

23 December 2016

**Submission to Senate Standing Economics Committee Inquiry
into the Superannuation (Objective) Bill 2016**

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Summary

We welcome the Senate Standing Committee on Economics Inquiry into the *Superannuation (Objective) Bill 2016*.

We support the government's plan to establish an objective for our superannuation system. Despite managing more than \$2 trillion in assets, the system has never had legislated aims. Without moorings, the system has provided excessively generous tax breaks that cost the budget \$25 billion each year in lost revenue, while doing relatively little to support the retirement incomes of those in need. Ad hoc changes, without clear aims, have delivered a tangle of rules, limits and exceptions.

A historic view was that superannuation should ensure that capital is available for investment in Australia. But this is a general consequence of well-designed savings regime rather than a particular aim for superannuation. Nor is superannuation required to fund infrastructure. Only a small fraction of super is invested in infrastructure, and there is no shortage of funds for infrastructure assets with proven cash flow.

Instead, super today primarily aims to smooth incomes over a lifetime. So we support the Government's proposal that the primary objective for the superannuation system is to 'provide income in retirement to substitute or supplement the age pension.' This rightly implies that the system should limit support for those with enough means that they are unlikely to receive even a part Age Pension. It also implies that superannuation should not support savings at a high cost to the budget if Age Pension liabilities are only reduced a little.

Superannuation is just one part of Australia's retirement incomes system, alongside the Age Pension and other voluntary savings,

including the family home. Even without counting the family home, most households of any particular age and level of income or wealth hold more wealth outside super than inside super. The superannuation system should not aim to fulfil every objective of the broader retirement incomes system.

So the Committee should reject the view that superannuation's objective is to provide an adequate, or 'comfortable' retirement income for all Australians. This view could lead policymakers to force people to save under the Super Guarantee so that their incomes while working are less than their incomes in retirement. This view misleads, because the Age Pension and Rent Assistance are better tools than super to provide an adequate retirement for those on low incomes. And this view would support maintaining generous tax breaks, at substantial budgetary cost, for those whose retirement will be comfortable without them.

The Committee should also reject suggestions to use the ASFA 'comfortable' retirement standard as a benchmark for the system. This standard supports an affluent lifestyle more luxurious than most households experience during their working lives. The average household can only reach the 'comfortable' benchmark in retirement by being less than 'comfortable' beforehand.

Although not the focus of the legislation under inquiry, it would be worthwhile to set objectives for the retirement incomes system as a whole. These objectives should guarantee some minimum 'adequate' standard of living to those at the bottom. They should help people to maintain a more consistent standard of living across their lives. And they should allow policymakers flexibility to use the right combination of policy tools – superannuation, the Age Pension, and others – to achieve these ends.

1 The purposes of superannuation are becoming clearer

Despite assets of more than \$2 trillion,¹ annual administrative and management costs of \$21 billion,² and tax breaks on contributions and earnings costing \$25 billion in lost tax revenue each year,³ the superannuation system does not have legislated aims.

Originally, the superannuation system was set up to achieve at least four objectives:⁴

1. increasing local savings so that Australia was less dependent on foreign capital for economic stability
2. increasing local savings that could be invested in infrastructure
3. encouraging people to save more while they are working so they have more to spend in retirement
4. reducing future government liabilities for the Age Pension.

The first of these aims – creating a pool of Australian capital for investment in Australia – is less relevant today. It was conceived in an era that was focused on the ‘twin deficits’ – current account and budget deficits – and the concern that Australia was over-reliant on overseas capital to fund its growth. With the increasing mobility of international capital, it is less clear that this is a real economic problem today. While Australian superannuation funds played a significant role in financing the de-leveraging of corporate Australia during the global financial crisis,⁵ the Financial

System Inquiry argued that ‘funding economic activity is a consequence of a well-designed long-term savings vehicle that invests in the interests of its members, rather than an objective in itself’.⁶

Similarly, it is not clear that greater superannuation balances are required to fund infrastructure. Only a small portion of the existing pool is invested in infrastructure.⁷ There is no shortage of funds, from both local and overseas investors, for Australian infrastructure assets with proven cash flow.⁸ Investors are relatively reluctant to support new infrastructure with uncertain returns.⁹ However, this reflects the poor risk and return of these investments, illustrated by a number of high profile failures,¹⁰ rather than any shortage of capital.

