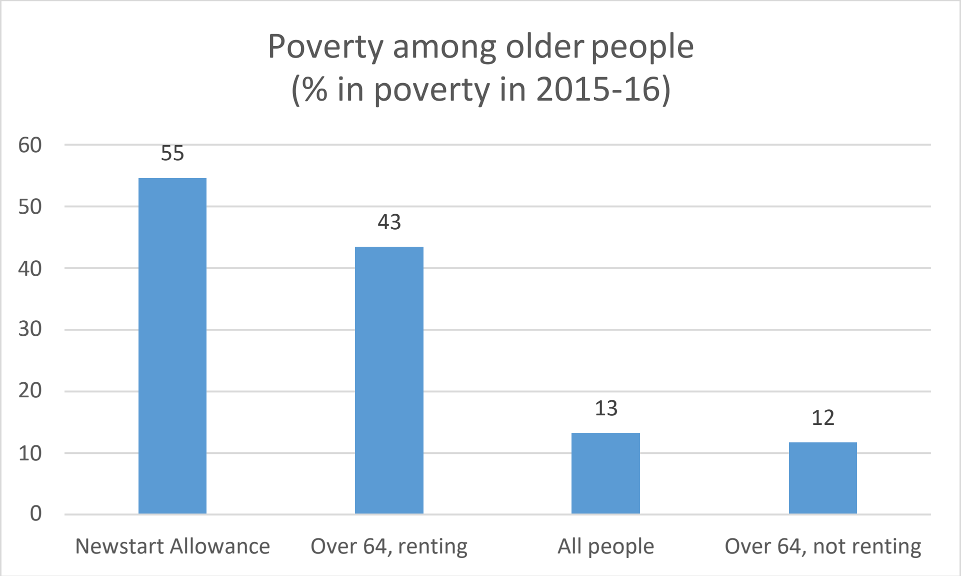
Social security payments will achieve this goal more cost-effectively if they are targeted towards people at risk of poverty. At the same time, income and assets tests for Age Pensions should take account of additional risks facing retirees, including longevity risk and their lower capacity to earn income from employment.

Strengths and weaknesses of the present system

The evidence overwhelmingly shows that those older people most at risk of poverty are renting their homes, or relying on Newstart Allowance (or Special Benefit) because they do not yet qualify for a pension.[19]

Figure 2 compares poverty among older people (after accounting for housing costs), who own their homes, rent, and those who rely on Newstart Allowance.

Figure 2: Proportion of older people in poverty (2015-16)



Source: Davidson P et al (2018), Poverty in Australia, ACOSS and UNSW Sydney. Note: Poverty Line is 50% of median household disposable income, after deducting housing costs. 'Newstart Allowance' refers to people in households where the reference person received that payment.

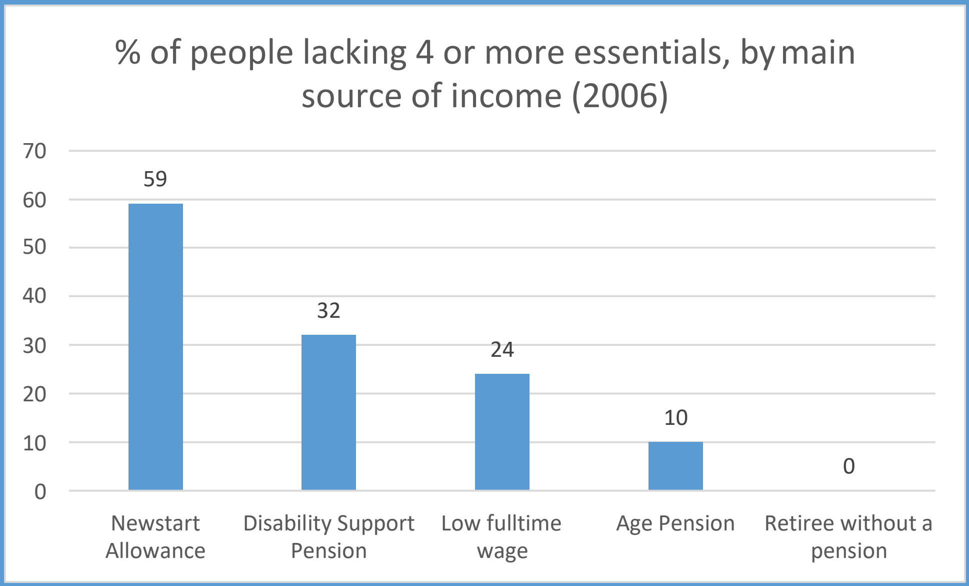
[19] Saunders P & Wong M (2009), Deprivation and other indicators of the living standards of older Australians, Social Policy Research Centre UNSW, Report for Department of Families, Housing, Community Services and Indigenous Australians.

Clearly, those facing the greatest risk of poverty are in households relying on Newstart Allowance (55%) and those who are renting (43%).

This is supported by research on deprivation of essentials, in which people were asked whether they regarded certain items as essential, whether they had those items, and if not, whether this was because they could not afford them. The 19 items which a majority of people identified as essential included a substantial meal at least one a day, a decent and secure home, and dental treatment if needed.[20]

In a report for the 2008 Pension Review, Saunders and Wong calculated the shares of people with different income sources that lacked four or more of the 19 items. The results are summarised in Figure 3. By far the greatest risk of deprivation (59%) was faced by recipients of Newstart Allowance.

Figure 3: Proportion of people lacking 4 or more out of 19 essentials (2006)



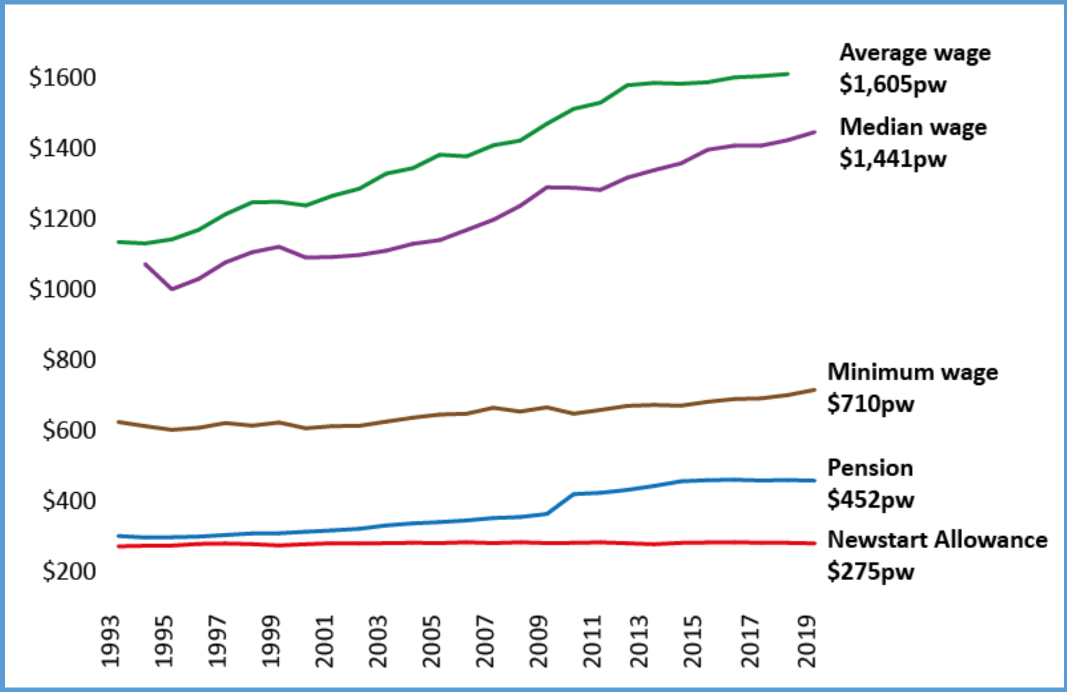
Source: Saunders P & Wong M (2008), Deprivation and other indicators of the living standards of older Australians, Social Policy Research Centre UNSW.
Note: People lacking four or more out of 19 items judged by a majority of respondents to the survey to be essential.

[20] Saunders P & Wong M (2008), Deprivation and other indicators of the living standards of older Australians, Social Policy Research Centre UNSW.

Newstart Allowance

The maximum single rate of Newstart Allowance is $284pw, which is $183pw less than the pension. The growing gap between these payments is partly due to the exclusion of Newstart Allowance from the $32pw increase in pensions for single people awarded after the Pension Review in 2009, and partly due to the different indexation arrangements for the two payments (Figure 4). Pensions are indexed to movements in average wages as well price movements, whereas allowance payments are indexed to prices only. Newstart Allowance has not been increased in real terms (above price inflation) for more than 25 years, so the living standards of recipients are frozen in time to an era when the internet was in its infancy.

Figure 4: Trends in social security payments and wages ($pw from 1993-2019)



Source: ABS Survey of Employee earnings

Rent Assistance

A major reason for poverty among people renting privately is the inadequacy of Rent Assistance for private tenants with low incomes.

As with Newstart Allowance, maximum rates of Rent Assistance are only indexed to movements in the Consumer Price Index, not rents (which have grown much faster). As a result, the maximum rate of Rent Assistance for a single adult living alone is just $69pw, well below median private rents in most parts of Australia. For couples without children, the maximum rate is just $65pw.

The latest Rental Affordability Index published by National Shelter and others found that median rents for a one bedroom flat in Sydney, Melbourne, Brisbane, Perth, the rest of Western Australia and the Australian Capital Territory were equal to 100% or more of Newstart Allowance plus Rent Assistance.[21] In the same regions, median rents were at least 60% of the income of a single pension recipient (including Rent Assistance).

[21] National Shelter et al (2019), Rental affordability Index, Key findings.

Age pension

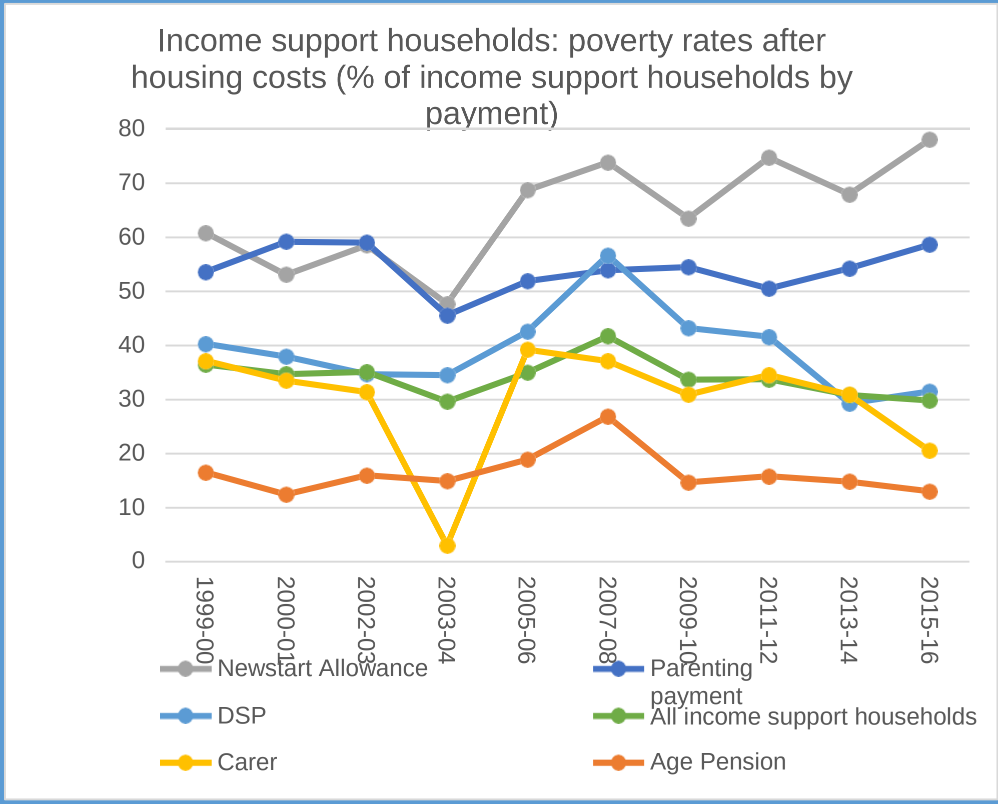
Adequacy

The current rate of the Age Pension (including Pension Supplement and Energy Supplement) is $467pw for singles and $704pw for couples.

