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Can the taxpayer afford 'self-funded retirement'?

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Policy Brief

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Summary

Australian taxpayers contributed $30.2 billion to the private accounts of that portion of the population with superannuation 2011-12. By 2015-16 this sum is projected by Treasury to rise to more than $45 billion by which time it will be, by far, the single largest area of government expenditure. By 2015-16 the taxpayer contribution of $45 billion to private superannuation balances will account for almost twice the $24 billion projected to be spent on defence in that year. Indeed, the $45 billion subsidy is almost as much as the $51 billion provided by the Commonwealth to the states in 2012-13 and territories to provide health, education and other essential services.

By 2015-16 the annual cost of taxpayer contributions for private superannuation will again exceed the annual cost of the age pension. That said, from that point on, taxpayer subsidies for superannuation are likely to grow significantly faster than the annual cost of providing the age pension.

According to Treasury the top five per cent of income earners receive 37 per cent of all superannuation tax concessions. While comprehensive data matching individual's wealth and income is not available we do know that the net worth of the highest income quintile (that is, wealthiest 20 per cent of the population) was $2.2 million per household in 2009-10. The non-housing assets of that top 20 per cent averaged $1.4 million. Given that the assets test for the age pension currently means that no pension is payable to a single person with assets of more than $696,250 (excluding the family home) it would appear that a significant proportion of tax concessions for superannuation are going to individuals who will almost certainly be ineligible for the age pension.

While we know from Treasury that a disproportionate share of the benefits of tax concessions for superannuation accrue to the highest income earners we also know from the ABS that none of the benefits go to Australia's lowest income earners. Despite Australia's superannuation system often being described as 'universal' in fact a substantial portion of the working age population does not make contributions to superannuation and, in turn, receive none of the $30 billion available to 'boost retirement incomes'.

Superannuation tax concessions can only 'boost' the retirement incomes of those who contribute, and it 'boosts' those income proportionate to the level of contribution. Put simply, superannuation tax concessions are designed in such a way that the more income a person earns the more taxpayer support they will receive. Those Australian who cannot work receive nothing. While it is possible that such an inequitable system design maximises the capacity of the superannuation tax concessions to 'take pressure' off the age pension such an outcome is highly unlikely, especially as it is low income earners who are the most likely to rely on the age pension and very high income earners who do not.

The belief that the tens of billions per year spent on taxpayer contributions to private retirement accounts 'takes pressure off' the commonwealth budget may be widespread but the source of this belief is not well documented.

The sheer size, and rate of escalation, of the cost of tax concessions for superannuation combined with the small reduction in the expected number of retirees who do not receive the age pension make clear that it is unlikely that the current subsidies will deliver long run savings for the overall budget. That said, a closer look at the detailed design features of the current superannuation arrangements make clear that the architects of the system had goals that are quite divergent from minimising the future cost of the age pension. Consider the following:

- If the Howard and Costello Government were worried about the impact of baby boomers on the cost of providing the age pension why did they substantially loosen the age pension means and assets tests in 2007?

- If the objective of the subsidies for superannuation is to reduce the cost of the age pension why can people access their super at 55 when they cannot access the age pension until they are 65?

- If the objective of the subsidies for superannuation is to reduce the cost of the age pension why can people take their super in the form of a lump sum, spend it all, and still be eligible for the age pension?

- If the objective of the subsidies for superannuation is to reduce the cost of the age pension why can people who already hold more assets than the amount prescribed in the assets test continue to make concessional contributions?

- If the objective of the subsidies for superannuation is to reduce the cost of the age pension why don't the poorest third of the population, the third of the population most likely to rely solely on the age pension, receive any of the $45 billion contributions?

- If the cost of providing tax concessions for superannuation are greater than the cost of providing the cost of providing the age pension how could substituting the former for the latter save the government money?

Whatever the rationales for the creation of the current system of tax concessions for superannuation, minimising the future cost of the age pension does not appear to be among them.

