Mind the gaps: Why the proposed objective for superannuation isn’t fit for purpose

Submission to the Senate committee inquiry into the Superannuation (Objective) Bill 2023

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Summary

We welcome the opportunity to make a submission to the Committee's inquiry into the Superannuation (Objective) Bill 2023.

Despite managing $3.5 trillion in assets, Australia's superannuation system, and our retirement income system more broadly, have never had legislated aims.

Without moorings, the super system has provided excessively generous tax breaks that cost the budget $45 billion each year and will soon exceed the cost of the Age Pension. The policy settings force most Australians to save more than they need (or are likely to spend) in retirement, turning superannuation into a taxpayer-funded inheritance scheme that exacerbates wealth inequality. Superannuation is being used at great budgetary cost – via failed policies such as co-contribution and carry-forward schemes – in an effort to boost the retirement incomes of vulnerable Australians, when better tools are available.

Setting clear policy objectives can help by anchoring policy changes and boosting public understanding. They can also provide a framework for assessing the system's performance.

Unfortunately, the government's proposed objective for the superannuation system 'to preserve savings to deliver income for a dignified retirement, alongside government support', is unlikely to prove an effective guide to fixing many of these problems. A bad objective for superannuation is worse than no objective at all.

We therefore cannot support the Bill as proposed.

The proposed objective elevates the role of superannuation as the primary source of retirement income, despite the fact that superannuation accounts for less than half the income that retirees draw on today, and will account for little more than half the income of retirees in future. Rather than providing a solid foundation for good policy-making, the proposed objective is a recipe for parochial, super-centric policy-making.

Beyond referencing the importance of preservation, the proposed objective says nothing about how the superannuation system should trade-off current and future consumption, despite the fact the core purpose of the compulsory Superannuation Guarantee is to force Australians to forego spending today in return for more in retirement.

Further, the concept of a 'dignified' retirement is entirely subjective. To the extent 'dignity' has a commonly-understood meaning in relation to retirement income, it pertains to a minimum standard of living, which superannuation cannot guarantee.

There are real challenges to ensuring our retirement income system delivers for Australians, including low-income earners, women, and especially renters. But the Age Pension and Rent Assistance, rather than superannuation, remain the best tools to help people at risk of poverty in retirement. Overstating the role of super risks ineffective and costly policies that divert resources and attention away from policies that can better prevent poverty in retirement.

The government should go back to the drawing board and establish an objective for the retirement income system as a whole, as recommended by the Retirement Income Review in 2020. The Retirement Income Review argued that the retirement income system should aim 'to deliver adequate standards of living in retirement in an equitable, sustainable, and cohesive way'. This remains the best starting point for future work on a more effective objective.

1 Retirement incomes are much more than superannuation

Superannuation plays an important role in helping Australians to save enough for their retirement. Alongside the Age Pension and other government support, non-super savings, and housing, superannuation contributes to retirees' living standards.

But the role of super in supporting retirees' living standards should not be overstated. Many people do not rely on just their super to fund an adequate, or even a 'comfortable', retirement. Rather, most retired Australians draw on a range of assets to support their retirement – including housing, and other investments outside of super – in addition to at least some amount of Age Pension and other government support.

1.1 Australians rely on multiple sources of income in retirement

We identify four 'pillars' of Australia's retirement income system: the Age Pension, compulsory private savings via the Superannuation Guarantee, voluntary private savings, and home ownership. Each of these play a role in ensuring Australians achieve an adequate retirement.[1]

The **Age Pension**, provided by government, helps poorer people avoid poverty in retirement. It guarantees a minimum 'safety net' income in retirement for people who earned low incomes over their working lives, including because they had periods of unemployment, caring responsibilities, or working part-time. The Age Pension is targeted through age, residency, and means tests. Rent Assistance is paid to Age Pension recipients who rent privately or from community housing providers.

But the Age Pension does more than alleviate poverty. It also contributes substantially to the retirement incomes of middle-income Australians.[2] Together with the broader tax-transfer system, it redistributes income towards low- and middle-income retirees, reducing income inequality in old age. And it supports people who live longer than expected and exhaust their private savings (i.e. it provides insurance against 'longevity risk').

