Retirement incomes policy systems: towards better targeting

Proposed reforms better meeting relevant adequacy concepts

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Key themes ....

Targeting saving concessions is very efficient.

Targeting welfare benefits often isn’t (EMTRs).

Yet we’ve worried more about doing the latter.

And we’ve *seriously* neglected the former!

There’s some ‘low hanging fruit’ to be gathered.
We need a framework ....

Is our retirement income system really 3 pillars?

On what principles should it rest?

Policy-wise, what should ADEQUACY mean?

How does our current system stack up?

Could we do better?
A 3 pillar retirement income system?

It’s said we have a 3 pillar system:

First, we have the Age Pension as a retirement income safety net.

Second, we have compulsory superannuation saving (at 9%).

Third, we have voluntary super saving concessionally treated.

Are we missing a pillar or two? What about the wealthy? What about appropriate use of super savings (eg, to address longevity risk)?
Some design principles

1. Governments should focus on the less well-off
2. Address fiscal pressures from population ageing
3. Adjust retirement incomes policy to reflect 1 & 2
4. Deal with resulting EMTRs explicitly & up-front
What does ADEQUACY mean?

Does it mean *absolute real income*?

Income relative to *community standards*?

Income relative to *X% of pre-retirement income*?

Is it consistent with *sustainable Budget support*?

Can Governments ignore the last of these?
Does the Oz system stack up? …

In a word: NO
Does the Oz system stack up? Exhibit #1

- Those least able to save: age pension candidates
- Those most needing, and able to respond to, super saving incentives
- Those least needing super incentives

Percentage of population/tax incentive rate

Taxation/subsidy incentive rates (stylised)

Population distribution by taxable income (stylised)
Could we do better? Structural reforms #1

At present, we’re ‘locked in’ to flat rate super taxes on contributions & earnings

Super funds can’t be expected to do otherwise

So the first structural reform must deal with this

**CONTRIBUTIONS TAX SHOULD BE LEVIED BEFORE CONTRIBUTIONS HIT SUPER FUNDS**

This structural reform unlocks many possibilities
Could we do better? Structural reforms #2

With super contributions tax paid by employers …

we can apply a new super saving tax rate scale

This allows us to better target super concessions

As a result, we can get a better Age Pension saving ‘payoff’ over time

Earnings tax must remain as a flat rate, however
Contributions tax reforms: a smorgasbord

There are many contributions tax rate options – provided the shift to employers is made:

- apply the standard personal tax scale
- offer the same %point rebate to all
- offer tax ‘discounts’ varying with taxable income

We could also drop the Government co-contribution
Variable discounts might be a better option

At least they’d eliminate the current EMTR
Benefits of contributions tax reform

Reforming contributions tax as proposed:
- improves system fairness
- better targets tax concessions
- improves Age Pension savings over time
- improves system adequacy as defined above

Note a key feature: targeting super savings can be precise - low income concessions don’t ‘leak’

This is very different from low-income tax cuts – they leak to all higher income earners as well
Earnings tax reforms: more simplicity?

Do we need to tax super fund earnings?

- better to allow unfettered accumulation?
- this improves superannuation adequacy
- it also contributes to a simpler system
- concentrate tax up-front; deal with equity there
- this puts super on a par with the family home
- hard to go back to benefit taxation (eg, pre-’88)
- too many ‘grandfathering’ and related problems
Super tax reforms: Budget costs & benefits

The super tax reform smorgasbord offers an equally broad smorgasbord of Budget effects:

- at one end, net Budget costs are negative
- many can be close to Budget-neutral
- at the other end, Budget costs can be large
- the first group tends to help lower income groups
- the middle group is more neutral
- the third group is less ‘fair’ than the status quo

But the smorgasbord is large!
24 tax reform options: summary of effects

Source: Access Economics
24 tax reform options: equity effects

Source: Access Economics
A word about Age Pension means tests #1

Income via tax-free super is treated differently from taxed income for Age Pension access.

It’s not ‘grossed-up’ to deliver neutrality as regards pre-tax income under means tests.

This generates incentives to draw on super early.

It undermines adequacy and raises longevity risk.

‘Grossing up’ tax-free super corrects this defect.
Table 1. ‘Grossing-up’ effects on Age Pension income test taper rates

<table>
<thead>
<tr>
<th>Assessable annual income band</th>
<th>% effective taper rate*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to $21,999</td>
<td>40.0</td>
</tr>
<tr>
<td>$22,000 - $22,999</td>
<td>40.6</td>
</tr>
<tr>
<td>$23,000 - $23,999</td>
<td>41.5</td>
</tr>
<tr>
<td>$24,000 - $24,999</td>
<td>42.3</td>
</tr>
<tr>
<td>$25,000 - $25,999</td>
<td>43.1</td>
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<td>$26,000 - $26,999</td>
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<td>47.7</td>
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<tr>
<td>$33,000 - $33,999</td>
<td>48.3</td>
</tr>
<tr>
<td>$34,000 or over</td>
<td>48.8</td>
</tr>
</tbody>
</table>

* Based on current 40% taper for a single pensioner.

Source: Towers Perrin
What about longevity risk? #1

Better targeting of super concessions & better targeting of access to the Age pension:

- lift incentives to own-provide retirement income
- targeted at those otherwise on the Age Pension
- increasing superannuation adequacy
- with particular attention to Budget sustainability
- thus reducing longevity risk (to the Budget)

We can buttress these effects by making tax-free super draw downs assessable (above a limit)
What about longevity risk? #2

But more is needed:

- lifting the Age Pension age is desirable
- aligning the preservation age with it, is desirable too
- I recognise these are hard reforms to sell
- but they help delay access to super
- they therefore prolong the accumulation period
- there also is a case for compulsory annuities

There’s no one measure that can do it all, but a suite of measures as outlined here can help
Policy conclusions

A simple structural change to the super contributions tax point opens up avenues for better targeting concessions.

This can be used to improve Age Pension savings later.

Combined with better targeting of the Age Pension, an increased Age Pension age, and alignment of the preservation age and the pension age, these can improve superannuation adequacy in a Budget sustainability sense.

Supporting measures (eg, making large super draw downs assessable above a limit, compulsory annuities) can help too.

Together, these & other measures can reduce longevity risk.