

# **TAXATION OF SUPERANNUATION IN AUSTRALIA: AN ASSESSMENT OF REFORM PROPOSALS\***

Jocelyn Horne  
jhorne@efs.mq.edu.au

## **Abstract**

This paper assesses critically recent proposals for tax reform of superannuation in Australia against criteria of efficiency, equity, administrative complexity and revenue impact. The main conclusion reached is to support the general thrust of reform, including the removal of multi-stage taxation. But this support is qualified by the need to provide quantified analysis of the long-run fiscal costs of reforms relative to both the present system and that projected under unchanged policies.

**Key words:** tax reform, superannuation

**JEL Classification:** H20, H55

\*This paper is a revised version of a written and oral submission to the 2002 Senate Select Committee on Superannuation **Superannuation and standards of living in retirement**. The author thanks Glenn Jones and Trevor Whitehead for their helpful discussion but accepts full responsibility for the views expressed.

# **TAXATION OF SUPERANNUATION IN AUSTRALIA: AN ASSESSMENT OF REFORM PROPOSALS**

## **I. Introduction**

In recent years, considerable attention has been directed towards reform of Australia's retirement income system and, in particular, taxation of superannuation. The policy significance of this issue is highlighted by the recent Senate Select Committee on Superannuation with terms-of-reference to conduct an inquiry into: "the adequacy of the tax arrangements for superannuation and related policy to address the retirement income and aged and health care needs of Australians" (Commonwealth of Australia, 2002). The 152 submissions to the inquiry indicate that there is no shortage of reform proposals (see also Bateman and Pigott, 1993; Knox, 1992; ASFA (1998); FitzGerald, 1996).

The objective of this paper is to provide a critical assessment of the main proposals for tax reform of superannuation based upon economic principles. The economic principles are standard tax criteria of efficiency, equity, administrative complexity and revenue impact. The reform proposals are assessed against the criteria in the broad context of Australia's retirement income policy and its objectives.

In common with industrial countries, Australia's retirement income system is built on the three pillars approach (see Holzmann, 1999). The three pillars are the safety net provision financed from Commonwealth government revenues, employment-linked defined contribution plans financed from mandatory employer contributions and voluntary superannuation with other savings. Major reforms introduced in the past two decades have been driven largely by population aging and a projected rise in the budget costs of financing the age pension and related benefits. But the reforms also reflect policy concerns about a potential gap between the adequacy of private retirement savings and individuals' expectations of retirement income.

The cornerstone of recent reforms is the introduction of mandatory retirement savings through compulsory employer contributions (9 percent) under the Superannuation Guarantee Act in 1992. Tax policy plays a supporting role in retirement income policy by providing tax concessions to both voluntary and mandatory superannuation savings. This policy is justified on the grounds of

perceived savings myopia although budgetary concerns with the revenue costs of tax concessions have led to a general scaling-down of these concessions in Australia since 1983. Post-1983 measures include the taxation of lump sums, the taxation of superannuation fund income and restrictions on tax deductibility through the introduction of reasonable benefit limits and the superannuation surcharge.

The focus of this paper is directed towards determining whether existing and proposed tax policy for superannuation meet standard tax criteria. However, even if the answer is positive or negative, the role and significance of tax policy needs to be placed within the context of retirement income policy and government objectives, namely to achieve adequacy of retirement income for individuals in a cost-effective manner. In view of the uncertain impact of tax policy on private savings incentives and the related problem of estimating the long-term fiscal impact of tax concessions, other policy instruments such as social welfare reform regulation of fund fees and competition policy may be more effective in attaining these goals.

The paper examines three specific proposals put forward by ASFA (1998), Bateman and Pigott (1993) and Fitzgerald (1996). The specific proposals considered share many features with the Senate submissions as discussed below. In particular, the reforms are directed towards three broad areas; (a) measures to rationalise the present system of multi-stage taxation of superannuation; (b) measures to increase adequacy of retirement income, including regulation of fund fees, extension and/or raising SG coverage and further tax concessions and (c) measures to strengthen the integration of taxation of superannuation with the overall tax and social welfare systems.

The remainder of the discussion examines in more detail the above issues and is organised as follows. Section II discusses the background to recent reform of superannuation and the problems of defining and measuring adequacy of retirement income and cost-effectiveness of tax policy. Section III discusses the choice of tax criteria in assessing reform of taxation of savings. Section IV assesses three main proposals for reform against selected tax criteria. The final section brings together the main conclusions.