Instead the superannuation system today is primarily about consumption smoothing – maintaining a more consistent standard of living across people’s lives, particularly for middle-income earners.¹¹ Superannuation encourages people to save while they are working so they have more to spend in retirement.¹² It is well established that people tend to focus disproportionately on the short term, leading many to save less for their retirement than is

¹ APRA (2016)

² Minifie, *et al.* (2015), p.2.

³ See *Super Tax Targeting*, Section 2.8.

⁴ Greenwood (2010)

⁵ Henry (2009) and RBA (2014), p.171 .

⁶ Financial System Inquiry (2015), p.98.

⁷ Only 4 per cent of funds managed by APRA-regulated superannuation funds are invested in infrastructure (APRA (2015), Table 1d).

⁸ Productivity Commission (2013), p.188.

⁹ *Ibid.*, p.131.

¹⁰ Terrill, *et al.* (2016)

¹¹ Mirrlees, *et al.* (2011), p.288.

¹² The superannuation system also aims in pension phase to encourage people to manage financial risks in retirement (Maddock and King (2015)), an issue beyond this report’s scope.

required to maintain relatively consistent consumption levels across a lifetime.¹³ Although superannuation leads people to save less outside of superannuation than they would otherwise, it leads to higher *total* savings at retirement (including superannuation).¹⁴

Superannuation also requires governments to give up tax revenue today so that governments do not have to spend so much on the Age Pension in future. This encourages intergenerational equity since each generation pays more of the costs of its own retirement, rather than imposing this burden on the next generation.

So overall, the superannuation system is designed to promote retirement savings so that people enjoy a higher standard of living in retirement, but with less support from government through the Age Pension, reducing the burden on future taxpayers.

However, superannuation does not and should not aim to provide limitless support for savings that increase retirement incomes. We would all like to be rich. But the benefits of higher retirement incomes must be balanced against the costs of achieving them.¹⁵

We therefore support the Government's primary objective for superannuation, first proposed by the Financial System Inquiry¹⁶, for the superannuation system to "provide income in retirement to substitute or supplement the age pension". The super system should promote retirement savings so that people enjoy a higher standard of living in retirement, while reducing government's

future Age Pension liabilities, subject to the budgetary costs of doing so.

Implicitly, superannuation should not aim to support the savings of those who already have such ample resources that they are not going to qualify for even a part Age Pension. Of course, some of those that retire without qualifying for the Age Pension may qualify later in retirement as they draw down on their savings.¹⁷

¹³ Financial System Inquiry (2015), p.4.

¹⁴ Gruen and Soding (2011); Connolly (2007).

¹⁵ Daley, *et al.* (2015), p.16

¹⁶ Financial System Inquiry (2015), p.4.

¹⁷ The level of super savings required for a reasonable retirement, and where taxpayer support might be justified, is discussed in Daley, *et al.* (2015), Section 3.3.

