Dear Sir / Madam

Please find attached for your consideration a submission to the Review of Taxation, which proposes an integrated reform of superannuation and income tax.

I have also attached a further paper proposing "stakeholder investment" strategies for superannuation funds. This paper does not propose Government policy changes, but its' emphasis on the risk-reducing benefits of stakeholder investment strategies is of relevance to my proposed superannuation tax changes and an overall strategy for encouraging voluntary superannuation investment, especially in response to the current global financial crisis.

I would be happy to discuss these ideas further.

Yours faithfully

Dr. David Thorp

Super Tax Reform – submission to the 2008 Review of Taxation
Preface: an update for the 2008 Tax Review and response to global financial crisis

This paper is a submission to the Rudd Government's 2008 Review of Taxation.

It proposes an integrated reform of superannuation and personal income tax, to support flexible and efficient working and saving patterns.

The paper comprises the following parts (in addition to this preface):

1. A covering critique of the superannuation tax changes introduced by the previous Government in the 2006-07 Budget, which was submitted to the then Government, Opposition leader and shadow Treasurer during parliamentary debate of the measure.
2. The proposed reforms (starting p. 6), itself consisting of two parts.
    - This was submitted to the then Treasurer during the 2006-07 Budget process, and was based on entries to the Australian Superannuation Funds Association "Simply Super" competition in September 2005 (including elements of the winning entry).

The present global financial crisis reinforces the arguments made in this paper, both for the proposed reforms, and against the superannuation tax changes introduced in the 2006-07 Budget, which at the time were widely condemned by independent experts (e.g. refer Sydney Morning Herald, 4th June 2006).

New increased need to encourage time-averaged investment strategies

The foundation of a sensible, risk-managed approach to savings, should be to make regular savings over a period of time, so that investments in markets at their peak are balanced by investments made during troughs. The current financial crisis clearly reinforces the importance of this "time-averaging" investment strategy, and the fundamentals of the proposals in this paper are exactly aligned with this objective – offering the same incentives for savings made at any time, with incrementally increasing incentives the longer funds are retained in superannuation accounts.

Current policy has hurt retirees and damaged confidence for future investment

In contrast, thousands of retirees are now suffering from having been encouraged (by recent superannuation tax reforms) to transfer large amounts of money into super over a short period of time (many investments occurring at the peak of the market). Many of these will get burnt twice, as they panic and withdraw funds near the bottom of the market (because current policy, giving tax free withdrawals after age 60, offers no incentive to keep funds in super).

The Government needs to use this Tax Review to respond effectively to the financial crisis, by introducing reforms that will re-establish efficiency and confidence to Australia's superannuation saving system, whilst also supporting (in an integrated way), more flexible and efficient working and saving patterns - for the benefit of individuals, families, the community and the economy.

Whilst I note the Terms of Reference for the Tax Review state that the outcomes must "preserve tax-free superannuation payments for the over 60s", it is time to reconsider the current ill-conceived policy. It was always bad for taxpayers (current working families who will increasingly have to pay the cost of retirees' tax-free super). Now it is also bad for retirees.

The Terms of Reference should be interpreted as a commitment to ensure that there is no net disadvantage to retirees who are *currently* at or approaching 60 (or to preserve tax-free superannuation payments on *current funds invested* for these people). The cover section to this paper (p.3-5) offers some ideas on how a new long term reform direction can be set, with transition arrangements adopted to manage shorter term budget and other policy constraints. If there is a will to move in the proposed new direction, there are undoubtably many other ways of transitioning to the final goal.

Super Tax Reform
- response to the Commonwealth 2006-07 Budget Proposals

The Budget's proposal to eliminate tax on superannuation withdrawals misses a great opportunity to provide modern Australian society with the efficient savings incentives and flexibility it requires. The proposed policy may have been determined by short-term budget needs, but the long-term cost will be much more significant.

Although the Budget proposals simplify superannuation, the tax savings will predominantly go to more wealthy retirees. For people close to retirement, superannuation policy now does nothing to promote long term saving – it is little more than a tax dodge.

Now that these tax reductions have been offered, the policy should be revised so that the intended beneficiaries still receive broadly the same benefits, but within a longer term policy framework that taxes withdrawals rather than contributions, and focuses all tax benefits on investment earnings. This cover paper suggests a means of doing so within budget limits.

The problems with the Government's (existing and) proposed policy are:

- Tax benefits on contributions and withdrawals do not encourage longer term saving, because, quite simply, they do not depend on how long people save for.[1]
  - This is *why* superannuation policy has had to resort to complex and inflexible regulations controlling how people may or may not remove their funds (and how they get taxed). The budget proposals remove these complications, but this simply leaves us with the pre-existing problem – a tax dodge (which is now proposed to be controlled by less flexible limits on pre-retirement contributions).
- To compensate for these inefficient tax incentives, inflexible policies must be adopted that reinforce a rigid and arbitrary retirement age – just when historic notions of permanent full-time employment followed by permanent full-time retirement, are becoming increasingly outdated.
- Abolishing tax on withdrawals for everyone over 60 will cost society an increasing amount in the future. As society ages (and places increasing demands on public services), tax policy cannot afford to become increasingly dependent on the incomes of those under 60.

The budget proposals are expensive, but fail to provide the flexibility and efficient saving incentives needed by a modern, flexible workforce. As this paper argues, consistent with superannuation industry proposals and policy positions developed internationally, superannuation should be taxed only on withdrawals, with all tax benefits focussed on earnings (e.g. tax free). The key reasons for this are:

- The benefits of reduced tax on earnings automatically increase (in totality) for funds that are saved for longer. The policy objective of encouraging long term savings is achieved through flexible incentives, rather than complex regulations.
- Applying the progressive tax system to withdrawals, rather than contributions, automatically encourages funds to be withdrawn gradually rather than "blown" as a lump sum (followed by resort to State benefits).[2]

It is vital that Government substantially revises its proposals now, because the ability to do so without substantial Budget cost will diminish in future, as the community increasingly relies on tax free withdrawals when making superannuation investment decisions.[3]

---

[1] The tax benefit is derived through a combination of reduced income tax on contributions from pre-tax salary, and reduced or no tax on withdrawals, such that the combined tax is less than would be paid in income tax – regardless of how long the funds are saved for. This contrasts with the benefits provided by the currently reduced level of tax on earnings (15%, vs standard income tax rates), which increase in totality the longer funds are saved for.

[2] This is because the larger the amount withdrawn in any one year, the higher the tax rate will be.

Why has the Commonwealth chosen this path?

The attached paper shows how superannuation could be made simpler, but also much more flexible and efficient, by having tax-free contributions (from pre-tax income), tax-free earnings, and withdrawals taxed at standard income tax rates, and that this would incur no significant *long-term* tax revenue loss.[4]

It is not clear, but the Commonwealth may have chosen an inferior policy position, which is out of step with international patterns, in order to minimise the *short-term* budget impact. Because super fund contributions have been gradually ramping up over the last decade (with the phased introduction of compulsory contributions), and because a large proportion of those funds that are currently being withdrawn are already tax free, there is relatively little short term budget impact from exempting all withdrawals from tax. However, the cost will grow dramatically in the future when current contributors reach retirement.