Introduction

Australian taxpayers contributed $30.2 billion to the private accounts of that portion of the population with superannuation 2011-12. By 2015-16 this sum is projected by Treasury to rise to more than $45 billion by which time it will be, by far, the single largest area of government expenditure. By 2015-16 the taxpayer contribution of $45 billion to private superannuation balances will account for almost twice the $24 billion projected to be spent on defence in that year. Indeed, the $45 billion subsidy is almost as much as the $51 billion provided by the Commonwealth to the states in 2012-13 and territories to provide health, education and other essential services.[1]

Politicians and industry groups regularly claim that the enormous expenditure on tax concessions for superannuation is justified, in part at least, on the basis that such outlays today will yield future dividends for taxpayers in the form of lower age pension payments. For example:

> *"Investing in superannuation now means there will be less reliance on the age pension as baby boomers retire." Assistant Treasurer, David Bradbury*[2]
>
> *"It eases the long-term pressure on the budget." Minister for Superannuation, Bill Shorten*[3]
>
> *"These measures will take the pressure off the Age Pension" Super Guru*[4]
>
> *"Superannuation will take the pressure off Government budgets (and taxpayers) of the future by reducing the reliance on the Age Pension" ASFA*[5]
>
> *"Superannuation is not about short-term collections of tax, it's about addressing a long-term, demographic time-bomb" ASFA*[6]

As discussed below, claims such as those made above are typically made with no reference to quantitative analysis. Furthermore, it is largely irrelevant whether tax concessions for superannuation reduce the 'age pension budget' as no such 'budget' exists. The question that should be of interest to those interested in the long run public finances of the Commonwealth Government is 'what is the relative size of the costs of providing tax concessions for superannuation and the benefits associated with any reduction in the cost of providing the age pension?'

Indeed, given the enormous size of the taxpayer contribution to private retirement incomes a number of other questions also deserve serious attention, questions such as:

Of all the ways to boost retirement incomes, are tax concessions the most effective?

Would policies such as subsidised child care or subsidised elder care which encourage more women to remain in work for a larger proportion of their working life have a bigger impact on retirement incomes than tax concessions for superannuation?

This paper argues that the net impact of tax concessions on the Commonwealth budget is negative both in the short and long run. It provides a range of evidence to support this

[1] Australian Government (2012).

[2] Bradbury, D (2012).

[3] Shorten, B (2012).

[4] Association of Superannuation Funds of Australia (2011).

[5] Association of Superannuation Funds of Australia (2012).

[6] Association of Superannuation Funds of Australia (2012).

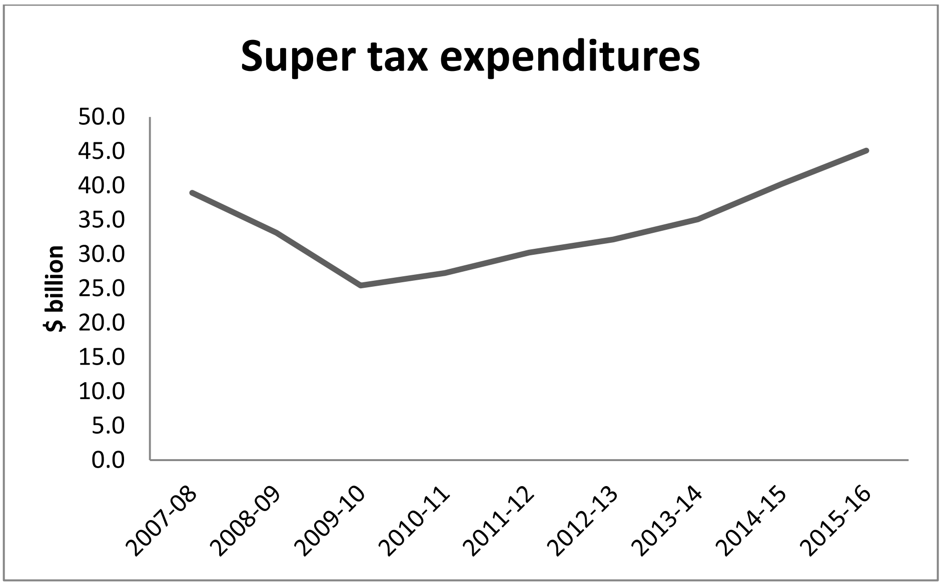
conclusion including estimates by Treasury of the very small impact of increases in superannuation assets on the proportion of the population who do not receive the age pension, evidence from Treasury on the concentration of superannuation tax concessions among households with too much wealth to be eligible for the age pension, and estimates by the author that suggest that up to 61 per cent of a person's 'self-funded retirement' is actually attributable to the tax concessions provided by other taxpayers.