2 Retirement incomes are more than superannuation

2.1 The system has multiple components

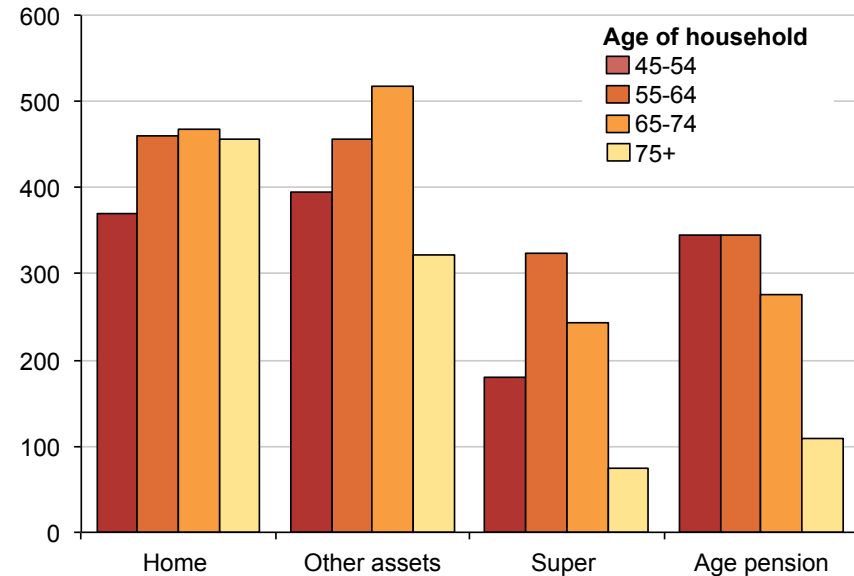
Superannuation savings form only part of Australia four-pillar retirement income system, which is made up of:¹⁸

1. **Voluntary savings in other assets** that can contribute towards living standards in retirement, such as other financial assets, and especially housing and other property.
2. **Compulsory saving through the *Superannuation Guarantee***, currently set at 9.5 per cent of wages.
3. **Voluntary superannuation savings**, including voluntary pre-tax and post-tax super contributions.
4. The **means-tested Age Pension**, provided by government, which guarantees a minimum ‘safety net’ level of income in retirement.

Many commentators equate retirement savings with superannuation. But superannuation savings (pillars 2 and 3) are the least important part of Australia’s retirement incomes system (Figure 1).

Figure 1: Superannuation is the least important ‘pillar’ in Australia’s retirement incomes system

Mean wealth per household by type and age, \$ thousands (\$2013-14)



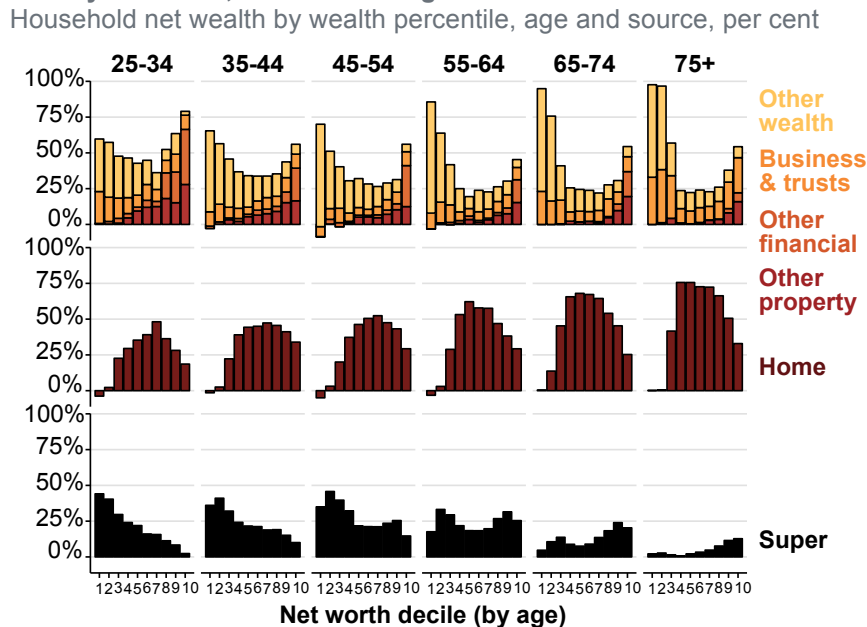
Source: *Super Tax Targeting*, Figure 2.1.

¹⁸ Some authors identify three pillars in the retirement income system, either by combining all superannuation savings into one pillar, or separating out compulsory and voluntary superannuation savings but ignoring voluntary savings beyond superannuation such as housing assets (see Treasury (2009), p.9). More recent approaches distinguish between compulsory and voluntary superannuation savings (Derby (2015), p.17).

2.2 Non-super savings are larger than super

Superannuation savings account for only a quarter of the wealth of most households (Figure 2). Even without counting the family home, the average Australian saves as much outside as inside the super system.

