A submission to the *Australia's Future Tax System* Review

Reform of the Australian Retirement Income System

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Executive summary

Reform of the retirement income system is best treated in the context of reform of the tax-transfer system in general and the underlying question of the type of society in which Australians might choose to live, including considerations about the role and size of government. All other issues relevant to retirement income follow from this. It involves matters of both fact and value which — in the case of retirement income — focus on the twin objectives of protecting those unable to save against poverty in their old age while providing the means by which individuals must or can save for their retirement; and ensuring the system is equitable while not inappropriately biasing other saving decisions.

Anglicare Australia follows Treasury in regarding the most appropriate conceptual framework within which to deal with the issue to be the ‘capabilities approach’ developed by Amartya Sen. This combines a concern with ensuring the essentials of life with developing higher facilities and freedoms such as the right to live a ‘life without shame’. Recent work by Anglicare and others provides empirical substance to this approach in the context of living a non-disadvantaged life in 21st century Australia. Financial security is evidently critical to this.

For policy purposes, the capabilities approach is best integrated with the tradition of social contract theory. In practical terms this means a set of arrangements — within and between generations — to promote equity and a dignified standard of living, but also to encourage self-reliance wherever practicable. This provides an ‘ideal type’ against which existing arrangements can be assessed and which can also inform practical measures to minimise deficiencies and promote a more equitable, realistic alternative.

The most obvious ideal — in line with the majority of OECD countries — is a system of national social insurance. This has the defining features of being based, by definition, on the insurance principle; serving social as distinct from, but in addition to, individual objectives; and being government-sponsored with greater or lesser compulsion and statutory obligations. Australia’s established ‘three pillar’ retirement income arrangements constitute, in effect, a quasi-social insurance system. It would not, in principle, require a significant policy shift to enable the current system to meet the insurance principle. The main change would involve the manner in which the Superannuation Guarantee is incorporated into a social insurance contribution (predominantly with Medicare); and its component of retirement income turned into a mandatory defined benefit income stream.

From this perspective, the deficiencies of the current system become clearer, and their mitigation manageable. Apart from the complexity, confusion and unfairness of superannuation arrangements and the imbalanced distribution of wealth among aged pensioners, there are two principal failings: the preference for allocated or account-based over lifetime income stream annuities or pensions;

and the inadequacies of financial advice provided by the private sector over superannuation and other investments.

While these and other deficiencies would be remedied by a robust system of social insurance, certain intermediate measures can be taken to ameliorate the situation during the transition period. These measures would be advisable even were a full system of social insurance not to be implemented. They include:

Extending the draw down contained in the 40 hours work provision.

Instituting an Exceptional Circumstances Relief scheme, similar to that which applies in the case of farmers and farm-dependent rural businesses, to apply to self-funded retirees.

Pegging the deeming rate for self-funded retirees eligible for a part-pension to fluctuations in the cash rate, rather than indexed annually against the CPI.

Denying access to superannuation until Age Pension age — other than in exceptional circumstances such as ill-health, disability or the assumption of caring responsibilities.

Government's stimulating and fostering a defined benefit annuities market; in part by using the prospective issue of government bonds as the cornerstone of such a market.

Comprehensive re-evaluation and reform of the role of financial advisers; and a greater role for government.

The submission ends with individual responses to the Review's consultation questions.

Preamble

Anglicare Australia welcomes the opportunity to make this submission to the review of Australia's taxation and transfer payment system on the issue of retirement income. As a nationwide network of locally based Anglican agencies responding to the needs of some of the most disadvantaged people in our society, Anglicare Australia has a particular interest in addressing the review's objectives through the lens of the federal government's social inclusion agenda and the needs of vulnerable older Australians.

The submission is in four parts. First, an overview of the retirement income system in the context of the interests and character of Australian society in general, with a view to developing an appropriate conceptual framework (that of the 'social contract' from the capabilities approach) for dealing with the specific question of retirement income. Secondly, a general discussion of 'ideal type' options for social insurance, given the existing Australian system and possible future developments. Third, an application of this general discussion to identify deficiencies of the existing system and propose intermediate remedies. And fourth, specific responses to the Review's consultation questions.

This paper should be read in conjunction with Anglicare Australia's initial submission to the Review Panel (Anglicare Australia 2008b: copied at Attachment One); its submission to the Pension Review (Anglicare Australia 2008c); as well as that to the current inquiry from Anglicare member the Brotherhood of St Laurence, and the research report it commissioned from the National Centre for Social and Economic Modelling at the University of Canberra (2009). Naturally, it is also intended as only one element of our detailed overall response to the General Review, due by 1 May 2009.

Part One: Retirement income and Australia's social contract

The most fundamental challenge the Review Panel identifies — not only for retirement income but the entire tax-transfer system — is that listed at the beginning of the first chapter of the Consultation paper (henceforth 'Paper'): namely, determining 'the type of society in which Australians might choose to live, including considerations about the role and size of government in Australia' (Paper: 5). All other issues relevant to retirement income follow from this, or may be framed within its terms of reference.

The question invites consideration of matters both of fact and of value. Among the more important of the former:

- The uncertain nature of the international economy (including the financial system) and Australia's future place in it.
- Growing unease about the dominant economistic model of society.
- The implications of climate change for sustainable growth.
- The implications of demographic change and intergenerational relations and responsibilities.
- The rapidly changing structure of the job market.
- The nature of Australia's mixed economy and its impact on:
    - income inequalities, as reflecting market bargaining power and legal obligations flowing from the ever-changing industrial relations system;
    - differential arrangements for compulsory and voluntary saving among the working population; and
    - the disparate and often confusing options for non-Age Pension financial benefits.
- The short-term budget planning process with regard to future retirement and pension obligations.
- The transitional nature of the current 'three pillar' arrangements for retirement income, primarily because of the lead-time for a mature Superannuation Guarantee (SG) system in 2037.