Other elements of the income support system, including Commonwealth Rent Assistance, Newstart, and the Disability Support Pension also support retirement incomes for people who do not own their homes in retirement or are unable to keep working until retirement age.

Compulsory private savings via the **Superannuation Guarantee**, currently set at 11 per cent of workers' wages, require Australians to give up a portion of their wages while working, in exchange for a higher standard of living in retirement. The Super Guarantee is legislated to rise incrementally to 12 per cent of wages by July 2025. Superannuation is taxed concessionally compared to most other savings.[3]

Voluntary private savings, including pre- and post-tax voluntary super contributions, other financial assets, and investment property, provide people with additional resources for retirement. Taxes are lower on some forms of savings, especially voluntary pre-tax super contributions, negatively-geared investment property, and assets that accrue capital gains. These voluntary savings are large for many households, particularly the wealthiest 20 per cent.[4]

1. In contrast, the Retirement Income Review specified three pillars: the Age Pension, compulsory superannuation savings, and voluntary savings (including voluntary superannuation contributions): Callaghan et al (2020).
2. Ibid (Chart 2C-5).
3. Coates and Moloney (2023, Figure 1.2).
4. Daley et al (2018, Appendix A).

Home ownership supports living standards in retirement, because home-owning retirees do not need to set aside income for rent. The family home tends to be Australians' largest single asset. Home ownership also partly insures against longevity risk and rising housing costs, and is often used to fund aged care.

Retirement living standards also depend on other parts of the social safety net – especially subsidised healthcare and aged care. The costs of specific healthcare and aged care needs are best met via targeted supports or universal health services, rather than by pushing all retirees to save and self-insure against these potential costs themselves. Government already funds most aged care costs, for both residential and home-based aged care.[5]

1.2 Superannuation is far from the most important part of Australia's retirement income system

As outlined in section 1.1 on the preceding page, retiree living standards are supported by a range of resources and policies. Super is just one of these, and certainly not the most important. Among current retirees, only the well-off rely on super for a material share of their income.[6]

Future retirees will retire with larger balances, and so super will play a larger role in retirement incomes. But even by 2062, the median retiree will still draw on the Age Pension.[7] In fact, the Retirement Income Review expects nearly half of younger Australians today to receive half or more of their income from the Age Pension when they retire in three decades' time.[8]

And most retirees will still rely on non-super savings. Superannuation savings account for only 20-to-25 per cent of the wealth of households.[9] While superannuation will account for a larger share of retirement savings as the system matures, other sources of retirement savings will remain important. Even younger Australians hold a substantial share of their savings outside of super.[10]

The enduring importance of non-super savings should come as no surprise. While compulsory super forces people to save more via superannuation, non-super savings have not fallen much in response.[11]

In particular, home ownership will remain a key determinant of retirees' living standards. Retirees who rent are much more likely to be in poverty or financial stress, in no small part because home-owners can expect their housing costs to decrease in retirement, whereas renters can expect them to increase.[12] Further, home-owning retirees benefit from having only the first $242,000 of home equity assessed in the assets test.[13]

5. Callaghan et al (2020, pp. 440–443).
6. Coates and Moloney (2023, Figure 3.2).
7. Australian Government (2023, Section 7.5).
8. Callaghan et al (2020, Chart 4A-20).
9. Daley et al (2018, Figure A.2).
10. Ibid (Figure A.2).
11. Coates and Nolan (2020, p. 10).
12. Callaghan et al (2020, Chart 2A-8); and Coates and Nolan (2020, Figures 2.4 and 3.2).
13. See Services Australia (2023). Although rates of home-ownership are falling, particularly among the young and the poor. See Australian Government (2023, Chart 7.22) and Coates (2022).

2 The government's proposed objective won't help solve the problems with superannuation

Despite several attempts, Australia's superannuation system, and our retirement income system more broadly, have never had legislated aims. This has contributed to poor policy settings and outcomes. Excessively generous tax breaks cost the budget $45 billion each year and will soon exceed outlays on the Age Pension.[14] The rate of the compulsory Superannuation Guarantee has been set too high, forcing most Australians to save more than they need (or are likely to spend) in retirement. And there have been repeated, misguided attempts to use the super system to boost retirement incomes for low-income earners.