The attached proposals, in contrast, would have far greater initial tax impact, through the loss of all tax on contributions and earnings, but would recover this in the long term through tax on withdrawals.

Good policy should be dictated by the long term (or more correctly, the present value of all future costs and benefits), and be founded on sound principles for efficiency and effectiveness. The policy should then be fine-tuned, and phased in through transition policies, to accommodate budget (and other) needs.

Proposals to reconcile short and long-term Budget objectives with efficient super tax policy

If financial analysis shows that shifting all super tax onto withdrawals will in the long term be roughly budget-neutral (in present-value terms), then one could justify an increase in Government debt to cover short-term costs to Treasury.

If however increased general government debt is to be avoided, then short-term and long-term budget objectives may be reconciled by introducing the concept of "superannuation tax credits". These would be non-cash items accredited to individuals' superannuation accounts, to offset tax paid on contributions and earnings. Super tax credits would then be redeemed in retirement, by offsetting tax payable on withdrawals.[5]

In addition, as the Government has now created significant expectations of tax benefits for current and soon-to-be retirees, any revised policy position will need to accommodate these expectations.

I propose:

1. Adopt the policy proposals in the attached paper as the long term policy position – flexible accounts with tax-free contributions and earnings, but full income tax rates paid on withdrawal.

---

[3] The Budget proposals will encourage people to defer savings compared to under the more efficient tax regime proposed in this paper, where savings made at an earlier age will receive relatively more tax benefits (on earnings) and savings contributed close to retirement (and subsequently withdrawn) will receive minimal tax benefits).

[4] For someone aged 30 beginning a 30-year savings plan, with no tax on contributions from pre-tax income (avoiding a 30% marginal income tax rate), no tax on earnings, and 30% tax on withdrawals, the retirement benefits (and total tax revenue) are the same as having 15% tax on contributions and earnings, but no tax on withdrawals (the Budget's proposed policy). Whilst people paying the 30% marginal rate in retirement will on average pay less than 30% (due to lower tax rates and tax free thresholds), this revenue loss may be offset by some people paying higher marginal tax rates on withdrawals.

[5] Essentially this means Government would borrow from individuals (with this government liability offset by an entitlement to future tax on withdrawals), but the cash and accounting treatment may be more favourable to Budget accounts than if general government debt were increased.

2. Apply this policy immediately for all new contributions, but:

   (a) Continue to deduct 15% tax from contributions to, and earnings on these accounts (cash to Treasury), but then offset this by granting an equivalent amount of super tax credits to individuals' superannuation accounts.

   (b) Add tax credits equal to the 15% tax already paid on existing account balances (this is actually more than 15% of the existing account balance, but may be simply set at a fixed percentage – see below).

   (c) Annually grant interest on these super tax credits (in the form of more super tax credits), equal to either the Government bond rate (this is probably preferred, to moderate the budget impact – see below) or, for consistency with the long term policy position, the rate of interest earned on the accounts' real assets.

   As a consequence, the combination of an accounts' real asset balance and the value of tax credits will equal the account balance that the individual would have had if they had not paid tax on contributions and earnings.

   (d) When super funds are withdrawn, tax will be payable at full income tax rates, but this can be offset by the super tax credits.
   This could be done in a number of ways, but one option would be to "cash in" tax credits in proportion to their relative size vs the account's real asset balance. For example, if an individual's balance is $510k, plus $90k of tax credits (15% of $600k), and they withdraw $40k in a year, then 15% of this $40k ($6k) would come from cashing in $6k of tax credits. The total of $40k, plus any other earned income, would then be taxed at full income tax rates (note tax credits, being equivalent to untaxed income, would themselves be taxed on withdrawal). Depending on other income and deductions available, the tax payable could be, say, $8k (20% of $40k). Of this, $6k could be met by tax credits, leaving only $2k tax actually payable from the individuals' real super assets withdrawn. The net result would be their balance reduces to $476k plus $84k tax credits (total of $40k gross withdrawn), and they receive an after tax income of $38k.
   Another option would be to only allow tax credits to be offset against tax payable on withdrawals.

3. Develop a transition strategy over 10 or more years, so that taxes on contributions and earnings (and offsetting tax credits) are phased out, and the budget impact of this tax loss is offset (in-year) by the increased level of superannuation being withdrawn and taxed at full income tax rates (as can be expected in the future).
   This could be done in a number of ways. One option would be to have tax-free contributions and earnings (and no tax credits) for new contributions made by people aged under 40 (say), so that after 20 years no-one under 60 would have any tax credits. This age threshold could be adjusted to help achieve the desired short-term budget outcome.

4. Conduct financial modelling of these policies and fine-tune policy settings to achieve consistency with Budget objectives. This could include revising the tax-free earnings policy proposal to a minimal tax rate of say, 5% (see below).

How will tax benefits compare under this policy to the Budget's proposal?

Implementation of the attached proposals, as above, will create a far more flexible regulatory regime, with efficient saving incentives. But what will it cost?

For someone aged 30 beginning a 30-year savings plan, with no tax on contributions from pre-tax income (avoiding a 30% marginal income tax rate), no tax on earnings, and 30% tax on withdrawals, the retirement benefits (and total tax revenue) are the same as having 15% tax on contributions and earnings, but no tax on withdrawals (the Budget's proposed policy).

Note that the tax credits received on existing balances in 2(b) above would ensure that anyone paying 30% tax on withdrawals (even those already on the threshold of, or in retirement, who have less to gain from a reduced earnings tax) would receive the same net super benefits as if their current balances were withdrawn tax free – consistent with the Budget's proposal.

However, it should also be noted (as with the example in 2(d) above) that anyone withdrawing funds in one year totalling less than the (new) 40% income tax threshold, would receive the standard income tax-free threshold and other lower thresholds and rates, before paying 30% tax, and would therefore pay tax on withdrawals averaging less than 30% (perhaps only about 20%).

The policies proposed in this paper could therefore be more generous and costly than the current Budget proposal, although it may be offset by higher tax revenues from people withdrawing amounts above the 40% tax threshold.

Policy fine-tuning (& simplification) to moderate the budget impact

One way of moderating the cost during the transition period would be to simplify the calculation of tax credits on existing balances, which is in any case desirable as accurate calculation would require a full history of account contributions and earnings. A 25% credit would ensure that a new retiree paying an average of 20% tax on withdrawals would receive about the same amount as under the Budget proposal (80% x 125% = 100% = tax-free withdrawal). However, a 25% credit would be overly generous for younger people. For example, someone was has contributed $100 to super in only one year, taxed at 15%, only needs a 17.6% credit (1/0.85) to restore the balance back to $100. A 25% credit would convert the net $85 contribution up to $106. So whilst a fixed 25% credit would be simple and avoid negative impacts on current and imminent retirees (compared to the Budget proposal), it would come at additional cost to the budget. A simpler alternative would be to add a lesser amount of "franked" credits (e.g. 20%), which would be excluded from the calculation of income on which withdrawal tax is payable.

