Legislating the objective of superannuation: Consultation paper, 20 February 2023

Comments by Terrence O'Brien, 31 March 2023

The Government proposes to legislate the objective of superannuation as follows:

> The objective of superannuation is to preserve savings to deliver income for a dignified retirement, alongside government support, in an equitable and sustainable way. (Consultation Paper, p 9)

The idea of such a legislated objective is apparently to serve as an 'accountability mechanism', 'anchor any future superannuation policy settings to a meaningful base', 'provide stability and confidence', and reduce the risk of 'haphazard and inconsistent' policy changes.[1]

The Consultation Paper was published on 20 February 2023, followed by the Prime Minister's and Treasurer's announcement on 28 February 2023 of a doubling to a nominal 30% of the tax rate on superannuation earnings on balances over an unindexed $3 million.[2] A Treasury explanatory note shows that earnings are defined for the first time to include unrealised capital gains, taxed in full as income without the 1/3 discount usually applied to capital gains on assets held for a minimum qualifying period within a superannuation fund.[3] Because the higher nominal tax rate is applied to a novel, wider definition of income, the effective tax rate would be more than doubled.

We can reasonably assume that the Government considers these 28 February policy changes conform to the spirit of the 20 February proposed objective for superannuation. But they also create, in effect, a progressive wealth tax applied only to one important form of wealth: high savings balances in superannuation. The broader taxation implications of such a superannuation proposal deserve serious analysis, which is of course unable to be secured by legislating the objective of superannuation.

Summary

We argue that:

- the proposed legislated objective is not fit for purpose. But a shorter, better stated objective could be helpful;
- even so, the problem of unstable and haphazard superannuation policymaking would remain, and can affect policies more broadly than superannuation and retirement income. The wider tax system can be adversely affected.
- Such problems arise at root not from a failure to have a clear objective for superannuation, but a failure of policy processes that are too short-sighted and compartmentalised into one aspect or another of the retirement income or tax systems.

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[1] Consultation Paper, pp 4, 13.

[2] Press Conference Transcript, Prime Minister, Canberra 28 February 2023.

[3] Better Targeted Superannuation Concessions, the Treasury, 2023.

- We propose in brief outline a superior approach that would improve policy formulation: a simple *Retirement Income Charter* which should be able to draw bipartisan support.

Brief comments below are organised around the four questions posed in the Consultation Paper.

1 What do you see as the practical benefits or risks associated with legislating an objective of Australia's superannuation system?

Benefits

A potential benefit of a suitable statement of purpose would be to explain superannuation in the broader context of:

- the discrimination against saving under the general principles of the Australian tax system, and the particular discrimination against long term saving that would occur in the absence of special tax treatment of superannuation and the principal residence; [4]
- the retirement income system as a whole, including:
  - the means tested Age Pension (the principal means of addressing the equity objective of dignified income in retirement); and
  - voluntary saving, including in housing.[5]

It seems unrealistic, however, to hope that a statement of purpose could bind or guide future governments or competing political parties in debate about the retirement income system.

There is no other area of policy where government compels and incentivises saving to be locked away for some 40 years of working life, with funds withdrawn from super over some 20 years of retirement[6]. The main need is for a framework to stabilise superannuation policy so that individuals can save under predictable rules for the standard of living they wish to achieve in retirement. Honouring legislated rules is an important element of fairness, considered as honouring commitments and a fair reward for effort.

There would be no benefit from the proposed objective in reducing the largest risk presently confounding savers in superannuation: taxes and rules are changed frequently[7], mostly without consideration of the interaction of superannuation with the Age Pension, and without a necessary long term view of the continuing maturation of the superannuation system over coming decades and without long-term modelling of the impacts of policy

[4] The taxation of savings in Australia: Theory, current practice and future policy directions, ANU Tax and Transfer Policy Institute, Policy Report No 01-2020, Varela, Breunig and Sobeck, pp 37-39.

[5] Retirement Income Review Final Report , Callaghan, Ralston and Kay, July 2020, p 26.

[6] The tax-free drawdown of a superannuation balance through retirement is conditional on use of an allocated pension which requires depletion of super capital at annual percentages rising with age.

[7] See A super charter: fewer changes, better outcomes, Cooper, Goldberg, Jones, Rubin and Tucker, 5 July 2013.

change.[8] Over just the decade from 2005-06, there were 30 significant changes with revenue impacts of over $50 million over the budget forward estimates period.[9]

Moreover the Age Pension asset test taper and superannuation changes in 2016 and 2017 , and the changes proposed in 2003 have been 'effectively retrospective', reducing retirement living standards under new taxes higher than had been legislated to draw the savings into superannuation in the first place.[10] The objective does not address that problem.