## **II. Present system and reform objectives**

Australia's retirement income system shares a common structure with that of other industrial countries, namely the three pillars approach. Specifically, the financing structure of the retirement income system is built on three pillars (see Holzmann,

1999): (a) safety net provision (age pension and related welfare benefits) with means-tested benefits determined by policy and financed from Commonwealth government revenues; (b) employment-linked defined contribution plans financed from mandatory (SG) employer contributions with tax concessions and (c) voluntary superannuation with tax concessions and other retirement savings..

In contrast to a number of industrial countries, the first pillar is intended to perform a dual function; to provide a safety net for the most vulnerable and a minimum retirement income (presently 25 percent of male average earnings). As a consequence, the effective working of the system and its financial viability require an even tighter integration of the three pillars, and especially between first and second components.

Major reforms in retirement income policy have been introduced in recent years in Australia driven by a projected rise in budgetary costs associated with population aging and a perceived inadequacy of private and national savings to meet retirement needs. These reforms are intended to shift the structure and sources of financing from the first to the second and third pillars and to raise the overall level of private and national savings. Superannuation continues to receive tax preferences but concessions have been scaled down since 1983. Various tax measures have also been introduced to tighten integration between the pillars, including tax incentives to make annuity streams more attractive relative to lump sum payments.

The central policy initiative underpinning recent reforms is the introduction of mandatory private retirement savings under the Superannuation Guarantee Act in 1992 (see Appendix table A1). As noted above, mandated and voluntary superannuation receive concessionary tax treatment with limits applied to tax deductions for high income earners. There is no requirement that benefits be taken as income streams although tax and other incentives are designed to help make annuity streams more attractive relative to lump sums in order to reduce the degree of asset dissipation after retirement and subsequent recourse to the age pension.

Two features of tax concessions to superannuation in Australia deserve particular comment when compared with other industrial countries; the relative size of tax concessions and the transactions stage at which taxes are levied in the life cycle.

In regard to the tax treatment of pensions, a ranking of marginal effective tax rates on pension saving of OECD countries by Whitehouse (1999) suggests that despite the post-1983 reforms, Australia falls within the most generous group when measured relative to either an expenditure benchmark (zero effective tax rate) or

comprehensive income tax (top income tax rate). However, inter-country comparisons are sensitive to assumptions adopted, especially the effect of inflation on returns to saving even at low inflation rates as well as differences among countries in their special tax treatment of pensioners.

Table A2 highlights the second feature, namely the differential tax regimes for retirement savings that exist across countries. In principle, the existence of the three stages of transactions opens up a number of possible tax arrangements. A simplified classification is suggested in Whitehouse (1999) based upon five regimes depending upon which transaction point is taxed; an exempt, exempt, taxed (EET) regime that taxes at only the last stage, that at which pensions that are drawn; a taxed, exempt, exempt (TEE) system that taxes only at the contributions stage; a taxed, taxed, exempt (TTE) regime that taxes contributions and income earned by funds but exempts benefits drawn; an exempt, taxed, taxed (ETT) system that exempts contributions while taxing fund income and benefits and, finally a taxed, taxed, taxed (TTT) regime. It is noted that among OECD countries, only Australia has the last scheme whereas all other countries tax only at one or two stages with the majority opting for the pension payment stage.

The first two tax regimes are equivalent to an expenditure tax benchmark since pre and post tax rates of return are neutral between present and future consumption. However, while equivalent in terms of present-value revenue, the tax timing of revenues differs. Under the first regime, revenues are deferred whereas the second regime yields immediate revenues to the government. The last three regimes do not satisfy the neutrality property in terms of intertemporal resource allocation since they create a tax wedge between the pre and post-tax rates of return. The post-tax return is driven below that of the pre-tax return with a consequent disincentive to savings. Theoretical and practical issues related to the neutrality of the taxation of savings are taken up in the next section.

### **Adequacy criteria and present system**

The issue of adequacy was at the centre of the 1988 Senate Inquiry whose focus was upon the adequacy of the age pension in terms of poverty alleviation (see Parliament of the Commonwealth of Australia, 1988). That focus remains relevant to issues of integration of the age pension with self-funded retirement but is no longer that of the present (post-SG) retirement income system. Adequacy in the present system is defined in terms of meeting income replacement not poverty alleviation per se.

