SUPERANNUATION
THE COSTS AND BENEFITS

DARYL DIXON

Brotherhood of St Laurence and
Public Sector Management Institute, Monash University

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Foreword

The Brotherhood of St Laurence and the Public Sector Management Unit at Monash University are pleased to publish Daryl Dixon's report *Superannuation: the costs and benefits*.

Superannuation has been a subject for debate for a long time. Major problems have been identified with the form of government assistance to superannuation schemes and with the use of superannuation savings by the funds. However, the direction for reform has been hotly contested.

Superannuation is a critical issue, because it is a major avenue for savings that is likely to increase substantially. In addition, superannuation will become in the future a much more important contributor to retirement incomes than it is at present. The form of government assistance to support superannuation has a significant impact on incentives to save, on the equitable distribution of assistance to savings and also on retirement incomes.

Daryl Dixon has made an important contribution to this debate over a long period of time. He was among the first to demonstrate the problems with superannuation and has acted as a stimulant for reform.

The report builds on that earlier work and shows that, despite the many changes to superannuation over the past decade, the essential problems remain.

The current form of government assistance is deficient in many respects. It is costly to the community, as it means a large loss of government revenue, which will escalate in the future. It is highly inequitable, in that it gives too much assistance to high-income earners and too little assistance to low-income earners. Low-income earners will receive insufficient long-term benefit from supperannuation, because of the low levels of taxation assistance, the impact of fund charges in eroding the benefits of contributions, and the loss of at least some age pension payments. It is also ineffective because it is not sufficiently geared to those who need additional incentives and assistance to save, and it is not sufficiently targeted to new savings. The inequitable nature of government assistance to superannuation is strongly at odds with a highly targeted and needs-based welfare system.

There are other problems, which include lack of immediate vesting, lack of full coverage and responsiveness to the needs of families at different stages in their life cycle, and the differential treatment of different sources of superannuation contributions.

The report canvasses a number of options for reform. While we do not endorse any particular option, they all deserve serious attention and debate. It is clear that substantial reform is still needed to improve the equity, efficiency and simplicity of superannuation in Australia.

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Contents

LIST OF TABLES

List of abbreviations

ACOSS	Australian Council of Social Services
ASC	Australian Securities Commission
ASFA	Association of Superannuation Funds of Australia
CAI	Confederation of Australian Industry
CPF	Central Provident Fund (Singapore)
ETP	eligible termination payment
HAS	highest average salary
ISC	Insurance and Superannuation Commission
LIFA	Life Insurance Federation of Australia
RBL	Reasonable Benefit Limits
SGC	Superannuation Guarantee Charge
SRA	Supplementary Rent Assistance

1 Introduction

This research paper has been prepared with the financial assistance of the Brotherhood of St Laurence, Monash University's Public Sector Management Institute and an anonymous sponsor. Its purpose is to review and analyse the key aspects of superannuation policy from the viewpoint of their suitability for the 1990s and later years.

The current system contains many defects, inequities, inefficiencies and complexities, which in many instances have been the consequence of rapid and frequent changes. The rules were, for example, changed dramatically by Treasurer John Dawkins' 30 June 1992 initiatives. Further changes are inevitable, either from a re-elected Keating government or from a newly elected Coalition government later in the present financial year.

Despite the prospect of further changes and the complexity of the existing arrangements, it is still essential that decision-makers understand the key policy issues involved with superannuation. Because of the size of the superannuation industry, with its assets now totalling $155 billion, its health and growth are absolutely crucial to the performance of the Australian economy. The government is, for example, looking to superannuation to provide a much-needed boost to national savings.

Equitably financed and distributed superannuation benefits can also play a very important part in supplementing and/or substituting for age pension provision in coming years as the Australian population continues to age.

These two factors alone provide sufficient reason for concerned Australians to focus upon the issues raised in this paper.

2 The current system

Overview

Superannuation is a crucial component of the present government's retirement incomes policy, providing major taxation subsidies to individuals putting aside money for their future retirement. The arrangements are compulsory only for wage-earners covered by the Superannuation Guarantee Charge (SGC) arrangements, which enforce a minimum level of employer contribution to superannuation fund benefits. These workers can, along with other people eligible to contribute to a superannuation fund, make additional contributions to funds within prescribed limits.

Prior to changes implemented in 1988, contributions to superannuation funds and fund earnings were totally free of tax until benefits were paid out on retirement or at some other time. Today, however, superannuation fund contributions attracting a tax advantage, and fund earnings are subject to income tax at a special flat rate of 15 per cent, which compares with marginal rates of personal income tax ranging from 21.25 per cent to 48.25 per cent.

Benefits are subject to tax when paid out either as a lump sum or pension, although, following the 1988 changes, the tax rate on some benefits can be as low as zero. In most cases the overall taxation treatment is a favourable one, encouraging savings to be built up in superannuation funds.

Unlike most other countries, Australia allows total freedom to individuals to take their benefits as either a lump sum or pension, attempting only to encourage pension pay-outs via more generous tax treatment of annuities and by allowing larger benefit payments when at least half the payment is taken as a complying annuity. From 1 July 1994 onwards, penalty tax rates will apply (subject to generous transitional provisions) to lump sum benefits in excess of $400,000 and combined pension/lump sum benefits in excess of $800,000.

The current system allows considerable flexibility in the mechanism of superannuation savings, permitting savings to be built up in employer, union or industry-based funds and/or in personal superannuation accounts. The Insurance and Superannuation Commission (ISC) has overall administrative responsibility, though the Tax Office is responsible for applying taxation in the method prescribed in the legislation.

As the result of frequent changes in the rules in recent years, many participants in superannuation funds now find the rules complex and difficult to understand, particularly when they have participated in superannuation funds for a considerable period of time. The introduction of rollover funds in 1983 has expanded the range of choices available to individuals on changing their jobs and retiring from the work force. Rollover funds operate effectively as personal superannuation funds, except that contributions can be made only from approved sources, called eligible termination payments (ETPs).

Accumulated assets in all superannuation and rollover funds now total some $155 billion. The benefits promised by government sector schemes not backed by fund assets add as much as $60 billion to the amount of benefits promised to individuals.

Superannuation is thus an important component of individual wealth as well as a major source of national savings. When the government's proposed mandatory contribution level in respect of wage-earners reaches the proposed level of 12 per cent, including a 9 per cent compulsory employer contribution, of payroll in the year 2002, annual new inflows of savings will amount to a minimum of $20 billion based on current employment and wage levels.

At the present time, aggregate new levels of contributions are unlikely to be in excess of $10 billion annually. Many large employer funds have (due to high earnings rates and favourable claims experience in recent years) been in an over-funded position, allowing them to reduce their new contributions to their funds, even to the extent in some cases of not having to make any contributions at all (called a contributions holiday).

A brief history

The current arrangements have developed not as part of a deliberate government plan, but largely from a series of changes to arrangements introduced to the Australian tax system following practice in the United Kingdom. The government sector has, for example, virtually followed United Kingdom practice until recently, offering defined benefits to employees in the form of indexed pensions and/or lump sums not backed by fund assets.

Prior to union initiatives culminating in the 1987 productivity-based award superannuation schemes, the bulk of superannuation schemes were those initiated by employers and/or by individuals wishing to join or establish personal funds with the help of life insurance companies, banks and similar financial institutions.

Except with respect to the eligible level of approved contributions, the taxation arrangements offering generous concessions remained largely unchanged for many years, until the current Labor government initiated major changes in 1983. Since that action, the rules and regulations have been subject to frequent amendments as the government has set about implementing its long-term retirement incomes policy. Table 1 provides a selected summary of recent changes.

Table 1	Summary of recent changes to superannuation rules
1983	Major changes to lump sum tax arrangements.
1984	Introduction of rollover funds.
1985	Relaxation of Maximum Benefit Rules.
1986	Forced preservation of improvements in benefits.
1987	Introduction of compulsory award funds.
1988	Introduction of 15 per cent superannuation tax.
1990	Major changes to rules for deductibility of contributions.
1992	Introduction of compulsory superannuation for all employees.
1992	Changes to prudential and supervisory standards.
1992	Changes to tax deduction rules for employees.
1994	(proposed) Reduction in maximum permitted benefits.
1996	(proposed) Extension of compulsory preservation requirements.

The arrangements are still subject to close scrutiny and change from several viewpoints, including equity, security of benefits and integration with the as yet totally separate social security system. Until the past decade, no effort at all was made to integrate the superannuation and social security systems to ensure the adequate provision of retirement incomes. The present emphasis, however, is on policies that encourage superannuation as a way both of reducing dependence on the age pension in future years and of increasing retirement incomes for ordinary Australians.

The current government and the union movement have, for the first time in our history, placed primary emphasis on expanding the coverage of superannuation to all of the work force via compulsory superannuation arrangements. Previously, the only compulsion in the system was that involved when employers made membership of their superannuation scheme a compulsory condition of employment with the company or government concerned.

The initiative for expanded coverage has been greatly assisted by changes that require compulsory preservation of certain benefits to the age of 55 or later retirement and/or encourage preservation of benefits in a rollover fund until the age of 55 or some later date before age 65. In June 1992 the government announced a phased-in increase of the preservation age from age 55 to age 60, commencing from 1 July 1994.

In recent years the government has also acted to encourage the payment of benefits in the form of annuities by changing both tax and social security arrangements to reduce the effective tax rate on annuities.

The legal framework

The federal government's control of superannuation is exercised via its constitutional responsibility for taxation powers. The available taxation concessions are extended only to the income of and benefits payable by complying funds; that is to say, funds that comply with the rules and regulations administered by the ISC.

The government also does not in any way guarantee the payment of benefits to individual fund members. That responsibility is assigned to fund trustees who are governed by the relevant law applying to trustees. The trustees are, of course, constrained by the relevant superannuation fund trust deed as well as the general law applying to trusts and trustees.

The security of the fund benefits is in all cases determined by the value of superannuation fund assets and the legal obligations (if any) placed on employers to contribute to or otherwise fund the pay-out of fund benefits.

The relevant ISC rules permit fund benefits to be provided either as defined benefits related, for example, to years of fund membership or service and final average salary and/or as the accumulated value of fund assets generated, for example, by a defined level of fund contributions.