Risks

The risks are that the legislated objective could:

1. rely on undefined, subjective terms in an attempt to prejudice or foreclose debate about policy change
2. fail to highlight the interaction of superannuation and the Age Pension over the multi-decadal time frames over which the superannuation system matures, and
3. bias future Parliaments against reforms that would address the broader challenge of a more neutral taxation of long term savings and better interactions between rising superannuation savings and the Age Pension.

Four key terms of the proposed objective are subjective and ambiguous:

- 'dignified retirement' – who defines 'dignified retirement' standards? One might imagine they are the level of the Age Pension, which exists to provide a dignified retirement. Or are they the standards of defined benefit payments to former politicians, soldiers and public servants? Isn't dignity in retirement more effectively addressed through the safety net of the means-tested Age Pension which is effectively indexed to wage growth, and then allowing people to enjoy any higher retirement standards they are prepared to work and save towards through superannuation?
- 'alongside government support' – this leaves the interaction with the Age Pension and other government transfers unclear, and makes no attempt to explain which 'government support' (housing, age care?) is considered related.
- 'equitable' – is this a focus on vertical redistribution (eg taxing high savings balances at a higher rate than lower balances), or on reward proportionate to effort? Many would argue that lawful saving over a working lifetime in response to legislated incentives should lead to the living standards in retirement that were worked and saved for, rather than some retrospectively reduced standards.

[8] See for example of ignored interactions Retiree Time Bombs, Bonham and Corbett, 30 October 2019.
[9] A super charter: fewer changes, better outcomes, *op cit* pp 16-18.
[10] For the idea of 'effective retrospectivity', see Address to the SMSF 2016 National Conference, Adelaide, Scott Morrison, 18 February 2016. For the ways the 2016 and 2017 changes were effectively retrospective, see Submission on second tranche of superannuation exposure drafts, O'Brien and Hammond, 10 October 2016.

- 'sustainable' – is a term with wider usage in environmental debate than in the fiscal context. Indeed the Consultation Paper itself flags a worrying idea, albeit in very vague terms:

> "There is a significant opportunity for Australia to leverage greater superannuation investment in areas where there is alignment between the best financial interests of members and national economic priorities, particularly given the long-term investment horizon of superannuation funds." (Consultation Paper, p 4)

The references to equity and sustainability deserve particular attention. If the Government proposes to rely on them, it should define them.

Unfortunately, the Consultation Paper shows it has not properly considered the operation of the retirement income system by significantly misquoting the Retirement Income Review. It claims the Review concludes:

> "The Review recommended the objective of **the superannuation system** should be 'to deliver adequate standards of living in retirement in an equitable, sustainable and cohesive way.'" [14]
> (Emphasis added. Footnote 14 of the Consultation Paper refers simply to the entire 695 page Review, but does not cite a particular page number for its alleged quote.)

In fact, what the Review actually notes in at least two places (page 17 and page 87) is quite different to what the Consultation Paper claims.

> "The **retirement income system** should deliver adequate standards of living in retirement in an equitable, sustainable and cohesive way." (Emphasis added, page 87)

The distinction is important. Expecting the means-tested Age Pension, voluntary saving and superannuation saving to be equitable overall in the context of a progressive income tax and social welfare assistance is quite different from expecting the superannuation system alone to meet one interpretation of equity objectives (eg by taxing large savings balances at a higher rate than smaller savings).

Because of such subjective language and misunderstandings, the proposed legislative objective cannot bear the weight the Government wishes to place on it as an anchor for framing superannuation changes, ensuring stability, and preventing haphazard, inconsistent changes.

2. Does the proposed objective meet your understanding of the objective of the superannuation system in Australia?

No.

A better wording than the Government's proposition in the consultation paper would be simple and unambiguous, as proposed in 2016 by John Roskam: [11]

> "The objective of the superannuation system is to ensure that as many Australians as possible take personal responsibility to save for their own retirement. The Age Pension provides a safety net for those who are unable to provide for themselves in retirement."

Such an objective is clear and avoids the problem of reliance on the subjective and undefined terms flagged above. It is straightforward on the respective roles of superannuation and the Age Pension in the retirement income system.

3. Is the proposed approach to enshrining the objective in legislation appropriate? Are there any alternative ways the objective could be enshrined?

No. The proposed approach cannot work as an anchor for framing superannuation changes, ensuring stability, and preventing haphazard inconsistent changes.