Setting clear policy objectives can help by anchoring policy changes, boosting public understanding, and guiding assessments of the system's performance. Unfortunately, the government's proposed objective for the superannuation system 'to preserve savings to deliver income for a dignified retirement, alongside government support', is more likely to exacerbate problems than fix them.

It is too broad, traversing policy well beyond the super system. It overstates super's role in the retirement income system (see Chapter 1 on page 3) and is a recipe for parochial, super-centric policy-making.

And it does not provide sound guidance to assess the adequacy of retirement incomes. It downplays the trade-off between more spending today and more spending in retirement. The concept of a 'dignified' retirement is subjective; if it has any shared meaning, it pertains to a minimum living standard, which superannuation cannot guarantee.

The biggest risk of the proposed objective is more misguided attempts to use super to achieve equity objectives that crowd out the use of better tools in the income support system.

14. Australian Government (2023, p. 171).

2.1 Previous attempts to set objectives have failed

There have been several attempts to specify the objectives for superannuation, or the retirement income system as a whole.[15]

In 2016, the then Coalition federal government sought to legislate an objective for superannuation to 'provide income in retirement to substitute or supplement the Age Pension', adopting the objective proposed by the Financial System Inquiry in 2014.[16] But the Bill failed to pass the Parliament.

The Retirement Income Review,[17] published in 2020, proposed an overarching objective for the retirement income system as a whole: 'To deliver adequate standards of living in retirement in an equitable, sustainable, and cohesive way.'

This was accompanied by nine sub-objectives to 'provide additional detail on how the broad system objective could be clarified':

- The system should ensure a minimum standard of living for retirees with limited financial means that is consistent with prevailing community standards.
- The system should facilitate people to reasonably maintain their standard of living in retirement.[18]

15. See Callaghan et al (2020, p. 89) for a summary.
16. Parliament of Australia (2017); and Murray et al (2014).
17. Callaghan et al (2020, Section 1C).
18. The general consensus is that 'adequate' consumption smoothing is achieved for *middle-income* earners by replacing 65-to-75 per cent of pre-retirement income. Low-income earners will need higher replacement rates for an adequate standard of living, while high-income earners can achieve adequacy with lower replacement rates. See Callaghan et al (ibid, pp. 494–501) and Coates and Nolan (2020, Section 3.2.1).

- The system should target government support to those in need.
- The system should provide similar outcomes for people in similar circumstances.
- The system should be cost-effective for taxpayers in achieving adequate outcomes.
- The system cost should be sustainable and robust to demographic, economic, and social change.
- The system should have effective incentives to smooth consumption and support people in taking personal responsibility for their retirement incomes.
- The system should interact effectively with other systems.
- The system should not be unnecessarily complex for consumers.

Grattan Institute has also specified a set of objectives for the retirement income system, as a whole:[19]

- Alleviate poverty.
- Help people maintain a consistent standard of living across their lives.
- Deal with investment, inflation, and longevity risks
- Be fiscally sustainable.
- Maintain reasonable incentives to work, save, and invest.

The general thrust of the Retirement Income Review objectives and Grattan's objectives is the same. Both are comprehensive and robust frameworks for thinking about retirement income policy.

19. See Coates and Nolan (2020, pp. 7–8) for more detail.

Critically, neither front-runs roles for different pillars, but rather focus on clarifying the desired outcomes for individuals from the combination of the different pillars.

2.2 The proposed objective is too broad an objective for the superannuation system

The Albanese Government's proposal says:[20]

> The objective of superannuation is to preserve savings to deliver income for a dignified retirement, alongside government support, in an equitable and sustainable way.

Despite being presented as an objective for superannuation, the draft Bill and explanatory materials encompass the purpose of the retirement income system as a whole. The draft objective acknowledges the role of government support in 'delivering income for a dignified retirement, in an equitable and sustainable way'.

This approach means the Bill effectively provides a framework for a broader retirement income objective, but one couched as a superannuation objective. Government support is relegated to a secondary role, non-super savings are relegated to the explanatory materials, and home-ownership is absent. Arguably, the only element of the draft objective that pertains solely to superannuation is the reference to preservation.

2.3 The proposed objective does not provide guidance on how to trade-off spending while working and spending in retirement

A core objective of Australia's retirement income system, as a whole, must be to ensure Australians enjoy an adequate retirement income.

