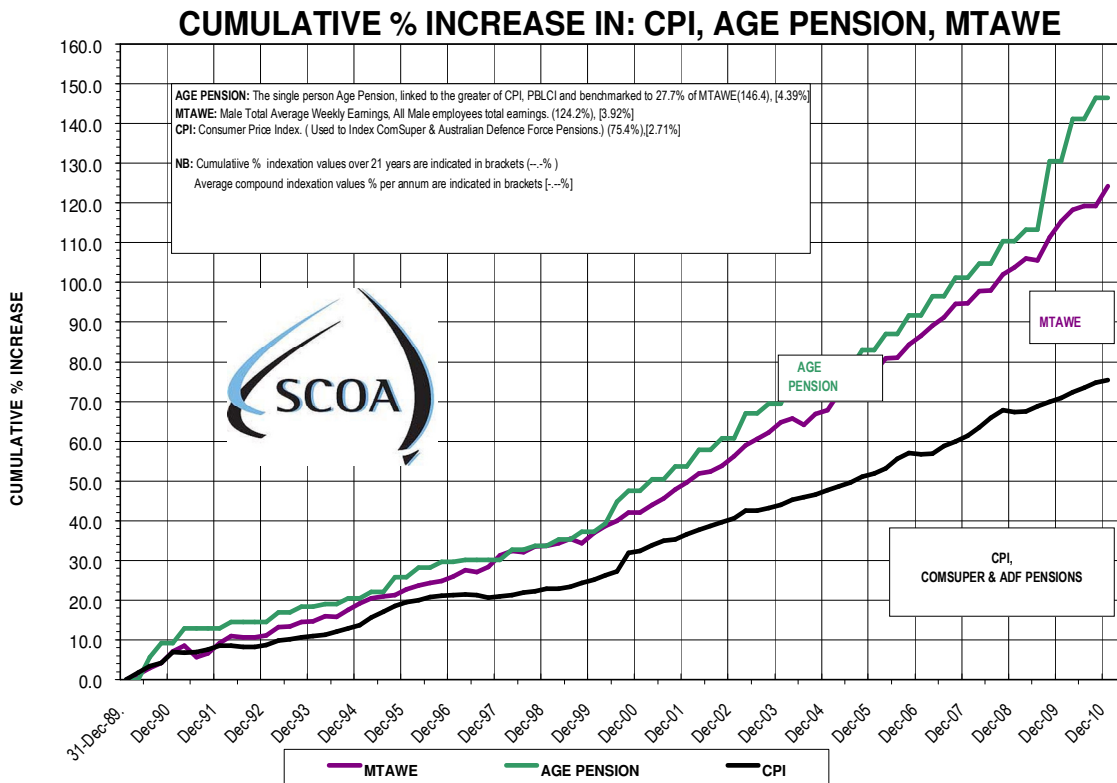




A SUBMISSION BY
THE ALLIANCE OF DEFENCE SERVICE ORGANISATIONS (ADSO)
TO
THE SENATE FINANCE AND PUBLIC ADMINISTRATION COMMITTEE
INQUIRY INTO
THE DEFENCE FORCE RETIREMENT AND DEATH BENEFITS
AMENDMENT (FAIR INDEXATION) BILL

14 APRIL 2011



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Executive Summary

This is the eighth Inquiry into the indexation of military superannuation pensions, all but one (the discredited Matthews Report) recommended a different mechanism for indexing pensions the most popular being the same rate as the Age Pension. Even the Matthews Report, while suggesting the CPI was an adequate measure did say, in Recommendation 4,

‘That, if a robust index which reflects the price inflation experience of superannuants better than the CPI becomes available in the future, the Australian Government should consider its use for indexing Australian Government civilian and military superannuation pensions.’