Figure 2: Most Australians save as much outside superannuation as they do inside, across most ages and levels of wealth

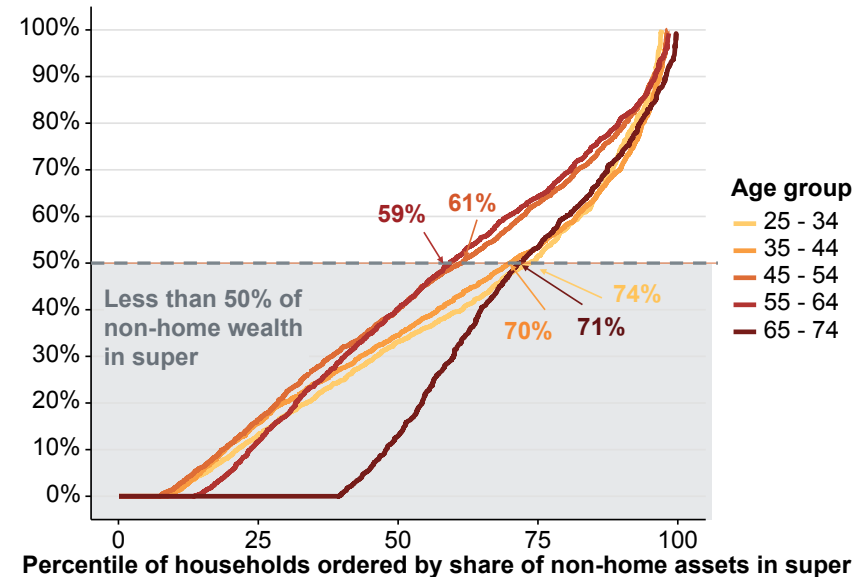


Note: Home is net of related mortgage liabilities; Other property is net of other property loans; business assets and trusts are net of related liabilities; all other wealth is net of all other liabilities; superannuation assets excludes some defined benefit schemes.

Source: Grattan analysis of ABS (2015).

Figure 3: Most households of each age hold less than half their non-home wealth in super

Super share of total non-home wealth by age of head of household, per cent of non-home net wealth



Notes: Non-home wealth excludes owner occupied housing and related mortgage liabilities, but includes investment property equity (net of related mortgages); superannuation assets excludes some defined benefit schemes; excludes households with no or negative non-home wealth.

Source: Grattan analysis of ABS (2015).

Some commentators have claimed¹⁹ that presenting averages of household savings, even across narrowly defined age, income and wealth cohorts, obscures how the majority of households save for retirement. Yet a closer look at the *proportion* of

¹⁹ Industry Super Australia (2016)

particular cohorts that have particular levels of non-super wealth shows that more than half of households in each age group hold more than 50 per cent of their non-home wealth outside of super (Figure 3).

It is true that many of those with little wealth report a larger share of savings in superannuation than in other assets, but only because their total savings are small. For such low-wealth households, the Age Pension will always be their main source of retirement income.

This analysis includes non-investment assets in net wealth, notably vehicles and household effects since these assets support living standards in retirement, either as a potential source of income, or by providing in-kind services to their owners (what economists call imputed rents). That's why they are counted in the Age Pension assets test. Yet even when these components of household wealth are excluded many households report significant non-super assets.

2.3 Non-super savings will remain large

When confronted with facts about the modest contribution of super to retirement savings, super's cheerleaders point out that the system is immature. Compulsory super only began in 1992, with compulsory contributions of 3 per cent of wages, rising to 9 per cent by 2002 and 9.5 per cent since 2014-15. It will be another two decades before typical retirees will have contributed at least 9 per cent of their wages to super for their entire working lives. So surely super will account for a larger share of household savings in future?

While we might expect younger households to save more in super, and less outside, that's not true in practice. Their assets

outside are typically as large as their assets inside superannuation, even without counting home ownership. This is so even for households in the 25-34 and 35-44 age groups who have had high levels of compulsory super for most of their working lives (Figure 2).²⁰

The enduring importance of non-super savings should come as no surprise. While compulsory superannuation forces people to save more via superannuation, there's little evidence that non-super savings have fallen very much in response.