To illustrate, consider the last 4 major changes to the Australian superannuation landscape:

1. The creation of the Superannuation Guarantee in 1992, accompanied by the FitzGerald Report on National Saving.[12]
2. The 2007 Simplified Superannuation changes introduced by an extensive discussion paper in 2006.[13] These changes reduced the savings trap from a high taper rate in Age Pension means testing that discouraged growth in superannuation saving and tended to lock in reliance on the Age Pension. These changes also simplified a thicket of complex tax treatments of superannuation and removed the tax on allocated pensions in retirement, conditional on such pensions consuming the remaining capital in the fund by an amount which grew as the saver aged. This effectively forced super to be spent to fund retirement, or be re-deposited in a higher tax environment.
3. The 2016 and 2017 measures that partly reversed both aspects of the Simplified Superannuation changes.
4. The 2023 proposal to further increase taxes on the income from high superannuation balances lawfully made under earlier legislated incentives, and introduce a new capital gains tax practice into the Australian tax system.

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[11] The Turnbull Government Backs An Unprincipled Purpose Of Super, John Roskam, Australian Financial Review, 9 September 2016.

[12] National saving: a report to the Treasurer, FitzGerald, June 1993. We have been unable to find an online link to full text of this seminal report.

[13] A plan to simplify and streamline superannuation, Australian Government, May 2006.

Reviewing the processes surrounding these four episodes, the major changes of 1992 and 2007 were clearly well thought through; extensively modelled for their interactions between the superannuation and Age Pension aspects of the retirement income system; tested for long-term impacts on national saving and the Commonwealth Budget; set in the context of demographic ageing; and open to extensive consultation.

In contrast, the 2016, 2017 and 2023 changes have no such supporting public analysis or long-term modelling. They seemed driven by the hope of short-term fiscal gains from super alone, regardless of the broader context.

The 2023 changes came with no initial indication of how the higher tax treatments would bite over time as savings grew above the un-indexed $3 million trigger, notwithstanding the fact that long term impacts are of the essence in superannuation and vital to trust in the system. It took Parliamentary questioning to elicit on 6 March two limited snapshots of near-term future effects.[14] The longer-term impacts were explicitly handed off to some future government's consideration.[15]

Notably, it seems that all four of these episodes would 'pass' the test of the Government's proposed legislated objective of superannuation, at least in the eyes of the governments that introduced them. This suggests the Government's proposed objective has no discriminatory power to guide good policy development.

A better approach

A more powerful approach to developing better-considered, less volatile superannuation policy was sketched in one form in July 2013 for then Treasurer Bowen in A super charter: fewer changes, better outcomes. The idea of a 'super charter' has never been heard from since.

Its authors proposed an elaborate and formal process, with the establishment of an independent Super Council to ensure that any future changes to superannuation would be consistent with an agreed Super Charter that would operate along the lines of the Charter of Budget Honesty. A proposed Council of Guardians would be charged with applying some 6 pages of detailed principles.[16]

There is no need to be so elaborate, but there are certain core ideas from the Charter's approach that would prevent the worst aspects of excessive, short-sighted changes to super rules, presented without necessary underlying information, analysis and projections.

In our view, just five core ideas could be formalised into a new *Retirement Income Charter* that could earn bipartisan support:

[14] Senate and House of Representatives Hansards, Questions without notice, 6 March 2023.
[15] " A future government may decide to change the $3 million threshold, but the way that I've designed it in conjunction with Treasury colleagues is for a $3 million threshold. If some future government decides that they want to lift that, then they can pay for that, but that's not our intention." Chalmers, Press Conference, Blue room, 1 March 2023.
[16] A super charter: fewer changes, better outcomes, *op cit* p 44-50.

1. Proposed retirement income policy changes should be properly specified and presented in draft for public consultation and testing, with adequate time for response.

- We suggest 6 months as a minimum for public consultation, properly informed by the measures below.

2. The multi-decadal impacts of the proposed change must be made clear. Lifetime retirement savings is in essence the lengthy interaction of compound growth of returns to saving and investment, compound growth in nominal incomes and marginal income tax rates that rise with nominal income. Any proposed superannuation or Age Pension changes should be articulated in a formal projection and modelling framework for the retirement income system that clarifies its impact on individuals and the Commonwealth budget over the time horizon a superannuation saver has to consider in their own planning, and which governments ought consider in theirs.