Flexibility of arrangements

Current Australian arrangements are highly flexible, permitting individuals to establish their own superannuation fund, join an employer, union or industry-sponsored fund, purchase a managed personal superannuation plan or product from a variety of fund managers or, if they so desire, not become involved with superannuation as a way of saving.

Employers, however, are now placed under a legal obligation by most industrial awards to provide a totally employer-funded benefit (currently 3 or 4 per cent of salary) to all employees. This legal obligation will now be enforced through the *Superannuation Guarantee (Administration) Act 1992*. Employers not making the required statutory levy of contributions to their employees' fund will be subject to a special non-tax-deductible levy equivalent to their liability to contribute to superannuation, plus an effective 'fine' for not contributing.

As a result of these arrangements, the government, employers and individual fund members now have an important role to play in superannuation decisions. Individuals are concerned, with the help of their unions in some cases, about receiving their entitlements under the relevant industrial awards or as set out in the SGC arrangements. They are also involved in decisions about what top-up arrangements, if any, they want to make privately.

Employers and fund trustees chosen by the employers and/or fund members are responsible for making contributions to funds, as well as determining the relevant rules of the fund, such as to the type of fund, the level of benefits, vesting arrangements, fund investment strategies and other actions required to comply with the law.

A significant point is that a large number of separate entities are involved with the design, operation and efficient functioning of superannuation in Australia today. Interested parties include: individual fund members, unions, industry associations, employers, fund trustees, investment fund managers, superannuation fund administrators, accounting advisers, lawyers, auditors, actuaries, financial advisers, consultants and a variety of government entities and organisations, including the ISC, Tax Office, Departments of Employment and Industrial Relations, Attorney-General's Department and Law Reform Commission officials at both federal and state levels of government.

3 Evaluation of equity issues

Largely because the incentives to save via superannuation are delivered through the progressive income taxation system, major inequities in the form of the provision of greater assistance to some individuals than to others are contained in the system. The discrimination involved, as will be detailed below, is difficult to justify, particularly on vertical equity grounds, because the bias is in favour of older, higher income taxpayers, who would be better able to afford to save in any event in the absence of any concessions.

The current arrangements create problems for both concepts of equity: horizontal and vertical equity. Horizontal equity is concerned with the equal or consistent treatment of people in the same financial situation (for example, with the same income). Vertical equity relates to the relative taxation treatment of people with different capacities to pay tax, with the traditional view (and one used in this paper) being that people in better financial circumstances (for example, with more income) are able to pay more tax than those in worse financial situations.

The remainder of this chapter outlines specific areas where current arrangements raise major problems or issues of equity.

Bias against lower income earners

The superannuation tax provisions create a major bias in favour of higher income taxpayers in two ways. First, the absolute level of subsidy per dollar invested increases with the taxpayer's taxable income. Second, higher income taxpayers are eligible to receive much larger, subsidised pay-outs than lower income taxpayers. The combined result of these provisions is to make superannuation more attractive as a way of saving to higher income people than to lower income people.

The larger per dollar subsidy to higher income groups results from three aspects of the tax arrangements:

- the larger value of tax deductions to taxpayers with the highest marginal rates of income tax;
- the taxation of superannuation fund income and contributions at a flat 15 per cent rate; and
- the method of taxation of superannuation fund pay-outs where even some very large pay-outs can be subject to very low rates of tax.

The tax concessions operate by allowing employers and some eligible individuals tax deductions for their contributions to funds that are then subject to a flat 15 per cent tax rate in the hands of the fund. With marginal rates of income tax ranging from 21.25 per cent to 48.25 per cent, the tax advantages from saving via a superannuation fund at various income levels are shown in Table 2.

Table 2 Tax advantages of superannuation contributions 1991/92

Taxable income	Value of deductions	Super tax payable	Net advantage
In range	%		%
$ 5,400 - $20,700	21.25	15	6.25
$20,701 - $36,000	39.25	15	24.25
$36,001 - $50,000	47.25	15	32.25
$50,001 and over	48.25	15	33.25

In a limited number of cases (for example, when individuals are making contributions to an employer's fund and do not have an assessable income exceeding $31,000 a year), taxpayers can be eligible for a tax rebate of up to $100, equal to 10 per cent of their personal contribution subject to a ceiling of $1000. This arrangement is of significant value only to lower income persons with incomes of less than $20,700 a year, who would otherwise receive a tax saving of only 6.25 cents in the dollar on their contributions.

The tax on final benefits when they are paid out reduces the extent of the tax advantages from saving in a superannuation fund, but not in a way to substantially and systematically lower the advantages accruing to higher income groups. For older people with substantial periods of employment prior to the July 1983 lump sum tax changes, a large proportion of the final pay-out is subject to the very generous pre-1983 tax rules, with only 5 per cent of the pay-out being subject to income tax. The remainder will be tax-free within the limit of the indexed $76,949 component of post-1983 benefits, which is exempt from tax for persons aged 55 or more.

The fact that the tax on lump sum benefits is payable in many instances at some distant date in the future also reduces the effective rate of tax. The major equity problem with the lump sum tax rules is that the tax rates payable are not systematically related to the level of taxation subsidy provided during working life. In several instances (for example, where lower income people are forced to withdraw their benefits prior to the age of 55 because of financial hardship), the rates of lump sum tax result in people paying more tax than they would have by saving in their own name. A low-income taxpayer receiving her/his money in a hardship situation before age 55 can, for example, pay a combined lump sum/income tax rate of 36.25 per cent on superannuation savings, compared with the normal income tax rate of 21.25 per cent.

Problems of transitional provisions

To date, Australia has chosen to implement its superannuation approach by altering the rules only for new contributions and/or benefits payable after the relevant date of change, for example 1 July 1983, in the case of the very significant increase in the rates of lump sum tax. This procedure is called 'grandfathering'.

Grandfathering as a concept raises major inequities, because of the different treatment of people in the same economic situation. Consider the example of a superannuation lump sum pay-out of $200,000 received after 1 July 1992 by two retirees each aged 65 at that date, with one retiree having built up that amount since 1 July 1983, while the second has been a member of a superannuation fund for 40 years.

Under the current tax rules, the late starter will be subject to $19,996 lump sum tax, while the second individual will pay a maximum of $3600 in lump sum tax because of her/his pre-1983 benefits. This is a blatant breach of the principle of the equal treatment of equals approach to taxation.

The situation is made much worse by the fact that people who changed jobs prior to 1 July 1983 did not have access to rollover funds to allow them to preserve their pre-1983 benefits. Through no fault of their own, these people are now denied the benefit of previous membership of superannuation funds granted to employees who remained with the one employer throughout their whole career or who were fortunate enough to have access to a preserved or portable superannuation plan. As a result, the grandfathering arrangements have had an unfair impact on the overall equity of the system, with the harshest possible impact on all younger people and on older people joining a superannuation fund later in life.

Several of the grandfathering provisions, particularly those relating to Reasonable Benefit Limits (RBLs) and lump sum tax rates, have been made even more inequitable and capricious in their operation by the use of days of service in the administration of the rules. Even though the total amount of benefit payable is subject to tax and/or the RBL rules, the grandfathering provisions operate by reference to the days of service before and after the change.

This method of operation is capable of manipulation, for example by people with many years of prior service but little accumulated benefits at the time of change of the rules. By increasing contributions under the new rules, the level of benefits built up and taxed under the old rules will be dramatically increased. Take, for example, the case of a person who at 30 June 1983 had built up accumulated superannuation benefits of $50,000 over 30 years and who then builds up a further $350,000 of benefits over the next 10 years (all amounts expressed in dollars of the same value).

The correct measurement of that person's pre-1983 benefits was $50,000 yet the grandfathering provisions would consider the pre-1983 component of benefits to be $300,000, namely 30 years pre-1983 membership divided by 40 years' total membership times the total pay-out of $400,000. The tax reduction from this grandfathering provision in this instance would be not less than $30,000. This is one of the main reasons why superannuation is an attractive tax shelter for those fortunate people with long periods of qualifying pre-1983 service.

Integration with social security

Fund members can take their benefits as a lump sum prior to retirement age or at the time of retirement, thus creating opportunities to double-dip, i.e. to receive both a generous superannuation pay-out and an age pension as well. These possibilities mean that the government assistance provided to some people to subsidise their retirement will be greater than that provided to others.

To deal with these problems over a number of years, organisations such as the Life Insurance Federation of Australia (LIFA) and the Association of Superannuation Funds of Australia (ASFA) have argued for more formal arrangements to integrate the social security and superannuation systems. So far, however, action has concentrated on amendments to social security rules addressing all persons owning assets and not those directly obtained as superannuation fund benefits.

Inconsistent treatment of contributions

Present taxation arrangements can result in a totally different treatment of the same level of contributions, even when made over the same period. This is the result of the different taxation treatment of employer, employee and self-employed contributions.

The most generous treatment, except for lowest income taxpayers, is that provided to employer contributions, where the employer obtains a tax deduction for all contributions and the employee is not subject to any income tax on the value of the monies put aside in the superannuation fund on their behalf. All employer contributions are, however, subject to the 15 per cent contributions tax.

The contributions made by self-employed people attract a full tax deduction for the first $3000 and a 75 per cent deduction for the remaining contributions. The 15 per cent superannuation contributions tax applies to all contributions attracting the above tax deductions.

Employees receiving employer support for their superannuation are placed in an even less favourable situation when making their own contributions to their employer's or another fund. When their taxable incomes exceed $31,000, they receive no tax benefit at all. For lower income taxpayers, a tax rebate of no more than $100 is available to them.

These arrangements provide a distinct and inequitable bias in favour of schemes fully funded by the employer (called non-contributory schemes) and against arrangements involving employee contributions. Table 3 provides illustrations of the inequities involved for a taxpayer subject to the 39.25 per cent marginal tax rate for a combined employer-employee and/or self-employed contribution of $10,000 a year. As highlighted in Table 2, the subsidy level also varies with the marginal rate of the taxpayer.

Table 3 Value of taxation deductions for a 39.25 per cent marginal rate taxpayer 1992/93

$10,000 contribution	Tax saving*
All paid by the employer	$2,425
All paid by employee (self-employed)	$2,000
Shared 50/50 between employer/employee	$1,213

* After allowing for personal income tax at a 39.25 per cent rate and the 15 per cent superannuation contributions tax.