The $32pw increase in the single pension rate in 2009 substantially reduced poverty among older people, though the payment is still frugal and, as discussed above, most recipients only avoid poverty if they own their home.

The impact of the 2009 pension increase on poverty among recipients of Age Pensions can be seen clearly in Figure 5 (refer to the lowest line). We estimate that, after accounting for other factors, the pension increase reduced poverty among people relying on the Age Pension for most of their income by around 9 percentage points (with a greater reduction for single age pensioners).

Figure 5: Poverty among people in households mainly relying on social security payments (%)



Source: Davidson P et al (2018), Poverty in Australia, ACOSS and UNSW Sydney. Note: Poverty Line is 50% of median household disposable income, after deducting housing costs. 'Income support households' are households where the main source of income is social security payments. 'Mainly relying' means that at least 50% of household income was social security payments.

Targeting and sustainability

Broadly speaking, under current policy settings the Age Pension is fiscally sustainable. The Parliamentary Budget Office projects an increase in the cost of the Age Pension of $9 billion a year (in present values) by 2028, due to population ageing.[22] The overall budgetary cost of pensions in Australia is well below the OECD average, as is the projected growth in those costs over the next 30 years.[23]

ACOSS opposes any increase in the age of eligibility for the pension beyond the legislated rise to 67 years. Under present policy settings this would merely increase the number of people forced to live on the inadequate Newstart Allowance. Further, this would exacerbate inconsistency in the treatment of the public pension and superannuation, given that the preservation age for superannuation savings is 55 years (rising slowly to 60 years).

The tightening of the pension income test in 2009, and the assets test in 2016, helped ensure that pensions are paid to people who need them – those at risk of poverty. The highest priority for social security reform and Budget expenditure should be increasing maximum rates of payments for those at greatest risk of poverty – Newstart and related allowances, and Rent Assistance – rather than extending eligibility for the age pension to those with greater means.

The pension means test has two components: an income test and an asset test. The income test applies to both earnings and investment income (which is 'deemed' from financial asset values), while the assets test applies to financial assets but not the primary residence.[24]

In 2009, the pension income test taper rate was tightened from 40% to 50% in exchange for the $32pw increase in the maximum rate of payment for singles referred to previously.[25]

Apart from the inexplicable exclusion of Allowance payment recipients and sole parents from this pension increase, this was a sensible trade-off between reducing poverty and containing future budgetary costs.

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[22] Population ageing is projected to lift Age Pension expenditure from $45B (10% of Commonwealth expenditure) in 2018 to $54B in 2028. An additional, though much smaller, increase in pension spending is due to other factors. Parliamentary Budget Office (2019), op cit.

[23] OECD (2019), Pensions at a glance.

[24] At December 2019, the income test restricts the maximum pension rate to singles with private incomes below $87pw (plus a $150pw 'work bonus' for earnings from employment) and couples with incomes below $154pw (plus a $150pw 'work bonus' each). Above these thresholds, the pension tapers off at a rate of 50% (50 cents per additional dollar of private income). The pension cuts out fully at private incomes of $1,020pw for singles and $1,561 for couples.

[25] Harmer J (2008), Pension review report. Note that the pension taper rate was previously 50% before it was reduced to 40% in 2000.

In 2007, the assets test was substantially eased, reducing the taper rate from $2.50 per $1,000 of assets to $1.50. In 2016 it was tightened to $3 per $1,000, while at the same time the assets test-free thresholds were increased.[26]

The income and assets tests are the main tools used to target pensions to those who need them. The impact of means tests on incentives for paid work and investment is ambiguous. To the extent that people aim to reach a fixed income target in retirement, a tighter means test is likely to encourage them to *increase* their earnings or investments to reach that target (the 'income effect'). To the extent that people decide it's not worth earning extra income because the pension will be reduced, means tests will *reduce* earnings and investments (the 'substitution effect'). On balance, means tests are more likely to encourage older people to *increase* their private income. [27]

The main argument for loosening means tests is therefore one of equity rather than incentives to earn or invest. For example, while it is reasonable to expect people to draw down their superannuation over retirement to supplement or replace the Age Pension, it may not be reasonable to withdraw the pension at a higher marginal 'tax rate' than 100% of the next dollar of private income received. The 'taper rate' in the present asset test may have this effect, taking account of typical returns from investments.

A key consideration is the share of older people who receive full or part pensions. Currently, two-thirds (66%) of people aged 65 years and over receive the Age Pension (41% receive the full pension and 25% a part pension), and another 4% receive a Veterans Pension – 70% of the older population altogether.[28]

Before the above income and assets test changes, the share of older people receiving a pension was close to 80% (Figure 6).

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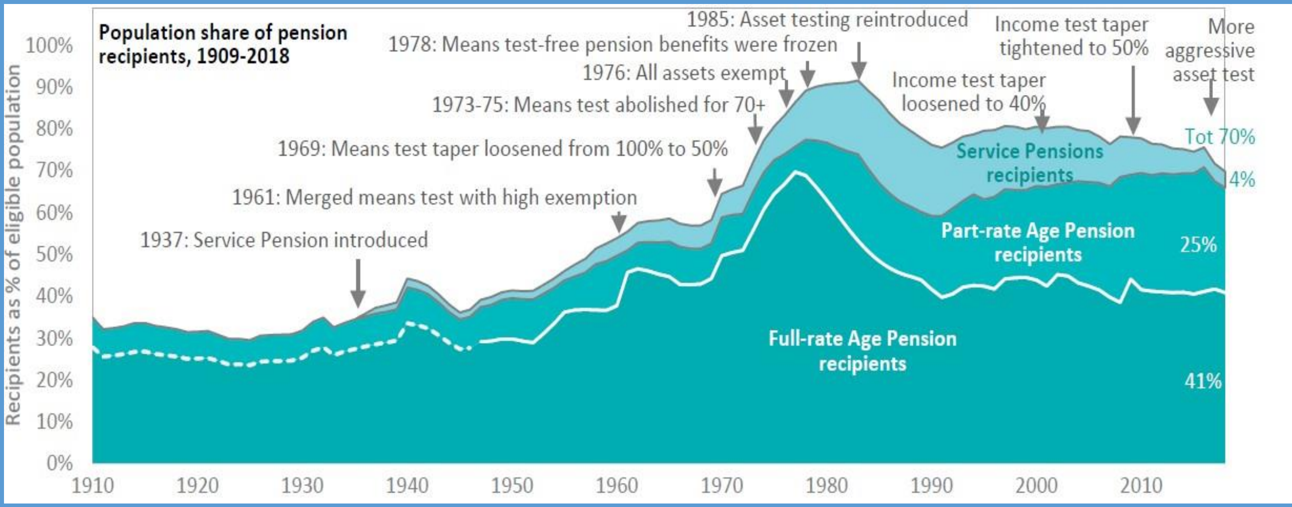
[26] The assets test applies to financial assets above the following thresholds: $263,000 for singles and $395,000 for couples in the case of homeowners, and $474,000 for singles and $605,000 couples in the case of non-homeowners. In this way, the assets test indirectly takes account of the first $210,000 of the value of the main residence.
Assets above these levels reduce the pension at the rate of $3 per $1,000 of assessable assets, so the pension cuts out at asset values of $575,000 (singles) and $864,000 (couples) for home-owners, and $785,000 (singles) and $1,074,000 (couples) for non home-owners.

[27] Freebairn J 2007, Some policy issues in providing retirement incomes, Melbourne Institute Working Paper 6/07

[28] CEPAR (2018), op cit.

Figure 6: Proportion of the older population receiving pensions (1909-2018)



CEPAR (2018), Retirement income in Australia, Part 2 – public support.

If the pension is well-targeted towards people at risk of poverty, the share of older people receiving a pension should gradually decline as older people benefit from higher incomes and financial assets as the superannuation guarantee matures. Indeed, this is the logical outcome of greater reliance on superannuation. This is the likely outcome of the tightening of income and assets tests described above.

While the means test arrangements are not ideal – we have proposed a lower assets test 'free area' for home owners, combined with a lower taper rate – any reform of pension means tests should be revenue-neutral to make room for the more urgent improvements to social security payments for those in the deepest poverty: Newstart Allowance and Rent Assistance.

Directions for reform

ACOSS advocates a $95pw increase in the maximum single rate of Newstart and related Allowance payments. This is based on the difference between Newstart and other payments received by Newstart recipients (including Rent Assistance) and the minimum household budget developed by the Social Policy Research Centre for a single adult living alone.[29] While this would benefit the growing number of older people on allowance payments, the increase should extend to *all* single people and sole parents receiving Newstart, and the away-from-home rate of Youth Allowance.

[29] Saunders P & Bedford M (2017), New minimum income for healthy living budget standards for low paid and unemployed Australians, Social Policy Research Centre, UNSW Sydney. The $95pw figure is based on an updated budget standard for single unemployed people, given that the original budgets were drawn up in 2016.

We propose that an independent statutory Social Security Commission be established to set and update benchmarks for the adequacy of social security payments. This would provide a mechanism for objective, factual advice to the Parliament on future social security policies.

To help reduce the worst poverty among people aged 65 years and over we propose an immediate 30% increase in the maximum rate of Rent Assistance for private tenants with low incomes. The increase should extend to recipients of this payment who are of working age, since they also face a high risk of poverty, due to low incomes and excessive housing costs. This should be followed by a broader review of the rate and indexation arrangements to ensure adequacy, noting that others including COTA Australia and the Grattan Institute are calling for a higher increase in Rent Assistance and that the payment takes no account of large regional differences in rents.

We discuss the need for public investment in social housing to reduce homelessness later in this submission.

Ease the most severe poverty and continue to target pensions to people at risk of poverty

1. Increase Newstart and related allowance payments

Raise the maximum rates of Newstart, Youth Allowance and related payments for single people by a minimum of $95 per week, and index these payments to wages. This immediate increase should apply to:

- Newstart Allowance (including the single parent rate)
- Youth Allowance (both away from home rates for student/apprentice and Other)
- Austudy
- Abstudy
- Sickness Allowance
- Special Benefit
- Widow Allowance
- Crisis Payment

* Note: This amount, previously $75, has been revised upwards to take account of changes in community living standards since 2016.

