Australia's Future Tax System - Retirement Income Consultation Paper – Comments

The following comments are forwarded on the Retirement Income Consultation Paper by Mr. Anthony William Townsend [removed for privacy reasons]

Introduction

With two separate bodies undertaking the Pension Review (Harmer Review) and the Future Tax System (Henry Review), there is obviously some overlap and the decisions of the latter may impact on the former in an adverse way. E.g. If the Henry Review were to recommend changes to the age at which eligibility for the age pension cuts in, this could impact on both the quantum and indexing arrangements recommended by the Harmer Review. Similarly, were the Henry Review to recommend alterations to the interrelationship of the three pillar retirement income system, this would also impact both on the Pension and related issues addressed in the Henry Review.

With this in mind, these comments include some basic concerns already raised with Harmer, together with comments deriving from demographic, social, and economic considerations before focusing on the specific questions raised in the Consultation Paper.

Harmer

Although both reviews are headed by Departmental Secretaries of the Government Departments most closely involved with policy issues, the structure of the two is markedly different. In the case of the Henry Review, a Panel has been appointed, but Harmer has an Advisory Panel only. The significance of this is that where comments received from this advisory panel, and/or public consultations differ from FaHCSIA Departmental policy, it could be difficult for them to receive due consideration. This perception is reinforced by all members of the advisory panel being required to sign confidentiality agreements, thereby reducing transparency in the review process and confidence in its outcomes.

The Background Paper issued in August 2008 is significant in that it sets the tone for the Harmer Review and is the basis for all subsequent considerations. Consequently any possible flaws in that paper are likely to be carried forward into the Review and into subsequent recommendations. Unfortunately, the more that paper is scrutinised the more it becomes apparent that the main aims of the Department (FaHCSIA) are:

- To hold any further expenditure of public funds on any increase in the quantum of the aged pension, or any proposal to change the methodology of periodical reviews of the adequacy of the aged pension to an absolute minimum. This is in spite of the findings of the Senate Standing Committee on Community Affairs report released in March 2008, and the background community pressure leading to the setting up of both reviews.
- To recoup any such additional expenditure by penalising the 26.3% (Table 10) of single aged pensioners who have attempted to improve their quality of life by enjoying the company of

family, friends or other pensioners in shared accommodation, thereby also possibly reducing some proportion of their living expenses.

Apart from social considerations which lead Australians to share, and also to reduce the impact of social isolation, particularly among the older members of the population, there would be immense practical difficulties in implementing this latter proposal leading to significant additions to the Centrelink bureaucracy with a commensurate increase in costs. E.g. a pensioner requiring a live-in carer should not have their pension reduced, but what is the differentiation when a family member, friend or other pensioner provides that care and companionship? Furthermore, when family, friends or carers look after the frail or disabled they are saving the tax transfer system the costs of other options, such as aged care facilities.

It is possible, however to address the quantum of Rental Assistance received by a household where accommodation is shared. Where the total rent paid by the household attracts Rental Assistance, it is obviously inequitable for all members to benefit from the full rebate; rather, all members might share a proportion of the rebate attracted by the entire household.

Demographic and Social Challenges

The challenges facing Australian Society resulting from the ageing of society are well summarized in Section 6 of the Consultation Paper and call for innovative strategies and some thinking ‘outside the square’ if these challenges are to be met, particularly in the light of the current financial crisis. The recent National Seniors Australia paper AdvantAGE Australia issued on 27th August 2008 canvassed a number of options based on the premise that ‘thinking of the ageing population as an asset rather than a liability is a crucial first step.’ The older generations already contribute greatly to the Australian Community, much of it unrecognized. Given the right climate, there is much more that the older members of the community can contribute and it is all too easy to dismiss the ageing of society in terms of increases in expenditures and reductions in earnings. It is up to Government to provide the right policy settings to encourage the realization of the potential of all Australians. Review of the Tax Transfer system is only a part of this process; a whole of Government approach is required.