Reasonable Benefit Limits (RBLs)

RBLs set the maximum amount of superannuation benefits for any individual receiving preferential taxation treatment. The RBLs have, since 1 July 1990, been determined as a multiple of the fund-member's highest average salary (HAS) and other income from personal exertion over any three consecutive years of employment. The relevant multiples are higher for people with higher incomes, and particularly for those with substantial periods of eligible service prior to 1 July 1990. The multiples are significantly higher for people opting to take 50 per cent or more of their benefit as a complying annuity.

Apart from the fact that higher income persons are able to obtain larger pay-outs and associated tax advantages than lower income persons, the RBLs contain major inequities, which allow some people to increase the size of their maximum benefit while others cannot. A problem area is the definition of HAS, where the amounts contributed to superannuation are included as income for self-employed and other people subscribing to their superannuation fund, but excluded for wage- and salary-earners who are members of employer funds.

This inconsistency means that individuals with the freedom to determine their own superannuation arrangements can increase their HAS merely by varying their superannuation arrangements over a consecutive period of three years. Consider the case of a person with an indexed total remuneration package of $100,000 a year consisting of $80,000 salary and a $20,000 employer-funded superannuation contribution. The HAS for this individual is measured as $80,000. Yet if the same individual chose not to join the employer's superannuation fund and subscribed separately to a personal fund, the measured HAS under current rules could be $100,000, permitting a major increase in the RBL and the personal tax advantage.

Table 4 provides some illustrative examples of the different RBLs for an employee receiving a total package of $100,000 with varying periods of pre-1990 and post-1990 employment. As mentioned previously, these

RBLs are based on eligible periods of service rather than superannuation benefits accumulated prior to the date of the change. The RBLs as a result can vary widely, even for individuals in the same or approximately the same situation, largely for capricious reasons, such as whether or not they changed jobs over a long career or whether they have had the freedom not to be a member of an employer's fund for three consecutive years of employment.

Table 4 Illustrative RBLs for a person with a total package of $100,000 under various assumptions 1991/92

Assumptions Pre-1990 service years	Post-1990 service years	Pension RBL	Lump sum RBL
Employee		**$**	**$**
30	10	872,093	541,393
20	20	844,185	522,787
10	30	816,278	504,181
0	40	788,370	485,575
Self-employed			
30	10	1,067,093	661,393
20	20	1,009,185	622,787
10	30	951,277	584,181
0	40	893,370	545,575

On 30 June 1992 Treasurer John Dawkins announced arrangements to simplify RBL arrangements by setting caps from 1 July 1994 of $400,000 on lump sum benefits and $800,000 on combined lump sum pension benefits. Transitional rules based on current RBL rights will, however, protect higher accumulated benefits based on the existing RBL entitlements at the time of implementation of the changes.

Source of contributions

A further and often overlooked equity issue is that better-off contributors can gain access to the superannuation tax concessions merely by transferring existing savings, existing assets that are acceptable for superannuation purposes and/or the proceeds of special borrowing transactions into a superannuation fund. These transactions generate no additional savings for the nation, yet still provide valuable tax benefits to the individuals concerned. Lower income and less well-off persons without the capacity to borrow can in stark contrast gain access to the tax concessions only by new savings out of their current incomes.

Vesting

Except for personal superannuation funds, legal requirements do not as yet force all accumulated superannuation benefits to be fully vested in the name of individual fund members. The situation varies from fund to fund. For example, the compulsory award-based funds are fully vested in the name of the member, while others provide benefits progressively vested over a number of years. The SGC will, for example, require the full vesting of all compulsory contributions and related earnings from 1 July 1992 onwards.

At present the only legal requirement on superannuation funds is to ensure the full return of all employees' contributions plus accumulated interest on those earnings at the time of leaving their job. The protection for individual fund members thus varies widely, depending on the terms of their employer fund trust deeds. The terms of these arrangements thus greatly affect the attractions of joining an employer's superannuation fund.

A further and related problem is the practice of several funds, including fully vested accumulation schemes supposedly owned fully by the members, of building up unallocated reserves usually to smooth out fluctuations in fund earnings rates. The creation of these reserves causes major inequities, because of the reduction in final pay-outs to departing employees, unless the final pay-out includes that particular member's fair share of such reserves. In effect the reserves have been created by reducing the declared investment return paid out to fund members, usually to make life more comfortable for the fund trustees in the event of a fall in investment returns. These reserves are then used to increase investment returns in periods such as the present to boost reported returns to members.

Where superannuation benefits are not fully vested in members, major equity problems arise, especially for people such as married women and part-time workers with intermittent participation in the work force. Without vesting, changing jobs can result in a substantial loss of benefits.

Coverage

A serious equity problem is that many employees, who are likely to be women and others on lower incomes, such as part-timers and casual workers and other people, have limited opportunities to participate in superannuation on a financially rewarding basis.

The introduction of award superannuation coverage and the SGC has improved the situation somewhat by vastly expanding the number of superannuation fund members. But the benefits available for low-income people are still minuscule compared with the value of the taxation benefits for higher income persons. This unfortunately will still be the case even when the compulsory contributions increase as projected to 12 per cent of salary.

Table 5 illustrates the grossly different value of the maximum tax savings available to the various income groups from employer and voluntary superannuation contributions, even when the contribution rate increases as projected in the year 2002 to 12 per cent of salary. The calculations are based on an assumed employer contribution of 12 per cent of salary plus an additional voluntary personal contribution of $1000 a year, the maximum amount qualifying for a tax rebate for lower income taxpayers.

The 12 per cent compulsory contribution includes the already legislated 9 per cent mandatory employer contribution and the additional 3 per cent contribution from other unspecified sources to be legislated for at a later date.

Table 5 Value of superannuation tax savings under current rules with maximum award superannuation benefits and $1000 voluntary contributions, 1991/92 tax rates

Annual income level	Maximum contribution	Tax saving	Saving as per cent of contributions
$	$	$	%
10,000	2,200	175	8.0
15,000	2,800	213	7.6
25,000	4,000	728	18.2
50,000	7,000	1,995	28.5
100,000	13,000	3,990	30.7

As highlighted by the tax concession of only $175 for a worker on $10,000 and $3990 for a person on $100,000 a year, expanded coverage of the work force will not improve the equity of current arrangements unless further adjustments are made to the taxation subsidy arrangements.

Clearly the beneficiaries of the present arrangements, even with the progressive introduction of the SGC, will be concentrated among the higher income groups, for two reasons: the larger contributions payable by these people and the higher per dollar subsidy given to the higher income earner.

Other issues

The current arrangements also raise important policy issues in a number of areas. These include the problems of younger and other people who may need access to their superannuation savings prior to reaching retirement age. Relevant problems include those occurring on the loss of a job and/or the inability to fund a house mortgage or other financial commitments.

The ISC does permit access to preserved benefits in the case of demonstrable hardship, but does not permit employers to cash-out compulsory award superannuation payments, even if their employees are in major financial difficulties. This is a problem with any compulsory award benefits, and it needs to be seriously considered in scheme design. The Singapore compulsory arrangements, for example, allow people to borrow back some of their superannuation savings to fund a house purchase and/or for other desirable purposes.

This issue will become increasingly important as the level of compulsory award payment rises as projected to 12 per cent of salary and/or the relevant preservation age is increased to age 60 as proposed by the government and Coalition parties.

A second issue is that of the over-funding of defined benefit funds promising future benefits to employees. In recent years some employers whose defined benefits funds have accumulated large surpluses have been removing the surplus assets in their funds and/or reduced the contributions to their funds. The absence of any controls on such practices raises doubts about the security of the future benefits promised to employees (if, for example, the over-funding is the result of optimistic actuarial assumptions and/or over-estimation of asset values) and about whether the employees should also benefit from the surpluses built up due to over-funding (for example, in proportion to the employees' contributions to the fund).

So far, as with the approach taken towards the vesting of benefits, the Australian government has made no decisions on these important issues. The government is, however, in the process of introducing action to increase the security of fund benefits, which includes action to control the withdrawal of fund surpluses.

Another area of concern relates to the compulsory award and SGC contributions in respect of lower paid workers. For these people, administration and other costs of fund membership, including insurance and taxation levies, absorb a disproportionately large part of the contributions and associated earnings. The result frequently is that fund membership often provides little tangible benefits in a savings context for the individuals concerned.

It is little wonder that unclaimed benefits from former fund members who have changed jobs is now a serious problem for all award funds. Even when the SGC is fully operational, unclaimed benefits and administration costs will remain two major problem areas for lower income Australians.

4 Revenue implications of current policies

The taxation concessions offered to occupational superannuation savings result in an annual cost to government revenues, which are costed in the annual Treasury Tax Expenditure Statement. These costings are the subject of considerable dispute, with commentators (including David Knox and ASFA) querying the validity of the Treasury methodology.

That a large cost to budgetary outlays is involved is not in dispute, and the Treasury estimate of around \$3 – \$4 billion is not an unrealistic ballpark figure. The major difficulty with measuring any tax expenditure (i.e. government outlay resulting from special tax arrangements) is that of defining the counter-factual situation of what would happen if the relevant tax expenditures did not exist.

For example, would people save via other means in the absence of the superannuation tax concessions? And do the superannuation tax concessions result in a reduced use of other tax shelters, particularly negative gearing, which also involve a substantial reduction in tax revenue? The superannuation tax expenditures could also increase the total tax base if the additional savings generated result in an increase in national income.

Assets built up in superannuation funds also offer the potential of reduced social security outlays in future years because of increased incomes and assets subject to the age pension assets and income tests.

Again, the major problem is determining the extent to which superannuation savings augment or replace other savings. For higher income taxpayers also, their retirement incomes and total assets can far exceed the levels at which eligibility for the age pension cuts out. Such people would thus be unlikely to receive an age pension, even if the occupational superannuation tax concessions did not exist.

A detailed cost-benefit analysis of the occupational superannuation tax concessions, while an interesting exercise, is unlikely to lead to any clear-cut conclusions. Of greater immediate relevance is the possibility of policy action that can increase both the equity and savings generation aspects of whatever concessions are offered.

A priori reasoning, for example, suggests that policies that target the tax concessions at lower income groups would be much more effective and equitable than current arrangements, which are focused on the higher income groups. Put simply, higher income taxpayers have both greater opportunities and capacity to save because of their higher disposable incomes and the greater need to maintain their pre-retirement standard of living in retirement. The budgetary savings in age pension outlays would also be more significant for lower income persons because of the flat rate method of payment of age pensions and the operation of the pension income test.