A recent Reserve Bank of Australia study found that each extra dollar of compulsory superannuation savings was accompanied by an offsetting fall in non-super savings of only between 10 and 30 cents.²¹ As a result, compulsory super has added a lot to private savings in Australia – an estimated 1.5 per cent of GDP a year over the past two decades.²²

There is little reason to expect this pattern of non-super saving to change radically. Households hold a material portion of their wealth outside of super so that they have an option to use it before turning 60, and because they are nervous that government may change the superannuation rules before they retire.

²⁰ For a more detailed analysis of trends in asset holdings by age, see Daley, *et al.* (2016); Daley and Coates (2016); and Daley, *et al.* (2016).

²¹ Connolly (2007). That is, there was only a small offsetting fall in other savings in response to the introduction of the compulsory Superannuation Guarantee.

²² Gruen and Soding (2011)

Other asset classes, such as negatively geared property, are taxed lightly and so will likely remain an attractive vehicle for accumulating wealth. Whatever the motivation, many households heading towards retirement have substantial non-super, non-home assets to draw on.

3 Overstating the role of super can lead to poor policy for middle income earners

The fact that many Australians save for their retirement through vehicles outside of superannuation has important implications for the amount of superannuation people need for an adequate retirement. Many people do not rely on just their superannuation savings to fund an adequate, or even a ‘comfortable’ living standard in retirement. Rather, most retired Australians draw on a range of assets to support their retirement – including housing and other investments outside of superannuation.

3.1 Compulsory savings levels

Ignoring non-super savings may lead policymakers to force people to save too much through superannuation. For example, compulsory saving via the Superannuation Guarantee forces people to save while they are working so they have more to spend in retirement.

But there is no magic pudding when it comes to superannuation. Higher compulsory super contributions are ultimately funded by lower wages, which means lower living standards for workers today.²³

3.2 Replacing the Age Pension

Similarly, the superannuation system should not seek to replace the Age Pension entirely for all, or even most, retirees. The budgetary cost of doing so would be crippling. The tax breaks would cost the budget much more than the Age Pension. To ensure that a very large number of people didn’t need an Age Pension, tax breaks would need to support *everyone* to save

enough to support themselves in retirement beyond average life expectancy even if they don’t live this long. Given targeting would not be perfect, there would be substantial tax breaks beyond those needed to replace the Age Pension for most people.

3.3 Most Australians can already expect an adequate income in retirement

In fact current levels of compulsory super contributions and Age Pension are likely to provide a reasonable retirement for most Australians.

If we project forward the retirement income for a median income earner working for 40 years, and account for just compulsory super contributions – in other words, we ignore any voluntary superannuation contributions and savings outside of super – we find that today’s 9.5 per cent Superannuation Guarantee and the Age Pension would provide the average worker with a retirement income equal to 79 per cent of their pre-retirement wage, also known as a replacement rate (Figure 4).

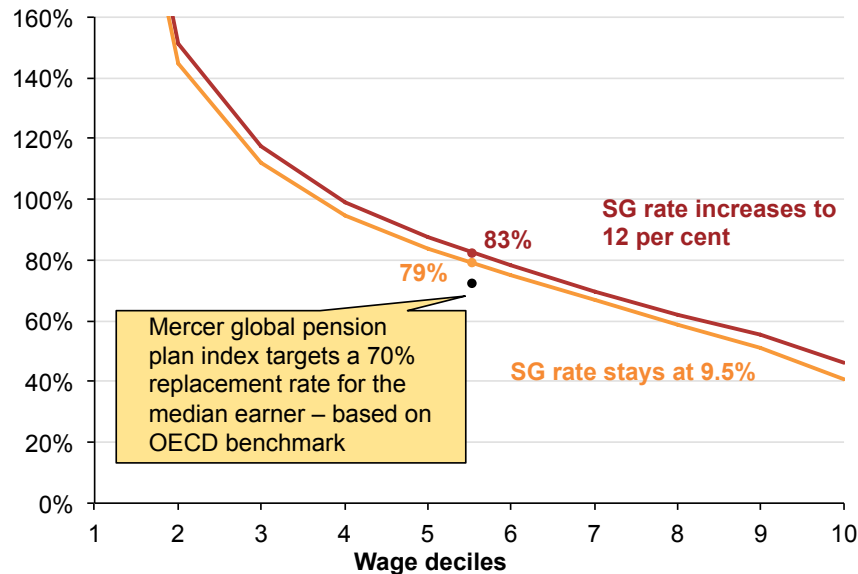
About two-thirds of income earners can expect a retirement income of at least 70 per cent of their pre-retirement income – the replacement rate for the median earner used by the Mercer Global Pension Index and endorsed by the OECD.²⁴

