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Review R

A world of issues, ideas & opinions

FRIDAY LIFTOUT

Age As we get older we ask, how will I live, what will it cost? **Paul Howes** says rework superannuation.

THE GREAT SUPER RETHINK

One of my first jobs in the union movement was responding to inquiries from members about their pay and conditions. It wasn't glamorous work, but it was rewarding. I'd check on the members' award or enterprise agreement conditions, clarify if they were being underpaid and then regularly take action to get the member back-pay if they were being underpaid.

I would often field calls from members just seeking clarity on what their rights at work were, or sometimes just seeking assurance that they weren't being ripped off.

It's been about 18 years since I started that job, so naturally all the details of those hundreds of interactions with members haven't stayed with me, but there is one call that has always remained in my memory.

I can't recall the member's name, but she was a middle-aged woman who just started working part-time in an automotive components plant in western Sydney. She was confused and irate about her boss withholding a section of her wages. She was certain it must be a mistake.

We talked it out and it became clear that her problem was her compulsory superannuation contribution. I told her that was actually fine and legitimate. She was not reassured.

"No, the government pays my superannuation," she said. "It can't be up to my boss to take money out from my wages without asking me." No, I explained, that was exactly how it worked.

"But it's my money, I earned it. And I really need it now. Surely you must be able to help negotiate that." I couldn't, of course. But her perspective always stuck with me.

Like most Australians, I was, and continue to be, a strong believer in the virtues of our superannuation system. It is a unique Australian economic triumph, improving the lives of millions. But I think it is important to be mindful of people such as that worker.

Even the most ardent superannuation proponent should appreciate what a big deal it is to compulsorily quarantine someone's wages.

There is therefore a moral imperative for the system to provide a clear explanation for why this extraordinary intervention is necessary. The answer may seem straightforward: to fund your retirement.

But super has meant many things to many people. When it was introduced to a significant portion of the population in the 1980s, it appealed to government as a clever way to offer a heavily unionised workforce a benefit without contributing to inflation.

In 1992, when treasurer John Dawkins made super universal and compulsory, he noted it would "increase our national savings overall, thus reducing our reliance on the savings of foreigners to fund our development".

Things have not become much clearer since then. For many earning high incomes, super has been viewed as a tax-effective savings vehicle to build wealth that can be bequeathed.

For many in the union movement, superannuation represents a pool of "workers' capital" capable of reshaping the economy and society. And just recently we have even seen serious calls for superannuation to be used as a means of helping young people buy houses.

Top: Looking age in the face. *Self-portrait* by Rembrandt, painted in 1669, the last year of his life. Below, Paul Howes, KPMG.

The question is, do any of these goals justify the statutory quarantining of earned wages? And if not, what does? A robust definition is vital, because it needs to justify a serious imposition on Australia's citizens.

The government's Objective Bill is currently being considered by the Economics Legislative Committee, which is due to report soon. The definition it's working with is: "To provide income in retirement to substitute or supplement the age pension." Hardly the kind of wording to stir passions.

But what this definition does, for the first time in superannuation's history, is make clear what super is not. It is not a tool for extreme wealth accumulation. It is not an obligation Australian citizens have to contribute to a nationally useful savings pool. It is not a sovereign wealth fund. It is not a pool of "workers' capital" to be used for social causes. It is not a savings scheme for home ownership.

Its only defined objective under this wording is to provide a retirement income that can substitute or supplement the age pension.

Even this would not be without controversy, however. What does "substitute" mean in this context? Does it simply mean replace dollar-for-dollar? What if a future government interpreted the definition such that any income drawn down from super in excess of the age pension would result in no tax concessions whatsoever? Clarification would be helpful.

Superannuation is not a tool for extreme wealth accumulation.

But put that aside for the moment. Assume a retirement income that "substitutes the age pension" must be significantly more than the aged pension, because otherwise the incentive to save is lost. We then get a new question: what constitutes "significantly more?"

If super is not a wealth-building tax haven, if it's not a nation-changing pool of workers' capital, if its legally defined purpose is simply to replace or supplement the age pension, then how much is enough?

This is obviously a tough question to answer, because "enough" lies very much in the eye of the beholder. For those living at the top of society's tree, $100,000 a year may be inadequate to support the kind of lifestyle they have grown accustomed to over their working lives. For those battling, a retirement income of $100,000 would be far beyond their wildest dreams.

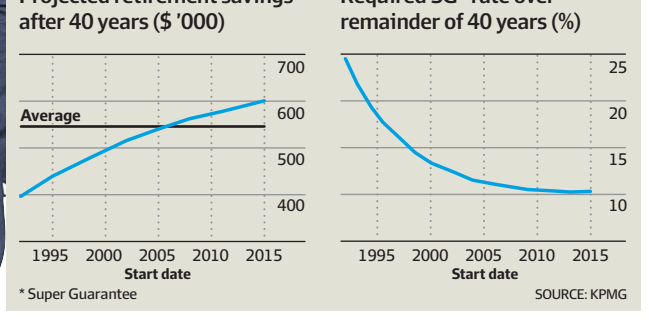
But defining some kind of answer is vital since we need a figure on which to calibrate our entire superannuation system. On one side of the equation, government should only be taking money from pay packets if it is absolutely clear that the outcome is worth it. On the other side, government should only be providing tax breaks if they are necessary to help hit that same objective. So here's a bash at that answer.