The other major defect in current arrangements is the lack of any rules that would force occupational superannuation pay-outs to be used to fund retirement incomes. Present rules permit such monies to be dissipated in the purchase of capital assets, such as expensive houses and consumer durables, and/or in early retirement prior to reaching age pension age. The encouragement to take a continuing pension exists only for higher income persons receiving the highest tax subsidy for their superannuation savings and the largest benefits from the higher RBLs and special tax rebate for those opting to take an annuity benefit.

The cost-effectiveness of the present tax concessions varies widely, depending upon fund members' marginal tax rates and the effective rate of lump sum tax. For low marginal rate taxpayers, the revenue cost to government is very small, because the 15 per cent superannuation tax rate is only 6.25 percentage point less than the basic rate of income tax of 21.25 per cent. The costs rise substantially with the marginal tax rates of individuals to a maximum of 33.25 cents in the dollar.

These high rates of tax subsidy are not recouped by the tax payable on end benefits, except in situations where fund members receive their benefits before the age of 55. After age 55 the maximum lump sum benefit tax rate is 16.25 per cent in the case of post-1983 benefits in excess of an annually indexed $76,949 which are subject to no tax .

For a high-income taxpayer to receive a lump sum benefit taxed many years in the future at a maximum effective tax rate of 16.25 per cent is to offer a major and costly tax advantage. Table 6 contrasts the effective level of this end benefit tax rate after a varying average number of years with the recurrent annual tax rate subsidy for a taxpayer with taxable income in excess of $50,000 a year. The calculations assume a real interest rate of 5 per cent per annum.

Table 6 Comparison of effective maximum rate of lump sum tax on person aged 55 or more with the annual tax subsidy for a person with an annual income over $50,000: post-1983 tax rules

Average period to payment of benefit	Annual tax subsidy	Effective maximum lump sum tax rate	Minimum level of subsidy
Years	%	%	%
1	33.25	15.5	17.75
5	33.25	12.7	20.55
10	33.25	10.0	23.25
20	33.25	6.1	27.15

The data presented in Table 6 is expressed as a percentage of each dollar accumulated as a final benefit and highlights the major costs to revenue of current arrangements for higher income taxpayers, even when benefits are subject to the maximum marginal rate of lump sum tax. The effective tax rate on pre-1983 lump sum benefits is not more than 2.5 per cent of total benefits and, as mentioned previously, the first $76,949 indexed of post-1983 benefits is exempt from tax. In effect then, a large component of lump sum benefits is effectively exempt from tax and the effective lump sum tax rates are in any event relatively low, as shown in Table 6.

Table 7 estimates the cost to revenue of lump sum pay-outs, excluding any undeducted personal contributions not eligible for a tax deduction, for people with varying income tax rates and an assumed average 20 years' delay in the receipt of benefits (assuming fund membership for a period of 40 years). For convenience, an illustrative lump sum benefit of $300,000 in today's dollars consisting solely of benefits accruing after 1 July 1983 has been chosen as the basis for Table 7.

In effect, Table 7 covers pay-outs to be made in the year 2023 or thereafter. A 5 per cent real interest rate is used to determine the present value of lump sum tax bills payable 20 years in the future.

Table 7 Long-run costs to revenue of current superannuation tax concessions for assumed $300,000 pay-out in the year 2023

Taxpayer's marginal tax rate	Annual tax subsidy*	Effective tax rate on lump sum	Net subsidy per dollars paid out	Total subsidy
%	%	%	%	$
21.25	6.25	4.6	1.65	4,950
39.25	24.25	4.6	19.65	58,950
47.25	32.25	4.6	27.65	82,950
48.25	33.25	4.6	28.65	85,950

* Taxpayer's marginal tax rate less the 15 per cent superannuation tax.

Table 7 illustrates how the cost to revenue increases with the marginal tax rate of the individual concerned. Higher income persons usually do receive higher total lump sum pay-outs and greater tax subsidies than lower income taxpayers, and this will continue to be the case even when the new uniform RBLs of $400,000 and $800,000 described previously apply from 1 July 1994. For this reason, a more realistic scenario is present in Table 8 allowing for the fact that on average the superannuation benefits paid out increase with the income of the fund member. Apart from the different amounts of total lump sum pay-outs, the assumptions used for Table 7 are retained for Table 8.

Table 8 Today's value of costs to revenue and tax collections from current superannuation tax concessions for lump sum payments to various categories of taxpayers in the year 2023*

Taxpayer's marginal tax rate	Annual tax subsidy	Effective lump sum tax rate	Lump sum pay-out	Total subsidy
%	%	%	$	$
21.2	6.25	2.2	150,000	6,075
39.25	24.25	4.3	250,000	49,875
47.25	32.25	4.8	350,000	95,936
48.25	33.25	5.2	400,000	112,200

* Includes all taxation concessions and taxes on end benefits.

These revenue costs are particularly significant for higher income persons receiving lump sum benefits in excess of $350,000. Table 8 shows a cost of $112,200 for a highest marginal rate taxpayer receiving a $400,000 superannuation lump sum benefit. This would not be an uncommon benefit for higher income persons. Indeed, lump sum pay-outs in excess of $1 million are frequently paid at present to senior company executives retiring after many years' service.

The cost to revenue of a $1 million pay-out would not be less than $280,000 and possibly considerably more, allowing for the fact that a substantial component of the pay-outs will be in respect of the lightly taxed pre-1983 employment. The government's latest action to restrict total lump sum pay-outs attracting tax subsidies to $400,000 will, however, limit the total benefit in respect of any one person in future years.

Effect of compulsion

The government's action to increase the compulsory level of employer superannuation contributions from the current 3 per cent of salary to a level of 9 per cent of salary in the year 2002 will inevitably have a major adverse impact on government revenues. Some parts of the increased compulsory contributions will be offset by reductions in voluntary contributions already being made, but overall aggregate employer contributions to superannuation funds now representing approximately 5 per cent of total wages and salaries will rise by up to another 4 or possibly 7 per cent of wages and salaries. The higher 7 per cent figure may be relevant, depending on the method of financing the additional 3 per cent of salary promised as part of the total 12 per cent contribution set by the government.

Based on a total wages and salaries bill of around $200 billion annually, additional employer contributions to superannuation funds could amount to $14 billion annually. And even if one-half of the employees affected were at the bottom marginal rate of tax, this measure would still result in a reduction in tax collections of at least $1.2 billion annually with very little of this amount being ultimately clawed back as tax payable after age 55 on lump sum benefits received from superannuation funds.

For compulsory superannuation to have any beneficial impact on government revenues and outlays overall, it would have to have a very substantial impact in reducing future demand for social security outlays (for which a 50 per cent income test applies to personal income received by individuals).

The prospect, therefore, is for compulsory superannuation contributions to have a major detrimental impact on the government budget, even after allowing for the 15 per cent superannuation tax and the higher rates of lump sum tax applicable to post-1983 benefits. Clearly these costs will be substantial, especially for highest marginal rate taxpayers, and the only major possibility of clawing back the costs of the superannuation tax concessions would be to adopt measures, discussed in following sections of this paper, which result in substantial future reductions in social security outlays.

To be successful in this context, the compulsory superannuation arrangements would have to be seen and actually operate as an alternative to the age pension. A major equity problem would still remain nevertheless. This is the distinct bias under present arrangements in favour of higher income taxpayers in the allocation of the current superannuation tax subsidies.

The latest compulsory measures also ignore the special problems of self-employed people, who are exempted from the SGC arrangements. These people can, if they wish, contribute to superannuation funds utilising generous taxation provisions, but they may equally eschew the use of superannuation as a savings vehicle entirely.

In the past, this arrangement may have been appropriate when self-employed people were building up assets in the form of goodwill in the value of their business. Increasingly, however, because of the impact of the recession and the introduction of the capital gains tax, there is no guarantee that the majority of self-employed people will have sufficient assets to help fund their retirement. This is another important reason why the compulsory superannuation arrangements may not augment national savings to the extent envisaged by the government.

Impact of annuities

What effect, if any, do the arrangements for annuities introduced in 1988 and changed again in 1992 have on the cost to revenue of the superannuation tax concessions? The recently announced tax arrangements apply from 1 July 1994 onwards, a special tax rebate of 15 per cent to all superannuation annuities paid. Together with the higher RBL rules applying to pay-outs where 50 per cent or more of benefits are taken as a complying annuity, these annuity arrangements will result in substantially lower taxation revenue overall than if benefits were all to be taken as a lump sum.

The major revenue benefits accruing from the provisions applying to annuities will thus have to come from the application of the age pensions' income test to these payments. Abstracting from these age pension considerations, Table 9 estimates the taxation advantages applying to benefits taken in complying annuity form. Table 9 considers the taxation subsidies again under the same assumptions as used for Tables 7 and 8, but where the whole benefit is taken as a complying annuity. For computational purposes, it is assumed that the life annuity is purchased at a price of 15 times the benefit payable.

Table 9 Long-run costs of occupational superannuation tax concessions for annuity payments for various categories of taxpayer in the year 2023

Taxpayer's marginal tax rate	Annual tax subsidy	Effective annuity tax rate	Annual annuity	Total subsidy
%	%	%	$	$
21.25	6.25	-2.0	10,000	12,375
39.25	24.25	.2	16,667	61,223
47.25	32.25	1.27	23,333	92,942
48.25	33.25	3.63	33,333	148,081

Table 9 demonstrates the generosity of the arrangements applying to annuities because of the higher level of budgetary assistance to benefits taken in this form. The ideal strategy for individuals is to combine the receipt of both annuity and lump sum benefits in order to maximise the advantages applying to both forms of benefit. These include the low rates of tax applying to the first $76,949 of post-1983 and all pre-1983 lump sum benefits and the tax rebate applying in respect of all superannuation annuity benefits on the basis described above.

5 Conflicts with other savings motives

As presently operating, the Australian superannuation laws result in a major conflict with other savings objectives, including acquiring a house and meeting other savings objectives, such as funding children's education during working life. Also, unlike savings outside a superannuation fund, superannuation fund assets cannot be used as collateral for loans, leading some investors to prefer investments in their own name. Superannuation savings, moreover, are tied up in a non-accessible form until age 55 or later retirement.