²³ Potter (2016)

²⁴ Mercer (2015)

Figure 4: Under existing super policy, most will largely replace their pre-retirement income

Replacement rate of pre-retirement disposable income, per cent, based on 30 year old in 2016



Note: Assumes a person who works from age 30 and until age 70, retirement lasts until life expectancy at 92. Includes only compulsory savings under the Superannuation Guarantee and the Age Pension. Earnings are assumed to be 6.5 per cent while working and 5.5 per cent in retirement, with an effective tax rate of 8 per cent on earnings. In retirement, superannuation is drawn down consistent with a CPI-indexed pension with no residual balance at death. Higher private savings under a 12 per cent SG are offset by lower Age Pension payments, especially under the new Age Pension assets test. Source: Grattan analysis of ABS (2015); HILDA (2015).

Once non-super savings are taken into account, many workers are likely to have a higher standard of living when they retire in 40 years' time than during their working life. This is before factoring in that many people have lower spending needs in retirement, particularly in the later stages of life when government covers much of their largest costs of health and age care.

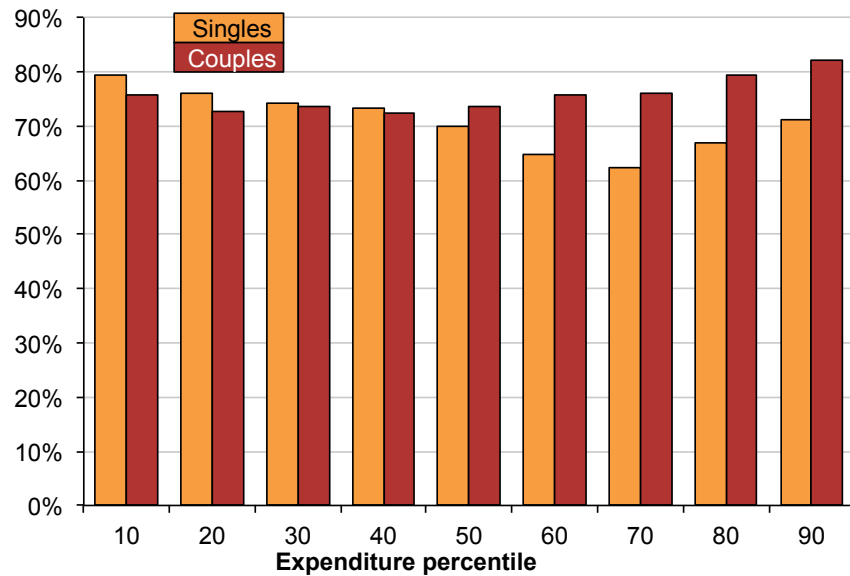
This modelling of the future shouldn't be a surprise. It matches what is already happening today. The non-housing expenditure of retirement-age households today, many of whom did not retire with any super, is typically more than 70 per cent of that of working-age households today (Figure 5).

Current levels of retirement spending appear to be sustainable. Most households in retirement only draw down very slowly on their superannuation and their broader savings. Consequently, most are likely to leave material bequests.

The policy implication is that there is no compelling case to compel households to save 12 per cent of their income through the Super Guarantee as currently legislated. This would effectively compel most people to save for a higher living standard in retirement than they enjoy during their working lives.