Matters of value are not as readily listed. As noted in Anglicare Australia's initial submission, values are of the utmost importance in establishing a context for discussion of taxation and social security.

> 'More specifically, financial arrangements are part of a broader economic system that in turn reflects certain cultural (and ultimately philosophical) values. One of the most important issues these encompass is the extent of collective as opposed to individual responsibility. A closely related concern of particular relevance to the tax-transfer system is that of equity or equitable distribution. The first and obvious challenge to be addressed through the tax-transfer system, therefore, is to determine the values which define the identity and direction of Australian society in the 21st century.' (Anglicare Australia 2008b: 4.)

While much has been written about Australian political culture and history — from the Federation Movement, through the Australian Settlement to current ideals of multiculturalism — it would be rash to settle on any one account as representative, let alone definitive. Nevertheless, there are certain general principles on which there appears to be consensus and which are reflected in the Panel's 'possible objectives' for a retirement income system (Paper: 7-8). We note in particular the objectives that the system should 'protect those unable to save against poverty in their old age' while providing 'the means by which individuals must or can save for their retirement'; and that it be 'equitable and does not inappropriately bias other saving decisions'.

Or as the Treasurer recently summarised the consensus (Swan 2009): '[T]he purpose of a better tax and transfer system is to promote national prosperity in a way that is consistent with our national values of fairness and equity.'

To synthesise these empirical and normative issues requires an appropriate conceptual framework. As argued in our initial submission and elsewhere (Anglicare Australia 2008a: ch. 6), Anglicare Australia's overall philosophical position aligns with Treasury's endorsement of the capabilities approach as developed by Amartya Sen and others (e.g. Sen 1999; Nussbaum & Sen 1993). In particular, we fully concur with the view that 'there is far more to sharing prosperity than simply ensuring that income is redistributed in a way that avoids inequality widening over time beyond some arbitrary level' and that effective capabilities include not only such essentials as adequate food, shelter and health but also higher order facilities 'such as the capability to live without shame, the capability to participate in the activities of the community, and the capability of enjoying self-respect' (Henry 2007).

Recent work co-authored by Anglicare has provided an empirically detailed picture of what this involves: in other words, what constitute basic capabilities in Australia today — or, we might say, what is needed for the individual to live as a full citizen. This was done by identifying the absence of items or experiences which enable one to 'live without shame'; that is, by developing new indicators of disadvantage and social exclusion 'grounded in the actual living standards and experiences of people in poverty' (Saunders et al. 2007: vii). Thus, apart from having a substantial meal at least once a day and a secure home, there should also be the ability, for instance, to buy prescribed medicines and school books and clothes for children. (See Appendix Two for details.) This notion of 'co-operative capitalism' (see Hertz 2009) accords with the concerns of classical liberal political economy, though not those of recent neoclassical theory and practice. It also allows greater conceptual and empirical precision in determining policy outcomes, as specifying disadvantage tends to produce a finite enumeration, while devising positive indicators of 'inclusion' — which easily conflates 'needs' with 'wants' and 'desires' — can encourage an open-ended wish-list. This approach also deals as well as possible with the inherent subjectivity of defining 'adequacy' (Paper: 14–16).

> By necessaries I understand not only the commodities which are indispensably necessary for the support of life, but what ever the customs of the country renders it indecent for creditable people, even the lowest order, to be without. A linen shirt, for example, is, strictly speaking, not a necessary of life. The Greeks and Romans lived, I suppose, very comfortably, though they had no linen. But in the present times, through the greater part of Europe, a creditable day-labourer would be ashamed to appear in public without a linen shirt, the want of which would be supposed to denote that disgraceful degree of poverty which, it is presumed, nobody can well fall into, without extreme bad conduct. Custom, in the same manner, has rendered leather shoes a necessary of life in England.
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> Adam Smith, *The Wealth of Nations* (1776)**,** Chapter II, Article IV.

While this indicates that the capabilities perspective calls for a wide-ranging view of human interests, including an appreciation of differences, it is evident that financial security is indispensable to any form of meaningful participation in mainstream society. At the same time, it should be considered primarily as a *societal* and ethical good, incorporating both rights and responsibilities. Or, to invoke a sometimes neglected (at least in recent years) tradition of political argument, questions surrounding lifetime financial security — as a basic element of the overall tax-transfer system — may properly be viewed as part of a *social contract* within and between generations to promote equity and a dignified standard of living, but also to encourage self-reliance wherever practicable.[1] This implies mutual interest: with the fortunate and strong having a responsibility for the unfortunate and weak; but also a responsibility on the part of the latter to attain or regain independence to the degree they are able.

In practical terms in early 21st century Australia, this means devising a contract that will promote an equitable distribution of financial and other goods while incorporating and respecting the legitimate interests of all members of a very heterogeneous society, who have quite distinct experience of, involvement in, and capacity to become involved in, the business of saving. At one end of the spectrum (the population with whom Anglicare agencies overwhelmingly deal) are the most disadvantaged, including those with severe disabilities, chronic illness, mental health problems, addictions, the homeless, and people who for other reasons beyond their control cannot participate fully in paid full- or part-time employment. At the other end are the market system's 'winners', with astronomical incomes, secure pensions and high social as well as economic status. In between are the majority, including those who:

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[1] Martha C. Nussbaum (2000) has explicitly used the capabilities approach, particularly Sen's notion of 'Substantial Freedom', to reinterpret the social contract theory of justice (notably that of John Rawls). An application in the American context — and taking account of current economic conditions — may be found in Butler (2009). For a general overview of social contract theory as a thought experiment underwriting a normative argument for just social arrangements, see the Stanford Encyclopedia of Philosophy (2008). There is a hint of this also in the Prime Minister's recent statement of social democratic philosophy in his celebrated essay for *The Monthly.*

- have secure but modestly rewarded employment;
- have precarious employment;
- are under-employed;
- are for whatever reason unemployable;
- have broken work patterns;
- are self-employed in unpredictable circumstances;
- are carers or volunteers; or
- have relatively mild or intermittent forms of disability or illness.