Arrangements in other countries are different from these in Australia. The rules of Singapore's Central Provident Fund (CPF) permit fund members to borrow back part of their accumulated savings to help fund the acquisition of a house. The funds can also be utilised within prescribed guidelines to help fund the education of children and also to fund the requirements of a small business.

Home-ownership constraints

Even allowing for the taxation subsidies accruing to savings built up in a superannuation fund, lower income taxpayers and younger people will generally find that it is in their financial interests to concentrate on paying off the mortgage or an owner-occupied house rather than joining a superannuation fund. This is the direct result of two features of the Australian tax system, the lack of any income tax subsidy to either home mortgage or rent payments and the application of a flat 15 per cent tax rate to superannuation fund income.

The money saved by paying off a house mortgage as quickly as possible accrues totally tax-free in the hands of an investor, while all superannuation fund income is subject to a 15 per cent tax. Allowing for the operation of compound interest, it will generally be desirable for investors to pursue their home-ownership objectives first, before seeking to allocate money into a superannuation fund. This will be the case especially for younger people subject to either a 21.25 per cent or 39.25 per cent marginal tax rate, attracting the lower superannuation tax concessions.

Any arrangements, such as those applying in Singapore and/or as proposed for Australia by the Coalition and the Australian Association of Permanent Building Societies, which allow superannuation monies to be used to help achieve home-ownership, would substantially improve the attractions of superannuation as a way of saving. An important aspect of these proposals is the incentives that would be given for younger people to be involved with superannuation funds. It should also help achieve government objectives of achieving superannuation fund investments in outlets such as housing and social infrastructure. To do otherwise would be to encourage younger people to by-pass superannuation as a way of saving until they have achieved home-ownership.

Put simply, the reason for this is that the investment returns from owning a residential house (namely, the capital gains and imputed rental income) are totally free of tax, while the investor receives no tax relief for the interest costs incurred in funding the home. At the current time, paying off a house mortgage results in a totally safe after-tax return of around 10 per cent compared with variable and uncertain returns from superannuation funds of around 6 per cent or 7 per cent (for capital stable funds investing in fixed interest securities and subject to fees and charges and the 15 per cent superannuation tax).

The fact that an investor gains a tax saving for his/her life contributions to a superannuation fund will usually not be sufficient reward to compensate for the lower after-tax returns from a superannuation fund for assets with the same risk levels. In any event, few people have the capacity to afford major borrowing commitments on their home and large superannuation savings, making these financial comparisons largely academic calculations in most situations.

Other taxation distortions

The decision to save is influenced by other aspects of the tax system, including subsidies to specific areas (such as special deductions for research and development expenditures and building depreciation allowances) and the allowance for inflation in defining the tax base. Fixed-interest investors receive no allowance for the impact of inflation, for example, while only capital gains in excess of the cumulative rate of inflation are subject to tax.

Capacity to save

The current arrangements also make no allowance for the fact that some people have a greater capacity to save than others. For example, the same taxation rules apply to a taxpayer with a dependent spouse as to a single individual. Thus, even though the resulting retirement income has to support two people rather than one person, no special arrangements apply to encourage saving via superannuation to help meet the retirement needs of dependent spouses. The Coalition intends, however, to allow spouses to make separate tax-assisted contributions to assist non-working spouses, a change that would go some way to addressing the problem. Similarly, no allowances are made for people with special problems and disabilities, which can increase their needs for assets and income in retirement.

Negative gearing

In many situations, negative gearing (borrowing to purchase assets resulting in a loss for tax purposes) can be a much more tax advantageous way of saving than superannuation under current rules. The reason for this is the fact that superannuation savings are subject to a 15 per cent tax rate, whereas negative gearing can involve no tax liability at all because of the full deductibility of all interest expenses and the exemption from tax of capital gains equal to the rate of inflation.

In an international context, these taxation provisions, together with the granting of full imputation credits on fully franked dividends are among the most generous in the world, encouraging borrowing rather than saving to purchase assets. While these provisions remain in existence, wage-earners, particularly those subject to higher marginal tax rates, will have a major incentive to bypass superannuation as a way of saving. Not all taxpayers, of course, are in a position to afford negative gearing, adding further distortions and inequities to the current system.

These considerations will be especially important if changes are made to superannuation arrangements that reduce the generosity of the tax concessions to any category of taxpayer. The attractions of saving outside a superannuation fund are increased also by the flexibility of action and ease by which money can be obtained either by borrowing or selling the privately owned assets.

Importance of income tax rate scale

The high marginal rates of personal income tax brought about by bracket creep (i.e. inflation pushing taxpayers into higher tax rates) have increased the tax savings from superannuation for many people. To retain the relative attractions of superannuation as a way of saving, it would be necessary to reconsider the superannuation tax provisions, especially the flat 15 per cent tax arrangement, in the event of any major restructuring of the provisional income tax system.

The government's 'One Nation' proposals would, for example, greatly reduce the tax benefits of superannuation for a very large number of taxpayers with incomes between $20,700 and $40,000, as their marginal tax rates are reduced from 39.25 per cent to 31.25 per cent in two stages by 1996. The Coalition's 'Fightback!' proposals already include mechanisms to encourage the interest of lower income taxpayers by providing a uniform tax rebate of 25 per cent of contributions subject to a cap of $1500 to all taxpayers. The 'One Nation' proposals would involve a subsidy of only 6.25 per cent to all taxpayers with incomes less than $40,000 in 1996 when the proposals are fully operational.

Ensuring that the superannuation incentives are not affected unintentionally by income tax changes needs to be an important element of any policy change.

6 Other problem areas

Both fund members and the superannuation industry are aware of a large number of defects and/or potential weaknesses in current arrangements. These have arisen either through oversight or from the largely incremental way in which policy in Australia has developed. The recent Australian Law Reform Commission paper (1992) on superannuation, has highlighted many problems with present arrangements, and the Senate Select Committee review of superannuation policy has also received numerous submissions about areas where change is needed. The specific issues considered below are not necessarily considered in order of priority.

Insolvency and bankruptcy

The current rules applying in situations of insolvency and bankruptcy create equity problems in at least four areas. First, creditors have no access to the superannuation assets of a bankrupt person in the majority of situations. This has even caused people fearing the prospect of bankruptcy to place large amounts of money into the comparative safety of superannuation funds.

Second, in the situation of insolvency or receivership of a sponsoring employer, the appointed receiver has the effective right to replace employer-appointed superannuation fund trustees with his/her own nominees. Because the receiver's role is to protect the interests of creditors rather than employees, the newly appointed trustees frequently are more concerned with extracting the maximum possible surplus out of the superannuation fund assets than protecting the superannuation rights of present and former employees.

Third, some funds contain an automatic trigger to wind up the fund, causing losses for many fund members. Even when there is no such trigger, a commonly used procedure, when allowed by the trust deed, is to dismiss all superannuation fund members paying out only the minimum entitlements required under the trust deeds, allowing the receiver to reclaim any remaining surplus for the benefit of creditors.

Fourth, fund members frequently suffer from the loss of contributions not yet forwarded to the superannuation fund prior to the liquidation and from losses in in-house investments in the sponsoring company.

Costs of administration

The government sets no limits on both the costs of fund administration and the proportion of fund contributions or assets that can be taken as sales commissions or fund management fees. Instead, it requires only a disclosure of costs, but not necessarily in a manner readily understood by purchasers. Such *laissez-faire* arrangements create major opportunities for unscrupulous organisations to profit from poorly informed consumers. The system also leads to excessive waste, particularly in situations where only small amounts of money are involved, such as the benefits of some members in award superannuation funds and in a large number of cases for regular contribution personal superannuation funds.

Apart from the lack of any controls on fees and charges, costs of administration have been increased by the forced membership of union and other productivity award funds when the member already has existing superannuation fund coverage in another fund.

The award superannuation funds generally involve a flat rate weekly membership fee of up to $1 per week and additional compulsory insurance costs, which the member may already be paying in another fund. Lower income earners with modest amounts in funds are, of course, the major losers from high fees and charges.

As far as fund members are concerned, membership of an employer-sponsored fund generally involves little or no payments of administrative costs. But by contrast with the award and personal superannuation funds, benefits accumulating in these funds are usually not fully vested in the name of the employee. People taking out their own personal superannuation policies are forced to shop around and compare fees and charges of different institutions offering their services. As would be expected, the fees charged vary widely, and comparisons are by no means easy.

The government has only recently taken steps to implement a formal disputes' resolution mechanism, and even now fund members who feel that their interests have been adversely affected are forced to resort to the legal system to gain protection. This system is weighted against individual fund members, even where union or other professional association financial support is available, because of the enormous costs of pursuing litigation through the courts. This system is thus strongly biased against the interests of poorer and less-well-informed members of the community.

Prudential requirements

The government has announced action from 1 July 1993 onwards to ensure the prudent investment of superannuation fund assets. There is no intention to direct the allocation of fund assets in any one direction, but existing prohibitions confined largely to restricting the level of so called in-house investment in the sponsoring or associated companies are to be tightened up.

These new initiatives will help protect the interests of fund members and will be a major improvement on present arrangements.

Assistance for non-home-owners

Some, primarily though not necessarily lower income taxpayers, are unlikely to be able to afford and/or desire to achieve home-ownership as part of their overall savings strategy. Such people are, unfortunately, discriminated against in both the taxation and social security systems by not having access to the special benefits available to home-owners.

The social security system does provide some relief to private home-renters via Supplementary Rent Assistance (SRA) and a higher threshold for the assets test. But this level of compensation does not adequately reflect the advantages accruing to home-owners, viz. the unlimited exemption of the owner-occupied home from the capital gains tax and the exclusion of imputed rent from the tax base.

The present superannuation arrangements unfortunately do not provide any special benefits for non-home-owners to compensate for the distortions listed above.

Security of the fund benefits

Unlike, for example, the USA, Australia has no formal arrangements to guarantee the security of fund assets and benefits promised to employee members. These commitments can be met only via accumulated fund assets and/or employer commitments to fund the level of benefits prescribed in the relevant Acts (for government schemes) or the trust deeds.