2. Increase Rent Assistance

Increase maximum rates of Rent Assistance for low-income households by 30% (approximately $20 per week for a single adult) and conduct a broader review of Rent Assistance payment rates and indexation arrangements.

3. Establish a Social Security Commission

Establish a statutory Social Security Commission to provide independent expert advice to the Parliament about the setting of social security payment rates (including family payments), covering adequacy, means test settings and indexation.

4. Target pensions to people at risk of poverty

(1) Pensions should continue to be targeted towards people at risk of poverty, which implies that the share of older people receiving a pension should decline as future cohorts receive higher private incomes through superannuation.

Any reform of pension income and assets tests should be close to revenue-neutral. For example, a reduction in the assets test taper rate could be accompanied by a lower assets test-free threshold for home-owners, or a higher taper rate (for investment assets) for those with high-value homes.

Pillar 2: Compulsory saving for retirement

Goals

The purpose of compulsory retirement saving is to help people smooth their incomes through life, topping up the modest pension payments. A sensible principles-based benchmark for compulsory retirement saving would be to ensure that a worker on a median wage and their partner (if any) can come within reach of their average living standard during working life, after they retire. This benchmark should take account of pension entitlements, and the costs of children (if any) and housing.

To assess the appropriate level of future compulsory contributions, pre-and post-retirement living standards should be compared for people entering the system when it fully matures.[30]

It makes no sense to force people with low or modest incomes to save to achieve a living standard in retirement higher than the one they had during working-age.[31]

Alternately, the purpose of superannuation could be broadened to take account of the other long-term saving needs of people with modest incomes, such as the cost of children, housing, and social risks such as unemployment, disability and relationship breakdown. Social insurance systems in most other OECD countries make provision for at least some of these 'working-life' financial risks.

Strengths and weaknesses of present system

Compulsory superannuation is a form of forced saving to smooth consumption before and after retirement. Our universal compulsory superannuation system has substantially lifted the incomes and living standards of many workers above the frugal Age Pension level. This comes at a cost, in lower wage increases and public revenue forgone through superannuation tax concessions. [32]

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[30] Replacement rates are lower for people who entered employment before the superannuation guarantee reached 9.5%, but this is a transitional issue, not a justification for higher contributions in future.

[31] For the many people that had inadequate living standards *before* retirement, simply maintaining them after retirement is not sufficient. Adequate social security payments are essential in these cases.

[32] There is limited empirical evidence on the impact of the superannuation guarantee on wage increases in Australia. Sandford finds that there is no consistent correlation between changes in the SG rate and aggregate wage growth (Sandford J (2019), The Relationship Between Superannuation Contributions and Wages in Australia, Centre for Future Work). He cites international studies indicating that around 70% of payroll taxes are typically offset against wages. We believe our arguments regarding a trade-off between income foregone before retirement to lift retirement incomes still hold if that proportion of compulsory employer contributions (rather than 100%) was withheld from pay increases. While some argue that higher compulsory contributions would not offset wage increases today (since pay rises are minimal), it should be noted that the higher contributions are being phased in over the next 6 years.

A key strength of the superannuation guarantee is that it is a universal system. This means that, for the most part, people with low incomes are not left to fend for themselves in securing employer contributions to lift their retirement incomes. Given their weak bargaining power, it is unlikely that people on low wages excluded from compulsory superannuation would consistently receive higher pay in lieu of employer super contributions.

Income smoothing and replacement rates

The superannuation guarantee is legislated to increase from 9.5% currently to 12% by 2026. This increase is not based on a thorough assessment of people's pre-and post-retirement living standards. It is not clear that a 12% contribution is needed for the 'median worker' and their family to attain a living standard after retirement that is within reach of their average standard during working life.

To the extent that compulsory superannuation contributions are offset by lower wage increases, a superannuation guarantee at 12% could exacerbate financial pressures for people with persistently low incomes during working life, including many workers with limited qualifications, women with broken employment patterns, and people with disabilities or chronic illness. They already face elevated levels of financial stress due to such factors as low pay, unstable employment, caring roles, unemployment, relationship breakdown and illness.

The same factors that depress their retirement incomes also make them more vulnerable to financial hardship during working life, in the event that they are forced to save more for retirement. This calls into question arguments that more compulsory saving through superannuation is a solution to growing income inequality between men and women, and people with high and low incomes – all the more so given the inequitable impacts of superannuation tax concessions (discussed later).

Figure 7 shows the average pattern of saving across the life course. Household saving rates decline sharply in the early child-raising years when paid workforce participation of parents (mostly women) is reduced and housing costs (especially home mortgage payments) peak. Saving rates peak close to retirement (between 50 and 65 years) and then decline as people leave paid employment.

This graph also suggests that financial hardship is more common among younger than older households.[33]

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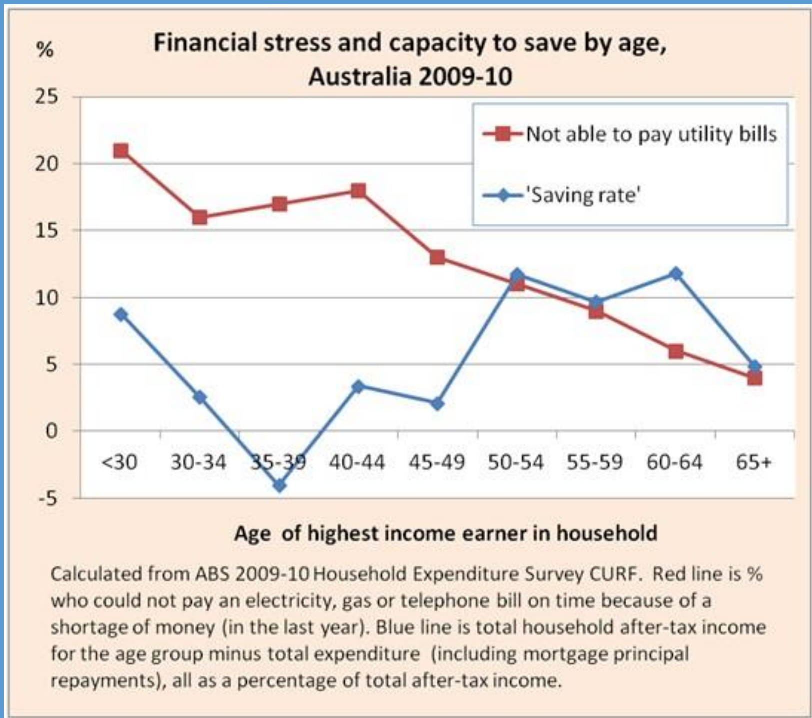
[33] This is supported by other, more comprehensive research. Wilkins & Lass (2018) found that the incidence of financial stress among households from 2001 to 2015 (the proportion of people reporting 2 or more of 7 financial stress indicators such as inability to pay electricity, gas or telephone bills on time, or asking for financial help from friends or family), was highest among single parents (28%), and higher among singles of working age (17-18%) than older singles (6-8%). Older couples reported very low financial stress levels (3%). Wilkins R & Lass I (2018), HILDA survey selected findings 2018, Melbourne Institute. See also Daley & Coates (2018), op cit regarding self-reported financial comfort.

Figure 7: Life-cycle saving patterns and financial hardship (2009)



Source: Bradbury B (2019), Saving the young from superannuation. Posted on January 5, 2012 http://clubtroppo.com.au/2012/01/05/saving-the-young-from-superannuation/

Two commonly-used retirement income benchmarks fail to take proper account of the consumption smoothing (income replacement) role of superannuation.

The AFSA 'comfortable living standard' which is widely used in the marketing of superannuation, is a fixed standard for the whole population rather than a target income replacement rate. It was developed to supplement the 'Modest but Adequate' budget standard (the 'modest' benchmark also used by ASFA) developed by the Social Policy Research Centre in 1996.[34] While the 'Modest but Adequate' budget represented a median (middle) level of household consumption, the 'comfortable' budget (originally titled 'affluent') was pitched at a much higher level.

Broadly speaking, the 'comfortable living standard' was pitched towards typical retirement spending patterns of the top 20% of the working-age income distribution (managerial and professional workers).

[34] Saunders P et al (1997), Indicative Budget Standards for Australia. Department of Social Security.

In 2016, 16% of single retired homeowners and 32% of couples had reached this level of spending power, along with just 3-4% of renters. [35]

The share of households reaching the 'comfortable' standard will rise in future as the superannuation guarantee matures, but the idea that workers should be forced to save for a retirement that includes an overseas holiday every two years and restaurant meal once a week is open to question when many people of working age cannot afford these items.

Another benchmark used to assess the appropriate level of the superannuation guarantee and related tax concessions is a retirement income 'sufficient to supplement or replace the Age Pension'.[36] While this benchmark neatly connects superannuation and social security policy, it is arbitrarily affected by changes in means tests for the pension (discussed previously). If, as we believe, the purpose of superannuation is to achieve a reasonable level of income replacement for the 'median worker' in retirement, rather than to reduce the budgetary cost of the Age Pension, supplementing or replacing the age pension is not the right objective.[37]

The best way to assess the appropriate level of compulsory retirement saving is to compare 'median' pre and post retirement living standards.

Figure 8 compares pre- and post-retirement disposable incomes (disposable income replacement rates) for singles and couples without children at different (pre-retirement) income levels, from research by Daley and Coates. Rather than take account of the costs of housing and children directly (which typically decline after retirement), they set a retirement income benchmark of 70% of pre-retirement disposable income. They find that, even before the superannuation system matures (and employer contributions are set at 9.5% of wages or more throughout employment), the existing superannuation system enables singles and couples at all income levels reach the 70% benchmark.[38]

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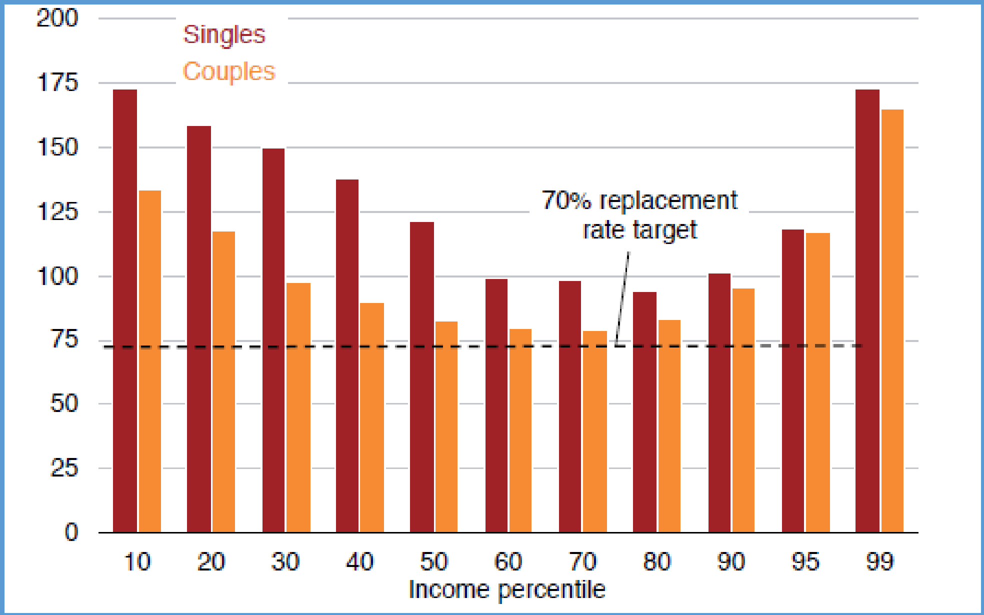
[35] CEPAR (2018), Retirement income in Australia, Part 1 – Overview.