The challenge for the social contract in general is to work out measures of fairness that do not unduly 'privilege' one group over others; and, for the tax-transfer system in particular, to devise a system that, as noted, is 'equitable and does not inappropriately bias other saving decisions'.

In the case of the general contract — given the capabilities approach as our starting point — we need only refer to the principles of 'justice as fairness' advanced by John Rawls (1971: 60–1):

First, that 'each person is to have an equal right to the most extensive scheme of equal basic liberties compatible with a similar scheme of liberties for others'.

Secondly: that social and economic inequalities are to be arranged so that:

- they are to be of the greatest benefit to the least-advantaged members of society (a.k.a 'the difference principle'); and
- offices and positions must be open to everyone under conditions of fair equality of opportunity.

Relating this to the tax-transfer system is, of course, far from simple. Not only are we dealing with principles — themselves always contestable — we must also square them with empirical reality and policy limitations. We may still, however, approach this from within the capabilities framework, beginning with an 'ideal type' application before moving on to specific recommendations for practical reform in Australia, given prevailing circumstances.

Part Two: An 'ideal type' of Australian social insurance system

If it is a central tenet of the social contract that every individual[2] should enjoy the basic capabilities outlined above, it follows that the community, through government, has a responsibility to ensure that all citizens and other legal residents have at least the minimal financial capacity to attain those capabilities. In Australia today, this may be secured by way of direct payments (as in income support) or subsidy (as in state education and basic healthcare). In the case of the three pillars of the current retirement income regime, this is presumably

[2] Naturally this excludes (though not entirely) those who put themselves outside the contract — for instance, by breaking the law.

covered by the Age Pension which 'is intended to provide a basic acceptable standard of living, taking into account community standards' (Paper: 14). Whether this should be seen as equivalent to a 'safety net' — and whether it is adequate in either case — is a moot point, but one that does not, formally, come within the direct purview of the current exercise.

What certainly does is the 'threshold issue' (Paper: ibid.) of the pension's role as a supplement to the other pillars. Given the variety of saving options covered by these, especially voluntary savings, it is evident no single criterion of equity could serve to provide general guidelines. (This is without considering the various general interpretations of the term: see Commonwealth of Australia 2008: 32-4.)

For the moment, however, and to provide a standard around which to assess actual policy options, let us return to the logic of community obligation to the individual. The provision of minimal financial aid to secure basic capabilities implies a guaranteed income, whatever happens to be the agreed amount. For those in the workforce this amounts to some variant of a Basic Income (perhaps through negative income tax). For those outside it, whether pre- or post-retirement age, it would amount to some equivalent pension. In short, the logic implies a system of social insurance.

As the Panel notes (Paper: 10-11) the majority of OECD countries have national insurance systems providing a defined benefit retirement income which operates as 'an after-tax replacement of an individual's before-retirement income, dependent on eligibility criteria such as their time in the workforce and period of contributions'.

There are various ways of funding such a system, usually through some manner of mandatory defined contribution scheme. However, the most important features of social insurance are that, by definition, it is premised on the *insurance principle* (rather than as an individual investment with attendant risks); that it serves social as distinct from, but in addition to, individual objectives (typically to provide collective responsibility for individuals' disability, unemployment, health and retirement; and to finance social goods like housing and education); and that it is government-sponsored with greater or lesser compulsion and statutory obligations.

Australia has what might be called a quasi-social insurance model, notably in the form of Medicare, but also 'under the table' in the form of the Superannuation Guarantee (SG) and actual and mooted restrictions on the draw down of superannuation and its use as an income stream (Paper: ch. 4).[3] This is

[3] 'Requiring an amount of superannuation savings to be taken as an income stream would better integrate the Age Pension and the superannuation system and provide greater protection against longevity and inflation risks. Income streams could be purchased to receive a set income for life (a lifetime annuity) or a flexible income based on the balance of an account (an allocated pension).' (Paper: 31.)

supplemented by voluntary savings, including superannuation contributions beyond the SG, which may be dispensed in a variety of ways.

Let us imagine what little would have to change to make this an authentic social insurance model, specifically with regard to retirement income. (General social insurance, obviously, would cover other life events; we are here concerned only with the principles underwriting retirement income.) For those in employment, under current arrangements, income tax and the Medicare levy are compulsorily taken at source, with employers obliged to contribute nine per cent of wages or salary through the SG (the particular fund being decided, in theory, by the employee). Individuals, if they have the means and inclination, may then make discretionary savings by putting more money into their superannuation account or through alternative investment vehicles. In a system of social insurance, the only practical difference (given the necessary condition of government sponsorship as well as the need to cover more than individuals' non-Age Pension retirement income) would be twofold: that SG contributions would go into a fund controlled by government to ensure uniform outcomes, probably through relatively low-risk investments; and that the SG and Medicare levies be bundled together — with, perhaps, an additional premium to cover whatever other items might be considered worthy of inclusion, like universal dental treatment.