As you've probably read, the Association of Superannuation Funds of Australia has defined a "comfortable" standard of retirement living at $43,372 a year for a single retiree, and $59,169 a year for a couple. To achieve this income, a single retiree would need to retire with a lump sum of $545,000, and the couple with $640,000. Whether you consider that too low or too high doesn't matter for now. The point is it gives us a benchmark for what our super system should do.

This is a huge change. Because since 1992 the only figure that has mattered is the Superannuation Guarantee figure: the percentage of our wages that are set aside compulsorily.

Continued page 4

It's all flexible



* Super Guarantee

SOURCE: KPMG

Payday, Leetona Cannery, 1984, a year after super was introduced. PHOTO: PAUL MATTHEWS

From page 1

The great super rethink

It started at 3 per cent. Paul Keating wanted to get it to 15 per cent. Kevin Rudd had a plan to push it steadily up to 12 per cent. Tony Abbott delayed that advance, and it now sits at 9.5 per cent.

Arguments about what percentage the Super Guarantee should constitute have been arbitrary, because the overall goal was never defined.

But if we take ASFA's definition of $545,000 for a single retiree then we can start doing the sums to see what a fit-for-purpose super system actually looks like, i.e. use the Super Guarantee as a means, instead of an end.

Consider someone with average earnings. If they started in the workforce in 1992 then we can assume their contributions were 4 per cent at the time. By the time they reach 2025-26 we assume they will be contributing 12 per cent. That's where their SG rate will remain until their assumed retirement (after 40 working years) in 2032.

Such a person would finish their career with just under $400,000 (in today's dollars – this calculation assumes inflation at 2 per cent.) That's considerably less than the $545,000 we're gunning for. We can say then that the super guarantee is too low for the average person. It needs to be raised to hit the benchmark we've defined.

Most low-income earners retire with tens of thousands, not hundreds.

But what about those who started their working lives later who started with a higher Superannuation Guarantee? KPMG has crunched the numbers (it's what we love) and the graph below makes it clear.

Anyone on average earnings who starts their career before 2006 will fail to hit our $545,000 mark. Everyone who starts after 2006 will exceed $545,000.

The point is that when we ask how big the Super Guarantee should be, the answer is: that depends on when you started work.

If you started in 1992 you would need the Super Guarantee to be 24 per cent starting from this year until your retirement.

But here's the rub. If you started work this year and plan to retire in 2057, then a Super Guarantee of just 10 per cent would be enough to get you to our $545,000 target.

This is a very significant finding for our national super debate. It suggests that the long-standing target of 15 per cent is not the holy grail. And that even Rudd's 12 per cent may be unnecessary.

What does this mean for our politicians? Perhaps it might make sense to ratchet the Super Guarantee up rapidly to 15 per cent now, to help Gen X reach a comfortable level of retirement savings. But then be prepared to lower the Super Guarantee down again when those who started work this century start making up the bulk of the workforce.

Of course defining a target of $545,000 also has massive ramifications for low-income earners. After all, can it be right to take money from people who could really use it today if it's not even going to help them enough tomorrow?

Take someone working full-time on the minimum wage. They are making $38,304 and the current 9.5 per cent SG rate costs them $2449 in lost take-home pay – $2449 is a life-changing amount of money for someone on such a wage. It's the servicing of an unexpected car repair, a much-needed holiday, a year of school excursions for the kids.

If government is to deny these things in favour of retirement savings, it has a serious responsibility to ensure the goal is worthy.

As things stand, a full-time wage earner on $38,304 would retire with $375,000 – far less than the $545,000 to make them comfortable.

And the fact is most low-income earners are not working full-time. They are retiring with super in tens of thousands, instead of the hundreds. So what do they do when it gets paid out on retirement?

Unsurprisingly, they often use the lump payment to retire debt, before going straight onto the aged pension. And that should give us pause. Because assuming this debt has been attracting interest during a lifetime of work, it surely would have been in the low-income earner's interests to pay it off earlier (or not create it at all.)

Government should consider raising the wage rate at which the Super Guarantee kicks in. To be fair, the objective being considered does make clear that super can be for "supplementing" the aged pension as well as substituting for it.

But there is still the question of whether that supplement is more useful in retirement than the money would have been over the course of a cash-strapped working life.

Defining the purpose of super as a substitute or supplement for the age pension, also has important ramifications for the age pension itself, which now becomes the sole benchmark of the retirement system. This can and should put pressure on governments to up the generosity of the pension, as this will potentially advantage everyone, including wealthier retirees.

The objective should also provide impetus to harmonise the preservation age (the age at which you can withdraw your super, currently 56 years) and retirement age (which will be 67 for those born after 1959).

If "income in retirement" is the point, it stands to reason that anyone accessing their savings should be retired. Such a change would increase the period over which superannuation contributions can accumulate and also reduce the period over which superannuation is drawn down. It might also enhance productivity by encouraging older people to stay engaged with the workforce and offer their knowledge and expertise.

For some industries requiring physical labour, exemptions could obviously be made. The retirement age, however, could still be regularly reviewed and increased according to life expectancy and the nature of work.

So while the heat and fury of our political debate seems to find itself elsewhere at the moment, there is actually a hell of a lot riding on this ostensibly drab little definition.

Codifying what super is actually for should have huge implications for both ends of the wage spectrum, and everyone in between.

If the government is to continue to temporarily confiscate the wages of people such as the worker who came to see me all those years ago – and everyone else for that matter – they are owed a good explanation. R

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