How big are the tax concessions for superannuation?

By 2015-16 the annual cost of taxpayer contributions for private superannuation will again exceed the annual cost of the age pension[7]. That said, from that point on, taxpayer subsidies for superannuation are likely to grow significantly faster than the annual cost of providing the age pension.

Figure 1 shows the projected increase in the annual cost of providing tax concessions to the segment of the population with superannuation accounts. It is interesting to note that in what are allegedly 'tough times' for the budget the question of where the $15 billion growth in expenditure on superannuation concessions has not attracted significant political, media or academic attention. A similar 'blow out' in the cost of providing health, education or other services would be unlikely to attract such little public scrutiny. Indeed, the recent $1.5 billion 'blow out' in the cost of providing the National Broadband Network (NBN) attracted significant media attention.[8]

Figure 1 – growth in cost of tax expenditure 2007-2015



Source: 2012-13 Budget Paper No 1.

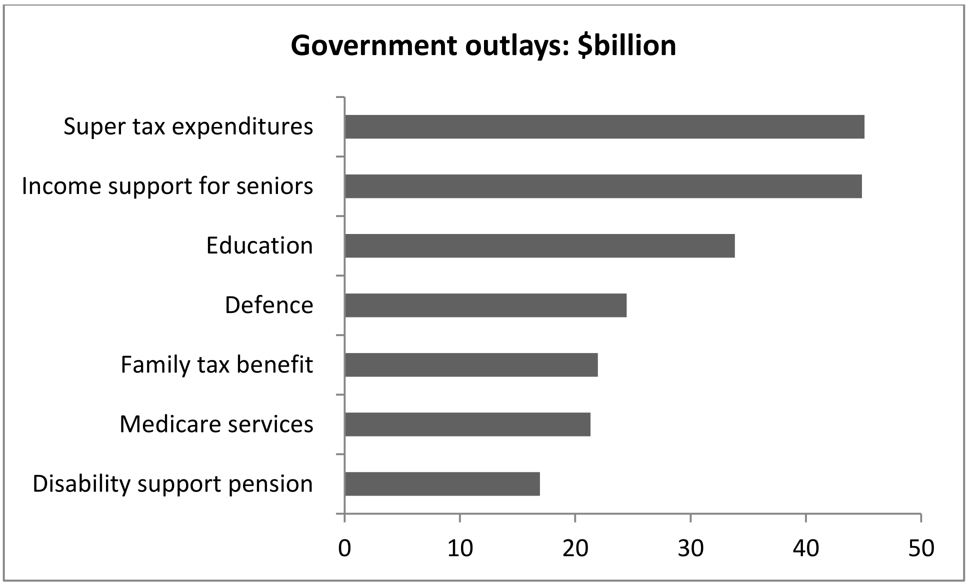
Figure 2 places the projected size of tax concessions into a broader budgetary context. Not only will the cost of taxpayer contributions to private superannuation accounts be nearly

7 The cost of tax concessions for superannuation exceeded the cost of providing the age pension before the GFC. The post GFC decline in the value of these tax concessions was due to the lower (often negative) returns earned on accumulated fund balances, the earnings on which are taxed concessionally at 15 per cent.

8 Battersby, L and Grubb, B (2012).

twice the size of the defence budget by 2015-16, it will in fact be twice the size of annual expenditure on Medicare services.

Figure 2 – 2015-16 super tax concessions compared to other areas of expenditure



Source: 2012-13 Budget Paper No 1.

Who receives the tax concessions for superannuation?

According to Treasury the top five per cent of income earners receive 37 per cent of all superannuation tax concessions[9]. While comprehensive data matching individual's wealth and income is not available we do know that the net worth of the highest income quintile (that is, wealthiest 20 per cent of the population) was $2.2 million per household in 2009-10.[10] The non-housing assets of that top 20 per cent averaged $1.4 million. Given that the assets test for the age pension currently means that no pension is payable to a single person with assets of more than $696,250 (excluding the family home) it would appear that a significant proportion of tax concessions for superannuation are going to individuals who will almost certainly be ineligible for the age pension.