Now suppose, in the case of retirement income, that current arrangements were to be replaced by a system that mirrored the division between mandatory and discretionary contributions. On the one hand, there would be mandated funds (Age Pension and SG in some appropriately tapered combination; and with due regard for other assets) taken as a lifetime income stream, along with medical subsidies. On the other, individuals would have full freedom to do whatever they chose with their savings from discretionary investment. Put another way: the current system — of having only one pillar (Age Pension) providing a guaranteed income with the other two dependent on the amount invested and returns on those investments — would be replaced by a system in which two pillars (Age Pension and SG) would provide guaranteed income, and the third be dependent on investments and returns.
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Such an arrangement would have several benefits:

- It would greatly simplify and render more efficient a system that, as the Review and NATSEM (2009) amply demonstrate, is complex and (for many retirees having to choose among competing investment options) confusing.
- It would remove many of the obstacles to individuals' making rational decisions about such matters as longevity and inflation risk.
- It would encourage saving and overall self-reliance.
- It would also encourage greater intergenerational balance as the non-Age Pension component of mandated income would reflect individuals' own saving rather than relying on outlays from those currently in the workforce.

- It might persuade governments to adopt a 'real', longer-term perspective on the budgetary implications of retirement income policy for the whole population, rather than only the federal public service.[4]

AN AUSTRALIAN MODEL OF SOCIAL INSURANCE

Contributions taken at source or invested during employment

Mandatory
Income tax
Social Insurance (replacing Medicare and SG)

Discretionary
Extra superannuation
Other insurance or investment income (in any form)

Retirement income

Mandated

Age Pension + SG income stream (tapered)
Medical expenses (with or without co-payments)

Discretionary
Income from extra superannuation or other investment contributions

As against this, it is evident many of the concerns expressed about the existing system would still have to be addressed — such as the adequacy and accuracy of available financial advice (see Part Three). There would also remain significant discrepancies in wealth. Those on higher incomes have an advantage over those on lower incomes. That this should continue into retirement is unsurprising. It is one of the realities of living in a liberal market society. The proposed form of social insurance would not be militantly redistributionist.

However, the notion of social insurance and the development of capabilities on which we have based it does put the goal of a decent, dignified life for all — living without shame — at the centre of the debate. As Rawls contends, social and economic differences are to be accepted only if they are of the greatest benefit to

[4] Indeed, in one possible application, the Future Fund might be completely overhauled to accommodate the long-term interests of the whole population.

the least-advantaged members of society. As such a system came into being, fewer people than at present would rely on the Age Pension alone (i.e. people who have made no SG contribution). But even these would be provided for on the basis of their needs (qua capabilities) rather than some residual notion of a safety net.

The main problem with the current quasi-social insurance model is that it is not a two-way obligation but, as Butler (2009) says about the American model, 'a one-way legal entitlement to assure a comfortable, long retirement for [the] middle-class — whatever the cost in terms of funding for other social programs or the burden on future generations'.

To repeat, our proposal is itself an ideal type that cannot be advocated as immediate policy, for entirely practical reasons — notably the need to address the anomalies inherent in the currently immature SG system. It does, however, provide working principles that can profitably underpin reform of existing arrangements and the transition to a robust, sustainable alternative. To this we now turn.

Part Three: Confronting major deficiencies in the current system

The problem of transition is chronic, if only because the SG system will not mature until 2037 (whether or not full social insurance is implemented). The extent of the problem has recently been highlighted by a reissued ABS report demonstrating that in mid-2007, the median superannuation balance of Australian workers was only $23,698 (for those in the 55 to 64 age group, it was $71,731). Men tended to have a balance about twice that of women, a similar ratio to that between public servants and those in the private sector, with only 20 per cent of men and 11 of women having $100,000 or more in their account (ABS 2009). Or, as noted by the Australia Institute (Ingles 2009), most of the benefits of the current superannuation system go to people earning more than $180,000 a year, with almost nothing for those on less than $40,000.

The picture for aged pensioners overall is varied (NATSEM 2009: section 3), but demonstrates a clear bias in favour of the better off (even taking into account the caveat mentioned above about the realities of a liberal market society). Although most age pensioners have lower overall incomes than average, two per cent — or 51,200 people — are in the highest income quartile; with half living in a household in the top half of the wealth range; and 14 per cent living in the wealthiest 25% of households with an average net worth of more than $1.6 million.

At the other end of the scale, pensioners who are renting have much lower private income, with 83 per cent enjoying private incomes of less than $20 a week. More than half of single age pensioners are in the lowest quarter of the income range. The single female age pensioner is the most disadvantaged, with three quarters in the bottom half of the income range.

While in the long run a system of social insurance might be expected to redress these imbalances, shorter-term measures will also be required.

Allocated or account based vs lifetime pensions and annuities

The present system is heavily weighted towards allocated pensions, which provide a less than ideal hedge against longevity risk. Particularly when coupled with mandatory draw down provisions, allocated pensions can provide a perverse incentive to profligacy. It is an entirely rational decision to opt for a plan which provides a higher income in the early years of retirement, on the assumption that one will either die before the funds are exhausted, or be able to fund a comfortable and active lifestyle, with the safety net of the Age Pension for later years. While it may not be an equally rational decision to draw down the whole of one's superannuation in a lump sum, it is not uncommon; many consider it their duty to 'leave something to the kids'. If forced to draw on their capital, some of these people then see no point in saving the money.

Longevity risk is best handled through lifetime annuities, but this type of financial product is seldom recommended, little-known and not widely available in Australia (Paper: 31). Further, there now exist significant obstacles to taking out a joint annuity, notably rules against using superannuation funds for the purpose. That said, the indexation of the income stream to inflation or another comparable yardstick guards against the depredations of poor investment decisions by fund managers. Conversely, an annuity income stream has clear disadvantages as a buffer against unexpected major expenses.