As highlighted recently by Lord Browne-Wilkinson (1992), there is a considerable potential for abuse of the system, leading to the actual or potential loss of fund assets, thereby depleting members' benefits. The purchase of unsuccessful investments could, for example, easily deplete fund assets, especially in situations where benefits are not adequately provided for in the first instance.

Unfunded benefits

Potential problems exist in two general areas. The first is the general practice of government schemes to offer future benefits not backed by the build-up of accumulated fund assets. In some cases the schemes are totally unfunded, with the employers meeting their scheme liabilities as and when they emerge (called an emerging cost basis), while in other cases fund benefits are only partly funded.

The second is where employer contributions to a fund are insufficient, usually because of poor investment returns, to cover accrued fund liabilities to date. This problem of under-funding is a potentially serious one only if the sponsoring employer is in poor financial shape and/or not committed to making contributions to the fund in a binding way.

From a national viewpoint, unfunded schemes raise difficult policy questions, both for the equitable application of the 15 per cent tax on superannuation fund contributions and earnings and from the fact that these schemes do not generate national savings in the way that funded schemes do. At present, an additional 15 per cent tax applies to the payment of unfunded post-1983 lump sum and pension benefits, but this rate of tax is not sufficient to compensate for the effect of the 15 per cent earnings tax on reducing investment returns in funded schemes.

Because of the existence of fund assets, the benefits payable under funded schemes offer employees greater security than unfunded benefits promised schemes. The financial problems now being faced by some state governments could, for example, greatly increase the difficulties they will face in future years in meeting their emerging unfunded liabilities.

Fund surpluses

The existence of fund surpluses (that is, fund assets in excess of actuarial estimates of accumulated liabilities) does not present problems as serious as does the under-funding of promised benefits. Nevertheless, there are at least three possible areas of concern.

The first is the cost to government revenue of extending preferential tax treatment to surplus assets being held in superannuation funds. The second is uncertainty about the ownership of these assets as and when the surpluses emerge. The third is the attitude that should be taken to employer attempts to withdraw surpluses from ongoing funds. In this particular context the major problem is one of determining whether the surpluses are genuine or not, because they represent merely estimates of potential surpluses on a variety of actuarial assumptions.

There have, for example, been instances overseas of employer withdrawals of surplus fund assets followed not long after by the occurrence of serious under-funding of the same schemes. The alternative option of employer contribution holidays can be an effective way to reduce the over-funding of benefits, provided remedial action to reduce contributions is taken promptly to prevent the emergence of a serious over-funding problem.

Haphazard vesting and preservation arrangements

Currently, a wide variety of vesting arrangements apply to superannuation fund benefits. Improvements in fund benefits implemented after 1986 and all award and SGC superannuation contributions have to be fully vested in fund members. The vesting arrangements applying to other fund benefits vary widely according to arrangements specified in individual trust deeds. The compulsory superannuation arrangements to be enforced by the SGC will also have to be fully vested in employees. As well, the government has recently announced measures to require progressive vesting and preservation of all benefits after 1 July 1996.

Compulsorily vested benefits are also required to be preserved in a superannuation fund until age 55 or later retirement from the work force, a condition also applying to personal superannuation fund assets of self-employed and other individuals. From 1 July 1994 onwards, the preservation age is to be increased from age 55 to 60 over a number of years affecting only those people currently aged less than 32. Until all benefits are vested in employees on a systematic basis, it will be difficult for those many employees who change jobs frequently to accumulate substantial superannuation benefits.

Dissipation of assets

Because assets can be taken as a lump sum in some cases before age 55 and on retirement at age 55 or some later date, the current system provides no guarantee that superannuation fund assets will actually be used for retirement income purposes. During working life, for example, assets obtained on changing jobs can be used for consumption or investment purposes, such as paying off a house mortgage.

Commonly also, superannuation fund assets are used to finance early retirement or lifestyle changes and are not preserved to fund normal retirement expenses. By using superannuation fund assets in these ways, retirees are able to gain access to a part or full age or service pension that would not have been available had superannuation assets been preserved for later use.

In this context, Australia is the only country that permits heavily tax-subsidised superannuation benefits to be taken in a lump sum form. The new government ceiling of $400,000 on lump sum benefits to apply from 1 July 1994 will not affect this situation for most of the population.

Special problems for low-income earners

The new SGC arrangements are meant to replace prospective wage increases by increased superannuation payments. This will result in a substantial squeeze on the standard of living of low-income earners, because of their greater immediate need for more disposable income. This is an inevitable impact of a SGC that is defined as a uniform percentage of wage income for all employees.

7 Proposals for change

Despite the continuing changes in superannuation rules over the past decade, further substantial changes are almost inevitable. The government, for example, has just announced major simplifications to current arrangements to apply primarily from the 1 July 1994 fiscal year. It is also in the process of devising new prudential standards for funds. The new SGC legislation will also require compulsory employer superannuation contributions up to a maximum of 9 per cent of salary by the year 2002.

The Coalition parties have also announced their intention, if elected to office, to make major changes to simplify and improve the equity of present arrangements. Current policies have been the subject of criticism from other quarters, including employer groups such as the Confederation of Australian Industry (CAI) and welfare organisations, particularly ACOSS, concerned about various aspects of present arrangements. Areas of concern include the equity issues already discussed and the problems associated with the costs to employers arising from compulsion.

Various organisations and individuals, including Labor members of parliament and some ministers, are also concerned about the direction of superannuation fund investment, particularly with encouraging investment into areas such as venture capital and social and economic infrastructure investment. The remainder of this chapter deals with the issues of compulsion, the Coalition's policy and a recent report by the Law Reform Commission in more detail.

Proposals for compulsion

From 1 July 1992 the *Superannuation Guarantee (Administration) Act 1992* requires employers to make a mandatory superannuation contribution in respect of each individual employee or be subject to a special non-tax-deductible levy (called the SGC). This arrangement was devised in order to overcome difficulties with achieving voluntary compliance with the 3 per cent employer superannuation contributions required under most awards. For larger employers the SGC has been set at 5 per cent of earnings, increasing in a series of steps to 9 per cent of earnings by the year 2002. The government intends to supplement this 9 per cent contribution rate by an additional 3 per cent of salary contribution via tax refunds or other sources.

For smaller employers (defined as those with payrolls of less than $1 million a year), the compulsory level of contribution will be set at 3 per cent of earnings until 1 July 1994, increasing thereafter in steps of 1 per cent of earnings until the same 9 per cent of earnings contribution required by larger employers is obtained. This arrangement will ensure that all employers comply with their award obligations, because the SGC will be charged in all cases where the compulsory level of contributions has not already been paid. For all employers, it will be far preferable to make the superannuation contributions rather than pay the SGC, because the levy will not be tax-deductible, whereas superannuation contributions are.

The SGC arrangements do not specify which complying funds are to receive the relevant level of contributions, although there is a requirement that all contributions needed to comply with the SGC provisions are both fully vested in the employee and preserved until age 55 or later retirement. This arrangement will require the amendment of many existing superannuation schemes to ensure the required progressive level of vesting of benefits as the SGC system is fully phased in.

The Coalition parties have announced their intentions when elected to office not to proceed with any further compulsion to contribute to employee superannuation benefits. The 'Fightback!' policy is to retain whatever level of SGC is in force at the time of their election to office, and make no further increases in the level of benefits. As presently envisaged, the SGC raises important policy issues in several areas, particularly with respect to the appropriate treatment of self-employed and other persons (such as contractors and consultants) not considered to be employees.

The Coalition's agenda

In addition to their proposals to limit the level of compulsion in the system, the 'Fightback!' proposals envisage a major restructuring of present superannuation arrangements. The overall objective is to control the aggregate cost to revenue in a way that provides an equitable level of tax concessions to all contributions.

The Coalition's approach is to remove the present controls exercised by way of the RBL system as a limit on the total benefits receiving preferred tax treatment and instead limit the annual tax saving on superannuation contributions to a maximum of an indexed $1500 a year per person. In the case of a married couple, the combined limit would be $3000, with one partner being able to claim tax concessions with respect to a spouse if he/she so desires. Taxpayers will be able to carry forward unutilised tax rebates to future years.

This method of control of the equity and cost of the concessions would be accompanied by other changes to the rules, including a limit on the size of the maximum lump sum benefit ($60,000 plus one-half of the total pay-out subject to a maximum amount of $300,000, both amounts being indexed for inflation), a change in the contributions tax regime to tax contributions at the taxpayer's marginal rate, a removal of lump sum taxes, new arrangements to encourage annuity benefits and an increase in the tax rate on fund earnings from 15 per cent to 20 per cent.

These proposals have been criticised by superannuation industry representatives, such as ASFA, who would prefer that the present limitations of cost to revenue by reference to the final benefit pay-out be retained.

ASFA argues, for example, that employers would face great difficulty in determining what rate of contributions tax would apply to individual employees whose marginal rate of tax will depend not only on their employment income but also on their income from other sources.

The reality of the situation, however, is that the major industry concerns with the Coalition's proposals centre on the significant reduction in the generosity of the present tax concessions. High-income earners would receive the same benefits as low-income earners for all contributions to superannuation funds under the Coalition's approach.

A 25 per cent tax rebate would, under the Coalition's income tax scale, generate an equal absolute benefit for all taxpayers and result in a tax refund of 7.55 per cent of contributions for lowest marginal rate taxpayers and an effective tax burden of 18.25 per cent on contributions by highest marginal rate taxpayers.

This contrasts with a 6.25 per cent tax saving for lowest marginal rate taxpayers and a 33.25 per cent tax saving for highest marginal rate taxpayers under present arrangements.

The Coalition's proposals have also been subject to industry criticism on the basis that they will reduce the aggregate level of superannuation savings below those that would be generated by the government's SGC proposals. That proposition, even if valid, would not mean that the Coalition's proposals would reduce aggregate national savings.

As part of its policy the Coalition intends to allow young households to gain access to their superannuation benefits to help finance home-ownership, a proposal that could generate substantial interest in voluntary superannuation membership by younger people. Increased forced saving occasioned by the SGC may also substitute for other saving that would have been undertaken by the individual. And, more importantly, the Coalition's policies to limit the size of the lump sum benefits would slow down the withdrawals of superannuation fund assets that occur under the present unfettered lump sum benefit arrangements.