While we know from Treasury that a disproportionate share of the benefits of tax concessions for superannuation accrue to the highest income earners we also know from the ABS that none of the benefits go to Australia's lowest income earners. Despite Australia's superannuation system often being described as 'universal' in fact a substantial portion of the working age population does not make contributions to superannuation and, in turn, receive none of the $30 billion available to 'boost retirement incomes'.

Superannuation tax concessions can only 'boost' the retirement incomes of those who contribute, and it 'boosts' those incomes proportionate to the level of contribution. Put simply, superannuation tax concessions are designed in such a way that the more income a person earns the more taxpayer support they will receive. Those Australian who cannot work receive nothing. While it is possible that such an inequitable system design maximises the capacity of the superannuation tax concessions to 'take pressure' off the age pension such an

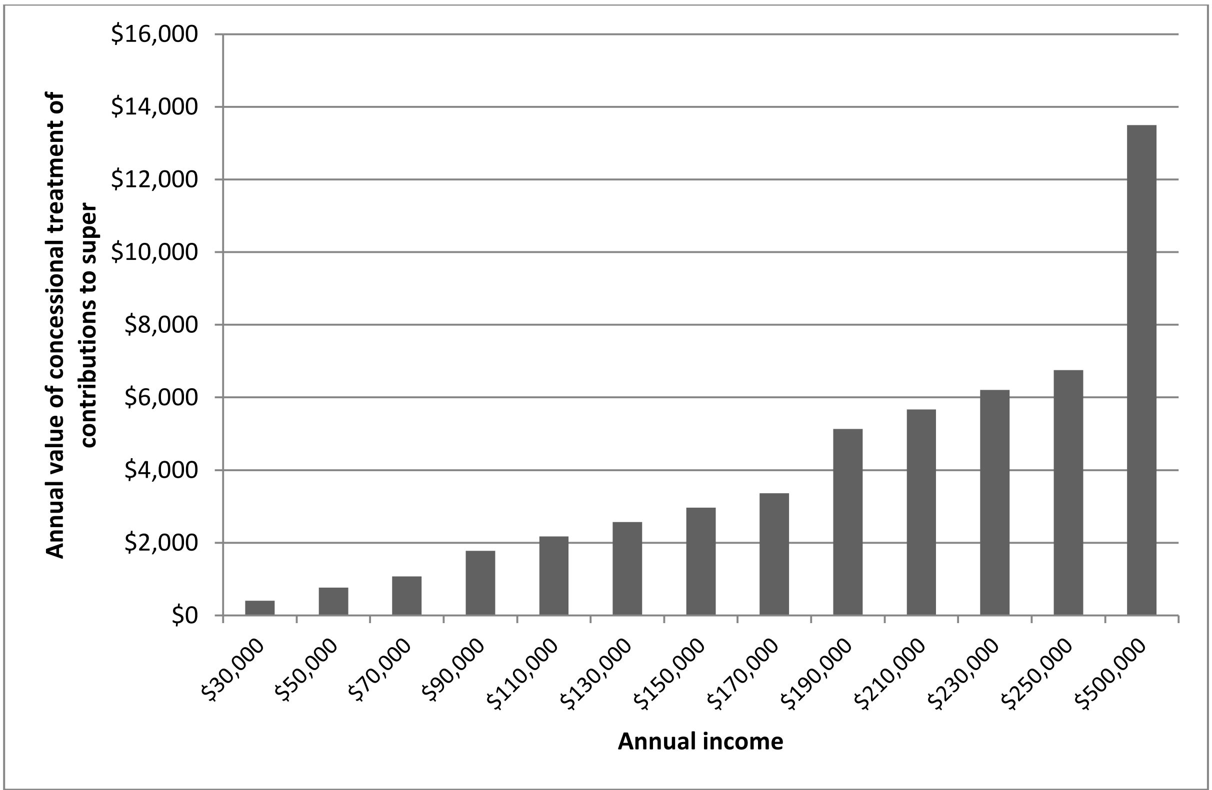
[9] Treasury (2008). Pp. 22.