Health and Ageing

People who are active physically and mentally are more likely to lead healthier and more productive lives for longer than those who are not. While an ageing population will lead in the end to a greater expenditure on health, a recent National Seniors study has estimated that ageing alone adds only 0.5% per year growth to health expenditures compared to a real growth rate averaging around 4.5% a year (Productivity Commission, 2005). Active interventions, funded through the Tax Transfer system which promote healthier living and wellbeing – not Preventative Health, that’s death, could reduce this 0.5% further. Similarly, incentives to remain active in the work force for longer periods will reduce some of the other expenditures.

Workforce Participation

The Consultation Paper notes trends towards greater participation in the workforce by older people and lists some of the current incentives. These trends will no doubt be exacerbated by the recent financial downturn and the hemorrhaging of superannuation funds. There needs to be a co-ordinated and detailed examination of all these incentives to ensure that those who wish to work longer are properly rewarded, contribute to the Tax Transfer system, AND CAN SAVE so that future reliance on the Aged Pension is reduced. For example, why does the co-contribution cut out at 71st birthday? Why does the SG cut out at 70? Current Aged Pension taper rates ensure that pensioners who work can earn more than the Pension before they are penalized by reductions in the pension – this is an important incentive and should be retained.

Working Hours

Although many older people want and should be encouraged to participate longer in the workforce, for a variety of reasons they prefer shorter working hours. There seems to be a bias throughout both the Retirement Income Consultation Paper and the broader Henry Review Consultation Paper against part-time work. This attitude is counter-productive to the participation of older people – and many other groups, and needs to be changed. There needs to be a co-ordinated and sustained programme promoting the advantages of part-time work and job-sharing, lead by governments at all levels and extending into private enterprise. The tax transfer system needs to be modified both to provide the requisite incentives, to extract reasonable tax contributions, and to enable workers to save thereby reducing reliance on the aged pension in future.

Volunteers

There is no mention of volunteers in either Consultation Paper, but Australians, particularly older Australians, have a long history of volunteering, and their contribution to GDP, while recognized as substantial and significant, has never been quantified. Volunteering represents an additional way of employing people who wish to age positively, and a recent National Seniors Productive Ageing Centre study released on International Volunteer Day on 5th December 2008, shows that it would cost the economy $3.9 billion a year to replace 587,794 older Australians who are providing unpaid help to people with a disability. People 55 and over volunteer in civic and political groups more than any other age group (30% compared to 19% in the general population). One of the major reasons more people do not volunteer is the lack of reimbursement for out-of-pocket travel and meal expenses. If such expenses were tax deductable or could be re-imbursed, more volunteers could be attracted. Re-imbursement is the preferred option as there is then no drain on limited incomes, but it is then vital that Aged Pension regulations recognize this option. Just as the taper allows workers to earn without reducing their pension, so also volunteers must be allowed to receive such reimbursement without detriment to their pension, as is currently the case.

Grandparents

Although the Harmer Review addresses both the Aged Pension and Carer Allowances, the specifics of Grandparents have been excluded for whatever reason, and there is no mention in the Concept Paper. An increasing number of Grandparents are being granted legal custody of their grandchildren following the breakdown of the family unit, but the financial implications of this decision by the Family Court is not similarly recognised through the tax transfer system. If it is difficult for a pensioner couple to manage financially, a circumstance leading to the Harmer Review, how much more difficult is it when grandchildren are added into the equation? This is a major social problem faced by an increasing number of people, which has only surfaced relatively recently, but despite the activities of Grandparenting groups, has not yet received the attention it deserves. The Henry Review needs to address this problem urgently.

Social and economic challenges

Part of the Australian Dream is to own a home, but explanation of the tax treatment, and possible future options, appear to have lost touch with reality and recent developments.

Rents have risen at a higher rate than the CPI and show no signs of reducing in the current financial climate. However, when considering the home owner, the additional costs include;

- Any mortgage. Repayment rates may have reduced recently from the peaks experienced last year, but they are still very significant.