Figure 5: Older household replacement expenditure is remarkably consistent

Elderly household expenditure as proportion of working age expenditure (excluding housing), percentage



Note: Elderly household expenditure is for households aged 60-79 years, compared to expenditure of working age households aged 25-59 years single household expenditure, by equivalised expenditure percentile. Expenditure is net of housing related costs.

Source: Grattan analysis of ABS (2013).

4 Overstating the role of super leads to inappropriate policy for low income earners

Compulsory superannuation payments help many middle-income earners to save more for retirement, but super is simply the wrong tool to provide material support for the retirement of low-income earners. Our analysis shows super top-up measures for low-income earners are poorly targeted and an expensive way to help low-income savers. With the Age Pension and Rent Assistance, government already has the right tools for assisting lower income Australians.

4.1 Super can't help many low income earners much

Superannuation is a contributory system: you only get out what you put in. And low-income earners don't put much in. Their wages, and resulting super guarantee contributions, are small and their means to make large voluntary contributions are even smaller. Their super nest egg will inevitably be small compared to Australia's relatively generous Age Pension.

For example, a person who works full time at the minimum wage for their entire working life and contributes 9.5 per cent of their income to super would accumulate super of about \$153,000 in today's money (wage deflated), making standard assumptions about returns and fees. If the balance were drawn down at the minimum rates, this would provide a retirement income of about \$6,500 a year in today's money.

By contrast, an Age Pension provides a single person with \$22,800 a year. For someone who worked part time on the minimum wage for some or all of their working life, super would be even less, but the Age Pension would be pretty much the same.

4.2 Government provides two top ups for low-income earners

Government provides two super top-ups for low-income earners.

- 1. The Low Income Superannuation Contribution (LISC):** introduced by the Labor government in 2013, puts extra money in the accounts of low-income earners who make pre-tax super contributions. Under the LISC, those earning less than \$37,000 receive a government co-contribution of 15 per cent of their pre-tax super contributions, up to a maximum of \$500 a year. The Abbott government was set to abolish the LISC, but the Turnbull government now plans to retain it, renaming it the Low Income Superannuation Tax Offset (LISTO), at a budgetary cost of \$800 million a year.²⁵
- 2. The Super Co-contribution:** introduced by the former Howard government in 2003, puts extra money in the accounts of low-income earners who make post-tax super contributions. It boosts voluntary super contributions made by low-income earners out of their post-tax income by up to \$500 a year, at a budgetary cost of \$160 million a year.²⁶

4.3 Top ups are not tightly targeted to those that need them

The LISC and the super co-contribution aim to top up the super and thus the retirement incomes of those with low incomes. But our research shows about a quarter of the government's support leaks out to support the top half of households.

²⁵ Commissioner of Taxation (2016)

²⁶ Ibid.

Whereas eligibility for the pension is based on the income and assets of the whole household, including those of a spouse, eligibility for superannuation top ups depends only on the income of the individual making contributions. That means the top ups also benefit low-income earners in high-income households. A far better way to help low-income earners is to increase income support payments such as the Age Pension.

Super top ups provide some help to households in the second to fourth deciles of taxpayers. But they do very little for the bottom 10 per cent of those who file a tax return (Figure 6). These households, many of which earn little if any income, only receive about 7 per cent of the benefits of top ups. A further set of households file no tax returns – typically because welfare benefits provide most of their income. Very few of them receive any material super top up.