Another option for reducing the budget impact (and simplifying administration) during the transition period would be for tax credits to only earn interest equal to the Government bond rate. This would reduce benefits the most for those furthest from retirement. This option combined with a 25% flat tax credit on existing balances may offer a reasonable policy balance.

Finally, if the long term cost to the budget is too great, the policy could be revised to retain a minimal tax on earnings, e.g. 5%, or even more. Indeed, such a minimal tax could be considered preferable, as it would do little to discourage savings, yet could still bring in significant revenue to Treasury (and allow limited funds to be directed to other public services or tax reductions). This would also be a prudent position to adopt initially, which could be relaxed in the future should it be affordable and a priority for budget funding (this would be easier to do than the reverse – exempting earnings from tax and then subsequently trying to restore a tax).

Financial modelling should be conducted to fine-tune these policy settings. Once finalised, the financial impact on individuals and the budget should be similar to the Budget's proposal, but the flexibility and efficiency of savings incentives would be much improved.

SUPER TAX REFORM
for flexible and efficient labour and capital markets

Dr. David Thorp

Summary

Current superannuation policy fails to support the flexible labour market espoused by Government and aspired to by younger generations (career breaks/changes, early retirement, semi-retirement etc.). Simple, more flexible and efficient regulation and taxation of superannuation and higher rate tax is required. I propose that:

- Superannuation funds are taxed only on withdrawal, at standard income tax rates (funds would be formed from pre-tax income and have tax-free earnings up to a maximum fund balance),
- Funds can be withdrawn at any time, subject to a minimum balance being maintained (where that minimum rises with age).

This would:

- Make superannuation savings more flexible and available to help people through mid-career, pre-retirement needs (e.g. career break/sabbaticals or unexpected unemployment).
- Thereby encourage more voluntary saving (thus improving people's retirement income) and productive investment in the Australian economy (with reduced investment tax distortions)
- Allow people to reduce their liability for higher rate tax by deferring income withdrawal to years with lower pay (whether mid career or retirement). This would remove current distortions in the progressive income tax system, which discourage flexible earning patterns and careers.
    - Thereby also encourage "job churn", increase job opportunities and encourage more varied, interesting and productive careers.
- Provide greatest reward (reductions in higher-rate tax) to those that adopt flexible careers, including those that work hard and then take career breaks or adopt more family-friendly or socially-beneficial (but lower paid) careers.

In short, these policies would be a powerful platform for facilitating and rewarding flexible working and saving patterns, for the benefit of individuals, families, the community and the economy.

To more clearly present the separate (but related) ideas, this paper consists of two parts:

1. Proposals for simpler and more flexible superannuation, with funds able to be withdrawn at any time (subject to a minimum balance being maintained), tax-free earnings (up to a maximum fund balance), and tax either applied only on contributions (i.e. funds formed from post income-tax contributions) or only on withdrawals (at standard income tax rates).[6]
2. Argument that the best option above is to only tax withdrawals, in order to create a more efficient progressive income tax system, without the current bias against flexible careers (page 16).

[6] Part 1 of this paper is a modified version of my entry to the Australian Superannuation Funds Association "Simply Super" competition in September 2005, which argued for funds formed from post-tax contributions. The winning paper of that competition, by Paul Collins of Superpartners, proposed tax only be applied to withdrawals, but did not suggest the more flexible withdrawal rules of this paper, nor recognise the wider opportunities and benefits from linking such reforms with higher-rate income tax reform.

Part 1 – SIMPLE AND FLEXIBLE SUPER

Summary

Current superannuation policy fails to support the flexible labour market espoused by Government and aspired to by younger generations, and industry antipathy to "choice of super" exemplifies a lack of customer focus that underlies many problems with current regulation.

The single biggest barrier to increased voluntary savings (and productive investment) is the inability to withdraw contributions before retirement. And this inflexibility is in large part a result of the complex and inefficient taxation of super, which provides significant tax benefits regardless of the period that funds are saved for.

Reform needs to link tax benefits to the duration that funds are saved for, by restricting tax benefits to investment earnings (i.e. tax-free earnings). Funds may then be withdrawn at any time (subject to a minimum balance being maintained) without abusing tax benefits.

Funds could be formed from post income tax contributions, or pre-tax contributions with standard income tax rates applied to withdrawals (for a given tax rate, the two policy options are financially equivalent).

The benefits (and specific policy settings) would be:

1. Ability to withdraw funds at any time, for example to support a planned or unplanned career break, career change, or unexpected redundancy or expenses.
    - Any person with funds below a minimum level (specified for their age) would have to contribute 10% of their income to the fund (perhaps, if the balance is very low, supported by Government co-contributions).
    - Any person with funds above the minimum would not have to make *any* contributions, but if they did, they would enjoy tax-free earnings (up to a maximum fund level).
2. Removal of the biggest barrier to voluntary contributions (lack of access in case of need), thus encouraging increased saving.
3. Overcoming current investment tax distortions biasing towards property and capital gains speculation, thus encouraging more productive investments in the Australian economy,
    - also ensure equal tax treatment of emerging "customer shareholder" super products, which can reduce investment risk, thereby increasing savings and economic growth.
4. No change in current superannuation tax paid by standard rate taxpayers (higher rate taxpayers may pay more, but this may be balanced by a lower marginal tax rate if taxed on withdrawal in a year of lower income – see part 2 of this paper).
    - But more effectively use tax benefits by rewarding contributions earlier in people's careers with greater total earnings tax benefit (received over the longer time in the fund) than contributions made close to retirement (and soon withdrawn).
5. Simpler taxation, allowing easier comparison of the tax treatment and potential returns with alternative investments. Decisions on voluntary contributions would also no longer be complicated by differing tax benefits/co-contributions depending on whether they're made before or after receiving income.[7]

[7] If funds are formed from pre-tax contributions (and taxed only on withdrawal), then the current co-contribution for additional voluntary post income tax contributions could be replaced with tax deductions for these contributions in the contributors' annual income tax assessment.

Part 1 - Contents

The problem – barriers to efficient investment	**Solutions**
Complex, distorting and inefficient tax incentives	Tax-free earnings
Inflexible, locked-in savings	Flexible, voluntary contributions and withdrawals

THE PROBLEM

Superficial policy analysis may diagnose “the problem” as inadequate retirement savings. With an underlying, paternalistic view that “people don’t know what’s good for them”, the solutions proposed are correspondingly simplistic and authoritarian. Namely, increase compulsory savings, or provide ever larger tax breaks to compensate for people’s bad decisions.

This is a crude and expensive sledge-hammer approach to compensate for a structurally flawed system. It’s time to adopt a more customer-focussed approach.

