FINANCIAL REVIEW
PREMIUM

Election 2016: Super doesn't add up for Peter Costello

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"I think people could start drawing the conclusion it is not a very safe investment," Peter Costello says of super.

By Jennifer Hewitt

The latest returns from super funds are further proof of how much financial reality has changed – but they also demonstrate how community and business expectations have failed to catch up.

For the business community, it translates into a stubborn view of what's acceptable as a return on investment. That's still relatively high compared to a global lowering of returns overall. It means a continued preference for sitting pat in terms of investment in expansion and instead relying on paying out generous dividends as the easiest short-term version of generating acceptable returns to shareholders.

For the community, that financial reality is reflected in the impact of a low interest rate, low wage growth environment on household incomes. That has all sorts of perverse effects as well as demands for ever more taxpayer assistance against a budget least able to afford it.

But in terms of the great superannuation debate, it means the government's figuring of its own decisions is missing the financial elephant in the cabinet room.

Returns on retirement income just aren't what they were – and unlikely to be so indefinitely. Yet none of this is reflected in the calculations on show, political or otherwise.

Dismal performance

According to independent research group Chant West, super funds are only just edging closer to a positive financial result for the financial year based on the results for April continuing to improve on the dismal performance in the first couple of months.

"Following a rise of 1.8 per cent in March, the median growth fund (61 to 80 per cent allocation to growth assets) gained another 1.4 per cent in April," the research said. "That takes the return over the ten months of the financial year to date to 1.7 per cent."

That, of course, compares rather unhappily with the previous few years where returns were 15.6 per cent in 2012-13, 12.8 per cent in 2013-14 and 9.8 per cent last financial year.

But rather than this year being an aberration, most analysts consider it more likely to represent the "new normal".

Former treasurer Peter Costello is attempting a vow of silence – at least for the duration of the campaign – on the approach of the current Liberal Treasurer to taxing superannuation.

But his frustration is obvious, even if cloaked in cautious political style. So his comments about the government's plan to limit tax free superannuation savings to $1.6 million in an account take on a particularly sharp edge despite his apparent restraint.

Riskier investments

Costello told a Women in Banking and Finance lunch this week the government had estimated that the return from $1.6 million was around $80,000 per annum – equivalent to around four times the aged pension.

"When you work it out that is on the assumption of a 5.5 per cent return rate," he said. "That is what the government thinks you are going to get. Does it really think that? It is issuing bonds at two (per cent)."

The mathematical point was obvious. It's going to be a lot less than the budget estimate – unless the government is actually wanting retirees to move into much riskier investments.

Costello certainly appreciates the impact of this new environment in his current role as the chairman of the Future Fund, set up to finance the pension liabilities of federal public servants. The yield on the 10-year Australian government bond rate fell into unprecedentedly low territory of 2.2 per cent this week.

According to Costello, the Future Fund can no longer achieve its own long-term return objectives of five per cent above inflation. Negotiations with the government are under way. Guess what? They won't be finished until later this year.

Undermine any confidence

What Costello can predict is that the historically low returns now on offer will also push more people who are not public servants on to relying on the pension while repeated rule changes will undermine any confidence in the super system.

He didn't add the corollary – none of this adds up as it is supposed to.

But in a previous interview with this column last April, he was far more forthright about the diminishing returns from increasing taxes on super in retirement.

He insisted this would not raise nearly as much money as predicted but it would add complexity to the system, along with all the added administrative costs.

"I think people could start drawing the conclusion it is not a very safe investment," Costello said of super. "And by the way, it isn't. It is locked up for 40 years but apparently it is not locked up against the government. The tax regime depends on the state of the budget in any one year."

Or, more likely, the state of the budget in any one decade.

Political indulgence

Such criticisms may be considered predictable enough given Costello was the treasurer to provide tax-free super to retirees over 60 while allowing those with the means a one-off chance to put $1 million into their accounts. He will be accused of just trying to protect a legacy that was unsustainable – except during a state of surplus revenue boosted by an unprecedented resources boom.

But it is obvious he believes this Coalition government has largely given up on the belief that super can encourage a generation of middle-class people in their forties and fifties to build up enough to self-fund their retirement. That so many of these are traditional Liberal voters becomes a political indulgence. The calculation is they are hardly likely to suddenly prefer Labor.

Under the budget proposals, annual contributions at a concessional 15 per cent tax rate are curbed at a maximum of $25,000 a year. The lifetime cap on post-tax contributions will drop to $500,000, backdated to 2007. And we now know the realistic calculations on what $1.6 million generates.

What all that means is that the world of super has tilted on its axis. Just don't say it out loud.

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