The Unique Nature of Military Service is often discussed but not often well understood. The ADF is the only employment group that surrenders its basic human rights under the Universal Declaration of Human Rights; Article 3. ADF members place their life, liberty and security of person in the hands of the State. In no other calling, occupation or profession has the State the power to accept or demand the surrender of these rights. The Unique Nature of Military Service deserves unique solutions and also places a great burden on the Government as the “employer” to ensure that ADF members are looked after both during and after Service.

There are three extant Military Superannuation Schemes (DFRB, DFRDB & MSBS)¹ and members contributed to these schemes though their service life. The indexation by CPI was intended to ensure that pensions received under these schemes maintained the buying power of that pension. While the CPI was appropriate when it was one of the major tools for wages determination, it has changed and now the **CPI no longer reflects costs of living** but rather inflation². The Government has recognised this and changed indexation of other Government payouts but not the Military superannuation pensions

Further revised estimates of the Cost of Alternative Indexation Arrangements for Commonwealth Superannuation Pensions have been released by the Government. These costings are considered to reflect assumptions at the most conservative end of the range of reasonable actuarial assumptions, thereby producing cost estimates at the higher end of the actuarial scale.

The costings could be considered exaggerated in the following areas:

¹ Defence Force Retirement Benefits Fund; Defence Force Retirement and Death Benefits Fund; Military Superannuation Benefits Scheme.

² The ABS concluded in 1997 that “*the tight nexus between movements in the CPI and wage and salary adjustments no longer exists. Outcome of the 13th Series Australian Consumer Price Index Review 1997*”, para 36. Australian Bureau of Statistics, states in its publication [6440.0 - A Guide to the Consumer Price Index: 15th Series, 2005](#), that the “*CPI is not a purchasing power or cost-of-living measure*”.

- They use an assumed unfunded liability investment return of 6.0%, which has no recognition of the existence of the future fund and the expected higher investment returns on the assets held in the Future Fund in support of the superannuation liabilities.
- They assume the increased rate of indexation (relative to current level of indexation) is 1.5% – this rate appears to reflect short term experience more than expected long term experience in the respective indices, and yet it is applied for 40 plus years into the future **with significant compounding effects on the cost.**
- They quote costs gross of the impacts of clawback, despite acknowledging a clawback effect in the order of 30%.

Taking all of these matters into account – the estimated costs of alternative indexation could be reduced by as much as 50% (20% for investment return and 30% for clawback effect).

There is a perception by some that the Military Superannuation Schemes are overly generous. This could not be further from the truth and that is reflected by comments by Senator Sherry in the midst of the GFC where he stated that over some 30 years Australian Superannuation has returned 5% above inflation whereas Military Superannuation Pensions are only indexed at inflation. Furthermore, military superannuants have no choice as to what scheme they contribute to, pay tax at their marginal rate (there is a 10% discount for those over 60) whereas members receiving their pension from an accumulation scheme receive their pension free of tax and have choice of schemes. ADF personnel also contribute to their schemes in after tax dollars where as members contributing to an accumulation scheme can contribute pre-tax dollars. This could hardly be called generous.

In summary, the purpose of indexation is to maintain purchasing power. The Alliance³ agrees with the ABS (the relevant Authority on this issue) that the Consumer Price Index has changed significantly, and by itself, no longer represents an adequate index for measuring purchasing power.

The maintenance of “fiscal responsibility” as a Government imperative is more than possible with the inclusion of the Future Fund in any analysis of how funding fair indexation can be achieved.

The Fair Indexation Bill provides a means of restoring adequate and fair indexation for DFRB and DFRDB recipients over 55 and is a welcome first step. The Alliance strongly believes the Bill should be passed by the Senate. The Alliance further believes that Parliament should go further to acknowledge other military superannuation pensions also require fair indexation and commit to address these issues in subsequent legislation as a matter of priority.

³ Comprises Defence Force Welfare Association (DFWA) and its affiliated organisations (Australian Army Apprentices' Association; Defence Families of Australia; Defence Reserves Association and the Totally and Permanently Disabled Soldiers Association-Qld), Naval Association of Australia, RAAF Association, RAR Corporation and the Australian SAS Association.