- We suggest a 50 year horizon is relevant, which realistically encompasses most of a super saver's experience: some 40 years of contributions typically triggered for young workers by the Superannuation Guarantee and some 20 years of drawdown in retirement.
- A 50 year horizon also encourages governments to address the measure's interaction with demographic change and national saving issues.[17]
- Such projection horizons were already used powerfully in the analysis by the FitzGerald Report (1993). Public policy processes seem to have regressed since then.

3. Modelling and projections should use publicly documented methodologies open to checking and sensitivity testing by academic, actuarial and think tank experts – in effect, a practice of open and continuing peer review.

- Modelling should include the impact on effective marginal tax rates on superannuation savings from proposed tax changes. This is necessary because the compounding over decadal time scales of the tax wedge between savings and ultimate returns can turn modest-sounding nominal taxes on superannuation into high effective rates.[18]

4. Analysis should explicitly address whether any proposed changes retrospectively damage the return from savings lawfully made under previous legislated incentives, and identify any significantly adverse impacts on those who have taken Parliament's existing superannuation and Age Pension laws as their guide.

- It seems the high super balances cited by the Government to rationalise its 2023 measures were lawful savings under previous, time-limited legislated incentives that can no longer be made. Such cases are bygones, and should not drive forward-looking policy.

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[17] The Retirement Income Review rejected calls for such long term projections: "There are no facts when making long-term projections." (p 25) True, but that is no reason to make changes uninformed by explicit and testable projections that can be sensitivity-tested with alternative assumptions.

[18] See Problem is the tax on super is too high, Ergas and Pincus, *The Australian*, 12 February 2021.

5. If significantly adverse retrospective impacts are identified, measures should clarify how such adverse impacts could be mitigated by grandfathering, as was commonly used in such situations in the recent past.[19]

4. What are the practical costs and benefits of any alternative accountability mechanisms to the one proposed?

The practical benefits of the alternative 'Retirement Income Charter' approach are:

- it goes to the heart of the problem of excessively frequent and poorly analysed policy changes whose implications on the retirement income system are not studied over the relevant lengthy periods in which lifetime commitments to superannuation saving are made.
- It highlights the interaction between potentially 'saving money' on super concessions only to more than spend it on Age Pension outlays.
    - At present, such interactions are disguised by counting an imaginary revenue cost from superannuation (Treasury's absurd '$50 bn tax expenditure') in one year compared to a hypothetical alternative tax system, with no cognisance of how more super saving leads to less Age Pension spending than would otherwise occur.[20]
- it avoids reliance on undefined and completely subjective notions such as 'equitable' and 'dignified retirement'.
- it leaves for direct political debate by the emergent community standards of the day the prioritisation and financing of government, while providing the information base such debate needs.
- it does not seek to bind rival political parties into some wordsmithed straitjacket of false consensus on deeply political and contested judgements about individual freedom to work and save towards chosen living standards, notions of equity (including fair return for effort) and the political direction of individuals' life savings.
    - We highlight again here the most concerning part of the Consultation Paper, "There is a significant opportunity for Australia to leverage greater superannuation investment in areas where there is alignment between the best financial interests of members and national economic priorities, particularly given the long-term investment horizon of superannuation funds." (p 4) Might the alignment of voters' long-term savings and national economic priorities be with Snowy 2.0, or a green hydrogen adventure? [21] Governments have a poor record of picking winners, but losers have a great record of picking governments.

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[19] See Grandfathering super tax increases, O'Brien, Centre for Independent Studies, *Policy*, Vol 32 No 3, Spring 2016. This paper also revisits the sensible rules for grandfathering that were codified by Justice Asprey in 1975.

[20] The Tax Expenditure Statement and the treatment of savings: Submission to Treasury inquiry into the Tax Expenditure Statement, O'Brien, 16 October 2017. On the effects of super saving on Age Pension outlays, see Implications of the Retirement Income Review: Public advocacy of private profligacy?
O'Brien, Centre for Independent Studies Analysis Paper 19, March 2021, p 4.

[21] Six years of bungled billions; time to cut losses on Snowy 2.0, Woodley, The Australian, 20 February 2023.
Hydrogen: the once and future fuel, Constable, GWPF Report 44, October 2019.

The costs of a Retirement Income Charter are modest. Indeed they ought be near zero, as the information, projections and modelling they require ought already be generated as a matter of course within policy departments advising ministers to make a retirement income policy change affecting peoples' life savings. If not, there is something wrong with the policy process.

The requirement to articulate the multi-decadal impact of proposed policy change and identify any lawful savings retrospectively disadvantaged by a proposed change might of course discourage some ill-considered proposed changes, but that would not be a cost.

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