THE AUSTRALIAN

Superannuation in Australia in vital need of radical change

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RICHARD HOLDEN THE AUSTRALIAN 12:00AM January 5, 2017

Polls show the Coalition taking a hit among older Australians for its changes to pensions and superannuation.

Indeed, probably the biggest surprise in last year's budget was the announcement of a $1.6 million cap on tax-free superannuation accounts.

So now that superannuation is no longer going to be an estate-planning vehicle for the wealthy, it is a good time to consider what it can be.

What it is clearly not is a comprehensive retirement savings program. About 90 per cent of retirees still receive the full or part pension.

Worse still, those numbers don't look set to fall under present policy settings.

That matters because it is a significant driver of our deficit problem.

The aged pension makes up 14 per cent of the whole budget, and expenditures are forecast to grow at 5 per cent a year.

To change super from a supplement to a substitute for the aged pension for a much larger proportion of people obviously requires balances at retirement to be larger. That involves fixing two design flaws in our superannuation regime.

The first flaw is that we tax savings a fair bit going in but not very much on the way out.

Taxes on the way in are 15 per cent for those earning less than (now) $250,000 and 30 per cent for those earning above. Taxes on the way out are zero, unless the new $1.6m cap is breached.

That's completely backwards. The great benefit of saving over a lifetime of work is what Albert Einstein described as "the most powerful force in the universe": compound interest. Taxing on the way in kills compounding.

We should abolish any contributions tax on people's (now) 9.5 per cent superannuation guarantee levy contribution but tax earnings in the retirement phase at the full marginal rate.

The second flaw is one that lowers the rate at which balances are compounded — that most people have their money managed by funds that actively pick assets, particularly stocks.

One of the most definitively established empirical facts in financial economics is that the great bulk of active fund managers underperform the broad stockmarket index (such as the ASX 300 in Australia).

But don't take my word for it. Economists ranging in outlook from Nobel laureate and godfather of the "efficient markets hypothesis" Gene Fama, to *Nudge* author and founder of behavioural economics Dick Thaler, advocate almost all investors being in a low-cost index fund that simply tracks the overall stockmarket.

In the US such funds charge about 30 basis points in fees. Compare that with the 200 to 300 basis points often charged by super funds in Australia.

We should establish a default option that puts super into a low-cost index fund. (Fund managers could bid to be one of several authorised providers based on fees and how accurately they track the index.)

To manage risk, the amount allocated to stock versus fixed-income securities could be on a sliding scale related to age; say, 100 per cent at age 20, going down to 0 per cent at retirement. If individuals wanted to opt out of the default and choose an alternative fund, they could elect to do so.

These would be radical changes and managing the transition would be crucial.

All contributions made under the existing regime could be treated according to those rules. So if you have a balance of $300,000, then that "account" would continue to accrue earnings, and payments in retirement would receive the present zero-tax treatment.

New contributions, however, would go into a second account that would not be taxed on the way in but would face ordinary income tax rates on withdrawal in retirement.

We also need to reach a political consensus about retirement income policy. It is not surprising that many people put little faith in Australian super because of the constant changes to the rules by both sides of politics.

This must end. And a big change, such as the one I am proposing, would require a big, public discussion.

That's not just a good thing - it's vital.

Say what you will about social security in the US, there is a reason it is called the "third rail" of American politics. You touch it and you die. And that provides voters with a measure of certainty about political meddling.

It has its own problems: since the trust fund is aggregate (there are no individual accounts), with an ageing population it may lead to a reduction in the size of benefits paid out.

What it does have going for it is immunity from constant tweaking by whichever party is in power.

Scott Morrison talks a lot about things being "fit for purpose".

If we want the purpose of superannuation to be more of a substitute for, rather than a supplement to, the pension, then big, structural changes need to be made.

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JOHN FERGUSON
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Rail sickies up on Fridays

GEOFF CHAMBERS, MARK SCHLIEBS
Queensland Rail train crew are taking sick leave days that coincide with long weekends and public holidays.