If we assume people *are* behaving rationally, and examine the underlying factors influencing their behaviour, we might get to the heart of the underlying problems. We can then devise more fundamental, effective, and popular solutions.

The following sub-sections discuss some underlying barriers to greater superannuation savings:

a) Complex, distorting and inefficient tax incentives

The investment market is seriously distorted by current tax treatment of property and capital gains. Capital gains are taxed at half rate (under some circumstances), whilst dividends are fully taxed, so we preferentially encourage the promise of future value over demonstrable value being delivered today.

Capital gains on owner-occupied homes are tax free, which diverts significant “investment” into property speculation, even though rising house prices are primarily based on increasing wealth in the rest of the economy (driven by more productive investment in ever-better systems of production and service). The problem is exacerbated by tax treatment of negative gearing on investment properties.

Yet whilst those that can afford to get into the housing market receive tax benefits, the superannuation system makes it even harder for low income earners to find funds for a first house, because 9% of their income (which could have funded a deposit or loan) is diverted to super. Ironically then, low income earners may reach retirement without even the asset of a home, and will have even greater need of a reasonable retirement income (to pay the rent). Those people in most need are pushed even further by the superannuation system from the first rung of the wealth ladder.

With its preferential treatment of (often speculative) property and capital gains, the tax system is biased towards the “get rich quick” outlook on life. The Sydney economy (and especially its less wealthy residents) may pay a heavy price for it.

Whilst it may not be realistic to directly reduce these tax incentives, superannuation can help level the playing field. Unfortunately, the current superannuation tax regime does a messy job of it.

Current policy provides a partial tax credit on contributions,[8] but also taxes earnings and then potentially taxes funds yet again when withdrawn (depending on the complicated rules and detailed circumstances).[9] The "co-contribution" only adds to the confusion. **For the average person it is impossible to comprehend the overall tax rate and far from clear whether (or to what extent) it is more favourable than other, more flexible, tax-effective investments** (such as home ownership and investments entitled to reduced capital gains tax).

Income tax deductions on super contributions are also an inefficient use of tax incentives as they provide the same incentive for super contributions even one year from retirement (hardly a personal sacrifice) as for contributions made by people early in their careers. Efficient tax incentives would provide bigger incentives for contributions made in early years.

b) <u>Inflexible, locked-in savings</u>

Probably the biggest barrier to greater voluntary savings is that funds are locked in until retirement age. This means a potential contributor must be *extremely confident* that they will not need these funds until retirement before they commit additional voluntary contributions. Even if they don't *expect* to need the funds, they are likely to keep them available, out of a super fund, *just in case* they may need the funds for the unexpected (e.g. losing their job).

Superannuation policy makers need to learn a lesson from the investment markets that they advise on. Shares are the longest term investment possible (businesses rarely pay back the capital, except through buy-backs), but the stock market encourages people to make such investments by providing an option out – the ability to sell. **Providing investors with the flexibility to change their mind and withdraw their funds is critical to encouraging the investment in the first place.**

Current super policy, locking voluntary contributions in until retirement, is guaranteed to minimise any voluntary contributions being made at all.

Why is superannuation policy like this? One reason is directly related to the flawed taxation treatment. If the Government provides an up-front lump tax benefit (income tax deduction) then it would be a gross waste of taxes if people were allowed to withdraw their funds soon afterwards.[10] The need to lock-in savings also requires regulation to define an inflexible retirement age (when funds can be released). This makes superannuation poorly suited to emerging trends of people *wanting* an earlier and more gradual transition through a part-time "working retirement".

The current model for compulsory contributions – based on a fixed percentage of income – also fails to provide the flexibility desired by young "aspirational employees". Increasingly, people these days *want* a flexible career, where they may work hard and earn a significant income early on, but then perhaps take a mid-career break, where they may wish to draw on hard-earned savings for a while. Conversely, many people now find they want to keep working at "retirement" age (often part time). These flexible career practices are blurring the prior distinction between the full time employment stage of life, and full time retirement. But current superannuation policy is incapable of responding to these changing needs.

Current tax deductions on voluntary contributions also reduce flexibility because in practice they require employees to decide whether to commit to regular contributions before receiving their pay. Given only the *possibility* of other unexpected needs for after-tax income, this reduces the chances of voluntary contributions being made. Contributions may be more likely if employees were able to continuously re-appraise their financial position before committing more funds to super.

[8] Although compulsory contributions are administered as *employer* contributions taxed at 15%, the economic impact is the same as *employee* contributions out of income taxed at a reduced rate.

[9] Also, because of the uncertain tax treatment on leaving the fund, dollars in the fund cannot be easily compared with dollars in the bank. For the average person, this simply adds to the confusion.

[10] and a retrospective tax adjustment on withdrawal, even if practical, would only add to current complexity

Although the Government's co-contribution scheme helps to address this problem (by effectively adding back a tax benefit if occasional contributions are made from after-tax income), it does so at the expense of more complex, confusing and inefficient administration. **It would be simpler and more efficient to have superannuation tax benefits that apply equally regardless of when an employee decides to make a voluntary contribution.**[7]

Clearly, encouraging increased voluntary super contributions requires a different approach to taxation.

SOLUTIONS

With a clearer identification of "the problem(s)", the solutions become almost obvious.

What is equally clear is that solutions derived from superficial observation of the problem do nothing to address the underlying barriers to investment, and in fact, actually worsen them. Increasing compulsory savings levels will even further reduce the ability of individuals to manage their overall finances flexibly, and increasing the up-front tax benefit for contributions or withdrawals only reinforces the need to prohibit withdrawals before retirement (which eliminates flexibility).

A more fundamental solution to the underlying problems is offered by the UK system, where there are no tax benefits for contributions to voluntary saving funds, but earnings (up to a limit) and withdrawals are tax free. We should however be cautious about abandoning all compulsory savings legislation. The lack of compulsion in the UK is exposing the most vulnerable members of society to greater risk of living old age in poverty.[11]

A more optimal approach lies in a combination of changing the *form* (but not magnitude) of Australian superannuation tax benefits (to be more like the UK), and adopting a new, more flexible approach to compulsory savings. Specifically, I recommend:

a) providing tax benefits on earnings only (tax free), and,

b) allowing funds to be withdrawn at any time, subject to a minimum balance being maintained (where that minimum rises with age).

Funds could be established from post-income tax contributions (with no tax on withdrawals), or pre-tax contributions with standard income tax rates applied to withdrawals. Although perhaps not obvious to the layperson (the latter option appears to eventually tax earnings, once withdrawn), the two policy options are financially equivalent for both investor and Treasury (because with the latter policy, the larger pre-tax contributions earn more earnings before being taxed on withdrawal).[12] In either case, there is no tax benefit from the combination of tax on contributions and withdrawals, which is a necessary requirement to ensure tax benefits depend on the period for which savings are kept in super (so that withdrawals can be allowed at any time without abusing tax benefits).

Part 2 of this paper argues why the best option is to only tax withdrawals (in order to create a more efficient progressive income tax system, without the current bias against flexible careers).