[36] O'Dwyer K (2016), Objective of superannuation: Discussion Paper.

[37] In any event, as discussed below, the superannuation guarantee will not offset the cost of the pension for the forseeable future, due to the resulting increase in the cost of superannuation tax concessions.

[38] These results are based on 37 years of fulltime employment. While many people (especially women) do not have this working pattern, they often retire with a partner who did. Single people with lower fulltime employment participation (and those whose partners also had lower earnings throughout working life) would not necessarily have lower replacement rates after retirement (since their income during working life was low). In the Attachment we call on the Review Panel to model replacement rates for a range of scenarios to reflect the most common patterns of paid employment and family formation among people at different income levels.

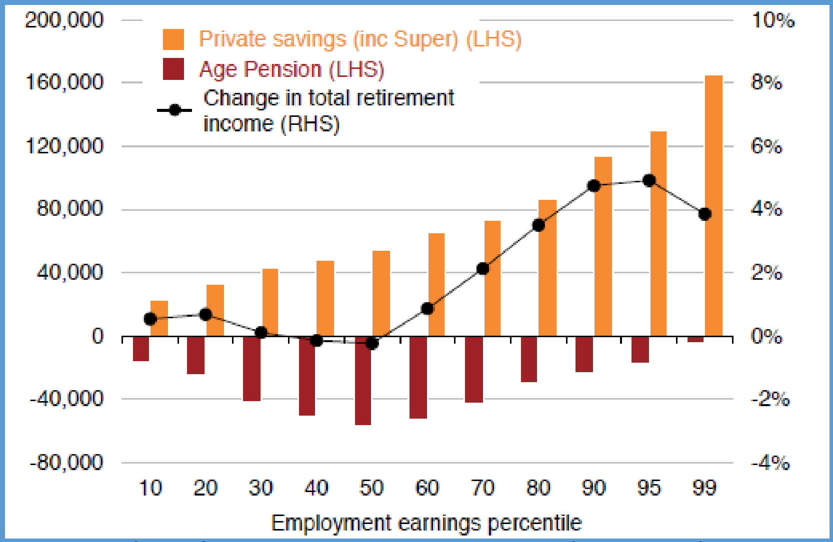
Figure 8: Disposable income for households 65-84 years of age in 2015, as a proportion of that for households 45-54 years in 1995 (in 2015 dollars)



Daley J & Coates B (2018), Money in retirement, more than enough. Grattan Institute.

Daley and Coates also find that an increase in the superannuation guarantee from 9.5% to 12% would make little difference to the retirement incomes of the lowest 50% of workers by income, since they receive little benefit from superannuation tax concessions, superannuation account balances are eroded by fees and insurance premiums, and the increase in their superannuation income is partly offset by pension means tests. (Figure 9).

Figure 9: Change in retirement income from an increase in the superannuation guarantee from 9.5% to 12% in 2015-16 dollars (indexed to CPI)



Daley J & Coates B (2018), Money in retirement, more than enough. Grattan Institute.

To make more compulsory saving worthwhile for people with low and middle incomes, major reform of superannuation tax concessions (discussed later) is essential. On the other hand, easing pension means tests to make additional contributions worthwhile for people with low incomes would be costly to public budgets at a time when governments lack the revenue they need to ease the worst poverty, and properly fund health and aged care (discussed below).

Ideally, benchmarks for income replacement after retirement should take direct account of reductions in the costs of housing and children (that is, it would measure 'spending capacity' after these major costs have been met), instead of relying on replacement rate targets such as 70% of previous disposable income. They should be based on modelling of a fully mature superannuation system (where a superannuation guarantee of 9.5% or 12% applies throughout working life). [39]

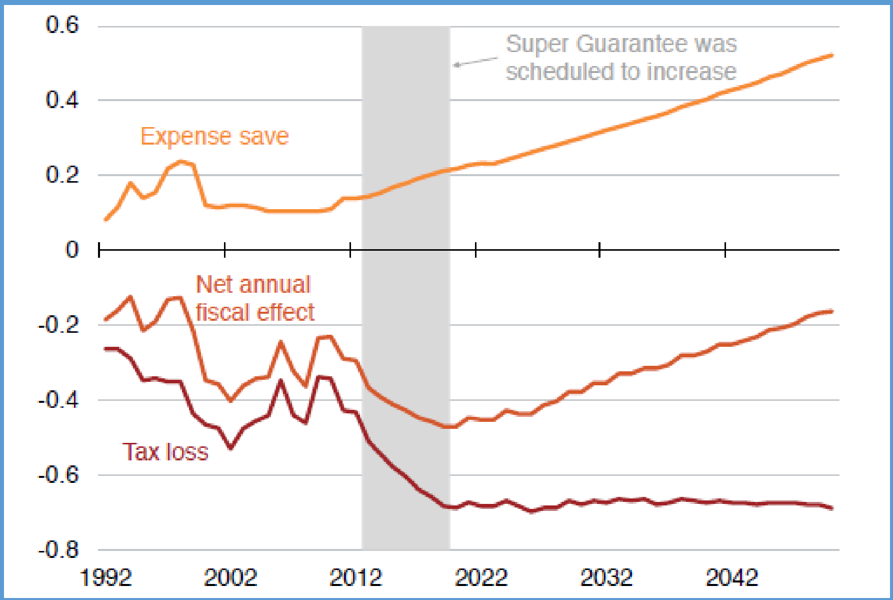
It would be helpful to model replacement rates based on typical employment patterns of single and partnered, male and female workers (with and without children) where the main earner receives a median full-time wage. When modelling replacement rates for couples with children, the typical pattern of male full-time employment and female part-time employment should be taken into account.

[39] The argument that compulsory contributions should be lifted to improve income replacement rates for baby boomers confuses the objective of a fully implemented superannuation guarantee with the (inevitable) transitional problem that this objective will not be achieved for the current generation of retirees. In any event, higher contributions late in working life would not make as much difference to retirement incomes as other strategies, such as delaying retirement or lifting social security payments.

Fiscal cost

Increasing the superannuation guarantee would substantially reduce public revenue, due to larger superannuation tax expenditures. This budgetary impact is likely to exceed savings in Age Pension expenses for the foreseeable future (Figure 10).

Figure 10: Fiscal cost of increasing the Superannuation Guarantee to 12%



Daley J & Coates B (2018), Money in retirement, more than enough. Grattan Institute.

Directions for reform

Any significant benefit in an increase in the Superannuation Guarantee for employees with low and modest incomes should be demonstrated, not assumed. It should only be lifted above 10% if it is demonstrated that increasing the level of compulsory saving would help employees with low and modest incomes (the lowest 50%) lift their retirement living standards within reach of their average pre-retirement level, and that the trade-off between lower incomes before retirement and higher incomes afterwards is worth it.

Another way to ensure that people with low incomes do not experience greater financial hardship in working life while they save for retirement is to broaden the purpose of superannuation to address financial risks throughout working life. Most social insurance schemes in other wealthy nations also provide insurance against unemployment and disability.

While the adoption of overseas social insurance models would be radical change to the Australian social protection system, the existing superannuation system could be adjusted to help people smooth consumption during working life and respond to major social risks such as unemployment.

This could be achieved by allowing people to withdraw from their accumulated superannuation savings to meet non-retirement needs, subject to modest caps on each withdrawal and the overall amount that can be withdrawn before preservation age. Reform along these lines would help those people with low incomes who are effectively forced to retire early due to redundancy, illness, disability or caring roles. In this way, reform along these lines could ease the path to lifting the preservation age.

In any event, the unfair tax system for superannuation contributions should be reformed before the superannuation guarantee is increased, so that compulsory saving is more worthwhile for people with low incomes, and the cost to government of an expansion of tax concessions for people with high incomes is minimised.

Strike the right balance in compulsory superannuation

5. Increases in the Superannuation Guarantee should only proceed if more compulsory saving substantially benefits people on low and modest incomes.

The superannuation guarantee should only increase above 10% where:

a) *The tax treatment of superannuation contributions is reformed* as proposed below:
   - so that people on low wages receive at least the same tax support per dollar contributed as those with higher incomes; and

b) *The increase is justified.* That is, it is either:
   - consistent with the above compulsory superannuation benchmark (to minimise the number of people who are required to save for a higher living standard after retirement than during working life); or
   - the purpose of superannuation is broadened so that fund members can draw down part of their superannuation balance, within modest annual and lifetime caps, to meet long-term saving needs other than retirement; and

c) The superannuation system *must remain universal*, with the same compulsory saving requirements and conditions applying as far as practicable to all employees (so that people on low incomes are not left behind in saving for a decent retirement)

Pillar 3: Superannuation tax concessions

Goals

The purpose of superannuation tax concessions is much less clear than Age Pension and compulsory superannuation. The design and targeting of these tax breaks are a vestige of a previous era when superannuation was for the most part a privilege enjoyed by people with high incomes.

There is a strong case on equity grounds for concessional treatment of compulsory contributions, since public policy requires people to forego consumption now to improve incomes after retirement.

The case for tax concessions for voluntary saving is not so clear cut, especially when the people with the greatest capacity to take advantage of them are those with the highest lifetime incomes.

Some argue that superannuation is not taxed as concessionally as it seems when compared with personal income taxation, since expenditure tax treatment (where contributions and fund earnings are not taxed and benefits are taxed instead) is more appropriate for long-term saving. They argue that income tax treatment is inherently biased against saving.

While elegant in theory, the evidence on the effect of these different tax treatments of saving is mixed. We do know that deferring tax until savings are spent disproportionately benefits people with higher lifetime incomes (and saving opportunities), and that people with high incomes are more likely than those with lower incomes to save in the absence of tax breaks. This suggests that the optimal tax treatment for long-term saving is a uniform tax discount off normal marginal income tax rates, along the general lines proposed by the Henry Report.[40]

Superannuation tax concessions should offer at least the same public support per dollar contributed to people with low incomes as they provide to those with higher incomes.

The concessions should be capped at a level that ensures governments are not subsidising 'luxury' retirement living standards, and the system should guard against the use of superannuation for estate planning (bequests).

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[40] "To sum up, a reasonable estimate for the share of new savings in total retirement savings in tax-favoured plans would be between a quarter and a third. Low-to-middle income earners are more likely to respond to tax incentives by increasing their overall savings, but they hold disproportionately less of private pension assets. By contrast, high-income earners hold a large share of total private pension assets but tend to reallocate their savings.'' OECD (2018), Financial incentives and retirement savings (p95);

See also Henry K et al (2008), Australia's Future Tax System, Report to the Treasurer.