[10] These and similar figures are taken from, or based on ABS (2011b).

outcome is highly unlikely, especially as it is low income earners who are the most likely to rely on the age pension and very high income earners who do not.

Figure 3 shows just how inequitable the 15 per cent tax on superannuation contributions is. Because contributions to superannuation are taxed at a flat rate of 15 per cent and ordinary income is taxed progressively, high income earners receive a far larger contribution to their private retirement savings than low income earners do. For example, person who earns $190,000 and faces the 45 per cent marginal tax rate receives far more taxpayer support than a lower income earner both because the absolute value of their contributions is so much larger and the difference between their marginal tax rate and the 15 per cent contributions tax is also so much larger).

Figure 3 – Individual benefit of the tax concessions on superannuation contributions – by income[11]



Source: Authors' calculations

While the highest income earners receive significant taxpayer support to accumulate their 'self-funded' superannuation assets Australians with significant care responsibilities, those who are studying, those who cannot work due to sickness or disability or those who cannot find work all miss out on the generous taxpayer support for other people's retirement. In addition to those who are not working a large number of those who do work also miss out on taxpayer contributions to so called 'universal superannuation'.

According to the ABS only 90 per cent of workers had employer contributions paid into a superannuation scheme: 95 per cent of full-time workers and 80 per cent for part time workers. The numbers fell more dramatically down to only 51 per cent for those earning

[11] Estimates based on the assumption that individuals only make the 9 per cent compulsory contribution to superannuation. Higher income earners are in fact more likely to make additional voluntary contributions and, in turn, receive even higher benefits from tax concessions.

under $200 per week. Women are overrepresented in the groups missing out on superannuation. [12][13]

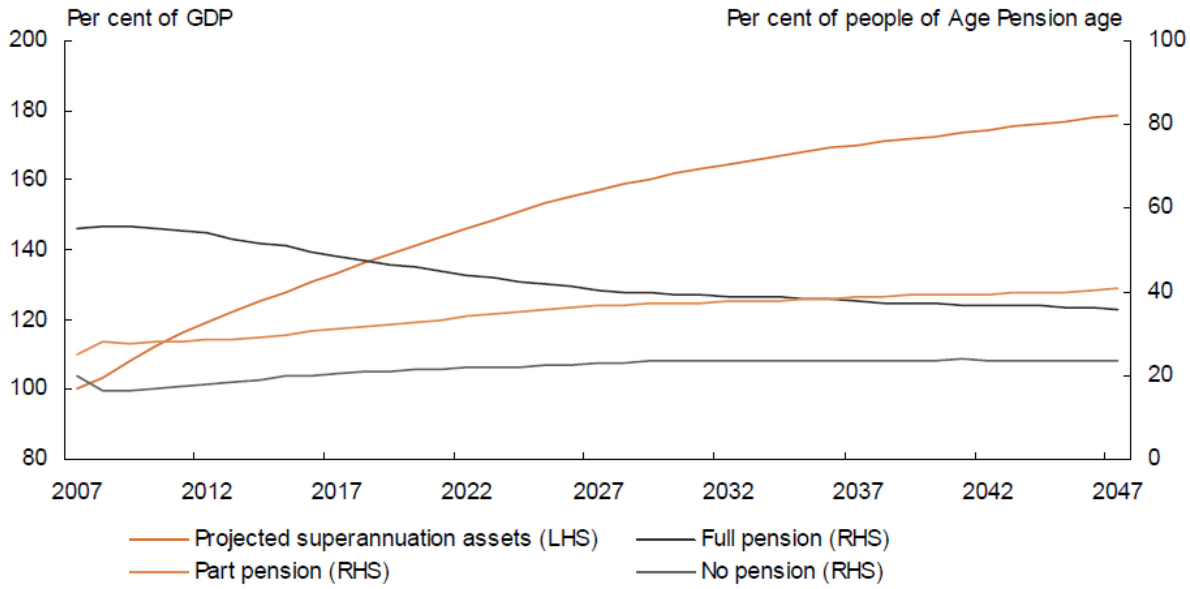
While the highest income earners who receive the largest share of tax concessions from superannuation are highly unlikely to pass the means and assets tests to qualify for the age pension, the lowest income earners, those who do not receive any benefit from tax concessions on superannuation, almost certainly will be eligible for the age pension. As discussed below, it is difficult to reconcile these observations with the assertion that the vast cost of tax concessions for superannuation leads to a significant reduction in age pension payments or, more importantly, delivers a net saving to the budget.