Further details on a more flexible regime for voluntary contributions and withdrawals, and the advantages with respect to the underlying problems noted above, are set out following.

---

[11] This is because poorer members of society tend to have least bargaining power in employment, and are more likely to accept bare minimum wages to cover only the present day cost of living. Statistically, poorer people also tend to be less well educated on matters of personal financial planning.

[12] If \$x are contributed and taxed at t%, then earn r% interest over a period, the final balance will be x(1-t).(1+r), and the tax revenue, if it is also invested by Treasury, will be x.t.(1+r) at the end of the period (in reality Treasury may choose to earn lower interest for lower risk). Alternatively, if \$x is untaxed and earns r%, then taxed, the balance will be x.(1+r).(1-t), and the tax revenue (at the end of the period) will be x.(1+r).t. i.e. the same.

a) <u>Simplified tax benefits – tax free earnings</u>

The model proposed above – with tax-free earnings as the sole tax benefit – can help address the problems of current distorting, inefficient, inflexible and complex tax incentives, but at no cost to taxpayers. Specifically:

- Tax benefits are accrued gradually over time. The longer you leave funds in, the greater the tax benefit. There is therefore an incentive (rather than compulsion) to keep savings in for longer (ultimately until retirement, which may no longer need to be specified as a particular, inflexible regulatory age).
- Because tax benefits are not all given away up-front, it is more reasonable (from a Treasury perspective) to allow contributions to be subsequently withdrawn at any time (refer details below). This in turn encourages voluntary investment in the first place (refer discussion above).
- The tax-free earnings can be easily understood and compared to other investments. They also overcome the bias of the current tax system towards property and capital growth.
    - Tax free earnings also ensure equal treatment with another form of investor returns – discounts on company products for shareholders.[13] Such discounts were growing in popularity in anticipation of "super choice" legislation,[14] and are likely to regain momentum now with the implementation of "choice". They effectively reduce investment risk by enabling customer investors to *control* their returns through their own level of product consumption, and thereby may reduce one of the biggest intrinsic barriers to greater saving (and in turn promote increased economic growth).
- For a person paying 30% income tax, simple financial analysis indicates that for a typical 30-40 year savings plan, the present-value of total tax benefits to the investor (& cost to Government) are the same as under the current system (with 15% tax on super contributions made from pre-tax income, 15% tax on earnings and assuming no tax on withdrawals). However, tax benefits are greater for earnings on contributions made in early years, and negligible for contributions made near to retirement (and subsequent withdrawal).
- For a person paying higher rate tax, who currently enjoys 15% tax on contributions from pre-tax income instead of a marginal income tax rate of 40% or 45%, the tax benefits are reduced with this proposed policy if one ignores tax paid on higher withdrawals under pre-Budget policy (as determined by complex rules), but may on balance be similar if one included these current taxes. Moreover, as part 2 of this paper argues, if tax is applied on withdrawals (only) at standard income tax rates, then these taxpayers have an ability to reduce their tax liability by withdrawing their funds during subsequent years in which their income is below the higher rate tax threshold (i.e. deferring access to their income to years with lower pay, whether mid career or at retirement). This would remove current distortions in the progressive income tax system, which discourage flexible earning patterns and careers.
    - In addition, higher rate taxpayers will benefit from the greater flexibility of this proposed model. And in any case, it may be argued that higher rate tax payers have less need for tax benefits to encourage saving, and should not be a community priority for (further) tax relief (beyond the reduced tax rates given in the Budget).

---

[13] Which, if not declared as income, effectively provide tax-free dividends

[14] I consider the demise of the prominent Coles-Myer shareholder discount card to be a (large) blip on this trend. To the extent that this card failed, it did so because the discounts were excessive and were in addition to, rather than *instead of* regular shareholder dividends. Economic logic suggests that although an additional "free lunch" (such as the Coles discounts) for consumers/investors may not be viable, it does make sense for the consumer to bear sales risk (since they can best control it), which can be done by linking that element of share dividend risk to their own personal consumption. Shareholder discounts are also a variant on more efficient "access" or "Ramsey" pricing widely adopted by utilities (with the purchase of shares being equivalent to a monthly access fee covering fixed investment costs), which allows marginal prices to be reduced closer to marginal costs, thereby increasing economically beneficial sales.

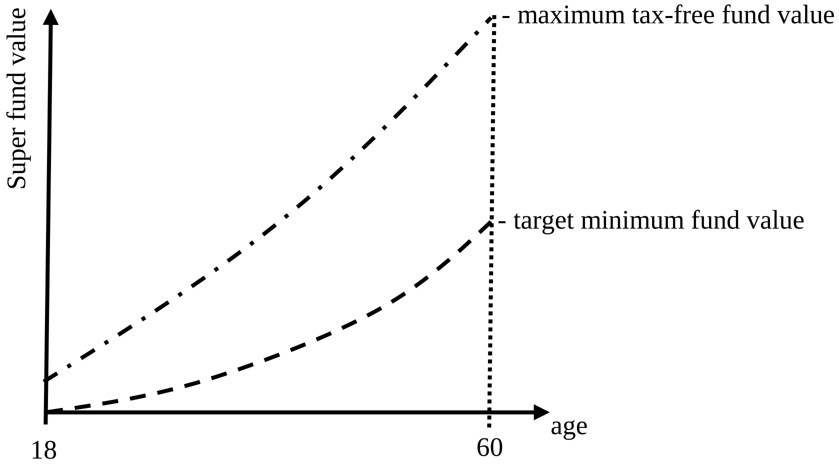
b) Flexible, voluntary contributions and withdrawals

The simplified tax model above allows for a more flexible approach to compulsory and voluntary contributions and withdrawals. An improved model for compulsory savings can be devised by going back to fundamentals and focussing on what employees want:

- The desire for a minimum retirement income. This requires that at any given age, an individual needs to have assets of a minimum value – taking into account a reasonable expected asset growth and minimal expected contributions in the future ("minimal", to be risk averse). This can define a minimum regulatory fund value target that increases with age.
- The desire to save more than this minimum, for a "rainy day", a mid career break, and/or a better than minimum standard of retirement, and with the flexibility to withdraw funds as and when each need arises.
  The simple solution to this desire is that any amount saved above the minimum fund value defined above may be withdrawn at any time. Up to a maximum limit, these excess, voluntary savings will enjoy the same tax-free earnings as those below the minimum.

These policies, and their benefits for employees, may be best illustrated graphically, and through a number of employee lifetime earning scenarios:

The “Super Policy Graph”



The policy is defined by two lines on the graph:

- The lower line defines a minimum value of savings that any person should aim to have at any given age (based on contributing 10% [15] of a “minimal” income to fund a minimal retirement income).
- The upper line defines the maximum value of funds entitled to tax-free earnings (based on establishing a “comfortable” retirement income). Any earnings on funds in excess of this will be taxed at the individual’s marginal rate.