The government has not set specific targets for adequacy as measured by income replacement (see Dawkins, 1992). The age pension ratio of 25 percent (ratio of single age pension benefits to male gross average weekly earnings) is intended to provide a minimum floor to income replacement. Individuals solely reliant on the age pension do not pay income tax but in practice, the majority of recipients are not solely reliant on the pension and use the age pension and related benefits to supplement other retirement savings, suggesting a somewhat higher replacement ratio, as discussed below.

Three basic questions need to be addressed before assessing any reform proposal. First, what is an appropriate ceiling for income replacement? Second, does the present system with the SG fully implemented meet this upper target for different income and gender groups? And, third, what options for reform are available if the answer to the second question is negative?

One approach is to avoid directly answering the first questions and, instead project the long-run impact of the SG on income replacement. For example, projections by ASFA (ASFA (1998)) of the SG fully implemented at 9 percent of employee salary yield a pre-tax replacement ratio of 28 after 30 years work, rising to around 40 percent after 40 years of work. As noted in the study, the projections are sensitive to a number of parameters, including the contribution rate, years of contribution, average salary, age of retirement, fund fees and earnings, inflation.

The projections also ignore issues of SG transition and assume somewhat heroically that under full implementation, an individual has full access to the SG and an unbroken work history. While this assumption gives an upward bias, the projections exclude other savings from voluntary sources (third pillar). The resulting downward bias would, however, be more than offset by the assumption that health costs are borne by the government

ASFA (1998) also attempts to address directly the first question; setting an appropriate replacement target. The main message is that there are no clear-cut criteria with overseas targets demonstrating a wide range of between 20-25 percent of average weekly earnings to 70 percent. While acknowledging the “rule-of-thumb” 40 percent target, ASFA proposes a somewhat higher target of 50-60 percent of pre-retirement income (average weekly earnings).

If a target of 50-60 percent of pre-retirement income was adopted (and this assumption underpins their reform proposals, see below), a sizeable gap then arises between this target and that projected under full SG implementation.

Various reform options are open to close the adequacy gap, not all of which involve tax reform. One option is a rise in the SG rate (for example, to 12 percent as initially proposed (see Fitzgerald, 1991) or higher. Another option is regulation of fund fees such as a cap on fund fees as recently introduced in the United Kingdom. A third set of reforms involve changes in tax arrangements for superannuation and, in particular either removal of existing taxes such as the multi-stage system and the surcharge. Each measure may raise retirement income adequacy (although not equally for all income groups) but are unlikely to be equivalent in terms of their fiscal cost nor other economy-wide effects. The issue of measuring the cost-effectiveness of tax reform options is taken up in the discussion below.

### **Cost-effectiveness of present system**

Retirement income adequacy cannot be considered in isolation without reference to the affordability of income retirement policy options in terms of their long-run budget costs. There is considerable debate on the appropriate measurement of the cost-effectiveness of tax concessions to superannuation as defined narrowly in terms of measuring the foregone revenue from tax concessions or more broadly in the context of fiscal sustainability of retirement income policy (see Horne, 1994).

Focusing on the narrow approach to measuring the fiscal costs and benefits of tax concessions to superannuation, one methodology is given by the annual tax expenditure estimates (TES) published by the Treasury. Tax expenditures are calculated based upon a revenue foregone concept relative to a chosen benchmark tax system (income tax system in the case of Australia): the revenue foregone is measured by the tax payable if the concession were lifted, assuming private savings behaviour is unchanged. Based upon this methodology, tax preferences to superannuation are estimated to impose a net cost to the Commonwealth budget of an annual average 3 percent of GDP in Australia over the past decade.

Setting aside the issue of the choice of the sensitivity of the revenue estimates to the choice of benchmark and broader issues of fiscal sustainability, the application of the TES methodology to superannuation is flawed on two counts. First, it ignores the intertemporal nature of superannuation and second, the potential impact of tax incentives on savings and, hence the future tax base. Such estimates may overstate the revenue costs of tax concessions to superannuation because they exclude a potential longer-term strengthening of the revenue base from increased (net) incentives to savings and cost savings to the government budget from a possible future reduction in outlays on the age pension.