Strengths and weaknesses of present system

Inequitable treatment of people at different income levels

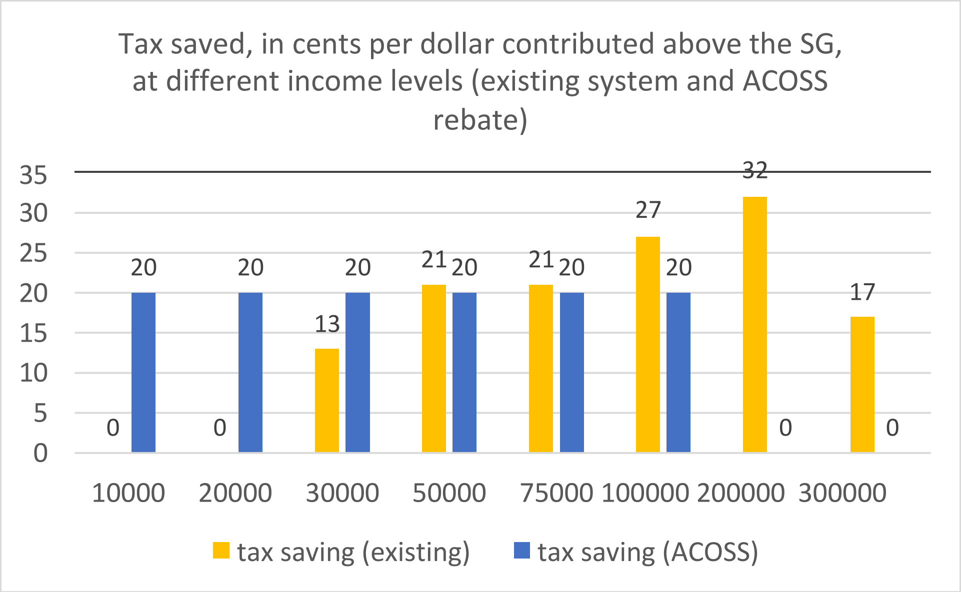
The poor design of superannuation tax concessions is the greatest weakness of our retirement income system, and ACOSS has argued for major reform in this area for over 30 years. Changes have been made, but these have been piecemeal and have failed to address the structural flaws. Those who object to 'too much change' in this area should support structural reform so that the fundamental problems can finally be resolved.

The first problem is that the $25 billion in annual tax breaks for contributions are complex and inequitable. The flat 15% tax on employer contributions, together with the deduction for self-employed people, gives people with high incomes a greater tax saving, per dollar contributed, than those with lower incomes. Half the overall cost of superannuation tax concessions goes to the highest 20% of taxpayers by income.[41]

Flat taxes on labour incomes are rightly rejected by most people, yet they have been tolerated for too long in the superannuation system.

Figure 11 shows that a person (typically a woman) earning $20,000 receives no tax benefit from employer contributions, since the Low Income Superannuation Tax Offset only offsets the 15% superannuation contributions tax. In contrast, a person earning $200,000 (typically a man) saves 32 cents in tax per dollar contributed.

Figure 11: Tax saving per dollar contributed at different earnings levels



Note: This graph compares existing tax concessions on employer contributions to superannuation (left hand bars) with the ACOSS reform proposal described below (right hand bars). It shows the tax saving per extra dollar invested in employer contributions above superannuation guarantee levels (9.5%). The proposed 20% rebate applies at all income levels (it is capped but not income tested).

41 Daley J & Coates B (2016), Super tax targeting, Grattan Institute.

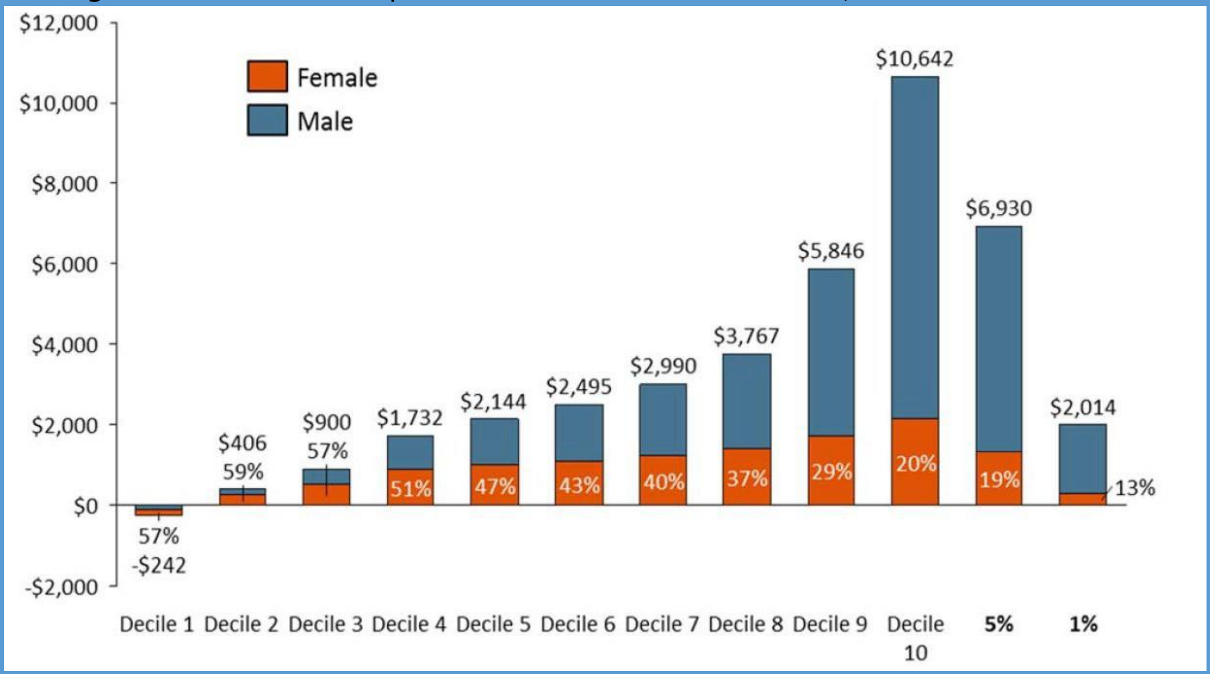
Inequitable treatment of women

The system particularly disadvantages women, who have lower earnings and marginal tax rates than men. Including part-time workers, the average female salary is $44,000.[42]

In 2017, 11% of female taxpayers earned less than $30,000 compared with 9% of men. At those income levels, people generally receive no tax benefit from super contributions.

The superannuation tax bias in favour of people with high incomes compounds the disadvantages faced by women when saving for retirement, including reduced paid workforce participation while caring for children, and lower rates of pay. Two thirds of the value of superannuation tax concessions goes to men, leaving just one third for women (Figure 12).[43]

Figure 12: Value of superannuation tax concessions $ millions in 2014-15



Source: Industry Super Australia (2016), Submission to Senate inquiry into economic security for women in retirement.

Consequently, the average superannuation account balance for women approaching 65 years is just two-thirds that for men. In 2017, average superannuation savings for a woman aged 60-to-64 were $227,800 compared with $336,360 for a man of the same age.[44]

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[42] Women in Super, Facts about Women and Super, at https://www.womeninsuper.com.au/content/the-facts-about-women-and-super/gjumzs

[43] Industry Super Australia (2016), Submission to Senate inquiry into economic security for women in retirement.

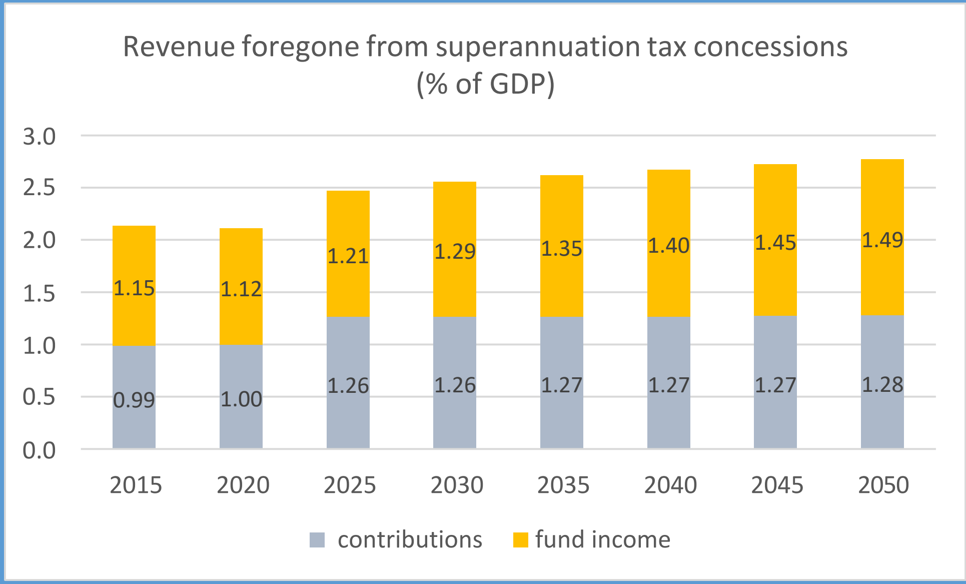
[44] Myer R (2019), Why the figures on women's superannuation are not always what they seem. New.Daily 19/12/2019 https://thenewdaily.com.au/finance/superannuation/2019/12/19/super-women-gender-gap-surprise/

Budgetary cost of superannuation tax concessions

In 2019-20, tax concessions for superannuation cost $45 billion (compared with full income tax treatment of super contributions and fund earnings), about the same as the cost of the Age Pension.[45] Of this amount, $19 billion was due to tax breaks for contributions (mainly the flat 15% tax rate on employer contributions) and $26 billion was due to concessional treatment of the investment income of super funds (15% in accumulation phase and zero in pension phase).

The cost of these tax concessions is rising rapidly as the population ages and the superannuation guarantee matures (Figure 13). The main driver of budgetary costs is now the concessional treatment of the investment income of superannuation funds, discussed in the next part of this submission.

Figure 13: Superannuation tax expenditures (% of GDP from 2015-2050)



Source: OECD (2019), The long-term fiscal cost of tax incentives to promote saving for retirement, in OECD (2019) Financial incentives and retirement savings.

This poses the greatest threat to the fiscal sustainability of the retirement income system, as public revenues will be squeezed just as more people need health and aged care services, a problem we discuss in the next part of this submission.