- Building Insurance. Premiums have risen faster than the CPI and recent natural disasters are likely to cause further rises.

- Rates. Most Council rates have risen faster than the CPI even when land valuations are taken into account.

- Body Corporate Fees and Levies on Unit owners. Body Corporate fees have risen faster than the CPI and the capital expenditures involved with Levies are unpredictable in both size and frequency, but can be expected to increase as the age of the building rises.

- Maintenance. As the home owner ages, so does the home and the need for capital expenditure for maintenance rises in both quantity and frequency. It is this consideration rather than the access to wealth noted in both Concept Papers which is the primary reason for the development of Reverse Mortgages. One of the main reasons for the decline in Public Housing is the failure of Governments at all levels to maintain their assets. If Governments have experienced this problem, how much more so is it a problem for private owners on a fixed income such as self-funded retirees and pensioners?

- While the value of property has generally increased over the years, apart from the recent financial crisis, this is a relative increase only. The sale of a property may well result in a capital gain, but with the rise in ALL property values, the costs of re-locating also increase proportionally.

Government Policy is directed towards older people remaining in their own homes for as long as possible, with assistance provided when necessary. This is a cheaper option than the provision of large numbers of Aged Care facilities, and accords with the desires of most Australians. The tax transfer system needs to recognise and support this Policy. Were the figures in Table 10.3 of the Future Tax System Consultation Paper brought up to date, for example, particularly following the financial crisis, there would probably be a high proportion of the Lower Middle Quantile, as well as the Bottom quantile gaining no tax benefit from home ownership, and the numbers involved would probably include most older people and a significant proportion of the rest of the population.

Specific Questions

Further to these preliminary remarks, my views on the specific questions posed in the Retirement Income Consultation Paper are as follows:

Q1.1 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?

I support the three pillar retirement system and in the main the current interdependence of the three pillars. Like many, I would like to see the SG raised to 15% over a period and measures to bring the self-employed into the system. This might include a levy on their taxable income equivalent to the SG and payable to a super fund of their choice. Such a levy could be paid annually or more frequently at their choice as an adjunct of PAYG and be treated in all other respects as is the SG.

All the objectives listed in Section 1 appear relevant, but in my view the most relevant is that the system should be broad and adequate. Added to that should be an objective that retirees have incentives and encouragement to participate in the workforce, either in paid employment or as a volunteer for as long as they are able. This objective, which encourages positive ageing, would enable retirees to continue to contribute to their ongoing finances, may reduce future dependence on the Aged Pension, but requires a whole-of-Government approach to set the right social and economic climate.

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?

Responses to this question are related to my response to Q1.1 In the first place, the Age Pension must continue to be the safety net and provide an acceptable quality of life (as addressed in responses to later questions).

As indicated in my preliminary remarks, a whole of Government approach is required to facilitate a climate where people can age positively and contribute to their retirement savings for as long as they so desire. Thinking of the ageing population as an asset rather than a burden is a crucial first step. At the same time, saving for the future should be encouraged by positive incentives. In the current financial crisis with the Government spending and encouraging Australians to follow that example to stimulate the economy, thrift has become a dirty word. Nevertheless, thrift and saving for the future are principles to be encouraged for Governments, Business and ordinary Australians in the longer term if the challenges of the ageing population are to be met.

The self-employed can be brought into the SG system as outlined in my response to Q1, but individuals with broken work patterns can only be weaned off the Age Pension through inducements to save and the provision of incentives to continue working for as long as possible, for example extensions to the Super Co-Contribution scheme. In this respect it is important to appreciate the contribution of volunteers to GDP, although not directly to the Tax Transfer system, and put in place measure to ensure that they are not unfairly penalized through out-of-pocket expenditures. Volunteers age positively and encouraging this avenue of employment will reduce outlays in other areas such as health.

Q2.2 Noting that the 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?