An alternative methodology for quantifying the cost and benefits to policymakers of present and future tax arrangements for superannuation has been developed by Brown (1993) who uses the retirement income model (RIM) as a framework for applying the present-value methodology of Knox (1992). This methodology gives an operational measure of the net policy gain in present-value terms from tax concessions to superannuation. Benefits to an individual are measured as the rise in present-value net disposable income in retirement and compared with the present-value fiscal costs of tax concessions net of saving in age pension outlays.

Notwithstanding the conceptual superiority of the present-value measure of cost-effectiveness over annual tax expenditure estimates, its policy and operational usefulness are weakened by several factors. First, the relaxation of the assumption of unchanged savings behaviour may be viewed operationally as a strength and a weakness. It is a strength insofar as savings behaviour responds predictably to shifts in tax policy regimes but also a weakness because of uncertainty concerning the magnitude of the private savings response to change in the post-tax rate of return.

A measure of cost-effectiveness based upon the cost-benefit methodology is sensitive to specific behavioural assumptions adopted, especially the size of the superannuation offset saving coefficient (the offset between superannuation and private savings) as well as parameters such as the assumed government discount rate. For example, Brown's estimates (excluding savings from age pension outlays) show that the net policy benefit from superannuation tax concession lie within a broad range, from 54.7 percent of pre-retirement income (assuming a zero savings offset) to 0.6 percent (assuming a full savings offset).

A second factor relates to the policy usefulness of the RIM model. While the model has been developed explicitly for policy analysis and discussion of retirement income policy (see Gallagher, 1995), its complexity may act as a barrier to general (and policy) understanding, especially concerning the central question of estimating and disseminating the budget costs of reform options.

A final factor concerns the desirability of incorporating the potential budget savings from reduced reliance on the age pension that is expected to come from implementation of the SG provided the first and second pillars are well integrated. These projections are excluded from the above estimates. In a separate study, Gallagher (1995) estimates the projected long-run savings from the impact of the SG on age pension expenditures to be of the order of 0.3-0.4 percent of GDP. However, these estimates are contingent upon an assumed effective integration of the SG with the social welfare system. As discussed below, this assumption may

be over-optimistic on account of a number of problems related to integration, including concessionally taxed retirement lump sums as well as early retirement patterns and gaps between the preservation and pension age.

### **III. Tax criteria**

#### **Efficiency**

Efficiency in resource allocation has two dimensions: static resource allocation within a single period (for example, the choice between work and leisure) and dynamic resource allocation over several over periods (for example, the choice between present and future consumption or saving. There is a presumption in the literature (see, for example, Whitehouse, 1999) and reflected in reform proposals that a personal expenditure tax on saving as approximated by a single progressive tax levied at the benefits stage is superior on efficiency criteria to an income tax system. The latter is a proxy for Australia's present system that taxes retirement and other savings at the contributions, earnings and benefits stages.

The theoretical case is ambiguous once dynamic **and** static efficiency effects are considered. An income tax creates dynamic efficiency losses by making present consumption more attractive relative to future consumption. An expenditure tax avoids this type of inefficiency. But both income and expenditure taxes create static efficiency losses by distorting the work/leisure choice by failing to tax leisure. The superiority of one system over the other is determined by the relative magnitudes of tax elasticities with little guideline from empirical work (see King, 1980).

Several efficiency arguments that underpin the proposed reforms, for example, neutrality of taxation of all tax instruments as proposed by FitzGerald (1996) also break down in the presence of distortionary taxes. Neoclassical theory is based upon the principle of neutrality of saving and investment tax instruments. The existence of tax preferences to superannuation violates this principle although it may be justified if there is market failure, for example saving myopia.

In a second-best world, the optimal tax on saving is redefined in terms of maximising a specified government objective function (for example, a social welfare function that specifies adequacy targets and poverty alleviation) subject to the government's present-value budget constraint. The optimal tax structure will be sensitive to the specification of this function and whether the government is

able to achieve an optimal steady-state path of saving and economic growth.<sup>1</sup> If it cannot, the choice between different structures for taxing saving will depend not only upon the size of distortions as above but also upon whether a particular tax regime brings the economy closer to its optimal growth path.

If it is assumed that the economy cannot reach its optimal growth path, a shift from the contributions to benefits stage moves the tax structure of superannuation towards an expenditure-based system and may raise private savings by shifting the timing of taxation. This argument presumes the absence of other policy instruments in developed economies such as Australia such as debt management that alters the maturity structure of government debt and thereby may enable the economy to reach its optimal savings and growth paths.