Do Superannuation tax concessions save the government money in the long run?

The belief that the tens of billions per year spent on taxpayer contributions to private retirement accounts 'takes pressure off' the commonwealth budget may be widespread but the source of this belief is not well documented.

The most comprehensive assessments of the Australian tax and transfer system in recent years was the 2009 Future Tax System Review conducted by the then Secretary of the Treasury, Dr Ken Henry. Figure 4, which is taken from Retirement Income Consultation Paper prepared for that review, shows that despite the incredible growth in the amount of assets expected to be invested in superannuation over the coming decades there is virtually no change expected in the number of 'self-funded retirees'.

Figure 4 – Superannuation Assets and Age Pension recipients



Source: Treasury (2008) p. 33

A close examination of the trends in Figure 4 highlights how few people are expected to retire without further assistance from the Commonwealth government. Of most interest, however, is the sharp drop in the number of people receiving no age pension after 2007. This sudden drop was caused by the Howard Government's decision to make the means and assets tests for the age pension significantly more generous. As discussed below, such a

[12] ABS (2011a).

[13] See also Australian Centre for Financial Studies (2012).

decision is hard to reconcile with the stated concern with the impact of the baby boomer generation reaching retirement age and placing pressure on the age pension system. Consider the following:

> Treasury's forecast suggests that there will be a slow but steady rise in the number of people receiving a part pension and a very small (around 3 per cent) increase in the number of people receiving no pension. As the following calculations show, it follows that a very small increase in the number of people who do not receive the age pension and a small increase in the proportion of the population who receive a part pension can only save the Commonwealth a relatively small amount of money.
>
> If we assume that the population in 2047 is 32 million and that 24 per cent of that population is aged over 65 [14] then the population of retirees will be 7.6 million. Taking the Treasury estimate of a three per cent increase in the proportion of retirees receiving no age pension (230,000 people) and a 15 per cent increase in the proportion of retirees receiving a part pension (1,152,000 people) it can be estimated that the reduction in the age pension bill, compared to today, would be equivalent to 10.5 per cent of the retiree population (15/2+ 3) multiplied by the age pension[15].
>
> That is, the projected reduction in the age pension bill in 2047 can be estimated as 806,000 people multiplied by the current single age pension rate of $695.30 per fortnight equates to a saving of around $14 billion per year in 35 years' time. Given that this year's tax concessions cost more than twice that amount, and that the future benefits need to be discounted to today's dollars, the Treasury projections included in the figure above make clear that the impact of the large, and rapidly growing, cost of tax concessions for superannuation do not provide a net benefit to the Commonwealth budget.

Another way of determining the impact of tax concessions for superannuation is to consider a specific example. Consider the following:

> Assume someone on the 45 per cent marginal tax rate puts away $10,000 in real terms every year for 40 years into a fund earning 7.5 per cent nominal or 5.0 per cent after inflation of 2.5 per cent. With the tax of 15 per cent on contributions and earnings that person would have a sum of $784,310 at the end of 40 years. However, if the contributor had to pay the actual applicable marginal tax rate of 45 per cent then the balance at the end of 40 years would fall to $306,496.8. The difference, $477,813.20 is due to the tax concessions on both the contributions and the income in the fund. Hence the taxpayer contribution accounts for 61 per cent of the 'self-funded retirement' in this example.

Unfortunately there is no clear statement from the Treasury in any of the three intergenerational reports concerning the rate of return to the taxpayers of our 'investment' in superannuation tax concessions. As shown above, however, a wide range of vague statements implying that the thirty billion spent this year will return even greater savings in the future are, however, easily found.

[14] ABS (2008).

[15] Assuming that the average part pensioner receives a payment equivalent to half of the age pension.