Directions for reform

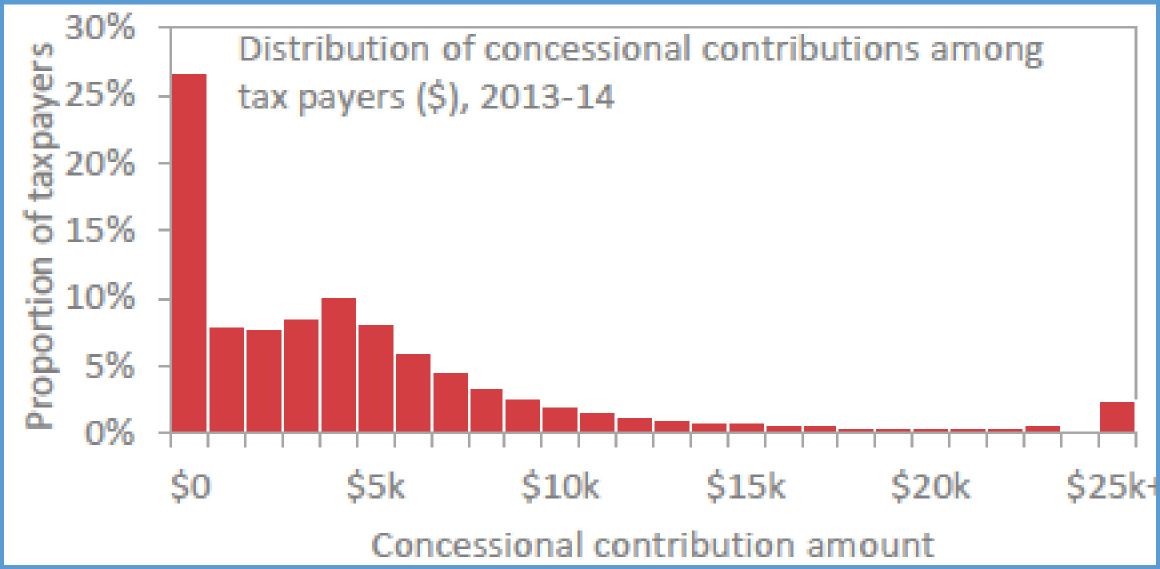
The complex and inequitable system of contributions taxes should be reformed before a further increase in the super guarantee is considered.

[45] Frydenberg J & Cormann M (2019), Budget Paper No 1, Australian Government.

This can be done by replacing the present system of concessional tax rates, deductions, and partner and 'catch-up' contributions with a simple two-tier rebate that is credited to super accounts at the end of each financial year (including those of fund members whose incomes are too low to pay income tax) for contributions *from all sources* up to a modest annual cap.

The rebate could, for example, be paid at a rate of 20 cents per dollar contributed from any source up to annual cap of $15,000. As Figure 14 shows, only a small minority of people can afford to contribute more than this in a single year (these people generally have high incomes).

Figure 14: Proportion of taxpayers benefiting from concessional super contributions at different annual contribution levels



CEPAR (2019), Retirement income in Australia, Part 3: private resources.

Reform should be kept revenue-neutral, by redirecting tax savings from people with high incomes to those with lower incomes. There is no justification for increasing the already heavy cost of tax concessions for retirement saving.

In addition, to make super worthwhile for people with very low incomes, the majority of whom are women, a higher rebate could be paid for (say) the first $500 a year contributed to super accounts.

This would not add much to retirement savings of people with high incomes (whose tax concessions would be reduced by the overall reform), but it would make a major difference for people who receive low wages for much of their lives.

Alternately, the superannuation accounts of people with low incomes could be 'topped up' by modest government co-contributions where accumulated savings consistently fall below minimum thresholds, as proposed by Industry Super Australia.[46]

The impact of our proposed reform on the tax savings available to people at different income levels *on the next dollar contributed* above the present super guarantee level (9.5% of wages) was shown in Figure 11 above. If the ACOSS rebate was implemented, the distribution of *average* (or overall) tax rates on super guarantee contributions would be more progressive than indicated here.[47]

Tax concessions should be capped at a level designed to ensure they do not subsidise a 'luxurious' living standard in retirement. This benchmark could be set at the living standard of a worker on an average full-time wage and their partner (if any), with adjustments for higher costs of housing and children (if any) before retirement.

To curb tax avoidance through re-contribution strategies, only *net* contributions (new contributions minus any benefits paid in a given year) would attract the rebate. The concessional contributions cap would also apply to net annual contributions.

Further, to reinforce the role of superannuation as a *saving* vehicle, self-managed funds should no longer be able to borrow to purchase investment assets such as property.

Make superannuation fairer

6. Fair and simple tax concessions for superannuation contributions

a) All tax concessions for superannuation contributions (including the 15% employer contributions tax rate, deductions for contributions, and rebates for contributions by people with low incomes and for spouses) should be replaced in a revenue-neutral way by an annual two-tier refundable rebate paid into the fund, that is capped at a contribution level sufficient to support (along with the Age Pension) an acceptable retirement income for a typical worker.
b) The rebate for concessional contributions would be structured as follows:

- 100 cents per dollar contributed from any source up to $500 per year (not income-tested, indexed to movements in average fulltime earnings), to support retirement saving by low paid part-time workers and replace the Low Income Super Tax Offset;

[46] Industry Super Australia (2016), Submission to Senate Inquiry into economic security for women in retirement. https://www.aph.gov.au/DocumentStore.ashx?id=73b1524f-fa47-458c-a447-99c1a42c8c9b&subId=406297

[47] Since Figure 11 models the marginal tax saving on contributions above the superannuation guarantee level, it does not capture the effect of the higher 100% rebate for the first $500 of contributions.

- plus 20 cents per additional dollar contributed (refunded for those below the tax free threshold) from any source up to $15,000 (indexed to movements in average full-time earnings), with no higher cap for 'catch-up' contributions;
- for this purpose, contributions would be calculated as *net* contributions, that is all contributions made to a person's superannuation accounts in a given year minus any benefits paid, in order to curb tax avoidance through 're-contribution strategies.

c) The annual non-concessional contributions cap should be reduced to three times the new concessional cap ($45,000), and the ability to contribute up to three years' contributions within the cap in a single year should be removed.

d) The exception to the general prohibition on direct borrowing by super funds for limited recourse borrowing arrangements by self-managed funds should be removed.

Pillar 4:
Guaranteed access to quality health and aged care

Goals

Everyone should have access to quality, affordable health and aged care services when needed.

Essential health and aged care services should be provided universally, without distinction based on people's income and resources. People can pay extra for 'luxury' services (such as luxury accommodation in residential aged care services), but the essential components of health and aged care services – especially good-quality care, should be equally available to all.

In practice, this means that good quality health and aged care services are guaranteed for all, out of pocket charges are kept to a minimum, and that everyone with capacity to contribute – regardless of age – does so.

The fairest and most efficient form of 'risk pooling' for this purpose is the income tax system.

Strengths and weaknesses of present system

The core strength of our health and aged care system is our system of universal primary and acute care services provided through Medicare, public hospitals, and the Pharmaceutical Benefits Scheme. These programs entitle people to health care based on need rather than income.

The main weaknesses include serious gaps in health care entitlements such as dental and mental health services, high out of pocket specialist fees and a poorly regulated and under-resourced aged care system with excessive out-of-pocket fees.

Our poor-quality aged care system requires better funding and regulation

We focus on aged care given its particular relevance to older people and the exposure of appalling maltreatment of people at one of the most vulnerable stages of life by the Aged Care Royal Commission.[48] Older people deserve a better system of care where, as far as possible they can age in place, and remain active, socially engaged, and in control of the care they receive. There is a pressing need for decent, enforceable standards of quality care, including adequate levels of suitably qualified health care workers. The backlog of over 100,000 home care places must be reduced. A viable workforce development strategy must be agreed between governments, employers, unions and training providers.

This will require a substantial lift in funding as well as a reorganisation of the way in which care is provided, financed and regulated.

[48] Royal commission into aged care quality and safety (2019), Interim report – Neglect.

Even the present, poor-quality aged care system is projected to cost the Commonwealth government an additional $5 billion a year (on top of the $18 billion currently spent) in a decade's time due to population ageing alone.[49]

The cost of health services is projected to rise by $3 billion a year due to ageing, and by much more than this for other reasons especially advances in technology and treatments.

Higher user charges are not the solution

In 2017, almost one quarter ($5 billion) of the $22 billion spent on aged care came from users through out-of-pocket expenses.[50] The bulk of user charges ($4.5 billion) were for residential aged care, contributing almost 30% of the cost of those services.

There is an inconsistency between free public hospital care and user charges for care (by nurses and carers) in aged care services. The Henry Report argued that the care component of aged care should not attract user charges.[51]

Growth in user charges in aged care and health services causes needless anxiety and discourages older people from drawing down their superannuation and fully enjoying their retirement while they are still healthy. Most retired people are drawing down their super at close to the minimum draw-down levels. [52]

The interaction between superannuation draw-downs and residential aged care deposits and fees is subverting the purpose of superannuation. For example, many retired people set aside a large part of their superannuation to pay for the substantial residential care accommodation deposits. If they enter residential care and retain the main residence, their adult children are likely to receive a tax free inheritance comprising (at the least) the home plus the refunded accommodation deposit.

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[49] Parliamentary Budget Office (2018), op cit.

[50] Aged Care Financing Authority (2019), Seventh report on the Funding and Financing of the Aged Care Industry.

[51] Henry K et al (2008), op cit.

[52] Coates B (2019), op cit; http://au.milliman.com/insight/2018/Surprising-new-research-reveals-the-majority-of-Australian-retirees-spend-less-than-the-Government-Age-Pension/ ; https://chf.org.au/sites/default/files/20180404_hear_our_pain.pdf

Taxation is the best way to fund future aged care and health services

A universal system of risk-pooling is required to fund health and aged care equitably and to avoid the emergence of a two-tier system of care in which quality of care depends on people's income. We should learn the lesson from our system of (mostly) privately-funded dental care which has clearly failed to provide a decent service for people with low incomes who cannot afford private health insurance.[53]

Since we will all need health and aged care at some stage in our lives, these risks should be pooled across the adult population, according to people's ability to pay. While some advocate separate systems of compulsory insurance or 'savings accounts' to finance aged care, this would draw more rigid funding boundaries between health services and aged care, which may give rise to cost-shifting and discourage innovation in aged care. [54]

Further, the introduction of an additional 'purchaser' in the health and aged care systems could make it more difficult for both governments and service users to contain future costs. We can learn here from the inefficiencies of our parallel systems of public health funding and publicly-subsidised private health insurance, which enable medical specialists to charge more than they could in a hospital system with a single public purchaser.

The most equitable and cost-effective financing arrangement currently available for aged care and health is income taxation. Experience with the National Welfare Fund (to finance social security payments) and later the Medicare Levy, suggest that equitable tax reforms linked to essential payments and services are widely supported, without the need for rigid hypothecation of expenditure to new revenue sources. This also helps to hold future governments to account to provide essential services.

Growing gaps in the personal income tax base must be closed

There are two major gaps in the personal income system which will loom larger as the population ages:

- only 16% of older people pays income tax, and
- wealthy people disproportionately benefit from the tax-free status of investment income received by their superannuation funds, once the fund pays a pension.[55]

These weaknesses in the taxation of older people undermine the principle that all should contribute to the cost of essential services if they can afford to do so, regardless of age.

[53] Australian Institute of Health and Welfare https://www.aihw.gov.au/reports/dental-oral-health/oral-health-and-dental-care-in-australia/contents/introduction

[54] Access Economics (2010), The future of aged care in Australia. Report for National Seniors.

[55] Daley J & Coates B (2016), op cit.

We have to choose between over-generous tax breaks for retirement, decent services, or a steep rise in out of pocket costs for health and aged care.