## **Equity**

Equity issues related to taxation of superannuation savings carry a high weight in policy debate. It is well recognised that neoclassical theory has nothing to say about equity issues. Standard tax criteria distinguish between vertical (redistribution of income between rich and poor) and horizontal equity (equal tax treatment of individuals in similar income groups) within a given generation. Taxation of superannuation introduces a further dimension of inter-generational equity between present workers and retirees. Inter-generational issues are a key factor driving the thrust of government policy to shift financing sources of retirement income from general tax revenues to self-financing. However, as discussed below, the differentiated treatment of retirement income stream products under age pension means-testing and tax preferences to retirees may create an unintended equity problem by favouring retirees over workers.

The main focus of discussion has been directed towards within-generation equity concerns. Several observers (for example, Knox, 1992) argue that present tax arrangements for superannuation including the SG violate horizontal and vertical equity criteria by the differential tax treatment of contributions (employer/employee; self-employed/employed; employed/non-workers). Other contributors to the debate (for example, ASFA) argue that vertical equity is violated because of greater tax support to high-income earners.

There also has been considerable discussion of specific equity issues faced by women who tend to be characterised by low-incomes and interrupted work patterns and longer life expectancies compared to men (Clare, 2001). The perceived inequity to women is refuted by McDiarmid (1994) who demonstrates

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<sup>1</sup> King (1980) provides a technical analysis of this and related issues.

that once interaction of superannuation, taxation and the age pension are modelled (using the RIM model), the present tax system is progressive in terms of income replacement rates. This result, however, assumes effective integration of the three policy branches. Nevertheless, the inequitable treatment of women arising from interrupted work histories for family rearing is somewhat compensated by access to reversionary pension benefits while newly introduced family laws that cover superannuation will help address problems faced by divorced women.

A further issue relates to an emerging problem of inter-generational equity between workers and retirees. Under current rules for means-testing of the age pension, life expectancy products taxed at concessionary rates are exempt from the asset test in contrast to allocated pensions. As a result, a retiree is able to draw on a partial age pension with full supplementary benefits (transport, health and other services) and receive a post-tax retirement income of \$40,000-50,000, well above the average pre-tax male salary of \$36,000.

### **Tax administration**

Tax administration involves multiple dimensions; ease, overall costs of administration (including compliance with regulation), simplicity in terms of clarity in what is being taxed and what is not; the amount of tax payable as well as an understanding of the benefits or costs to the individual.

The overwhelming view expressed in the recent Senate submissions is the perceived complexity of taxation arrangements for superannuation and their failure to meet the simplicity criterion. This view is supported by survey evidence (ASFA Attitudes Survey, 1999) which show that 65 percent of the sample surveyed favour a simpler system. However, the same survey also shows that the two main concerns of taxpayers are complexity of tax rules **and** taxation of superannuation. The latter finding also suggests a lack of public understanding of the tax advantages to the individual from mandated superannuation for most income tax brackets (see Rothman, 2000).

## **IV. Options for reform and recommendations**

A summary of the benefits and costs of the three main reform proposals under discussion is given in table 1 below. Proposals are directed towards three main reform areas: (a) rationalisation of multi-stage taxation; (b) extended coverage of the SG and tax concessions and (c) other measures, including strengthening of integration of taxation of superannuation with the overall tax and social welfare systems.

## **Status quo**

Option 1 is retention of the status quo. The main benefit from doing nothing is no further change in tax administration. As noted, the present system meets adequacy targets at the lower end of the income replacement range of 40 percent for an individual under full implementation of the SG after 40 years of uninterrupted work. Present taxation arrangements are cost-effective provided the savings offset coefficient is below 1 and also progressive provided the above assumptions hold. But even if the above assumptions are judged to approximate reality (an issue of contention), the system violates efficiency, equity and administrative criteria and is poorly integrated with the social welfare system.

## **Reform proposals**

### **a. Reform of multi-stage taxation**

The proposed reforms call for reform of multi-stage taxation of superannuation although the specifics differ. ASFA (option 2 a) propose reduction to a single progressive income tax levied at the benefits withdrawn stage. Bateman and Pigott recommend a single tax levied at the contribution stage. FitzGerald's proposal involves restructuring the present system to introduce a credit withholding tax on contributions and fund earnings with uniformity of tax treatment of contributions and all savings instruments.

