What lies ahead

JOHN DALEY reports on the intertwined futures of the superannuation industry and the Australian economy.

The future of the superannuation system will be shaped by Australia's wider economic policy challenges. These include the squeeze on government budgets and the limited opportunities for governments to promote economic growth in ways that are big enough to make a difference. Good superannuation reforms will require a balance between the purposes of super, and the economic challenges facing Australia, especially the looming decade of deficits for government budgets.

BUDGET PRESSURES

The Grattan Institute's 2013 report, *Budget Pressures*, estimated that pressures on Australian governments could reduce their budget balances by four per cent of gross domestic product (GDP) – $60 billion in today's terms.

The biggest single pressure is likely to be the relentless increase in the costs of healthcare, driven not primarily by the population ageing, but from providing more and better health services per person. If health costs continue to increase at the same rate as they did in the last decade, they will consume an extra two percentage points of GDP by 2023.

There will also be pressure to increase welfare payments. Over the last decade, and despite an increasing number of retirees with superannuation, welfare payments for seniors grew $13 billion in real terms, much faster than GDP.

The cost of Aged Pensions increased partly because there are more people over the pension age, and because they are indexed at weekly earnings rather than the consumer price index (CPI). Yet the faster-than-GDP growth arose from specific Government policy decisions to widen eligibility for pensions, and to raise the Age Pension even faster than weekly earnings.

Decisions to spend more on health and Aged Pensions were easier to make over the last decade because government budgets, especially the Commonwealth's, had large tailwinds from the mining boom.

In the next decade, budgets will be under pressure as mineral prices fall, reducing Commonwealth revenues. Estimates from the Treasury, the Parliamentary Budget Office, the Organisation for Economic Co-operation and Development (OECD) and Deloitte Access Economics all agree that the benefit from high mineral prices has been around two per cent of GDP.

The new budgetary environment will change our politics. Over the last decade, specific interest groups often stymied reform simply by identifying a 'loser' group. Reforms from the GST, to carbon pricing, to the Gonski Review, all had to be sold on the basis that no one would be worse off. But improving the budget position means, by definition, that someone will be worse off.

Therefore, improvement on the scale needed may be most likely to succeed if a government is clear that everyone will share the burden.

Thus, it will no longer be enough to show that superannuation reforms will leave some people with less money in their retirement. In future, it may be argued that everyone – including future retirees – needs to share the burden.

ECONOMIC GROWTH – GOVERNMENT OPPORTUNITIES

Faster economic growth would relieve the pressure on budgets. Unfortunately, there is no magic wand labelled 'productivity' in a governments' bottom drawer. What can they do?

The Grattan Institute's 2012 analysis of policy reforms to increase economic growth, *Game-changers*, found only three reforms big enough to matter over the next decade. Changing the tax mix, particularly the balance between company and other taxes, could encourage more investment. Female workforce participation is likely to be higher if reforms to welfare and childcare subsidies encourage women to work when they have young children. Older age workforce participation is likely to be higher if increases to the age of access to the Age Pension and superannuation encourage later retirement. Collectively, these reforms could increase economic growth by five per cent over the decade.

Superannuation has particular impacts on this last reform. Studies of worker behaviour in Australia, and cross-country analysis, suggest that retirement decisions are affected by the age at which people qualify for the Age Pension, and at which they can effectively access superannuation.

From a budgetary and economic growth

perspective, this is likely to be the largest single issue for superannuation for the next few years.

AIMS OF SUPERANNUATION

How superannuation policy might be affected by the pressure on government budgets, and the limited opportunities for government policy to increase economic growth, depends on the policy justifications for superannuation.

Firstly, superannuation aims to encourage 'lifetime income smoothing'. Our brains are hard-wired to over value short-term rewards. Superannuation is a way of forcing people to save more, earlier in their lives, so that they have more towards the end.

Superannuation also aims to encourage intergenerational equity, so that each generation pays for its own retirement, rather than imposing the burden on the next one. This is particularly important when the shape of the population is changing.

Thirdly, superannuation was originally intended to create a pool of Australian capital for investment in Australia. With the increasing mobility of international capital, it is less clear that this is a real economic problem.