Despite welcome reforms in 2016, the tax treatment of superannuation after retirement remains extraordinarily generous, especially for people with substantial wealth. In addition to the exemption from income tax of superannuation benefits, the investment income of a super fund is no longer taxed once it pays a pension to a fund member.[56] In contrast, during the so-called 'accumulation phase' interest, dividends and other investment income of super funds are taxed at the still-concessional rate of 15% (10% in the case of capital gains).

Figure 13 (above) showed that the concessional tax treatment of the investment income of superannuation funds, which currently costs the government $26 billion a year, is the fastest growing component of tax expenditures for superannuation.

Re-contribution strategies (where a fund member who receives a superannuation pension makes fresh contributions to super in the same year, thereby 'churning' their income through super) have blurred the distinction between 'accumulation' and 'pension' phases of superannuation. As the Henry Report recommended in 2009, this distinction should be removed and the same tax rate should apply to super fund earnings before and after retirement.[57] This would greatly simplify the system as well as reducing the budgetary cost of the tax concessions (provided the same 15% tax rate applies).

As well as undermining public revenue as the population ages and the superannuation system matures, the non-taxation of fund earnings in the so-called 'pension phase' opens up tax avoidance opportunities that have little to do with saving for retirement. People can avoid paying tax on capital gains accrued through working life by transferring or retaining assets in a self-managed superannuation fund until they reach the age of 60 and the fund pays them a pension, at which point the fund's earnings, including capital gains, are tax free. Small business owners can transfer assets into their super fund tax-free, taking advantage of the CGT rollover for small business assets used for retirement.

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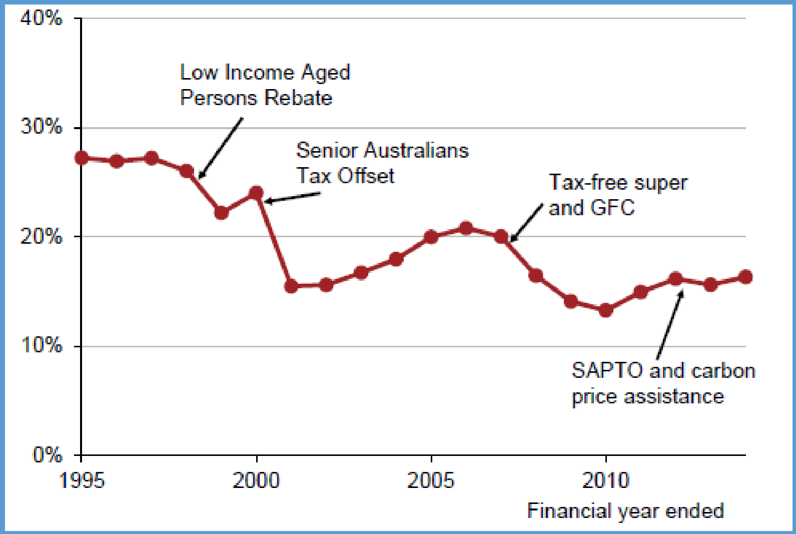
[56] Superannuation benefits were largely exempted from income tax after 2007. This is consistent with income tax treatment of savings (for example, money saved in bank accounts is not taxed on withdrawal). However, this is in addition to the exemption of the investment income of funds paying superannuation pensions, and very generous tax concessions for contributions and fund earnings in the accumulation 'phase'.

[57] Henry K et al (2009), op cit. Tax avoidance through re-contribution strategies was addressed *in part* by the government's decision in 2016 to apply the 15% tax rate to the investment income of 'Transition to Retirement' accounts.

In addition, the 17% tax on superannuation assets transferred to a deceased estate, which at least prevents part of superannuation savings from being used for bequests, can be avoided by transferring superannuation savings from 'concessional' to 'non-concessional' accounts. This facilitates the use of superannuation as an estate management tool as well as a tax avoidance tool.

People aged 64 years and over receive age-based income tax concessions in addition to those for superannuation. An older couple has an effective tax free threshold of $58,000 in addition to the tax free status of any superannuation benefits, around 50% higher than the tax free thresholds for a couple of working-age. As a result, the vast majority of older people pay no income tax (Figure 15).

Figure 15: Proportion of people over 64 years who pay personal income tax



Daley J & Coates B (2016), Entitlement of age, age-based tax breaks, Grattan Institute

Higher tax free thresholds for older people are largely due to the Seniors and Pensioners Tax Offset (SAPTO), a tax rebate for people of pension age. In its first iteration, its purpose was to exempt individuals receiving the maximum rate of pension (with private income below the 'free area') from income tax. Over time, it was extended to retirees who were too wealthy to receive a pension and then increased.[58] In addition, older people have higher tax-free thresholds for the Medicare Levy.

Another major weakness in our system of health care financing is the narrow definition of income used when calculating the Medicare Levy. Currently, the income base for the Medicare Levy is taxable income, which opens up opportunities for taxpayers to avoid paying it by taking advantage of negative gearing arrangements, salary sacrifice, or the use of private trusts.

[58] Daley & Coates (2016), op cit.

On the other hand, the income definition for the high-income Medicare Levy Surcharge ('MLS income') restricts these tax avoidance opportunities. This broader definition should extend to the Medicare Levy itself.

Directions for reform

Universal service guarantees and quality standards should apply to essential health and aged care services, without increasing out-of-pocket costs.

These service guarantees can be financed by removing age-based biases from the personal income tax, trimming superannuation tax concessions post-retirement, and strengthening the tax base of the Medicare Levy. In this way, everyone will contribute according to their capacity, regardless of their age, without the need for increases in the standard personal tax rates.

A robust public revenue base for health and aged care

Good-quality health and aged care services should be universally guaranteed for all regardless of their financial resources. To ensure they are properly and securely funded, the income tax system should be reformed so that everyone with capacity to contribute does so, regardless of age and investment choices.

7. Tax superannuation fund earnings after retirement to help pay for aged care and health

a) The 15% tax on fund earnings in the 'accumulation' phase should progressively be extended to the 'pension' phase over a three-year period from July 2021 (with a 5% increase each year).

b) This tax should be offset by a 15% rebate (minus any imputation credits) for taxpayers over the preservation age whose income (including Age Pension, earnings, superannuation and other investment income) falls below the taxpayer's tax free threshold. The rebate would be calculated each year by the ATO and deposited in a superannuation fund chosen by the taxpayer.

c) Close off opportunities for taxpayers to avoid or reduce tax on capital gains accrued during working life by holding assets in a self-managed super fund.

d) Ensure that transfers from superannuation accounts to the estates of deceased fund members (apart from spouses and dependent children) are taxed at the statutory rate of 17%.

e) Revenue collected from these measures (which would rise substantially in later years) should be earmarked for public expenditure on aged care, health, and disability services

8. Remove age-based tax concessions to help finance health and aged care services

a) The Seniors and Pensioners Tax Offset (SAPTO) should be restricted to pension recipients and redesigned so that it exempts the pension plus private income within the pension 'free area' from income tax.
b) The Medicare Levy exemption threshold for people over 64 years should also be equal to the relevant pension plus the 'free area'.
c) Revenue collected from these measures should be earmarked for public expenditure on aged care, health and disability services.

9. Strengthen the Medicare Levy

a) From 1 July 2020, the income definition for the Medicare Levy should be broadened from 'taxable income' to 'Medicare Levy Surcharge income' to prevent people from avoiding the Levy by using tax shelters such as private trusts, negative gearing or salary sacrifice arrangements.
b) Revenue raised from this change should be earmarked for public expenditure on essential health and disability services.

Pillar 5: Secure and affordable housing

Goals

Everyone should have decent, affordable and secure housing.

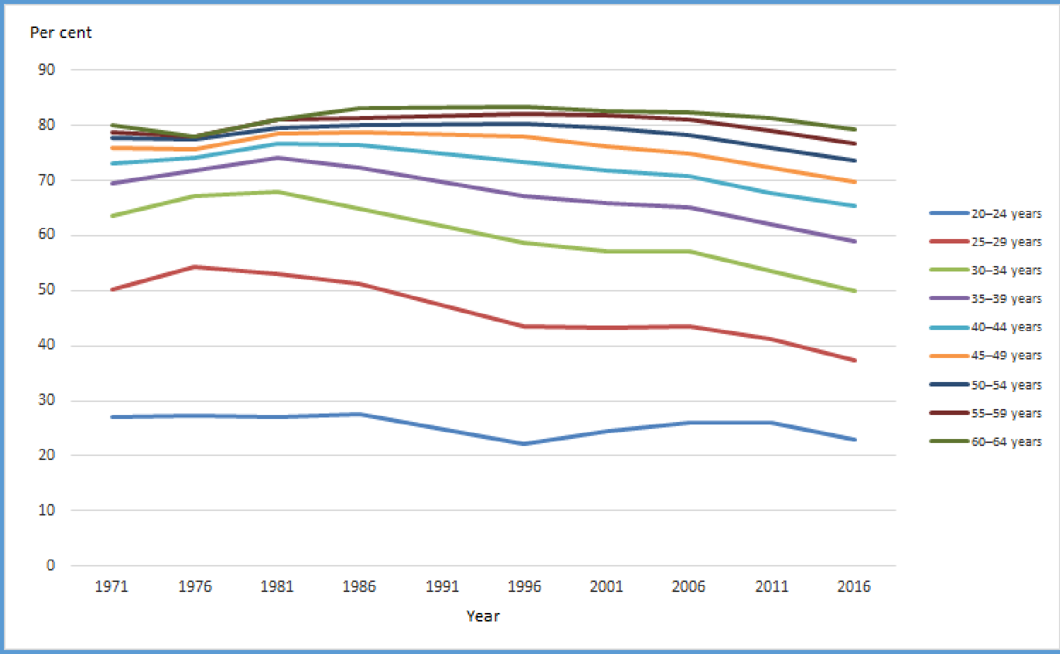
Strengths and weaknesses of present system

Our retirement income system is built on the foundation of home ownership among retired people. As discussed previously, poverty levels among older people who own their homes are much lower than for those who rent.

This foundation is crumbling, as a diminishing share of people approaching retirement owns their home (Figure 16).