Financial advice: lack of clarity/approachability, financial illiteracy and asymmetric knowledge

Existing arrangements are less than optimal. There are no standard definitions for the terms used by funds to describe what the various investment options are intended to do. An analysis of 413 investment options by industry research group SuperRatings saw 312 eliminated from the study because of ill-defined objectives (SuperRatings 2008), while terms such as 'growth', 'balanced', 'conservative' or 'capital stable' do not necessarily carry the same meaning from one fund to another. There is even disagreement about whether assets such as property should be classified as growth or defensive assets (Kavanagh 2009).

Even were the various investment options to follow a standard terminology, there would be no great improvement in communication. We might draw an analogy with medicine. Patients consenting to a procedure are required to give informed consent — a concept many medical ethicists regard as a bad joke. To give properly informed consent, a lay person would need to have a comparable technical knowledge to that of their doctor (or investment advisor). As more worldly economists (e.g. Stiglitz 2001) have often pointed out — and the general public is becoming increasingly aware these days — asymmetric knowledge is one of the main reasons the market system has neither an invisible hand nor a majority of rational utility maximisers.

Research shows that Australian workers typically have a relatively low understanding of many basic financial investment concepts, which calls into question their ability to make informed choices among various financial institutions and investments (Schulz 2005).

The problem of informed consent about superannuation funds did not exist until the introduction of Super Choice in 2005. The employer chose the fund, for better or worse — and frequently for worse. In the new environment, poor decisions are the responsibility of individual employees. Administrative costs vary greatly from plan to plan and can be very high (especially in small and/or retail plans), thus reducing the ultimate amount received. Projections of likely future rates of return must be scrutinised closely. These are often advertised without deducting realistic amounts for marketing, administrative costs, and investment management fees. Nevertheless, many workers have chosen, whether through fear, ignorance or inertia, to stick with the fund chosen for them, even if the returns are less than they might otherwise be.

Relatively low financial literacy and information asymmetry become even more problematical at the post-retirement stage. Individuals are greatly hampered in their ability to make decisions that are in their best interests by the structure of the financial planning industry, in which many practitioners are effectively tied to one particular financial services provider. They act, and are forced to act, by the circumstances of their employment as commissioned agents, as salespeople rather than disinterested advisers.

Intermediate measures

As argued above, Anglicare Australia contends that the problems inherent in the current retirement incomes system would ideally be remedied by a social insurance scheme — fully acknowledging the transitional difficulties. However, before such a scheme can be fully implemented the difficulties engendered by the current system will need to be dealt with. These measures would be advisable even were a full system of social insurance not to be implemented. To this end we offer specific suggestions to alleviate disadvantage to those affected by shortcomings in the scheme and by the current financial upheavals.

The suspension of the draw down requirement for account-based annuities and pensions, allocated annuities and pensions, account-based and allocated pensions payable from Retirement Savings Accounts, and market-linked annuities and pensions, is to be applauded. Given, however, that there is a great deal of uncertainty about the severity, depth and likely duration of the current financial downturn — in the course of which many retirees might incur significant financial loss from the drawdown — other options might need to be explored. In this regard, we propose the following measures.

First, *the exemption from the draw down contained in the 40 hours work provision be extended*. We argue this by analogy with the proposed community work HECS payment scheme. Many active retirees might well be able to contribute to the community through voluntary work of various kinds. It would appear to be feasible that they could be relieved of the requirement to draw down part of their capital in exchange for volunteering for a set number of hours working in the community sector — perhaps 80 or 100 hours.

2. An alternative approach to dealing with the current reduction in income streams might be to *institute an Exceptional Circumstances Relief scheme, similar to that which applies in the case of farmers and farm-dependent rural businesses, to apply to self-funded retirees.* Such a scheme should apply only during periods of financial crisis and/or rapid and dramatic falls in interest rates and investment earnings. The capital investment would be exempted from the assets test on the same grounds as the farm — as being essential to the running of the business (in this case the business of maintaining a retirement income other than the Age Pension).

3. Anglicare Australia also recommends that *the deeming rate for self-funded retirees eligible for a part-pension be pegged to fluctuations in the cash rate, rather than indexed annually against the CPI*. Part-pensioners whose investments are due for renewal shortly after the annual alteration in the deeming rate can find themselves severely disadvantaged in volatile times.

4. We contend that — other than in exceptional circumstances such as ill-health, disability or the assumption of caring responsibilities — *access to superannuation should not be available until Age Pension age*. We have already argued for the greater availability and uptake of annuities as retirement income streams. We suggest that in a retirement investment culture which is almost entirely oriented towards allocated pensions, and in the absence of a strong market in annuities, it is not only possible but desirable for government to stimulate and foster an annuities market. There are several options for doing so.

4.1 The first assumes that access to superannuation will continue to be available before Age Pension age. If this is indeed the case, it could be a mandatory condition of early access that the funds be invested in a lifetime annuity. The only exemptions to this policy should be for retirement due to ill-health, disability or the assumption of caring responsibilities.

4.2 One possible approach to creating a viable annuities market is to *use the prospective issue of government bonds as the cornerstone of such a market*. The bonds could be sold at a small but appreciable discount to funds willing to employ them as the basis of annuity products. This carries with it the potential to use the bond issue to save future outlays on the Age Pension.

4.3 The *differential requirements about which types of funds can be used to purchase allocated pensions and annuities should be abolished*. At present, it is impermissible to purchase joint lifetime annuities from superannuation funds. This appears illogical. There is little reason — given the increased crossover between financial institutions and insurers — to maintain an almost entirely arbitrary regulatory distinction between financial services retirement income products and insurance retirement income products.