None of the claims by supporters of the existing suite of tax concessions in the Introduction are based on a comprehensive assessment of the ‘net’ impact of tax concessions for superannuation on the Commonwealth Budget. Rather, to the extent that they are quantified at all they relate to the capacity of the tens of billions of dollars spent on tax subsidies for superannuation to lead to some reduction in the age pension as opposed to improve the net budgetary position. That is, while it is certainly the case that there is some ‘gross’ reduction in the cost of providing the age pension as a result of tax concessions for superannuation, none of the claims above are based on an assessment of the amount of any reductions in the age pension compared to the money spent on tax concessions to generate those savings.

The sheer size, and rate of escalation, of the cost of tax concessions for superannuation combined with the small reduction in the expected number of retirees who do not receive the age pension make clear that it is unlikely that the current subsidies will deliver long run savings for the overall budget. That said, a closer look at the detailed design features of the current superannuation arrangements make clear that the architects of the system had goals that are quite divergent from minimising the future cost of the age pension. Consider the following:

- If the Howard and Costello Government were worried about the impact of baby boomers on the cost of providing the age pension why did they substantially loosen the age pension means and assets tests in 2007?

- If the objective of the subsidies for superannuation is to reduce the cost of the age pension why can people access their super at 55 when they cannot access the age pension until they are 65?

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Whatever the rationales for the creation of the current system of tax concessions for superannuation, minimising the future cost of the age pension does not appear to be among them.

The rising cost of dignity in Australia

While the design of superannuation tax concessions does not appear targeted at reducing the future cost of providing the age pension it does do an effective job of making the income tax system less progressive. While this outcome may or may not be an objective of the Government it does seem clear that this government, and the previous government, have been pursuing the objective of increasing the standard of living for retirees, particularly for retirees with private savings. Indeed, Minister Shorten has made clear that it is not ‘realistic’ for the majority of the next generation of retirees to endure the standard of living deemed acceptable for the current generation of refugees. As Minister Shorten said:

> *"The Great Depression and Second World War generations of Australians did it tough. They were frugal in an era of bitter hardship and war, and widowhood and suburban sacrifice. But our current generations of Baby Boomers have learned to expect more and get more. Like Oliver they want more, and we are here to supply it.*
>
> *The amount of money required to live reasonably is much higher than previous generations required. Or put another way, we are no longer as good at living frugally. We are healthier than our great grandparents. We are more active and energetic. We don't just play bowls and chess and Scrabble, we hike, we bicycle, we travel overseas. We are keen to change our lifestyles in the years of 55 to 75. This means we need more money."*

Just why a demographic group that feels they deserve more money should receive such a 'boost' is left unstated by the Minister, but there seems to be little doubt that he is proud of his determination to deliver it. Similarly, it is not clear why such a group should take precedence over, for example, the need to improve the provision of primary health services to indigenous populations or the need to fund a National Disability Insurance Scheme (NDIS). Perhaps they to, like Oliver, just ned to ask for more?

It is often said in Australian debates about retirement that to retire with 'dignity' a couple would need a retirement income of around $50,000 per year. In order to help Australians achieve such levels of retirement incomes Australian taxpayers now contribute around $30 billion per year in tax concessions to help boost the retirement savings of so called 'self-funded' retirees. The desire to deliver on the expectations of the wealthiest Baby Boomers is not confined to Minister Shorten with the Coalition Government's Minister for Ageing, Julie Bishop stating:

> *"We are moving towards a future where older Australians will have different needs and expectations. With the advent of the Baby Boomers as the next generation of older people, old age will be characterised by different values and aspirations, needs, services, cultures and recreational activity."*

Similarly, according to the Association of Superannuation Funds of Australia (ASFA), the peak industry body for the superannuation sector:

> *"The Age Pension is the yardstick for the basic amount people can survive on in retirement, but most of us want and need more when we finish working."*

One of ASFA's members, Maritime Super, states that its goal is:

> *"…helping members and their families and friends achieve financial security and dignity in retirement."*

The ABC's economics correspondent, Stephen Long recently summarised the superannuation systems as follows:

> *"When Paul Keating set up the superannuation system the promise was it would give workers security and dignity in retirement."*

Even the Commonwealth Government helps to propagate the view that a comfortable retirement requires an above average income, stating on its 'Moneysmart' website:

> *"According to the Westpac – Association of Superannuation Funds of Australia (AFSA) Retirement Standard benchmarks, a comfortable lifestyle for a couple,*

> *including entertainment, a car, clothes, private health insurance and holidays, can cost about $55,000 a year. A modest lifestyle will still require about $31,000 a year per couple."*

The widespread acceptance of the idea that to retire with 'dignity' costs $50,000 raises some significant questions for the ability of the non-retiree population, especially in the context that the minimum wage is around $37,000, an amount from which some people manage to pay tax, pay for their housing and raise children while the $50,000 required for a 'dignified' retirement is based on a couple that has paid off their own home.