In 2016, 11% of people aged 65 and over were renting. This is likely to increase in future years, since the share of people aged 50-54 years who own or are purchasing their home declined from 85% in 1996 to 80% in 2014. [59]

Figure 16: Home ownership by age (1971 to 2016)

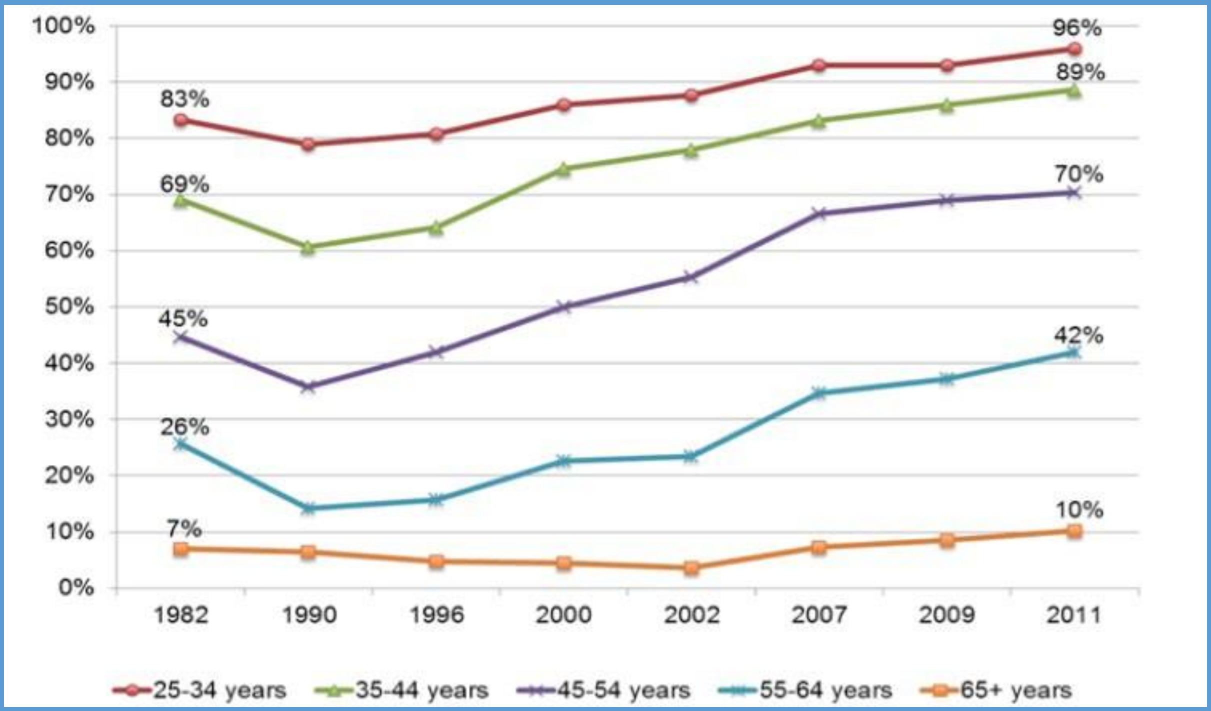


Source: Australian Institute of Health and Welfare https://www.aihw.gov.au/reports/housing-assistance/housing-assistance-in-australia-2018/contents/housing-in-australia

[59] ABS (2016), Census of population and housing; Yates J et al (2017), Housing as a fourth pillar of Australia's retirement income system. Discussion Paper for CSRI roundtable 6-7 April 2017. https://www.abs.gov.au/ausstats/abs@.nsf/Lookup/by%20Subject/2071.0~2016~Main%20Features~Ageing%20Population~14

Further, a growing share of older home-owners (10% of those over 64 years in 2011) still have mortgage debt (Figure 17).

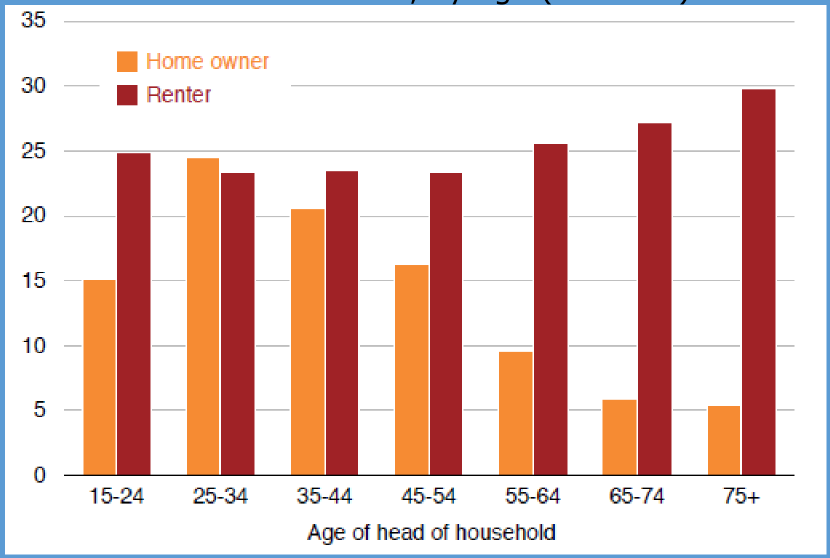
Figure 17: Percentage of home owners with mortgage debt, by age (1982 to 2011)



Yates J et al (2016), Housing as the fourth pillar of Australia's retirement income system, Discussion Paper for CSRI workshop 6-7 April 2016.
https://cfsri.files.wordpress.com/2015/09/yates-ong-bradbury-csri-work-stream-1-discussion-paper-5-aug.pdf

Housing is usually a household's largest single expense. While housing costs generally decline sharply with age for home owners and purchasers, they increase with age (as a share of income) for renters (Figure 18).

Figure 18: Average housing costs as a proportion of household income, by age (2015-16)



Coates B (2018), Money in retirement – more than enough, Grattan Institute.

A secure home is especially important for older people, who are less able to cope with the frequent moves associated with renting privately, and are especially vulnerable when they experience homelessness.

The rise in homelessness is unacceptable in a nation as wealthy as Australia. In 2016, at least 116,000 people were homeless, of whom 19,000 were 55 years or older. [60] The number of homeless persons aged 55 years and above has risen by 28% from 12,461 in 2006 to 18,625 a decade later. The rate of older persons experiencing homelessness has also increased, from 26 persons per 10,000 of the population in 2011 up to 29 in 2016.

[60] ABS (2018), Census of population and housing, estimating homelessness in 2016. https://www.abs.gov.au/ausstats/abs@.nsf/mf/2049.0

https://www.homelessnessaustralia.org.au/sites/homelessnessaus/files/2017-07/Homelessness_and_Older_People.pdf

There is a national shortage of just over 400,000 homes that are affordable for people who are homeless or living on the lowest incomes (the lowest 20% by household income).[61]

Social housing is the most appropriate tenure for people with low incomes who are at risk of homelessness. Residents in social housing are less than half as likely to become homeless as a similar group renting privately.[62] While social housing is targeted to people who are homeless (over one third of new tenants in social housing were previously homeless), the share of all homes that are public or community housing fell from 7.1% in 1991 to 4.2% in 2016.[63] Currently, 190,000 households are on waiting lists for social housing.[64]

Directions for reform

We proposed above a 30% increase in maximum rates of Rent Assistance and a broader review of the supplement to ease the most severe poverty among people renting privately.

In addition, we propose a boost to direct public investment in social housing as a key part of the solution to growth in homelessness. Building social housing is also a cost effective way to strengthen growth in jobs and incomes.[65]

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[61] Lawson J et al (2018), Social housing as infrastructure: an investment pathway, AHURI Final Report 306, Australian Housing and Urban Research Institute.

https://www.ahuri.edu.au/__data/assets/pdf_file/0025/29059/AHURI-Final-Report-306-Social-housing-as-infrastructure-an-investment-pathway.pdf

[62] Prentice D & Scutella R (2018), What are the impacts of living in social housing? Infrastructure Victoria Technical Paper No. 1/18. https://www.infrastructurevictoria.com.au/wp-content/uploads/2019/04/Infrastructure-Victoria-Technical-Paper-%E2%80%93-What-are-the-impacts-of-living-in-social-housing-May-2018.pdf

[63] Australian Institute of Health and Welfare (2018), Housing assistance in Australia. https://www.aihw.gov.au/reports/housing-assistance/housing-assistance-in-australia-2018/contents/priority-groups-and-wait-lists; AHURI (2018), Census data shows falling proportion of households in social housing https://www.ahuri.edu.au/policy/ahuri-briefs/census-shows-falling-proportion-of-households-in-social-housing

[64] Australian Institute of Health and Welfare (2018), ibid.

[65] ACOSS (2019), Social housing as infrastructure. https://www.acoss.org.au/wp-content/uploads/2019/08/ACOSS-Brief-Social-Housing-Investment-as-Infrastructure.pdf

Build social housing to reduce homelessness and ease insecurity among people who are financially vulnerable.

10. Build more social housing

Additional capital funding should be provided to state and territory governments to enable growth in the supply of social housing for people on low incomes, through a $7 billion, 20,000 dwelling package rolled out over the next 3 years, with most construction occurring in the first two years.

Attachment

Data to inform public discussion of retirement incomes policy

1. Adequacy of retirement incomes

1) The incidence of after-housing poverty and deprivation of essentials among:

   - People over 64 years old, disaggregated by family status, housing status, income support status, and wealth holdings
   - For comparative purposes, the same data for people of working age, including older people receiving Newstart Allowance

2) The housing status and costs of people aged 64 years and over, including:

   - Their distribution according to housing status (owner, purchaser, private rental, public rental, other)
   - Trends in the above
   - The distribution of housing costs for each of the above groups

3) Modelling of *average consumption possibilities* (taking account of disposable income, costs of housing and children) in working-life and retirement for cameo households at different super guarantee levels (e.g. 10% and 12%), including:

   - Median single fulltime employees with a typical lifetime earnings pattern
   - Median partnered fulltime employees with a typical lifetime earnings pattern
   - Median partnered fulltime employees with children and a typical lifetime earnings pattern [66]

[66] For example, in this case it would be appropriate to assume that one partner remains in employment fulltime while the other is employed fulltime until a child is born, leaves paid employment for a number of years, then returns to employment on a part time basis for a number of years.

- Average single fulltime employees with a typical lifetime earnings pattern
- Average partnered fulltime employees with a typical lifetime earnings pattern
- Average partnered fulltime employees with children and a typical lifetime earnings pattern
- Separating identifying results for men and women, and the main components of income

4) Modelling of the *distribution of disposable incomes* in working-life and retirement for different households, including

   - Individual incomes, and
   - Household incomes.
   - Separately identifying results for men and women, and the main components of income

5) Detail the modelling assumptions used for the above, including sensitivity testing (especially re: the indexation factor used post-retirement)

2. Distribution of public support for retirement incomes

1) *Cameo* modelling of the net present value of the following public retirement income subsidies across different personal income levels:

   - Age pensions and other income support payments
   - Tax concessions for superannuation
   - Expressed in net present values and as a share of gross annual lifetime incomes
   - Separately identifying results for men and women, and pensions and tax concessions
   - The impact on disposable incomes of different reform options

2) Distributional modelling of the net present value of the following public retirement income subsidies across personal income levels:

- Age pensions and other income support payments
- Tax concessions for superannuation
- Separately identifying results for men and women, and each type of subsidy
- The impact on disposable incomes of different reform options

3. Fiscal cost of public support for retirement incomes

1) Projections of the estimated annual fiscal cost (based on a comprehensive income tax benchmark) of the following public retirement income subsidies over the next (say) 20 years:

- Age pensions and other income support payments
- Tax concessions for superannuation, broken down into contributions, fund earnings in accumulation accounts, fund earnings in draw-down accounts, and other.
- Expressed in dollars and as a share of gross annual income
- Separately identifying results for men and women, and each type of subsidy

2) Modelling of the Budget impact of changed policy parameters on the above (over 20 years or a shorter timeframe):

- Increases in the Super Guarantee
- Options for reform of income support (including Age Pension and Newstart rates, pension means tests, and Rent Assistance)
- Options for reform of superannuation contributions concessions
- Options for reform of superannuation fund earnings concessions

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