The Law Reform Commission proposals

The Law Reform Commission has proposed major changes to the method of supervision and regulatory control of superannuation in Australia. Their concerns centre on the relevant responsibilities of the ISC and the Australian Securities Commission (ASC) and possible methods of ensuring the protection of members' benefits. The Commission's proposals have sparked considerable controversy in the industry, and the government's reaction will very much influence the course of future prudential and other regulatory standards control in Australia.

The 30 June 1992 changes

On 30 June 1992 Treasurer John Dawkins announced major changes to present arrangements, with the majority of changes being implemented from 1 July 1994. The changes do very little to deal with equity issues addressed in this paper, but they do set an absolute cap on the total level of lump sum and/or combined pension/lump sum superannuation benefits.

These changes will make the system less generous to the highest income groups and simplify RBL arrangements. They will also facilitate implementation of the Coalition's proposals in the event of a change in government at the next federal election. The major difference between the Coalition and government's proposals are that the Coalition intends to adopt a much more stringent approach to the tax deductions available in any one year for superannuation contributions.

8 Issues concerning the family and low-income earners

At present, superannuation (following tax) arrangements are based upon the individual as the unit of entitlement, whereas the social security system is based on the married or de facto couple as the relevant assessment unit. This fact can and has resulted in major inequities between individuals and families, depending on the capacity of the individuals in the family unit to gain access to superannuation benefits.

Coverage

Very rarely do both partners in a marriage gain access to superannuation on the same basis. Up to 40 per cent of married people do not work, either by choice or through inability to obtain a job. And even if they had the necessary money, people not attached to the work force are legally unable to contribute to superannuation and gain the relevant tax advantages.

The spread of compulsory superannuation will increase the coverage of people working full or part-time in the work force. But because of the structure of the present tax concessions and the ineligibility of persons not in the paid work force to join superannuation, one spouse (the full-time, higher paid worker) will have greater access to the superannuation tax benefits than the other. Under present arrangements, one spouse does not have the ability to top up the superannuation of the other, even if she/he is willing to do so.

The resulting equity problems thus involve both the consistent treatment of single people and married couples and the varying abilities of individual married couples to maximise their superannuation benefits.

Vesting and preservation

The present arrangements for the vesting and preservation of benefits vary widely from individual scheme to individual scheme. Where benefits are not vested, determining the entitlement of the individual concerned to those benefits (for example, for purposes of a matrimonial settlement) will be a difficult exercise. Similarly, when vested benefits have to be preserved, providing partial access to those benefits (for example, to a former spouse) will also present complications, unless the spouse receiving the value of those entitlements is also forced to preserve those benefits on the same basis as the contributor. In this situation, any proposed reforms would need to ensure that the contributor should be removed from the obligation to preserve the amount of any benefit transferred to his/her spouse.

Family law issues

The allocation of superannuation assets presents serious practical and conceptual problems in determining financial settlements at the time of marriage break-up. There are no existing formal arrangements to permit the transfer of part of an accumulated superannuation benefit to a former spouse, even in the form of a specially designated superannuation benefit. This is the situation whether or not the benefits are fully vested in the name of the contributor.

One option proposed by the Law Reform Commission would require the sharing of superannuation entitlements on a prescribed basis at the time of a marriage settlement. This would be accomplished by legal requirements to transfer the benefits as fully vested and preserved superannuation or rollover entitlements. A major problem, however, is that family courts presently have no jurisdiction to order fund trustees to do certain things with fund assets.

At the current time the usual family law procedure is for the allocation of a disproportionate share of the non-superannuation assets to the spouse with no or little superannuation coverage to compensate for the fact that splitting of the superannuation assets between spouses is not feasible. This arrangement immediately penalises the spouse with the superannuation assets, because these assets cannot be cashed in, for example, to purchase a replacement house for the one transferred to the other spouse.

Death of a partner

Having the individual as the basic unit for superannuation purposes complicates arrangements on the death of a spouse, especially in those cases where the surviving spouse may also have accumulated superannuation benefits. With some exceptions, primarily when paid by way of pension, death benefits paid to a spouse are largely exempt from tax, and the surviving spouse is under no legal obligation to preserve those benefits.

This is another aspect of present arrangements that has only recently been the subject of rational policy development. From 1 July 1994 new arrangements are proposed to ensure the consistent and equitable treatment of death benefits.

Low-income family issues

Compulsory superannuation presents major problems for low-income families, particularly those with financial commitments. The essential issue is that these families already have little enough money for their needs, and to force them to save via superannuation will only worsen their financial problems.

Because of their low tax rates and the high costs of any borrowings, these families receive less benefit from the superannuation tax concessions than higher income taxpayers. In this context, low-income families and households are double losers from being compelled to contribute to superannuation during their working life.

The relatively small amount of savings in their funds mean also that high fees and charges will have a disproportionate adverse impact on the ultimate benefits of their superannuation to them.

A worrisome fact is that low-income groups are likely to lose proportionately more of their age pension benefits because of their superannuation savings than higher income persons, who are not likely to get an age pension anyway.

9 A new regime

What goals should a heavily government-subsidised occupational superannuation system be attempting to achieve? And how could present arrangements be improved to assist in achieving these objectives? The essential requirement is to have a simple, well-designed and equitable arrangement that is fully integrated with that other crucial element of the retirement incomes system, the age pension.

If superannuation has a role to play in the economy, it is that of providing an alternative source of retirement income to the age and service pension as well as encouraging national savings generally. Certainly those with no or little superannuation entitlements should also be eligible for a full or part pension. But the community cannot afford to provide both generous superannuation tax concessions and an age or service pension to the same person. The distribution of age pension and superannuation tax concession outlays must be considered together when determining an equitable allocation of benefits.

Simplicity

The simplest superannuation arrangement by far would be to follow overseas practice and require the bulk of benefits to be paid out as a pension or regular stream of income. However, this would create major transitional problems similar to those that have already occurred in previous changes to the taxation rules. The anticipation of most Australians is that they can take their superannuation benefits as a lump sum to use for whatever purpose they may wish.

The Coalition parties have announced an intention to limit the maximum lump sum benefit to the lesser of $300,000 or $60,000 plus one-half of the total benefit. But the Coalition at this stage intends to provide a transitional period to protect people with accumulated lump sums larger than those to be permitted under the changed arrangements. Presumably these people will be permitted to withdraw their money on the existing basis during this transitional period.

The government, however, intends to permit everyone to take a maximum lump sum benefit of $400,000, with another $400,000 being available if taken as an annuity. While the system continues to be based on such a large lump sum benefit, the government will need accompanying action to increase the attractions of taking annuities. Instead of acting to limit the extent of the benefits available to any one person over their lifetime, albeit at very generous levels, the Coalition is proposing an annual limit on the tax advantages for contributions made by any one person.

The Coalition now intends also to allow every person to carry forward unutilised rebates in much the way of an annually indexed lifetime concession, which they can use up to fund their superannuation tax liabilities as and when they desire. This benefit could be integrated with the provision of age pension entitlements.

Under an alternative model, superannuation benefits would be subject to the normal income tax rates (for example, in the same way as any other trust regime), with that liability to tax being debited against an accumulated superannuation lifetime tax credit. When that credit is fully used up, the superannuation benefits would be subject to tax in the normal way. When people retire without using up their full taxation credits, they could be entitled to receive the unused balance as a refundable cash payment in addition to or as a replacement for the age pension. People using up their full superannuation tax entitlements would not be eligible for any pension.

This arrangement would avoid the present very complicated and inequitable arrangements, where superannuation and rollover funds are subject to separate taxation as trusts and final benefits are also subject to lump sum tax. The only fair way to tax superannuation benefits is on an accruals basis, as and when the income accrues to individual fund members. In this particular context, taxation on an accruals basis would be feasible only when benefits are fully vested in employees.

For both defined benefit and accumulation (or defined contribution) funds, it would be possible to apply this taxation regime on a consistent basis by requiring defined benefit funds to calculate the vested benefit for each employee on an annual basis. As part of the enforcement arrangements, unallocated contributions and fund earnings not vested in individual employees could be subject to tax at the normal company tax rate. (They would then qualify for a company tax deduction when actually vested in the names of employees.)

A changeover to such a system of taxation would still involve transitional problems to ensure the equitable treatment of those with large accumulated benefits built up under the current regime. But appropriate transitional arrangements would be feasible, provided that the government was willing to accept that the tax burdens on some people (primarily those gaining maximum advantage from the present arrangements) would be increased.

The government's recently announced simplification proposals do nothing to help ensure the national integration of superannuation and age pension policy. They do, however, set a cap on the maximum superannuation tax benefits available to higher income people. The changes did not attempt to rationalise the arrangements for taxing lump sum benefits, which would have resulted in major simplifications to the present system.

Equity

The proposals for achieving greater simplicity discussed above would also help improve the equity of the system. To offer every person a lifetime tax credit of equal value would be much fairer than present arrangements, which involve a generous cap on the maximum benefits available, tax deductions of greater value to some taxpayers than to others, a flat tax rate on trust income and taxes on end benefits.

Unless operated in combination with an imputation credit system, a flat tax rate on fund income and contributions inevitably results in major inequities. The flat rate of tax will always be more advantageous to higher rate taxpayers, a fact that cannot be systematically compensated for by, for example, heavier rates of tax on larger lump sum benefits.

Even the Coalition's proposals to introduce a rebate system to extend concessions to superannuation contributions does not address all equity problems. In particular, the fact that the superannuation fund income tax rate is to be set at a flat rate of 20 per cent will still result in larger tax advantages to higher income persons, who would normally be subject to 31.25 per cent or 43.25 per cent tax and will result in a tax penalty on lower income persons normally subject to a 17.45 per cent tax rate. This is an inherent defect in all flat rate tax arrangements that do not include full imputation credits paid on the investor's behalf.

The Coalition has recognised this problem in the case of rollover fund investors by foreshadowing a special 10 per cent tax rebate (up to a maximum amount of $1000) to lower the effective tax rate on some investors not eligible for any rebates on superannuation contributions in a given year.

The government to date has made no attempt to remove the present biases in favour of higher income persons in the present system. Movement to a system of tax rebates rather than tax deductions would help, in this respect, as would the consistent tax treatment of employee, employer and self-employed contributions.