Lastly, superannuation is sometimes justified on the basis that it increases retirement incomes. But we would all like to be rich. The increase in retirement incomes must be balanced against the costs. When a government offers concessions on superannuation, it must either collect less tax to pay for them – imposing higher taxes on someone else – or curb current spending, with a cost to the welfare of workers today. These factors must be considered before assuming that higher superannuation balances are in themselves a good thing.

IMPLICATIONS FOR SUPERANNUATION POLICY

Given these justifications for super, what do current economic challenges suggest for major issues in superannuation policy? How should we approach superannuation tax concessions, the access age, lump-sum payouts, and the costs of administration?

Tax concessions

Tax concessions for superannuation are large, and their intergenerational equity is doubtful. Many go to people who are older, and relatively well off, and who would otherwise save anyway, but pay a bit more tax. Tax concessions for people close to retirement do little to reduce intergenerational transfer. On the contrary, they increase the tax burden on relatively young taxpayers to benefit wealthier older taxpayers.

Access to super age

The age of access to superannuation is a key issue for economic growth. Lifting the access to superannuation age to the pension age would both lift growth and improve intergenerational equity.

At present, a third of all super balances are spent *before* people reach pension age. Fully half of those who live to 65 will be alive 20 years. Very few have enough superannuation to fund their entire retirement income for so long. Super spent before pension age, and the tax concessions it attracts, does nothing to improve intergenerational equity.

Ex-prime minister Paul Keating has argued that workers should be able to use their superannuation to fund an early retirement in exchange for giving up their wages to fund superannuation. However, this kind of thinking binds Australia in perpetuity to a particular political deal of the 1980s. Requiring workers to pay some of their income into superannuation accounts is conceptually no different from requiring people to pay tax. It is entirely justified if it prevents one generation imposing the costs of its retirement on the next. It is then perfectly reasonable to limit access to the money, particularly the fruit of tax concessions, until pension age.

Lump sums

One can take a similar approach to the payout of lump sums. The argument is that superannuation is 'my money', and if I choose to spend it all at once, such is my choice. Again, such an analysis ignores the substantial tax concessions provided for superannuation. These concessions are only justified if they improve long-run intergenerational equity by reducing future pension liabilities. Manifestly, superannuation spent in a lump sum does not do so.

The costs of administration

The costs of administration are best illustrated by a brief story. Imagine that a bright young Treasury official dreams up a brilliant new scheme to encourage lifetime income smoothing and improve intergenerational equity. Employers will pay a nine per cent payroll tax into accounts in the name of each worker. These accounts will pay out a pension when workers reach retirement age. A new branch of the ATO will collect the employee contributions, invest the money, and send annual accounts to individual Australians.

The Treasurer is impressed by the presentation. But then the official explains that the new government department to run this system is going to cost around $9.5 billion a year. The Treasurer replies that the idea is interesting, but the costs of administration need further work. The entire ATO is administered for $3.4 billion. For $4.6 billion, the Department of Human Services assesses eligibility, manages the paperwork, and distributes all Commonwealth welfare benefits, medical benefits, and delivers a range of services as well. Surely superannuation can be delivered for less?

The officially-estimated investment and operating costs of superannuation are about $9.5 billion a year. This cost reduces intergenerational equity by making future generations pay more for pensions. Sooner or later, the Commonwealth Government will decide that dollars spent in superannuation administration and fund management are dollars that would otherwise reduce future Commonwealth pension liabilities. If future Australian Government budgets are going to be under more pressure, then more vigorous government intervention is likely.

The Cooper Review stepped in this direction with MySuper. But the opportunity is so large that governments will inevitably look to do more.

THE FUTURE

Australia faces big economic challenges: rising budget deficits and only limited opportunities for governments to increase economic growth.

Super will inevitably feel the pressure for reform. Superannuation recipients will have to shoulder their share of the burden. Therefore, in the longer term, we are likely to see reduced taxation concessions, raised ages for access to superannuation, limits on lump sums, and requirements to reduce the costs of administration. SF

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What do you think about Daley's predictions? Email **mcollins@superannuation.asn.au.**