Is Lifting the Super Levy a Good Idea?

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Alarms should start ringing when you hear no criticism at all of a new policy. Ian McAuley takes a closer look at the changes to superannuation.

While resource rent tax has been capturing media attention, the Government's initiative to lift the superannuation guarantee levy to 12 per cent has gone by with little comment.

Perhaps this is because it has widespread support, including a rare coalition of unions and financiers. While many journalists crowd around controversy, few take the effort to probe issues characterised by cosy consensus. Although the announcement was made as part of the Government's response to the Henry Review, the review did not recommend an increase in the levy.

It did, however, recommend making the tax treatment of superannuation contributions more equitable. Why? At present the higher one's income, the higher is one's tax deduction for superannuation — which is what drives the rort of salary sacrifice.

Henry also recommended reducing the tax paid on superannuation fund balances from 15 per cent to 7.5 per cent. Its terms of reference constrained it from examining those arrangements introduced by the Howard government which exempt so-called "self-funded" retirees from almost all income tax.

Rudd and Swan have largely ignored the review's superannuation recommendations. On equity its limp response is to continue the co-contribution scheme and to introduce a new $500 annual contribution for those earning up to $37,000 a year. Both these measures involve churning: funds are collected through the taxation system and then passed through the administrations of superannuation fund managers. The Government hasn't yet explained why it did not take the simpler and lower-cost path of increasing the age pension.

Nor has the Government explained why it's increasing the superannuation levy. It is easy to point to the pitifully low amounts held in the superannuation accounts of many Australians — the average balance in industry and retail funds is less than $20,000. It's important to remember, though, that the 9 per cent levy has been in operation only since 2002. Perhaps the increase has nothing to do with adequacy: maybe it's a sneaky means of reducing disposable incomes in an overheated economy, or maybe it's a concession to the financial sector to compensate for the proposals to control the fees of "financial planners".

This being Fashion Week, I decided to launch my own supermodel on to the policy catwalk. It's an elegant Excel workbook, which allows one to test various policy scenarios. What are the consequences of increasing the levy to 12 per cent? What would be the effect if, as suggested in the Cooper Review into superannuation, fees could be reduced to reasonable levels? And what would be the effect of halving the tax on funds' earnings as recommended in the Henry Review?

The evidence from such modelling is that for many Australians, 9 per cent is probably quite adequate. There is no one objective test of adequacy, but it is often expressed in terms of the ratio of post-retirement to pre-retirement income. For example, someone with an annual income of $66,000 (average full-time earnings), with a low-fee fund, and with unbroken work to age 65, would retain 74 per cent of income post-retirement, even in a fund earning a modest 5 per cent return. (If the fund's earnings were 6 per cent, the average over the last 20 years, that figure would rise to 100 per cent.)

Of course, few people enjoy unbroken work; there are periods of unemployment, time off for child minding or study, and necessary early retirement. Most such breaks occur when people are young, which means they lose the benefit of many years of compounding returns on early contributions. (To illustrate the effect in the model, key in a break of, say, five years at age 25.)

On the other hand, many people have windfalls. An inheritance, a parental gift, a capital gain on shifting from an "empty nest" to a smaller house. Even a modest injection of say, $10,000 at an early age can have a strong effect on one's retirement income. (It is curious therefore that the Government has categorically ruled out any consideration of a bequest tax as suggested by the Henry Review.)

The model illustrates the strong effect of fees. If fees rise from 0.8 per cent to 1.8 per cent (the range between low cost and typical retail funds), that same worker with average earnings loses more than $100,000 of his or her final balance, and suffers a drop to 52 per cent of pre-retirement income. In fact, even if the levy is raised to 12 per cent, he or she would still be better off in a low-fee fund with a 9 per cent levy.

Fees count. Is it possible that the Government is anticipating that the Opposition will block its legislation on fees and the MySuper proposal, and is proposing a higher levy instead? Such a pre-emptive surrender would be consistent with other recent Government backdowns.

Providing for retirement income is important — but we can go too far. We are already asking the young and hard working to subsidise the old and idle. On our young people we have loaded the burdens of HECS, high house prices, explicit cross-subsidies in private health insurance, and, in exempting retirees from tax, the heavy share of income taxation.

Forcing people to pay more in superannuation deprives people of disposable income when their needs are highest, particularly when they are bringing up children. Also, it lessens their capacity to save for medium-term needs, such as cars and appliances, driving them into expensive forms of debt, such as store credit cards. This means they churn their funds through the financial sector, going in through superannuation and coming back out through consumer debt, with commissions in both directions. In this regard, it is particularly unfortunate that the Government has ruled out the Henry Review's modest suggestions, including relief on the tax on interest, aimed at making it a little more attractive for people to build up discretionary savings.

Many people do need higher superannuation contributions, but a one-size-fits-all approach looks good only on a mannequin and it is very inelegant public policy.