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Super changes will punish those who save relative to pensioners

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There is a fundamental defect in the government's superannuation proposals that has been entirely overlooked. Instead of growing in line with average earnings, the $1.6 million "transfer balance" cap, which limits the amount that can be held in the withdrawal phase, is only indexed to consumer prices.

As real wages rise over time, the cap will therefore fall relative to earnings, reducing the system's allowed replacement rate (that is, the ratio of pre-retirement to post-retirement income) and steadily increasing the effective tax rate on privately funded retirement incomes.

To make matters worse, the age pension is, and will no doubt remain, indexed much more generously, rising in line with the higher of consumer prices or nominal wages. As a result, the government's proposals ensure that the capped replacement rate under superannuation will fall not only in absolute terms, but also compared to the age pension.

The proposal would, in other words, punish increasingly severely those people who save for themselves relative to those whose retirement is paid for by taxpayers. And the effect is far from trivial, since compounding means even small differences in growth rates soon translate into large differences in outcomes.

Assume, for example, that initially, the $1.6m is sufficient to buy an annuity one and a half times greater than the pension, and that real wages and consumer prices each increase by 2 per cent a year. Within 10 years, the maximum annuity that can be purchased will have fallen to just a quarter more than the age pension, while in 20 years, it will barely equal the pension.

At that point, anyone relying on the withdrawal account will, despite saving for decades, be no better off than a person who did not save at all.

And adding insult to injury, it is of course those self-funded retirees who, during their working life, will have paid the taxes that finance the age pension others are enjoying.

Instead of frankly acknowledging those effects, the government's claim is that the initial $1.6m is generous, implying that its progressive erosion as a share of typical middle income earnings is of no consequence. To make that claim, its unpublished briefing to backbenchers assumes a return on investment in retirement of 5.5 per cent and compares the resulting income stream to the age pension.

That comparison is nonsensical. The age pension is effectively an annuity that rises in value as the economy expands and incomes grow. While there is some political risk associated with that annuity, experience suggests it is slight, making it close to a sure thing, both in absolute and compared to the uncertainties that plague the superannuation regime.

As a result, the proper comparison is between the value of the age pension and the income stream a superannuant would secure investing the $1.6m in assets whose yield is also a sure thing, i.e. government bonds, net of the fees incurred in purchasing and periodically renewing that portfolio. With the commonwealth bond rate reaching a record low of 1.82 per cent in August, the resulting relativity would look far less favourable to self-funded retirees than the government claims. And of course, as the difference in indexation arrangements played itself out, the relativity would deteriorate further.

In short, it may be that the greatest effects of the proposed changes would initially be on a small number of wealthy retirees, as the government argues.

What is certain, however, is that the indexation arrangements will soon spread the damage to an ever greater swath of middle Australia, in the process redistributing income from those who save to those who don't.

Unfortunately, the redistribution does not end there. As part of its package, the government intends to recycle a large share of the revenue it collects into subsidising the superannuation accounts of people on low incomes.

However, using the superannuation system, with its high transactions costs, to boost low incomes makes no sense: a carefully targeted increase in the pension some years down the road (when the accounts that would have received the subsidies would have matured) can achieve the same outcome at far lower expense to taxpayers.

But one person's excess costs are always another person's windfall income: with that other person being, in this case, the industry super funds, who will largely garner the fees taxpayers subsidise.

Moreover, the recipients of the transfers will also be grateful, although they are likely to thank Labor, which initially put the payments in place, rather than the Coalition, for the largesse. Little wonder then that the government's proposals are endorsed in whole or in part by its bitterest opponents.

The pity is that instead of using what little political capital it has to address our superannuation system's myriad weaknesses, the government is squandering it on changes that undermine the system's ability to serve what ought to be its purpose — facilitating the transfer of income from working life to retirement.

Bringing that missed opportunity into sharp perspective is the great merit of Rebecca Weisser's paper on superannuation reform released today by the Institute of Public Affairs. As the paper emphasises, these are not solely economic issues: they go to whether we want a society that rewards self-reliance or that punishes it.

So far, for all its statements about the taxed and the taxed not, the government shows no sign of understanding what is at stake.

"Stuff your pension!", Phillip Larkin famously wanted to shout in his poem *Toad*.

But despite belittling the aspirations for financial security in old age that he saw as profoundly middle class, even Larkin recognised "that's the stuff dreams are made on".

As those dreams take another battering, an efficient and equitable retirement income system seems more distant than ever.

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