20. Parliament of Australia (2023).

Yet the benefits of higher retirement incomes must be balanced against the costs of achieving them.

The proposed objective says nothing about how the superannuation system should trade-off current and future consumption. This is despite the fact that a core purpose of the superannuation system is to force Australians to forego spending today in return for more income in retirement.

Superannuation policy needs to balance this trade-off. After all, past Grattan Institute work has demonstrated that higher compulsory super contributions come at the expense of lower wages.[21] Therefore, higher compulsory super means working people will have less money to buy a home, invest in their children's education, or start a business. And working-age Australians consistently report higher rates of financial stress than older Australians.[22]

An under-appreciation of this trade-off has led to the Superannuation Guarantee being set higher than necessary. The evidence shows that even the previous Superannuation Guarantee rate of 9.5 per cent was sufficient to achieve adequate retirement incomes.[23] Failing to acknowledge the trade-off between working-life and retirement income in a legislated objective for super risks an even higher, and therefore even more damaging, Superannuation Guarantee.

21. Grattan Institute's working paper, *No free lunch: Higher super means lower wages*, examined the super-wages trade-off using a large administrative database of enterprise agreements. It found that, on average, about 80 per cent of the cost of higher super is passed through to workers in the form of lower wages growth over the life of an enterprise agreement, typically 2-to-3 years. See Coates et al (2020) and Callaghan et al (2020, pp. 477–485) for a full summary of the evidence.
22. Wood et al (2019).
23. The consensus tool to measure adequacy is replacement rates – retirement income as a share of pre-retirement income. A replacement rate of 65-to-75 per cent for middle-income earners is typically deemed adequate. See Callaghan et al (2020) and Coates and Nolan (2020).

2.4 'Dignified' is subjective and not useful for assessing the adequacy of retirement incomes

The concept of a 'dignified' retirement adopted in the proposed objective is entirely subjective and not useful.

Paragraphs 1.30 to 1.38 of the explanatory materials illustrate the problems with this approach. Paragraph 1.30 implies 'dignified' denotes a 'standard of financial security and well-being in retirement which allows the person to participate economically and socially in their community'. Paragraph 1.34 refers to a 'certain' standard of living. These passages (correctly) imply there should be a 'minimum' living standard that retirees cannot fall below. But then paragraphs 1.31 and 1.32 describe 'dignified' as a subjective concept which does not mean the same level of retirement income for all Australians.

This tension is why the Retirement Income Review and Grattan Institute separate the fundamental goal of adequate standards of living into two sub-objectives: one pertaining to a minimum standard, and one pertaining to consumption smoothing.[24] This approach provides much more clarity and allows for a clear-eyed analysis of the strengths and weaknesses of the pillars. For example, the Age Pension is naturally suited to guaranteeing a minimum standard, while superannuation can help facilitate consumption smoothing.

To the extent there is an intuitive interpretation of 'dignified', it would probably pertain to a minimum standard rather than consumption smoothing. It is hard to argue that a high-income retiree who foregoes a second Pacific cruise for the year is suffering an indignity, but it is easy to argue that an Age Pensioner who cannot heat their home is.

24. Callaghan et al (2020, Section 1C); and Coates and Nolan (2020, pp. 7–8).

Therefore, it is wrong to use of the concept of 'dignity' in an objective for superannuation – the pillar most useful for facilitating consumption smoothing.[25]

2.5 Overstating the role of superannuation can be particularly bad for low-income earners

Overstating the role of super risks ineffective and costly policies that divert resources and attention away from more effective policies to assist low-income earners, such as those on income support.

Super is simply the wrong tool to boost retirement living standards for low-income earners. Super is a contributory system – you only get out what you put in. For most low-income earners, adequate living standards will be achieved almost entirely by government support – via the Age Pension, Rent Assistance, and/or other social transfers such as social housing, and health and pharmaceutical subsidies.

Existing attempts to use super to boost the retirement incomes of low-income earners, such as government co-contributions and carry-forward provisions, have proven to be an expensive failure.