This is not to say that individuals on low incomes do not receive any support from the Commonwealth. Those on the minimum wage with children, for example, are eligible for Family Tax Benefits. The point being made is that even after such support is received low income individuals raising a child and paying rent or a mortgage are still expected to live on an income well below that which is considered necessary to sustain a retired couple who own their own home with no dependent children, and to carry a higher tax obligation.

It is interesting to note that in compiling the estimated cost of a 'comfortable' retirement ASFA has included, among a wide range of other expenses, the following costs of retirement:

- Weekly expenditure on restaurant meals and coffee $100
- Annual expenditure on domestic holidays $3,000
- Five yearly cost of overseas holidays $11,000
- Weekly cost of wine with dinner $40

While there is no doubt that some Australians spend such amounts on prepared food and holiday travel, and no doubt that even more people aspire to such levels of expenditure, the policy question addressed in this paper is simply whether or not such expectations constitute a policy problem that large amounts of taxpayers' money should be used to address a personal preference which individuals should be free to save their own money for if they so desire.

Conclusion

The retirement income system in Australia is now based on the provision of a minimum floor of the aged pension which is effectively topped up with tax free superannuation income. Those who earned the least during their working lives, particularly women who spent a lot of time caring for others rather than in the paid workforce, will receive the smallest 'top up' while those who earned the most over the course of their working life will receive the most generous top up. While the very wealthiest will not receive an age pension nor will they pay tax in their retirement, even if their income is in the millions of dollars per year. When it comes to age, it seems, the concepts of horizontal and vertical tax equity have been abandoned.

Thanks to the generous increase in the thresholds at which the aged pension begins to taper out all but the wealthiest of Australian's will receive a full or part aged pension. Indeed, a couple who lived in a home worth $2 million who had $700,000 in superannuation could comfortably draw a tax free income of $70,000 per year and still receive a part pension.

Superannuation has become a popular vehicle for tax planning and avoidance, especially for those over 55 who are able to contribute concessionally taxed income to 'fund their retirement' while simultaneously withdrawing the same money.

For policy purposes it would be preferable if super were directed into products that provide a continuing income rather than products that can be accessed all at once. That would better meet the policy objective of providing for retirement incomes while reducing the use of super concessions as a tax avoidance device.

Similarly, if governments were interested in equitably providing taxpayers funds to help individuals accumulate funds for their retirement then it is hard to imagine why they would not make equal cash grants to individuals retirement savings accounts (or means tested payments) rather than rely on tax concessions which, inevitably, provide the most support to those with the most income.

As Treasury has noted:

> *For many individuals with broken work patterns, or no work history, changes to superannuation policy may have minimal effect on their retirement income.*
>
> *Policies which support an efficient, robust economy and remove disincentives to work may have a greater effect on these individuals' retirement income than superannuation policies. For example, policies which support child care may encourage more women to return to the workforce. This may have a greater influence on their retirement income than increasing superannuation concessions.*
>
> *The Age Pension is likely to provide the majority of retirement income for individuals with broken work patterns. Therefore, consideration of the adequacy of the Age Pension is likely to have the most immediate impact on their retirement income. (Treasury 2009 p. 16)*

Put another way, women who spend their lives caring for others are at the highest risk of spending their retirement having to care for themselves. Not only do they benefit the least from the current tax concessions for superannuation but they would benefit the most from 'unaffordable' policies such as paid parental leave, subsidised child care, government after school hours care and the NDIS. Ironically, unlike the additional $15 billion soon to be spent on tax concessions for superannuation, such policies are typically deemed 'unaffordable'.

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