The policy may be implemented as follows:

- Any person with assets below the minimum level for their age [16] must contribute 10% of income to the fund.[17]
- Any person with funds above the minimum would not have to make *any* contributions, but if they did, they would enjoy tax-free earnings on them.
    - Funds in excess of the minimum can be withdrawn at any time.

The above “policy graph” may initially appear more complicated than a simple policy of 9% contributions. But the graph itself actually simplifies and explains superannuation for the average member of the public. If distributed to members with annual fund reporting,[18] the graph can help inform people:

- How much they must save in the coming year (subject to available income)
- How much extra they can voluntarily save that will enjoy tax-free earnings
- How much they can currently withdraw
- What their expected savings and income will be at retirement, for a range of future contribution levels.[19]

---

[15] I recommend 10% rather than the current 9% as the increase is unlikely to be a significant barrier to uptake of the scheme, but has the advantage of making it easier for customers to calculate the amount deducted.

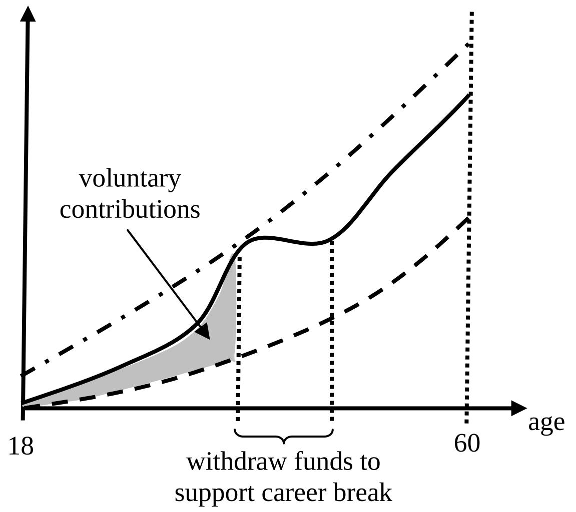
[16] The measure of a person’s total assets could include estimated home equity. This would reduce barriers to low-income households getting on the first rung of the “wealth ladder”. This policy option requires further detailed consideration.

[17] To reduce business administration costs, contributions could be made regardless of fund balances, but then subsequently made available by super funds for withdrawal (at least half-yearly).

[18] with values updated annually for inflation

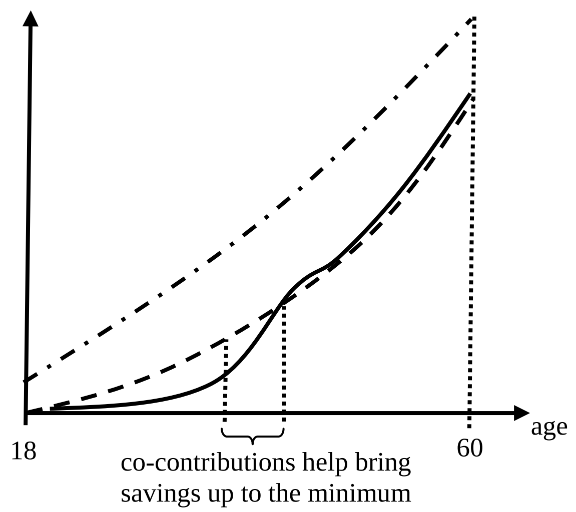
[19] Separately tabulated by current age vs current fund value for a range of future contribution rates.

An example savings profile follows for an “aspirational” employee taking a mid-career break (when funds reach the maximum tax-free threshold):



An alternative scenario similar to above could involve an unplanned career break, due to redundancy.

Another example follows for a low-income worker:



In this example (as an optional policy position, at additional cost to taxpayers), the co-contribution scheme could be made available to employees aged over 30 (say) who, despite making minimum 10% contributions of their (low) wages, still have fund balances less than the target minimum. Larger co-contributions could also be offered with further voluntary contributions.

Once funds reach the minimum, co-contributions (and probably voluntary contributions) cease, and in this scenario the fund grows in line with minimum compulsory contributions and expected investment earnings.

What happens at retirement?

The details of how to regulate funds at retirement requires further consideration, including options for a more gradual transition through semi to full retirement. However, one reason for having statutory savings is that as people age, their health and income-earning capacity will diminish, and if we assume the State will never turn its back on impoverished old people then this creates an incentive for people to avoid saving and “exploit the system” in old age (albeit for a meagre State pension). By the same logic, there would be good argument to compel the purchase of a lifetime minimum-level annuity pension at retirement age (at a cost in line with minimum savings targets), to prevent people withdrawing their savings too rapidly (e.g. as a lump sum). Any remaining voluntary savings could then be withdrawn at any time.

Compulsory purchase of an annuity could be debated however, as there are already good market incentives for people to do this. This is because individual "accumulation" superannuation, though beneficial in early years as it aligns saving incentives with the individual's future benefits, can be inefficient in later years, as many people would excessively reduce their expenditure (to minimise the gradual drop in savings) to cater for the "worst case" (!) outcome of a very long life, rather than their *expected* remaining life. Hence many people find purchasing a lifetime annuity with their superannuation savings an attractive option. The insurance company then pools the risk of many, so that those that die early fund the extended retirement of those that live longer than average.

Alternatively, as part 2 of this paper explains, if funds are taxed on withdrawal (rather than contributions being from post-tax income), this creates a disincentive for people withdrawing their savings too rapidly (as a lump sum), as tax will be minimised if savings are withdrawn over more years (with a lower income and lower marginal tax rate in each year).

Regulatory transition - choice of tax treatment?

A final element of flexibility in this proposal is that people could have the *option* to invest in super funds that are taxed and regulated in the way described, but they could, if they wish, continue to save through the current system. The reasons for this are:

a) Over a full working life, tax free investment earnings offer the same overall tax benefits as the current system, but with a greater proportion of benefits accrued during earlier years. However, someone who is aged 55 (say) will have based their life savings plan on an expectation of continued tax benefits on contributions made in the final years of their working life. A switch to a system with tax benefits on earnings only – where those earnings may be minimal over the final few working years – may not fully compensate a loss of tax benefits on these final contributions.
   Allowing people to choose how their funds continue to be regulated guarantees there will be no losers from reform.

b) Depending on their own personal career patterns (see part 2), higher-rate taxpayers may not receive the same total tax benefits as at present (since they currently enjoy a bigger tax benefit on contributions). However, even if this is the case, they may choose to invest in the new system anyway, due to the greater flexibility (if so, this would yield tax savings, which could fund co-contributions for low-income earners and benefit social equity).

Full transition to the new regime could be accelerated by allowing those with current savings to convert them to funds under the new regime. In the case of tax being applied on withdrawals,[20] converted funds could have tax credits equal to 15% of the fund value attributed to them, which could be offset against tax payable on withdrawal (credits would not be funded until cashed in as tax offsets). These tax credits would also notionally earn interest (more tax credits) equal to the recorded earnings of actual savings in the fund. (NB. Refer update to this section in attached post-Budget cover paper.)