The very fact that Aged Pensioner hardship stories have been listened to, the Media stories of hardship have been aired, the Senate Standing Committee on Community Affairs has released its report, and that the Pension Review is occurring, are all indicators that the current system for assessing the quantum of the Aged Pension have failed. This is despite the small real increase since indexation was linked to Average Weekly Earnings.

That said, there is no need to throw the baby out with the bathwater. On the assumption that the Aged Pension will remain the safety net, replacement rates would appear to provide an adequate benchmark when set at an appropriate level, higher than the current rate of Aged Pension. In this respect I would advocate a minimum level of retirement income for those totally dependent on the Pension, with a sliding scale as at present as a retiree’s income/assets rise above the Pension threshold. This minimum level should be set to provide a basic living wage rather than a replacing a proportion of income earned prior to retiring

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?

The main role of Government is to provide the policy framework which enables all Australians to age positively. The Tax Transfer system is only a part of this.

The first objective must be to provide a safety net for those Australians who are unable to provide for their own retirement – the Age Pension

The second objective must be to set a level of compulsory savings which will enable the majority of Australians to fund their retirement – the SG. The rate of SG was addressed in Q1.1.

The third objective, and the third pillar of the retirement system, is to provide incentives which encourage those who may not be able to fund their retirement through the SG, or who wish to better their retirement and reduce dependence on the Aged Pension to work for as long as they are able and wish to do so. This includes Volunteers whose contribution to GDP does not involve the Tax Transfer system but must be encouraged.

The only change to these objectives as an individual's income increases is that the focus changes from objective to objective. There is a case for limiting incentives to save for the very well-off in society.

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?

The level of SG was addressed in my response to Q1.1

With respect to concessions, current cut-off provisions are a positive disincentive to those who wish to contribute longer to the community – positive ageing. There seems to be no good reason why the SG is not payable in respect of anyone who wants to work, irrespective of their age, similarly why does the Super Co-Contribution scheme need to cut-off? Further, if an individual wishes to continue working, there seems to be no good reason why he should not be able to contribute to Super, irrespective of age.

Concessions for volunteers do need to be introduced to ensure that re-imbursement of out-of-pocket expenses are not to the detriment of their Aged Pension entitlements.

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, how should they be reformed?

No system will ever result in equal treatment for every individual because we are all different. Nevertheless a principle of fairness is involved to ensure no one is disadvantaged. This applies to the elderly who are disadvantaged should they wish to continue to contribute to the community, either in paid employment or as a volunteer. That those on higher incomes are advantaged by current tax concessions on super is not a problem as their savings should reduce reliance on the Aged Pension and their expenditure patterns will enable recovery of funds through other provisions of the Tax Transfer system.

Tax concessions provide an incentive for voluntary saving, which is the third pillar of the system, and I see no overwhelming reason for change, except to broaden the application of some as indicated in responses to other questions.

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?

It would be interesting to know what proportion of Australians access their super at the eligibility date, and of those, what proportion draws an income stream as opposed to a lump sum.

As Australians live longer, there is no doubt that the majority will not need to access super until later in life and aged 60 appears a reasonable date for the immediate future. It is important then to safeguard the quality of life of those who through disability, illness, caring (volunteering) or other interruption to their working life require earlier access to super. This can be achieved through appropriate adjustments to Allowances.

With respect to the Age Pension, this is the safety net for those unable to provide for their retirement. Under these circumstances, extension of the eligibility to the 70^{th} birthday in stages is not seen as a major problem. This would result in some much needed savings to the public purse, but would require the extension of eligibility of many allowances up to this age.

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?

Many of the comments made in this section of the Retirement Income Consultation Paper appear to predate the full effects of the financial crisis. Comments on risk apply as much to the accumulation phase as to retirement.

Education is the key to wise financial planning and in this instance the importance of a properly regulated Financial Planning industry which is available for all Australians is paramount. Were all fees payable to Financial Planners made tax deductable this would be an incentive for all Australians to take advantage of their services, and the costs involved would probably be more than offset by savings to the Aged Pension arising from wise investment strategies. Look at the fall-out from the collapse of Storm Financial, for example.