4.4 Some top up is fair for low income earners

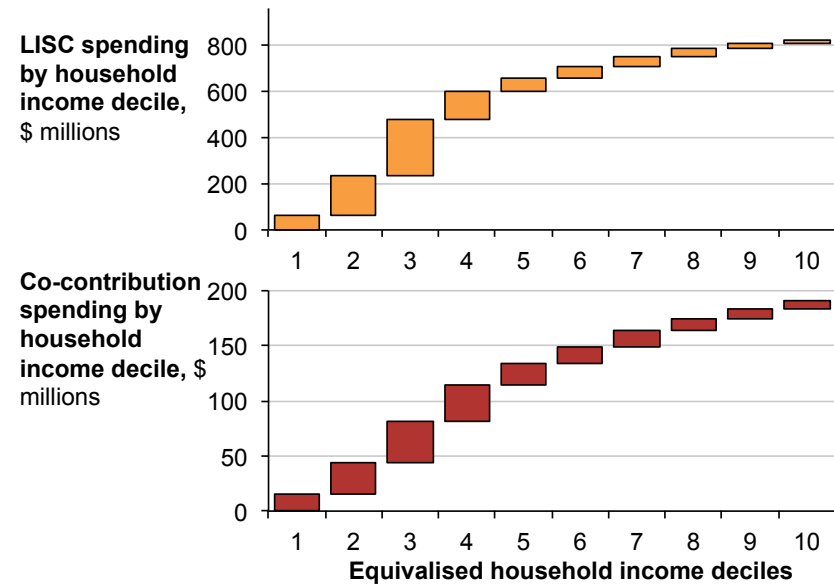
Superannuation compels people to lock up some of their earnings as savings until retirement. High-income earners are compensated for this delayed access because their contributions are only taxed at 15 per cent, rather than their marginal rate of personal income tax.

Without the LISC, which reduces the tax rate on their compulsory super contributions to zero, those earning between \$20,542 and \$37,000 would receive little compensation for locking up their money in superannuation. The 15 per cent tax on contributions would be only slightly less than their 19 per cent marginal tax rate.

And for those earning less than \$20,542, the absence of a LISC would take them backwards when they made super contributions taxed at 15 per cent rather than keeping the money in their pocket

tax free. Reflecting these concerns, the LISC, reborn as LISTO, is a fair mechanism so that lower income earners do not go backwards as a result of super.

Figure 6: A material portion of super top ups goes to well-off households



Note: Household income is constructed using the taxable income of the tax filer and that reported by the filer for their spouse. This household income for couples is equivalised by dividing total income by 1.5. Only includes entitlements for individuals who lodge tax returns.

Source: Grattan analysis of ATO (2016).

4.5 There are better tools to provide adequate retirement incomes for low-income earners

However super top ups should not be expanded. It is too hard to target them tightly at those most in need, and super fees can eat up their value.

Instead, a targeted boost to the Age Pension would do far more to ensure all Australians have an adequate retirement. But there is an even better way to improve the retirement incomes of those most in need.

As previous Grattan research shows, retirees who do not own their own homes are the group at most risk of being poor in retirement. A \$500 a year boost to rent assistance for eligible seniors would be the most efficient way to boost retirement incomes of the lowest paid, at a cost of \$200 million a year.²⁷ Only 2 per cent of it would flow to the top half of households, with net wealth of more than \$500,000.

By contrast, a wholesale \$500 boost to all Age Pension recipients would cost \$1.3 billion, with half the benefit going to households with net wealth of more than \$500,000, mainly because the home is exempt from the Age Pension means test.

²⁷ Daley, *et al.* (2016)

5 Super should not aim to provide a ‘comfortable’ lifestyle in retirement

The Committee should also reject suggestions that the ASFA ‘comfortable’ retirement standard should be the benchmark for retirement incomes. As we showed in *Super tax targeting*, the ASFA ‘comfortable’ standard amounts to an ‘affluent’ lifestyle in retirement more luxurious than most households experience during their working lives.²⁸

Such a high living standard is an inappropriate benchmark for the retirement incomes system. The fact that many households *aspire* to this level of retirement income²⁹ is irrelevant. We would all like to be rich. Average living standards before retirement are less than the ASFA comfortable benchmark. Consequently, the average household can only reach the ‘comfortable’ benchmark in retirement by living less than comfortably before retirement.

High income earners will not be able to expect a retirement income from super alone that replaces 70 per cent of their pre-retirement income. But replacing a percentage of the income of high income earners has not in fact been suggested as a benchmark by either Mercer or the OECD. Instead, both aimed to replace the income of a *median* income earner.

And in practice, high income earners in Australia are typically replacing their pre-retirement expenditure, presumably utilising non-super savings (Figure 5).

²⁸ Daley, *et al.* (2015), p.30.

²⁹ State Street Global Advisors and Rice Warner (2015), p.5

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