The first two regimes correspond to an EET and TEE system, respectively and thereby ensure savings neutrality. The regimes are also equitable in their treatment of different individuals and in present-value revenue. In practice, once allowance is made for differential marginal tax rates between work and retirement income and differences in tax timing, individual and government preferences may diverge.

**Table 1. Taxation of superannuation: reform proposals**

Option/reform	Benefits	Costs
<p><b>1. Retain status quo</b></p>	<p>No change in tax administration</p>	<p>a. Fails to address perceived weaknesses; efficiency, equity, complexity. b. Fails to address weak integration with social welfare system</p>
<p><b>2. ASFA (1998)</b> a. Reform of multi-stage taxation; (i) removal of 15% tax on super funds (ii) removal of contributions tax (iii) Replace flat tax on benefits with progressive income tax on benefits. b. Make coverage of SG universal c. Target tax concessions to specific income groups (eg women with broken work history; low-income groups). d. Retain differential tax treatment of savings instruments.</p>	<p>a. (i) Improve savings incentives; (ii) improve vertical equity; (iii) Simplify administration/reduce complexity.  b. Improve intra and inter-generational equity; simplify tax administration. c. Improve vertical equity; address transitional issues.  d. Increase productive efficiency</p>	<p>a. Long-run fiscal costs unclear but shifts tax timing to weight future over present revenues.  b. Fiscal impact unclear. c. Fiscal impact unclear.  d. Distortions</p>
<p><b>3. Bateman and Pigott (1993)</b> a. Reform of multi-stage taxation; (i) Removal of tax on fund earnings and benefits tax.  b. Extend coverage of SG to self-employed. c. Introduce tax deductibility for employees. d. Mandated annuities at retirement.</p>	<p>a. Increase incentive structure; increase savings rate; increase income replacement; simplify tax administration.  b. Increase replacement income; increase saving. c. Increase replacement income; increase saving. d. Strengthen integration with social welfare; simplify tax administration.</p>	<p>a. Long-run fiscal costs unclear but shift to contributions tax alters tax timing to weight present over future tax revenues. b. Fiscal impact unclear. c. Fiscal impact unclear. d. Administration costs; compliance</p>
<p><b>4. FitzGerald (1996)</b> a. Reform of multi-stage taxation; (i) Retain three stage system but restructure to introduce withholding credit system for taxes paid at contributions and earnings stages; (ii) contributions from all sources taxed through income tax; (iii) income tax treatment at benefits stage of all benefits withdrawn. b. Introduce 15% tax rebate for contributions from all sources. c. Neutrality of tax treatment of all savings instruments.</p>	<p>a. (i) Increase incentive structure.  (ii) Removal of anomalies in tax treatment of contributions to super from different sources; simplify tax administration; (iii) improve vertical equity; simplify tax administration. b. Improve replacement income; increase savings rate. c. Reduce distortions to financial intermediation; simplify tax system.</p>	<p>a. (i) Increase tax administration; long-run fiscal impact unclear.  (ii) Fiscal costs unclear.  b. Fiscal costs unclear. c. Fiscal costs unclear.</p>

The neutrality property would bring an EET/TEE system closer to the ideal benchmark for taxing saving. However, as argued above, the efficiency case for a personal expenditure based tax system is ambiguous once allowance is made for taxes on work and leisure.

There may, nevertheless, be other benefits based upon vertical equity, savings incentives and tax administration criteria that would justify the removal of multi-stage taxation of superannuation. For example, a shift to a progressive expenditure tax falls more heavily upon the wealthy who finance high consumption from savings and thereby may encourage private saving. With the exception of Fitzgerald's credit withholding scheme, the reforms would also simplify tax administration.

Even if the above benefits are identified, a striking weakness is the absence of estimated long-run budget costs of the proposals, especially relative to the existing system and that projected under unchanged policies. There is a consensus that TES budget estimates do not provide a useful measure of the cost-effectiveness of tax support as discussed earlier. Thus, the cost to the budget in annual terms of removing the 15% tax on fund earnings tends to overstate the fiscal costs as it fails to allow for behavioural response and any future savings from a reduction in age pension outlays. However, no costing of the reforms in terms of the net policy benefits has been done in the proposals and, hence, it is difficult to assess fully their effectiveness or rank them.

#### **b. Measures to widen SG coverage and further tax concessions**

Each proposal includes measures to raise adequacy of retirement incomes and address equity concerns. Proposed measures include a broadening of SG coverage (universal coverage as proposed by ASFA; inclusion of self-employed by Bateman and Pigott) and removal of anomalies in tax treatment of SG contributions.