Apart from this initiative, the only role for Government is provision of a safety net.

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?

The three pillar retirement system of itself is simple. Complexity arises only in the application of regulation to the system to try and eliminate duplication and ambiguity. While a return to first principles could result in some simplification, there does not seem to be much scope for this. It is then the task of Government to educate all Australians in their entitlements. Perhaps there needs to be a pro-active approach by both the ATO and Centrelink; in itself a change from the somewhat negative attitude at present.

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?

It is vital that the Aged Pension continue to be the safety net – this role is ongoing.

Until such time as the other two pillars of the Retirement Income System achieve their full effect, there will always be a proportion of individuals whose income is only a little above the Pension. This will include many older people who have given much of their life to volunteering as well as those with a disability, illness, caring or other interruption to their working life. These people should be given the opportunity to supplement their Pension through work or other savings until a certain level is reached, as is currently the case with the taper. The incentive to work should remain.

Similarly, means testing of assets and income should remain as at present, with the limits in both cases subject to regular indexing by the same rate as the quantum of the Pension.

There are so many proposals in this and other submissions, as well as the Retirement Income Consultation Paper itself, that it is impossible to determine sustainability until a decision is made on the final shape of the Tax Transfer System as a whole. The principles to be followed are:

- The ageing population must be treated as an asset rather than a liability
- The challenges presented by the ageing of the population will not be solved by traditional budgetary processes and require a whole of Government approach of which the Tax Transfer System is but a part.
- The main role of Government is to provide the policy framework which enables all Australians to age positively.

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?

Throughout this paper I have argued that incentives to continue contributing to the community through employment or volunteering are to be encouraged because they are a component of positive ageing, are likely to contribute to a longer and more healthy life, and are likely to result in savings to health, HACC, the Aged Pension and similar outlays from the Tax Transfer System. Further, if that work results in increased savings to fund retirement, this will also reduce calls on the Pension. If a cost/benefit analysis of the sustainability of the System will allow further incentives, such as reducing further the tax payable on income earned over and above the Pension, then go for it.

In this respect, however, the reduction in the proportion of younger people in the work force in the future needs to be taken into account. Greater participation by mature age workers will offset to some extent the rising cost of the Aged Pension, in itself reduced to some extent by extending the age at which it cuts in and by its role as a safety net only. The key is to realize the full potential of all Australians which requires a whole of Government approach as previously identified.

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

As I understand Financial Intermediation, it is an additional layer between the consumer, in this case the retiree, and the super fund. There may be advantages to financial intermediation in some areas of finance, but where retirees deal directly or through a Financial Advisor with a fund of choice, I am not convinced that an additional layer is justified. The recent financial crisis owes much in its genesis to financial wheeling and dealing which came unstuck; financial intermediation may or may not have contributed to this situation, but like many conservative older Australians, I have a mistrust of this type of product, particularly when something as important as my superannuation is concerned.

Q6.13 The cost of providing health and aged care to older Australians is currently met by government through the health sector. Should retirement income policy take into account projected increases in health costs for older Australians? If so, what would be the most effective mechanism and how might the transition to such a system be achieved?

It is interesting that this question does not appear in the Retirement Income Consultation Paper, but in the broader Consultation Paper. It is perhaps the first time that the requirement for a whole of Government approach is needed to meet the challenges posed by the ageing population.

The health of older people is no different to health issues faced by all Australians. A recent National Seniors study based on Productivity Commission data to 2005 indicates that ageing alone adds around 0.5% per year to health expenditures compared to real health expenditure growth rates of around 4.5%.

The major problem from the point of view of retirement income is that pensioners and many self-funded retirees are not able to access private health insurance and must therefore rely on an overstretched public health system. Were private health insurance premiums tax deductable there might be sufficient inducement for people to remain in private health as they aged, with a consequent reduction in pressure on public health services.

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