Michael Rice AO, Rice Warner

Michael Rice is Rice Warner's executive director. He specialises in providing strategic advice to the superannuation industry and contributes to Rice Warner's public policy work, which includes submissions to government inquiries, and research. Michael has undertaken pioneering research into Age Pension dependency and trends. He has a keen interest in the integration of social security and superannuation, as well as measuring the adequacy of retirement incomes.

Increasing the mandatory (SG) contribution rate to 12%

Would it reduce inequality in Australia?

Michael Rice AO

Retirement Income Review

The Retirement Income Review was formed in September 2019 with the appointment of the Panel Members, Mike Callaghan AM PSM (Chair), Ms Carolyn Kay and Dr Deborah Ralston. The Panel was supported by a strong secretariat from Treasury and it received many submissions from the superannuation industry, consumer groups, concerned individuals and other stakeholders.

The Panel delivered its report to the Federal Treasurer in July 2020 and it was released publicly four months later without any government analysis or indication of its likely impact on policy. The government has since indicated it will respond in the May 2021 Budget, which gave plenty of time for public analysis and commentary.

Almost all the public commentary relating to the Report has been on the level of Superannuation Guarantee (SG) contributions required for providing an adequate or comfortable retirement. While this is important, there are many other important areas which should help to improve public policy, and these have not been discussed. In coming weeks, we will focus on some of these matters, but we first need to analyse the arguments for setting the right level of SG.

What contributions do Australians receive today?

The SG started at 3% in 1992 consolidating the 3% (industrial) Award superannuation contributions begun in various industries from 1986 onwards, and which led to the creation of many industry funds. Labor legislated for the rate to rise to 9% by 2002 (which it did) and later for it to move to 12%. Following many deferments by various Coalition governments, the headline rate of employer contribution is 9.5% today. It will move to 10% on 1 July this year and then gradually to 12% by July 2025 in 0.5% annual increments.

The SG is not universal. The Review estimated that about 10% of employees do not receive SG contributions, including many casual workers earning less than the $450 monthly threshold. Coverage is higher (at 94%) for those working full time. About 17% of workers are self-employed (including most of those in the gig and black economies) and they are not covered by the SG legislation. People out of the workforce due to illness, unemployment or caring for family also miss out on contributions during these periods.

Meanwhile, there are groups of employees receiving higher levels of contributions from larger companies under industrial enterprise

bargaining agreements as well as many public servants receiving higher rates. For example, federal public servants receive 15.4% contributions, university staff get 17% and some state public servants receive 12% or more.

The full 9.5% is not set aside for retirement. There are deductions for fees, tax and insurance premiums which dilute the contribution as we showed in our submission [of 5 February 2020] to the Review. The move of the SG to 12% together with an expected reduction in fees from fund consolidation and competition will lead to higher amounts being accrued for retirement.

Table 1 shows where the contributions are spent. The addition 2.5% of salary as the SG moves to 12% will be highly effective and we expect most of it to be used for retirement incomes.

Table 1. Allocation of SG contributions

Item	Current	Projected	Comment
SG rate	9.50%	12.00%	0.5% annual increases from July 2021 until July 2025.
Life insurance	1.00%	1.00%	Many funds charge more than this, though these costs have been removed for new members under age 25.
Fees	1.00%	0.75%	Consolidation and efficiency will drive costs down.
Tax on contributions	1.13%	1.54%	15% tax on contributions less allowable expenses.
Allocated to retirement income	**6.38%**	**8.7 %**	**The allocation for retirement is 2.33% from the 2.5% extra contributions.**

Source: Rice Warner

What is the right level of SG for a comfortable retirement?

The debate about setting the ultimate level of SG is highly political. In 2019, two Rice Warner actuaries reviewed this issue in an actuarial paper ['What is the right level of SG?']. They noted that the rate is one of the levers towards achieving an adequate or comfortable retirement, but there are many others including home ownership, marital status, tax concessions, and eligibility for the Age Pension. Further, people can improve their retirement position by putting in additional contributions of their own, investing patiently in solid long-term growth assets, and retiring later (or working part-time for a few years before consuming their superannuation benefit).

In addition, as the Review points out, retirees do not use their retirement assets optimally, and this use could be improved to provide higher retirement incomes. This could be done as well as (or instead of) increasing contributions.

In the paper, the actuaries pointed out the SG rate should be set in a range of 10% to 15% of salaries and should also be better integrated with the other levers. The more valuable the impact of some of the other levers, the lower the required SG rate. For example, if there were no means-testing of the Age Pension, we could easily accommodate an SG below 10%.

Finally, retirement incomes are heavily dependent on long-term fund earnings rates. The industry has achieved spectacular returns over the last 30 years, though many members have earned far less than median returns as they have been placed in poorly performing funds. Over the next few decades, it is likely that real returns will be lower, but a higher SG partly protects against this outcome.

Higher SG rates reduce wages

One of the observations of the Retirement Income Review states:

> *A rate of compulsory superannuation that would result in people having an increase in their living standards in retirement may involve an unacceptable reduction in living standards prior to retirement, particularly for low-income earners. This is based on the view supported by the weight of evidence,[1] that* ***increases in the SG rate result in lower wages growth and would affect living standards in working life****.*

This argument implies that it is not possible for many workers to maintain an acceptable standard of living during both their working lives and their retirement, which is a sad indictment on a wealthy country like Australia. This century has also seen a reduction in real wage growth due to structural factors in employment markets and the broader economy rather than increases in the SG.