One other aspect of current policies is definitely in urgent need of attention. This is the different taxation treatment of employee and self-employed contributions to funds. No employee receives a tax deduction for their contributions, while self-employed people are eligible for a deduction of $3000 plus 75 per cent of all contributions in excess of that amount. In cases where assessable income is less than $31,000 a year, employees are eligible for a 10 per cent tax rebate on her/his contributions up to a maximum rebate of $100 a year.

These arrangements provide a distinct bias against employees who contribute to their retirement savings.

The only fair arrangement is to permit access to deductions or rebates on a consistent basis for all contributions, no matter what their source. Given the full deductibility of employer contributions, the only rational approach would be to grant a consistent level of tax rebate or tax deduction on all employer, employee or self-employed contributions. That, for example, is a basic feature of the Coalition's proposed changes.

Cost-effectiveness

To achieve cost-effectiveness, the superannuation concessions must be effective in achieving both an increased level of national savings and resulting associated benefits to the budget in the form of future tax revenues and also reduced social security outlays. On the first score, present arrangements contain no guarantee that the monies being invested in superannuation funds are actually newly generated savings.

Individuals can, for example, obtain tax deductions merely by transferring existing owned assets into a personal superannuation fund, either directly or by selling the assets and investing the proceeds in the superannuation fund. Such transactions are facilitated when the rules permit very large contributions to be made in any one year by people with little existing coverage. Allowing people to get superannuation tax deductions merely for selling assets and/or investing bequests in a superannuation fund is to reduce greatly the cost-effectiveness and equity of the system.

Similarly, the system must be capable of providing a large payback to government in the future to cover the loss in tax revenue of today. An effective way to do this is to integrate closely the provision of the age pension with the receipt of superannuation benefits. If the government is unwilling to compel the payment of annuity or pension benefits, an alternative approach is to deem a regular stream of income for pension purposes on all benefits taken as a lump sum. In cases where actual investment income is less than the deemed amount, the deemed amount could be used for pension purposes.

Arrangements that control the annual or lifetime eligibility for tax concessions are almost certain to be more cost-effective than open-ended arrangements, such as the current ones, which permit well-informed and better-off individuals to get substantially higher benefits from the tax and social security systems than other people. The real need is to ensure that all Australians gain access to a secure stream of retirement income, whether it be superannuation or age pension entitlements, on an equitable basis.

Security of benefits

Despite Treasurer Dawkins' latest announcement of measures to be implemented on 1 July 1993, further action is still required to ensure the security of fund benefits. This could take many forms, but the proposals recently advanced by Lord Browne-Wilkinson (1992) require serious consideration as possible options. Regulatory and prudential controls on their own will not necessarily ensure maximum protection for superannuation fund investors. Any system will still be capable of manipulation to the advantage of the unscrupulous, but the scope for such action can be greatly constrained by certain requirements.

Browne-Wilkinson, for example, proposed rules that would make it very difficult for employers to remove any estimated fund surplus. He would preclude or severely limit also in-house investments and require the appointment of at least one totally independent trustee to all boards of trustees. Similarly, rules limiting the amounts to be invested in any one avenue would minimise the risks of major losses through an inappropriate choice of investment.

In this process also, giving the individual fund member control over the choice of fund would greatly improve overall security arrangements. For example, allowing members to nominate the fund receiving their benefit would greatly reduce scope for abuse of the system, as would mandatory arrangements forcing compulsory employer, industry or award funds to offer a choice between capital stable and balanced or growth funds. ACOSS's proposal for a centrally managed fund is also relevant in this context.

The government needs also to set strict limits on the acceptable level of commissions, fees and management charges that can be debited to any fund. At present, there are no safeguards, and many personal superannuation fund contributions suffer major losses from the heavy fees and charges built into the costings of their policies. This is an especially important consideration for lower income families and others with small amounts of money in their funds.

Arrangements that prescribed a maximum schedule of fees and the manner in which those fees could be charged would go a long way to removing present problems. Despite an ISC requirement for purveyors of products to declare their fees and charges, the pricing formulas in some cases are so complex that even informed consumers have difficulty in appreciating the full ramifications of the charges they face.

Removal of conflict with other savings objectives

The Singapore (CPF) system has been highly successful in achieving a high level of compulsion in the build-up of superannuation benefits, while at the same time providing tangible benefits for employees during their working life. The ability granted to fund members to use their accumulated savings to help fund a home purchase and other investments overcomes many of the obstacles experienced by fund members when they have to purchase a house and/or save for other reasons, such as to fund the education of children or to finance a small business.

With some modifications that would be desirable in any event, the Australian superannuation system could also be used to help young people acquire their home and/or meet other savings needs. Proposals such as those of the Coalition and the Association of Permanent Building Societies to allow fund members to borrow their superannuation savings at commercial interest rates to fund the purchase of a first home would greatly assist the build-up of retirement savings. Instead of paying interest to financial institutions, fund members would be paying interest to their own retirement savings. This option would, of course, be available only to those with sufficient assets in their fund and a capacity to finance the costs of borrowing.

The most significant aspect of these and similar proposals is the boost that these measures would give to young people to join superannuation funds rather than saving outside a fund. And such arrangements are absolutely essential where membership of superannuation is compelled by law because otherwise less well-off people will find their capacity to afford home-ownership reduced by their compulsory superannuation savings.

An alternative approach would be to allow the tax-preferred build-up of assets outside superannuation funds, for example, in favoured savings accounts. A problem with these proposals is to ensure that they not be abused by people merely transferring savings from existing deposits to the new accounts.

Protection of disadvantaged groups

The best way to protect disadvantaged groups is to ensure that the superannuation rules are both equitable and flexible enough to accommodate the needs of persons with a marginal or variable attachment to the work force. Present compulsory arrangements are highly defective in that most lower income persons could make better use of their money than having it tied up untouchable in a superannuation fund until retirement. This is the direct consequence of the high fees and charges in relation to the contribution and the meagre tax subsidy given to the savings of lower income people.

To be effective, the superannuation benefits must be fully vested and able to be managed at low cost in a way that financially advantages the people concerned. To the extent that compulsion remains a feature of the Australian system in the future, it will be absolutely essential to improve equity arrangements and allow the use of superannuation savings to help lower and middle-income groups for purposes such as those permitted in Singapore's scheme.

Clarification of the rules

For the longer term, it is absolutely essential that the discrimination introduced by the grandfathering of changes be removed so that all fund members are treated on an equitable basis. For some superannuation benefits to have to be preserved while others are not is a ludicrous and totally unjust arrangement. Similarly, compulsory vesting of benefits within a designated period of time should also be a consistent feature of the rules if equity is to be achieved.

Similarly, the relationship between gaining superannuation benefits and access to the age and service pension needs to be clearly and definitively specified. Doing that would remove any anticipation that people may have of getting access to generous superannuation benefits and an age pension (called double-dipping).

In this process, however, the major inequities in the social security system treatment of persons owning and not owning a house need to be addressed. While the advantages of home-ownership in gaining preferred access to the age or service pension remains, it would be totally unfair to preclude a retiree from using her/his accumulated superannuation benefits to purchase an owner-occupied home. To do otherwise would penalise these people compared with others who concentrate first on achieving home-ownership before saving in a superannuation fund. So far, this issue has been ignored in the Coalition's proposals to limit the size of lump sum benefits.

Any double-dipping provisions would thus need to have regard to the genuine use of superannuation pay-outs to purchase an owner-occupied home.

User-friendly compulsion

To the extent that compulsory contributions are a feature of the superannuation system, the rules will need to be adapted to reduce as far as possible the extent of conflict with other savings objectives (discussed previously) and to minimise the adverse impact on lower income groups. The mechanisms by which people of work force age are permitted to gain access to their savings in emergency situations (for example, bankruptcy, unemployment and other financial catastrophes) need to be set out clearly.

Forcing superannuation benefits to be preserved in situations where the present financial problems of fund members are serious ones will only compound the long-run disadvantage of the individuals concerned. So far, compulsion via the SGC has been introduced into the Australian system on a rushed basis to ensure the compliance of employers under various industrial awards.

Insufficient attention has been paid to safeguarding the interests of less well-off members of the community for whom future retirement incomes are of a much lesser order of importance than solving immediate financial problems. Much greater emphasis will have to be placed on this issue, even to the extent of allowing lower income people to cash-out their compulsory superannuation benefits in defined situations.

A long-term investment perspective

Any new superannuation regime needs also to ensure that the large volume of superannuation savings is used to accumulate productive assets, which provide a continuing stream of income to fund members. To achieve this objective, major tax reforms are required to ensure that superannuation funds have the same financial incentive as other investors to invest in productive activities.

For example, because of the 15 per cent tax rate applicable to funds, depreciation allowances and other tax deductions are worth far less to superannuation funds than to other investors subject to the higher marginal rates of tax. The 2.5 per cent depreciation allowance on residential buildings results in a tax saving of only 0.375 per cent of the cost price for superannuation funds, compared with 1.2 per cent of the cost price for personal investors subject to the highest marginal tax rate of 48.25 per cent.

Similarly, appropriate tax arrangements could facilitate a greater interest in infrastructure investments by superannuation funds and would be an essential feature of a new superannuation regime.

The responsibility of institutional investors

Even though fund trustees are required at all times to act in the best interests of members, there is no such similar requirement on the institutional investors that invest fund assets on behalf of fund members. In the United States, for example, there are sophisticated rules in relation to the way in which institutions vote their share proxies, to ensure that those proxies are used in the best interest of the fund members ultimately owning the assets.

There are no such rules in either this country or the United Kingdom, but there are pressures for similar reforms, especially in the United Kingdom. Action to deal with this and related problems is also needed in Australia.

10 Concluding comments

With the Senate Select Committee on Superannuation also recommending major changes, this paper supports the need for fundamental reforms to present arrangements. The key issues include the equity and cost-effectiveness of present arrangements as well as achieving the safety and security of members' benefits.

Government moneys spent on taxation subsidies for and regulation of the superannuation industry are a direct substitute for direct social security outlays. Unless there is greater integration of policy in both these areas, present waste and inefficiencies will remain. With the serious budgetary problems now facing the Commonwealth government, the longer that remedial action is delayed, the greater will be the future problems of funding the needs of our steadily ageing population. An equitable, efficient and viable superannuation system is absolutely essential to the economic future of this country, both from the viewpoints of increasing national savings and of securing the future standard of living in our retired population.

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