5. Anglicare Australia also recommends that *the role of financial advisers be comprehensively re-evaluated and reformed*. In the simplest terms, while not all financial advisory services are formally tied to a single financial services provider, many are nonetheless forced in practice to align themselves with a life office or other large financial institution whose interests and services they are consequently expected (by that larger institution) to promote. At the same time, the companies are expected (by government) to provide advice to individual clients that is as disinterested as possible. Though these expectations are not necessarily mutually exclusive, they are exceptionally difficult to reconcile.

A report by Rice Warner Actuaries for the Industry Super Network encapsulates the problem. Not only is there a potential conflict of interest for those advisers who are paid by commission, the report also indicates that commission-based advice could cost clients 13 times as much as for up-front advice (Australian Broadcasting Corporation 2009). This clearly is a major impost, and one which is not disclosed.

Financially unsophisticated clients may fail to realise that the advice they are being given depends on several sets of commercial imperatives: that of the financial services group, that of the financial adviser working on commission, and finally, their own. There is a need for impartial financial advice on retirement income, and a dearth of places in which to find it. We suggest that the government might be the obvious provider.

The default position of the public service on advice of this kind is, rightly, that it does not advise about commercial products. But, arguably, in a case such as retirement income, where the government will be picking up the financial pieces in the case of poor or inaccurate advice, giving advice is precisely what government *should* be doing.

This is not to suggest that public servants should be asked to advise individuals directly on the merits of one commercial product or another. There are several arm's-length ways in which this might be done.

- The first is the creation of a website similar to the Department of Health and Ageing's *Aged Care Australia*. Users are asked questions about their requirements and given a list of those aged care homes in a designated area which meet their specifications. The site provides links to the homes.

- The second, related, possibility is that a similar questionnaire be available in person at Centrelink offices, with a designated staff member providing an encrypted list of appropriate services, with a key allowing the client to identify them.

- A third possibility is that the government fund a suitable NGO to provide free, disinterested financial services advice over the phone and in all Centrelink offices.

It must be stressed again that these proposals are geared towards the broader end of a comprehensive social insurance system, complementing voluntary national savings.

Part Four: Responses to consultation questions

Q.1.1 *In considering the future of Australia's retirement income system, which objectives are relevant in setting retirement income policy? Does the current system of the Age Pension and compulsory and voluntary savings meet these objectives? If not, how should the system be changed to meet these objectives?*

Anglicare Australia has argued throughout that the current three pillar system does not adequately meet the objectives of broadness, adequacy, robustness, sustainability and simplicity; and advocates in principle the development of a social insurance scheme. The overriding objectives for such a scheme are protecting those unable to save against poverty in their old age while providing the means by which individuals must or can save for their retirement; and ensuring the system be equitable while not inappropriately biasing other saving decisions. The main deficiencies of the current system are outlined in Part Three.

Q2.1 *As the SG system matures, it will become a greater part of an employee's retirement income. What are the implications for individuals partially or fully excluded from the mature SG system (the self employed, individuals with broken work patterns such as carers, women and migrants), and how can the retirement income system best accommodate these groups?*

In the long-term (i.e. by 2037) a mature SG system as a central element of a social insurance scheme would provide an income sufficient to enable all citizens to ‘live without shame’ (see also the response to Q2.2). However, inequalities will remain a reality of the liberal market system. There are various ways in which individuals wholly or partially excluded from the mature SG system may be assisted. Incentives to save for retirement are already built into the taxation system, through the government co-contribution scheme for low income earners and the treatment of capital investments used for business purposes. Government could also consider a requirement that part of the proceeds of a business sale on retirement be directed towards an investment that pays an income stream. There is, though, the caveat that — given the modest prices for which some businesses sell — there would have to be a threshold below which this would not be required.

Most women with children are in relationships where it is a family decision to have one partner stay home or work part-time (usually the woman). For these stay-at-home parents or part-time workers, household income may be a better benchmark for assessing capacity to save for retirement. There are existing mechanisms to fund retirement incomes for stay-at-home spouses, such as the capacity for spousal superannuation contributions where a spouse earns under $14,000 per annum. Perhaps this principle could be broadened to allow income splitting between partners, with both required to contribute to superannuation. Another vehicle for levelling the playing field for partnered parents out of the workforce for a period or working part-time for a number of years may be to strengthen the assumption of split entitlement to superannuation balances where couples separate and/or divorce, in recognition of the contribution to the other spouse’s capacity to continue working full-time.

Individuals with broken workforce attachment, for whatever reason, need different treatment. Incentives (or penalties) and support for these groups to engage in work and save may have more effect. These may just as effectively be directed at employers (including government and the corporate sector) as at the disadvantaged groups themselves.

Anglicare Australia also backs the call by Carers Australia (2008) for the Australian Government to make superannuation contributions for period(s) for carers unable to participate in the workforce.

Q2.2 *Noting that adequacy of the Age Pension is being considered by the Pension Review, what is an appropriate concept of adequacy for the retirement income system? Should it be to ensure there is a minimum level of income in retirement, to replace a proportion of income earned prior to retirement, or some other alternative?*

Adequacy should be determined with reference to the criteria of capabilities that reflect community expectations of a decent standard of living (see Part One). As with current arrangements for income support, there will be variations, depending on individual circumstances. Using the substantive empirical work of Saunders and others (2007) on indicators of disadvantage, a general replacement rate (see Paper:15–17; and Appendix D) may serve as an acceptable financial proxy. It should, ideally, not be based on some arbitrary percentage of others' income, but in relation to the 'basket' of goods denoting non-disadvantage.