By allowing existing funds to be converted to funds regulated as proposed in this paper, the minimum threshold of the new fund's balance would more readily be exceeded, thus allowing partial withdrawal of existing funds. This could appeal strongly to many in the community.

[20] If tax were applied on contributions only (i.e. all contributions made from after tax income), then funds held under the existing system could (optionally) be transferred to a new tax-free earnings fund by paying tax equal to the present value of expected tax (at 15%) on investment earnings until retirement (discounted at a commercial rate, since the risk on earnings tax is transferred from Government to the individual).

Part 2 – Higher-Rate Tax Reform for Flexible Careers

Summary

Current annual income tax assessments under the progressive tax system may distort people's career choices, by biasing against flexible careers with major fluctuations in income. The current system encourages uniform income from year-to-year over more lumpy earnings with career breaks. For example, someone who earns $45k p.a. for 2 years will pay less tax than someone who earns $90k in one year (paying a higher marginal tax rate) and then takes a year off. This is distortionary and inefficient.

Rather than discouraging flexible careers, it may actually be considered socially beneficial to reward people who work hard and then take career breaks to adopt more family-friendly or socially-beneficial (but lower paid) careers. Encouraging career breaks could also have wider community and economic benefits, by encouraging "job churn" and thereby increasing job opportunities for others, in turn encouraging others to also have more varied, interesting and consequently productive careers (see below).

The superannuation policy reforms proposed in part 1 of this paper, with standard income tax only applied on superannuation withdrawals, and withdrawals also allowed at any time before retirement (subject to maintaining a minimum balance), would simultaneously remove the current tax bias against flexible careers. Within maximum savings limits (as defined in part 1 above), people could choose to save gross (pre-tax) income earned during years of high income (when a high marginal rate would otherwise be incurred), and withdraw it during subsequent years of lower income (before or after "retirement"), when a lower marginal tax rate may apply.

In the example above, the person earning $90k in one year could choose to contribute $45k (untaxed) to super, then withdraw this (at standard income tax rates) in the second year (subject to complying with minimum and maximum fund balances, as described in part 1 of this paper).

The benefits of this proposed structural reform are more far-reaching than from simple reductions in the top rate of tax. With the proposals in this paper, the greatest reductions in higher-rate tax would go to those that adopt flexible careers, with social and economic benefits for their families and the wider community.

Similar issues arise at lower income levels, although here the issue is as much one of fairness as economic efficiency. If someone earns $40k in one year, but then becomes unemployed for a year, they will currently (pre 06-07 Budget) pay almost $4k more tax than someone who earns $20k in each of 2 years (benefiting from two tax-free thresholds and twice as much income taxed at 17% rather than 30%). Although low income earners may have little spare income to save, any savings they can make may, with the policies proposed in this paper, be withdrawn during subsequent periods of unemployment, without paying as much tax as would otherwise have been incurred. **This may increase the incentive (or rather, reduce current disincentives) for people to take the risk of switching to a more productive and higher paid job, even though it may have less job security.**

The benefits of flexible careers

The UK management consulting guru, Charles Handy, notes how the 1980's wave of workplace and productivity reform was based on *"Paying half as many people twice as much to work three times harder."*

The same logic explains why companies prefer to employ one full-time person than two part-time people, even though the progressive tax system means that two part timers will receive more net pay for the same total gross pay. It is simply much more efficient to have one person working hard full time.

Handy advocates a more efficient means for achieving a better work-life balance, which he terms "chunking". This means working hard for a period of time, then taking a break and subsequently returning to a different job.

"External" (or knock-on) benefits of career breaks ("chunking")

"Chunking" facilitates high productivity when working. Taking career breaks may also increase productivity further, by refreshing the worker, to be more enthusiastic on his return to the workforce (just as weekends and holidays do), whereas a lack of breaks can lead to "burn out".

But besides benefiting the employee taking a break, chunking can also provide knock-on benefits to families, other members of the workforce, and the unemployed.

Encouraging high income earners to adopt more flexible, changing careers (or rather, reducing current tax disincentives to do so) will increase "job churn" in these higher paid jobs. This will provide more opportunities for others to gain experience in these positions, which in turn will increase job churn at lower levels, and ultimately increase opportunities for the unemployed.

Increased job churn will also make it less risky to leave a job (as there is greater chance of finding a new opening when wanting to return to the workforce), which, in a virtuous cycle, will further increase job churn.

These knock-on benefits could justify a tax incentive. But currently we have a disincentive to chunking. It should be rectified.

Capitalist Co-ops

Introduction – linking superannuation to the present

This paper outlines a vision for a superannuation industry based on "stakeholder investment" principles. It is a strategy that links superannuation investments to the daily lives of the people that invest in super. In addition to wanting savings for retirement, these people are stakeholders in the companies that super funds invest in – they are employees, and customers (who buy the products and services produced by companies), and more broadly, members of the society in which these companies operate.

The superannuation industry has always struggled to interest most people, who in general are more concerned with addressing their present needs than locking away any spare cash they may have in risky investments until retirement.

The following sections outline the benefits to investors, customers and employees from applying stakeholder investment principles to super funds. Adopting these strategies will make superannuation investment genuinely more beneficial and attractive to people. By relating superannuation to people's present needs, it will also make it easier to market.

What is stakeholder investment?

All free trade involves voluntary exchange between customers, investors and producers (employees of the primary trading company, or of its suppliers), such that all participants benefit (or "profit") from the trade.

Most commonly, investors are only concerned with financial investment earnings (interest on loans and "profits" or dividends on equity). Stakeholder investors, however, are also interested in the consequences of their investment for the other stakeholders involved – customers, employees and indirectly affected parties that are not directly involved in the trade (e.g. the environment and those that depend on its sustainable management). This may be because they have a relationship or mutual interest in the welfare of these stakeholders, perhaps because they are close family, friends, or known members of the community. Alternatively, investors – being people with roles and interests that extend beyond being investors – may actually themselves also be the other stakeholders. e.g. customers or employees of the company in question.

Similarly, although customers are usually principally concerned with getting good value products or services, they can also demonstrate a preference to "buy locally/Australian", to support the local community and national economy. This is reflected in the expression, "community over profit" (or at least, if a profit is to be made, then preferably it's made by family, friends, or the local or national community).

Concern for the local or national community can in part be a reflection of the fact that people tend to care more about those closest or most familiar to them, but it can also reflect individual self interest. e.g. "If I support the local/national economy, this will help ensure I keep my job." The growing popularity of "community banks" is a reflection of this. People may also believe in an unwritten contract of mutual interest within the wider community, which may be expressed as "treat others as you would have them treat you".

The following sections describe means of recognising these wider interests through "stakeholder investment". The governance of stakeholder investment – collective representation of community interests, without recourse to Government – offers a "third way" in politics: a market-based, capitalist approach to democratising economic power, that is consistent with the long-standing principles of "social democracy".