There are many reasons for this including the declining power of trade unions, excess capacity of labour, increased global competition causing ongoing cost pressures on businesses, casualisation of labour markets as well as the rapid decline in inflation due to advancements in technology and globalisation of trade.

Over the past 40 years, the share of GDP represented by labour (wages) has declined materially from 60% to 52%, showing that real wages growth is not keeping up with labour productivity growth.[2] This is leading to increased community inequality. Further, the COVID experience is likely to widen inequality even further.

While superannuation contributions are part of all wage packages, there is not always a direct correlation between a rise in the SG being taken from annual wage increases. Further, when the economy is strong and workers receive real wage rises, it is possible to have both an SG rise and a reasonable pay rise. In fact, this occurred in the 1990s—there were real wage increases even as the SG level grew from 3% to 9%.

Over the past decade, wage growth has slowed in line with the reduction in inflation and interest rates to historical lows (even though there has been only a 0.5% increase in the SG since 2002). Current wage growth is negligible at about 1.4% a year and there is little expectation of growth over the next few years. For some workers, a rise in the SG might be the only wage rise they receive in the next two years. For others, an increase in the SG rate will constrain their rise in cash wages at a time when they would benefit from higher disposable income.

The quote

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Are there macroeconomic grounds for raising the SG?

Mean versus median

Thomas Piketty's complex book *Capital in the Twenty-first Century* pointed out that from about 1970, but accelerating recently, the rate of return on capital has been exceeding the growth rate of output. In other words, the wealthy are making more money (much of which is saved), and they are also benefiting from the growth in real assets such as property and equities. This global trend, a shift in profits from labour to shareholders and property owners, is creating widespread widening inequality.

We can measure inequality by comparing mean and median values. For example, average (mean) incomes in Australia are about $88,000 a year. Yet, those working part-time earn a lot less than this, and wealthier Australians earn many multiples of the mean. The mean value distorts the real position—half of all workers (including most part-time workers) are below the median result which is about $52,000.

When we look at wealth, inequality is even wider than income. Table 2 shows the mean and median wealth for a dozen wealthy countries. Australia is a wealthy nation and ranks very highly on per capita wealth (the 'Mean wealth' column). Remarkably, we are far ahead in median wealth—three times better off than the unequal USA.

One of the reasons for this is our high levels of home ownership. Another is our retirement system. With average superannuation balances now above $120,000, that has been a major contributor to equality in our society.

Table 2. International comparison of average wealth

Country	Mean Wealth	Median Wealth	Mean/Median
	$		
Australia	411,060	191,439	2.1
Canada	288,263	106,342	2.7
France	280,580	106,827	2.6
Germany	214,893	35,169	6.1
Italy	217,787	79,239	2.7
Japan	277,235	103,861	2.7
Singapore	283,118	91,656	3.1
South Korea	171,739	65,463	2.6
Spain	191,177	87,188	2.2
Switzerland	530,224	183,339	2.9
United Kingdom	279,048	97,169	2.9
United States	403,974	61,667	6.6

Source: Credit Suisse Global Wealth Databook 2019

Would a higher SG reduce future inequality?

Retaining the legislated SG increases, 0.5% over each of the next five financial years, would be a good step in stemming growing inequality. It would have several positive impacts:

- It would increase retirement benefits for the lowly paid—and give them more dignity in their old age. It is true that many of this cohort are struggling now (as seen by the take-up of the early release scheme last year). That can be properly addressed through our tax and transfer system (or through the existing hardship provisions for withdrawing benefits for extreme cases).
- It would not affect high-income earners as they generally salary sacrifice up to the maximum concessional contribution of $25,000 a year already.
- Importantly, it would improve the position of the median income/median wealth sector of the economy that has borne the brunt of changes in Age Pension means testing and tax concessions.
- The steady, stepwise increment in the SG is therefore reasonably well targeted, provided the tax and transfer system looks after the lowly paid and less well off in other ways.
- It provides a buffer if future investment earnings are lower than we have come to expect. If members do continue to earn strong real investment returns, that will give them more choices later in life.
- This form of forced saving is the most efficient means of assisting those who cannot afford financial advice and have little capacity to save.
- For those who end up *saving too much*, their excess benefits can contribute to the funding of end-of-life health and aged care requirements.
- There will be a moderate saving on future Age Pension costs. The costs to revenue from lower personal taxes will increase, but arguably these rates are too high anyway.

Conclusion

Low wage growth has presented middle Australians with significant challenges to their short-term financial security and living standards. When coupled with soaring asset values and the structural factors driving that rise, low wage growth also threatens their medium-term financial security and living standards.

Let us not threaten their long-term financial security and living standards as well by retreating from our commitment to what is globally recognised as one of the very best retirement systems. Instead, let us focus on ways to improve the system and make it even better. **FS**

Notes

2. The Review commissioned work from the Crawford School of Public Policy at ANU to research wages growth and changes to the SG rate.

3. La Cava G, 'The Labour and Capital Shares of Income in Australia', *Reserve Bank of Australia Bulletin*, March 2019.