Q2.3 *What should the role of the government be in assisting individuals to meet their retirement income expectations in relation to the support provided by the Age Pension, the level of compulsory savings and incentives to make additional savings? Should the role of government change as an individual's income increases over their working life?*

Anglicare Australia concurs with the reasons listed in the Review (Paper: 10) why governments, in general, establish retirement income systems. The long view needs to be taken of an individual's capacity to save for retirement over their working life (and not all will experience increases in income or maintain stable attachment to the workforce in this time). For low to moderate income earners, steady contributions over their full working life, in normal circumstances where balances accumulate and attract cumulative interest, will set them up better for retirement. However, for higher income earners, while wealth accumulation should not be capped (as with the abolished Retirement Benefit Limit), government incentives for additional savings should be withdrawn once income and savings have reached a certain level.

That said, given both our stated preference for a social insurance system and the inherent volatility of market investments, the emphasis should be on government-controlled 'safe' investments for SG funds.

Q3.1 *Do the settings of the retirement income system, such as the level of SG and access to concessions, adequately consider the needs and preferences of individuals both before and after retirement?*

'Needs' should be determined by reference to capabilities (as contended in response to Q2.2). 'Preferences' tend to be open-ended and often idiosyncratic, outside the business of government. Expectations, comparably, can be unrealistic. In principle — both in the current system and a mature social insurance model — they are best left to individual choice and savings beyond the requirements of need according to community standards.

Determining a satisfactory level of SG is inherently difficult, and largely subjective. It is also subject to contingent circumstances, such as the current financial meltdown. While, for instance, it may be advisable in general to adhere to the original (Keating Government) target of 15 per cent, attempting to impose that now might well result in a significant increase in unemployment. The critical question, in any case, is the relationship between the general level and additional government support for low income earners. If, say, the general level were lifted to 12% for all employees, the government might pay an additional two per cent to low income earners eligible for the full Low Income Tax Offset (LITO), with the contribution reducing based on the scale used for the LITO. All other employees would receive the full three per cent SG increase.

Q3.2 *Is the current level of superannuation income tax concessions appropriate and sustainable into the future? Are the current concessions properly targeted, and if not, should they be reformed?*

The flat rate tax on superannuation contributions and earnings is regressive, rewarding higher income earners to a greater extent than low to middle income earners. Tax rates for superannuation contributions and earnings should be on sliding scale aligned with (but not set at the same level as) an individual's personal income tax rate.

Some issues need to be examined. One of these is the ability to salary sacrifice to make additional superannuation payments (which again advantages higher income earners over low to middle income earners). Another is the effectiveness of the co-contributions scheme; the people at whom this assistance is targeted are usually just trying to make ends meet and are often not able to take advantage of the relevant concessions.

Q4.1 *At what age should an individual be able to access their superannuation and at what age should they become eligible for the Age Pension?*

In general, the minimum age at which people are able to access the Age Pension and SG income should be 65 years. However, flexibility does need to be provided to enable earlier access to superannuation for people under 65 in cases where illness, disability or the assumption of caring responsibilities is likely to prevent a return to the workforce, whether for any significant period or on a full time basis. SG accessed in this way should only be taken as an income stream. All superannuation income derived from voluntary contributions should be accessible after 55, with non-superannuation savings accessible at any time.

Under a full scale insurance system, all SG income would be taken as an income stream.

Q4.2 *What is the role of individuals in dealing with investment and longevity risk in accumulating and drawing down their retirement income? Do financial markets provide the means to deal with these risks? If not, is there a role for government to address these shortcomings?*

As argued in Part Three, sections 4.2 and 5, the role of financial advisers should be thoroughly investigated to eliminate the deficiencies of lack of clarity, financial illiteracy and asymmetric information between advisers and (most) individuals. Government's role should be particularly important in fostering an annuities market, in part by using the prospective issue of government bonds as the cornerstone of such a market. This is in addition to the information already provided through the Financial Information Service operated by Centrelink, which provides materials, seminars and one-on-one information sessions with individuals. Government also provides information for consumers, on a wide range of financial matters, through the FIDO section of the Australian and Securities Commission website.

Q5.1 *In what ways does the retirement income system impose undue complexity and cost on retirees and workers? How could this complexity be reduced?*

Accounting for and reporting on the combination of income from superannuation (which is tax free for most retirees), work (which is taxed) and the Age Pension (which is taxable) is complex and onerous for those pensioners who work. Simpler reporting arrangements for those receiving the Age Pension should be implemented. Centrelink is the most appropriate agency for this, as it requires information to assess pension eligibility on an ongoing basis, whereas most individuals' relationship with the Australian Taxation Office is annual. Other general issues are covered in Part Three.

Q6.1 *The Age Pension serves two roles, as a safety-net for individuals who are unable to sufficiently save for their retirement and as an income supplement for many individuals who do save. What should be the role for the Age Pension and means testing in a future retirement income system and what impact does this have on its sustainability into the future?*

In the immediate term, the role of the Age Pension as a minimum level of income in retirement and a supplement to private superannuation should remain as it is. The pension should be benchmarked and indexed to a capabilities rate that responds to changes in living costs and to broader community standards of living. (See response to Q2.2.)

In the longer term, the Age Pension should be made an integral part of a social insurance system, as discussed in Part Two.

Q6.2 *In what ways does retirement income policy affect workforce participation decisions and what, if any, changes might reduce disincentives to work? Does the sustainability and cost of the retirement income system affect the workforce decisions of younger generations of workers?*

As noted at the beginning of Part Three, one consequence of current immature SG arrangements is that, for most people, SG holdings are insufficient (given the low rate of the Age Pension) to secure a comfortable retirement income. It is reported (Colebatch 2009) that many people plan to continue working beyond the normal retirement age. The problems of disincentives to work; and the adverse effects of the sustainability and cost of the retirement income system on the workforce decisions of younger generations would be significantly reduced by the introduction of a social insurance system.