For example, co-contributions – a scheme in which the federal government makes contributions alongside the voluntary contributions of eligible low-income people – has cost the government more than $12.7 billion since it began in 2003-04. But recent research has shown the scheme is ineffective at helping low-income earners. It mostly provides a bonus to high-income earners who happened to qualify in a particular year, or the partners of high-income earners.[26]

Similarly, while there is a principled case to be made for paying super on government-funded Paid Parental Leave, doing so is unlikely to make a noticeable difference to the retirement incomes of middle-income women. And it will do nothing for women who have already had children.[27]

Instead, the income support system, specifically the Age Pension (and Rent Assistance for renting retirees), is the best tool to prevent poverty in retirement. Eligibility for the pension is based on the income and assets of the whole household, including those of a spouse. And by assessing eligibility at retirement, the Age Pension better targets retirement incomes to those who need it most. Boosting income support payments for needy retirees, especially for renters, will materially reduce the number of Australians suffering poverty in retirement.[28]

As outlined above, overstating the role of superannuation also risks inviting an ever-higher Superannuation Guarantee. Low-income earners will rely heavily on the Age Pension in any case, so higher compulsory contributions simply force them to forego income in working life – when they need it most – often for little gain in retirement. In fact the poorest 30-to-40 per cent of workers can expect a pay rise in retirement, because the Age Pension and the income they get from compulsory retirement savings will be higher than the wage they receive during their working life.[29]

2.6 The Bill misconstrues the role of super tax concessions

The explanatory materials make several references to concessional tax treatment encouraging saving for retirement. But the evidence indicates

25. The Retirement Income Review also flagged concerns that using a 'dignified retirement' as an adequacy benchmark risks under-appreciating the trade-off between working-life and retirement income. See Callaghan et al (2020, p. 95).
26. Breunig and Sobeck (2020) and Chan et al (2022). See Coates and Moloney (2023, Section 2.4.1) for more detail.
27. Coates and Emslie (2018); and Callaghan et al (2020, pp. 270–271).
28. See Coates and Nolan (2020, Section 5.2).
29. Ibid (Figure 4.5).

that savings tax breaks mostly influence people's choice of savings vehicle, rather than boosting savings overall.[30]

There are justified roles for the concessional tax treatment of superannuation, but it would be a mistake to formalise one not supported by the evidence.[31]

Both the Retirement Income Review and Grattan's proposed system objectives make broader reference to incentives. But critically, they refer to 'effective' and 'reasonable' incentives. The current concessional tax treatment of super includes incentives that are ineffective and unreasonable.[32]

30. See Daley et al (2015, pp. 19–22). See also Callaghan et al (2020, pp. 420–423) for a more recent literature review.
31. See Coates and Moloney (2023, Chapter 1) for a discussion of the role of super tax breaks.
32. See Coates and Moloney (ibid) for detailed analysis.

3 An objective should be legislated for the whole retirement income system

Retirees' living standards are influenced by a broad and complex web of resources and policies. Therefore, as the Retirement Income Review argued, the best approach is to set objectives for the retirement income system as a whole, and then define roles for pillars – e.g. the Age Pension, superannuation, non-super savings – based on their effectiveness in contributing to the system's objectives.

Any objective should guarantee some minimum 'adequate' standard of living for those at the bottom. It should also aim to help middle-income earners to maintain a more consistent standard of living across their lives. And that objective should aim for the system to be both equitable and fiscally sustainable.

Any objective should also recognise that higher retirement incomes always come at a cost: either people have lower living standards while working; or governments give up more revenue for superannuation tax breaks or higher Age Pension spending. The key challenge for retirement incomes policy is balancing these trade-offs.

The Retirement Income Review argued that the retirement income system should aim 'to deliver adequate standards of living in retirement in an equitable, sustainable, and cohesive way'.[33] This remains the best starting point for future work on a more effective objective.

In addition to an objective for the retirement income system, a separate objective could be set for superannuation focusing on its role in supporting middle-income Australians to enjoy the same standard of living in retirement as beforehand (i.e. lifetime consumption smoothing). Such an objective should not allocate superannuation a responsibility for ensuring all Australians enjoy a minimum 'adequate' standard of living in retirement. This role is better served by the income support system via the Age Pension and Rent Assistance. And it should make clear that superannuation is to support retirement income, rather than to help the wealthiest Australians minimise their tax.

33. Callaghan et al (2020, Section 1C).

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