Diversified employee share ownership

A new approach for super funds

- Current superannuation investors, though they represent individual people, many of whom actually work for the companies invested in, adopt a single-issue approach to their investment strategy – namely, maximise financial returns. This can even be at the expense of their customers (the individual investors), who may actually be employees of the investee companies, and may be made redundant in pursuit of higher profits. Whilst the “creative destruction” of markets is a necessary ingredient of progress, corporate governance that focuses solely on maximising profit may not maximise welfare for the community as a whole (particularly if there is an imbalance between corporate and employee bargaining power).
- Employee share ownership is generally recognised as beneficial for motivating employees and better sharing the risks and rewards of their labours.
    - However, employee share ownership is limited by peoples’ need to diversify risk. An employee cannot afford to risk all their life savings in their one employing company.
- A “capitalist co-op” would be a diversified group of companies, part owned in aggregate (to a greater extent than a single business) by the companies’ employees, via their super funds.[i]
    - Unlike traditional single-business/industry co-ops and mutualities (which are undiversified, lack access to capital and, due to narrow vested interests, can be introvert and resistant to change), capitalist co-ops would be dynamic, loosely structured network organisations, overseen by a strong governance centre similar to private equity groups.
    - Co-op members would elect a super fund governing board that seeks to strike a balance between achieving financial returns for retirement, and reasonable working conditions.
        - Governance of the group of companies would be concerned with maximising the welfare of the entire group and its stakeholders. Achieving this would, for example, require judgements to be made on the trade-offs involved in closing down poorly performing businesses, which may maximise investment returns but possibly precipitate long term problems from unemployment.
        - To facilitate value-adding business change whilst managing impacts on employees, the governing board could engage training and employment agencies to assist its members with retraining and alternative employment.

A new approach for unions

- Unions represent employed members. They fail to assist the unemployed.
- In today’s flexible labour markets, unions have become an obstacle to positive change.
- Unions need to focus on income security, rather than job security.
- Unions could better support modern workers by providing training and “employment agency” (or “labour hire”) services – assisting their members by constantly finding them better work.
    - This would also increase members’ individual bargaining power in current jobs – thus enhancing their ability to secure good pay and conditions.

There is a nexus between this future business model for unions, and the above business model for super funds. Unions’ links to “industry” super funds offer an opportunity to deliver this vision.

---

[i] The co-op could substantially or even wholly own the companies invested in (perhaps with the support of “external investors”), much like venture capital and private equity funds (which achieve superior returns for investors in part by adopting stronger governance, because all the benefits of this improved governance are fully reaped by the private equity fund, as sole owner of the business). However, following “tight-loose” management principles, the co-op grouping could also be quite loose and dynamic, with multinational investee corporations also being publicly listed, and joining and leaving the co-op as conditions change. These are the nimble conglomerates of the modern economy.

Customer share ownership

- Loyalty pricing structures, such as frequent flyer points and credit card rewards schemes, have grown dramatically in popularity over recent years.
    - These pricing structures stimulate demand and reduce business risk (from increased customer loyalty)
- One of the most popular loyalty pricing schemes was the Coles shareholder discount card
    - This was eventually terminated, as it was considered to offer excessive discounts (*in addition* to dividends).
- In the lead up to "super choice" legislation, a number of super funds, including the Australian Retirement Fund (the leading superannuation fund) began offering fund members discounts on products sold by the companies they invested in.
    - Media reports (see Sydney Morning Herald, Saturday 15th April 2000) indicated this was not just an attempt to attract fund members. It was also driven by investee companies (such as airlines and hotels) wanting to attract investment and customers. i.e. a win-win arrangement.
- With the delay in super choice and the abolition of the Coles shareholder discount card, these schemes appear to have stalled.[ii] Eventually, their fundamental advantages will bring a revival.
- Customer shareholder discounts, where customers who are also investors can choose to receive product discounts in place of dividends, offers an economically efficient pricing structure, analogous to "access pricing" (like utility bills with a fixed and variable price component).
    - Customers willing to pay a fixed charge (the purchase of shares) to cover fixed business costs, [iii] become entitled to a marginal product price that is closer to marginal costs. This lower marginal price boosts demand and total economic benefits (primarily consumer benefits, or investment returns).
    - As an investor, this also gives the super fund member an ability to control, and hence reduce investment return risk (if a member is confident of their future desire for the company's product).[iv, v]
    - The combination of increased returns and reduced risk should encourage increased investment, and a more productive economy.
    - An added advantage is that this approach brings superannuation returns into the "here and now" – of more interest to most consumers.

[ii] Regulatory barriers may also have contributed. This issue requires research.

[iii] Because super fund members are investing in shares anyway, this proposition does not involve customers choosing to invest in shares to get a discount when they would otherwise have simply paid the standard product price. The choice is between two different types of investment – one with risky returns and the other with returns controlled by the customer as product discounts.

[iv] Customer shareholder discounts could be recorded and offset against standard dividends. If customers chose not to buy the company's products, they would simply revert to being standard investors facing a risky return. They could then choose to sell their shares and reinvest in a different company with discounts on its (preferred) products. This would be a strong signal to companies about their future sales prospects.

[v] An extreme example of customer shareholders reducing investment risk could involve customers participating in an IPO. In this case a successful IPO (and the attraction of additional external capital) could by encouraged by the implied up-front commitment of customer shareholders to buy the future product.
A variation on this theme, of particular relevance to rapidly changing consumer products, could see purchasers of early release products (at initially high prices) treated as co-investors and rewarded subsequently with a share of future product sales revenue (which would be encouraged by the economies of scale stimulated from initial sales). This would encourage "early adopters", whereas current simple "unit pricing" practices actually discourage early adopters, due to the prospect of future product price reductions.

- Customer share ownership is likely to be of greatest value in industries with high fixed costs and persistent customer demand (conducive to customer loyalty).
    - Public transport and telecommunications companies are ideal examples.
    - For public transport, customers may place as much value on the existence of the service (available as an option in case its needed) as on its actual use. A customer shareholder IPO would be a means of capturing this value and setting up the service.
- Similar "customer" share ownership principles could also be applied to businesses, with downstream producers taking ownership stakes in upstream suppliers, in return for discounted supply prices. This could be a new dynamic approach to vertical integration.
- Customer share ownership could also be a means for giving customers some control, through fund manager governance arrangements over the management of businesses, particularly those with monopoly characteristics (again, public transport is a candidate).
    - More generally, such governance arrangements could encourage companies to adopt policies in support of the broader range of consumer desires, including ethical and environmentally responsible business practices, and community-focussed investment (super funds acting as "community banks").
- Customer shareholder discounts are likely to be most attractive when they offer customers a choice from a range of companies invested in by a super fund.[vi]
    - This diversified grouping of companies could be consistent with the "capitalist co-ops" structure discussed above for employee share ownership.
    - Competing global capitalist co-ops, adopting the above governance and pricing arrangements to create the most effective incentives for all stakeholders, could become virtual global communities that people could choose to join.

[vi] This is conceptually similar to the strategy adopted by credit card rewards schemes, where rewards and discounts are available from a range of companies in the scheme.