One option not addressed in the proposals under review but raised in several submissions concerns regulation of fund fees. Fund charges exercise a significant impact on adequacy of retirement income and may reduce rates of return by up to two percentage points (see Whitehouse, 2000). Given the mandated nature of private retirement savings, the case for government intervention of fund fees would appear to be strong. It also appears superficially to be a more attractive option to policymakers than changes to the SG or taxation since this regulation offers benefits in the form of improved adequacy and vertical equity without any direct costs to the budget. However, the issue is more complex since regulation of fund fees involves policy trade-offs in the form of reduced competition and

consumer choice. The major risk for policymakers involves setting the correct fee ceiling: if set too low, fewer providers and reduced competition may result while if set too high, some individuals and especially those in industry funds may be worse off compared to the present unregulated system of fund fees. Indirect costs to the budget may also occur if some funds are forced out of business.

There is weak support on equity criteria for ASFA's proposal to target tax concessions to specific groups, including women and low-income groups. RIM modelling studies show that the present tax system of superannuation is progressive and married women with broken work histories will not be disadvantaged because of access to reversionary pension benefits.

### **c. Integration of superannuation with overall tax and social welfare system**

The proposed neutrality of tax treatment of all savings instruments by FitzGerald may reduce distortions to financial intermediation. But if tax concessions remain on savings, unplanned distortions are introduced vis-à-vis other sectors. The net impact on efficiency is unclear.

Proposed measures to integrate the taxation of superannuation with the social welfare system, including mandated annuities (Bateman and Pigott) and raising of the preservation age (Fitzgerald) would help address weaknesses in integration within the retirement income system, especially the problem of asset dissipation at retirement. **This is a priority area.**

## **V. Conclusions**

The main message of this paper is to support the general thrust of reform of tax treatment of superannuation in Australia, including specific proposals such as the removal of multi-stage taxation. But this support is qualified by the need to quantify the benefits and costs of specific recommendations.

The basis for informed policy analysis and public debate on Australia's retirement income system already exists, as reflected in the development of the RIM model, individual contributions and Senate submissions. Three further initiatives would further strengthen this framework without any significant budget outlays:

**(i) Publication of the costs of administering the taxation of superannuation** relative to other taxes and Commonwealth government revenues, private and official burden of compliance costs. This information is desirable for costing the present system, especially in view of the high weight placed by taxpayers and

others on the perceived complexity of present tax arrangements for superannuation.

**(ii) Published data on the present-value fiscal costs of tax concessions to superannuation.** This data are necessary for policy analysis and costing of tax concessions to superannuation as the annual TES on tax concessions to superannuation is inadequate for this purpose.

**(iii) Wider public dissemination of the tax benefits of superannuation.** This information is needed to counteract the perception that **all** low-income earners do not benefit from the present system and to further encourage self-financing of retirement.

## APPENDICES

**Table A1: Superannuation Guarantee**

Established	1992
Contributions	9% employer
Funding	Fully funded
Benefits	Defined contribution; fully vested, portable and preserved to age 55 (60 by 2025); no early withdrawals; choice of lump sum, pension, annuity with tax incentives to encourage income streams
Statutory coverage	All employees aged 18-65 with earnings >\$450 month; self-employed
Taxation	Employer contributions tax deductible; fund income (contributions and earnings) and benefits taxed at concessionary rates
Administration	Complex
Safety net	Age pension, subject to income and assets means tests

Source: Bateman and Piggott (1997), p.12.

**Table A2: Tax treatment of pensions for OECD countries**

<b>Country</b>	<b>Contributions</b>	<b>Pension fund income</b>	<b>Pension payment income</b>
Australia	T	T	T
Austria	E	E	T
Belgium	E	E	T
Canada	E	E	T
Denmark	E	T	T
Finland	E	E	T
France	T	E	T
Germany	E	E	T
Iceland	T	E	T
Ireland	E	E	T
Japan	T	E	T
Luxembourg	E	E	T
Netherlands	E	E	T
New Zealand	T	E	E
Norway	E	E	T
Portugal	E	E	T
Spain	E	E	T
Sweden	E	T	T
Switzerland	E	E	T
United Kingdom	E	E	T
United States	E	E	T

Source: Whitehouse (1999), p.10.

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