Q6.3 What impact could financial intermediation have on the effectiveness of retirement income policy?

As noted in Part Three and the response to Q4.2, there is need for a thorough re-evaluation and restructuring of financial services as they influence retirement investment decisions. There is also a need for a significantly expanded role for government, in relation to SG investments, whether or not a social insurance system is introduced.

Conclusion

As with the tax-transfer system in general, retirement income arrangements are in need of thorough, if not necessarily radical, reform. This should revolve around the creation of a system of social insurance which would not require a fundamental transformation of the current system of quasi-social insurance. Yet for several reasons — not least the uneven nature and complexity of the prevailing system, especially the ‘immature’ SG component; and the volatile and uncertain economic circumstances in which we live — a fairly long transitional period is inevitable. And in that period and even beyond, inequities will remain. This is something that cannot be avoided; but it can be mitigated. Immediate and mid-term goals should work from the ideal type model, to reduce inequities and gradually realise the objectives of a mature system of social insurance.

As with the market system in general, the current financial and economic crisis provides an opportunity to consider ideas that, in more normal times, might have appeared unworkable or eccentric. It is clear, however, that orthodox thinking —

especially that of neoclassical economics — has not enjoyed practical success of late. Being a faith-based organisation, Anglicare Australia has always advocated social justice as an objective of *all* public policy. It would now appear this perspective is being increasingly adopted by many others as something eminently practical, even in such a technical sphere as retirement income reform.

Or as Franklin D. Roosevelt put it in his 1933 Inaugural Address:

> ‘The money changers have fled from their high seats in the temple of our civilisation. We may now restore that temple to the ancient truths. The measure of the restoration lies in the extent to which we apply social values more noble than mere monetary profit.’

About Anglicare Australia

Anglicare Australia is a nationwide network of locally based Anglican organisations serving the needs of their communities.

From Groote Eylandt, NT to Kingston, Tasmania, from Bondi to Bunbury, Anglicare member agencies are committed to caring for people in need and seeking social justice for all.

Anglicare agencies work in close cooperation with other community organisations and some receive funding from Federal, State and Local Governments to provide a wide range of services including:

- residential and community aged care
- foster care, Out-of-Home Care, adoption and child care
- family relationship support programs
- support for people with disabilities
- financial counselling and low/no interest loans
- family support and relationship counselling
- treatment for drug and alcohol dependence
- family violence
- youth programs
- emergency relief
- employment services
- community housing and emergency accommodation for homeless people
- community development through building communities of hope
- working with Aboriginal and Islander Australians
- assistance to refugees and migrants
- social research and advocacy

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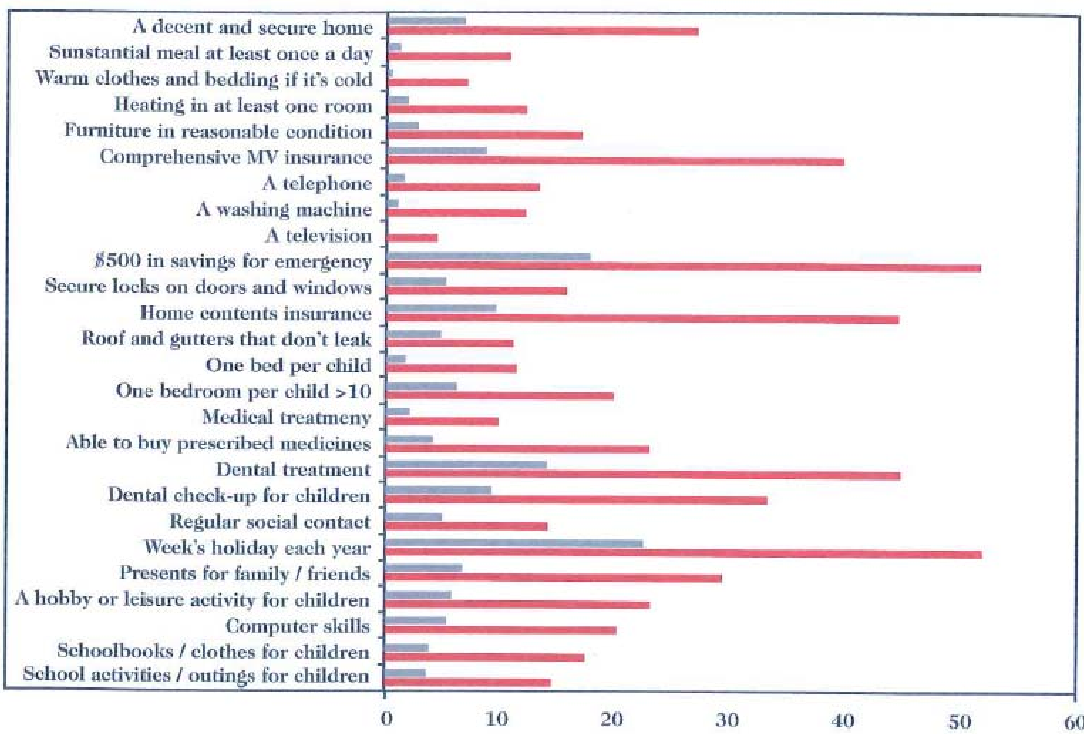
APPENDIX ONE: Anglicare Australia submission to the *Australia's Future Tax System* Review, October 2008.

APPENDIX TWO: Measures of disadvantage

Incidence of deprivation (2006 survey)



Grey bar indicates responses from a national postal survey of 6000 adults drawn at random from the electoral rolls.

Red bar indicates responses from recipients of welfare services provided by Anglicare Sydney, the Brotherhood of St Laurence and Mission Australia.

Source: SPRC Newsletter, No. 96, May 2007, p.8.