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Introduction

During debate on the Defence Force Retirement and Death Benefits Amendment (Fair Indexation) Bill, a decision was made to refer the Bill to the Senate Finance and Public Administration Committee for an inquiry, with a response due by 10 May 2011. Submissions to the Inquiry are required by 15 April 2011. This submission represents the considered views of the Alliance of Defence Service Organisations (ADSO)⁴.

This Bill proposes that the indexation of superannuation pensions for DFRDB and DFRB recipients over 55 be the same as that of the Service and Age Pensions. This is a very welcome first step to remove an inequity that results in a steady decline in value for all military superannuation pensions. The Alliance however would like to see the provisions of this Bill extended to include DFRB/DFRDB invalidity pension recipients under age 55. Adoption of the provisions of this Bill excludes members of the current MSBS scheme who will remain subject to the existing inadequate indexation arrangements and this will also need to be addressed in a future measure.

Senate and other Inquiries

This is the **eighth** inquiry on fair indexation of Commonwealth Superannuation Pensions. The preceding inquiries are listed at Annex A. All but one of these inquiries and reviews recommended that the indexation regime be changed to ensure the purchasing power of the Military Superannuation Pension is maintained. The exception was the widely discredited Matthews Report which reached the conclusion that the CPI was an appropriate method of indexing Military Superannuation Pensions which the Government eagerly accepted. It is incredulous to us that the Matthews Report says that the CPI is an appropriate indexation tool and in the Executive Summary of that same report states that "*the purpose of indexation is to maintain the purchasing power of pensions*" when the ABS advice available to Mr Matthews was that the "*CPI is not a purchasing power or cost of living measure.*"

In response to the Matthews Report, the Chair of one recent Senate inquiry is on record saying "*It is hard to explain to Commonwealth superannuants why their pensions, to which they contributed during their working life, should fall behind the pension increases of those who have generally not made provision for their retirement.*" The reason it is hard to explain is that the Government has been derelict in establishing any reasonable case for denying fair indexation that can withstand objective scrutiny.

⁴ Comprises Defence Force Welfare Association (DFWA) and its affiliated organisations (Australian Army Apprentices' Association; Defence Families of Australia; Defence Reserves Association and the Totally and Permanently Disabled Soldiers Association-Qld), Naval Association of Australia, RAAF Association, RAR Corporation and the Australian SAS Association.

Unique Nature of Military Service

Australia is a signatory of the Universal Declaration of Human Rights, adopted by the General Assembly of the UN in 1948. Volunteers (or for that matter, conscripts) in service with the ADF, accept the surrender of their basic rights under Article 3. They place their life, liberty and security of person in the hands of the State. In no other calling, occupation or profession has the State the power to accept or demand the surrender of these rights. Military service in this fundamental respect is unique, and the obligation this places on the State is as inescapable, as it is enduring.

The unique nature of military service poses challenges for the ADF when recruiting and retaining personnel beyond those encountered by other employers in the economy. The ADF has structured its conditions of service accordingly and those conditions, including the retirement, invalidity and death benefits, have been designed to meet these challenges. In meeting its obligations to those who serve (and have served) the Nation in uniform, it is incumbent upon Government to champion a package of measures that recognise their unique service. A more detailed explanation of the unique nature of military service is provided at Annex B.

The Military Superannuation Schemes

There are three extant military superannuation schemes: DFRB, DFRDB and MSBS. Both DFRDB and DFRB are closed to new members. The schemes are or were compulsory for all members of the ADF and there was a requirement to pay at least 5.5% of after tax salary into the closed schemes. MSBS has an option to increase member contributions, but the minimum is 5.0%.

Each one of these Schemes has death and invalidity provisions and the pensions received under these provisions are indexed at CPI, whereas any pensions received from DVA as a result of death and/or disability are indexed using the same mechanism as the Service and Age Pensions. The cumulative detrimental indexation effect on recipients' pensions can be profound because having been forced to leave the ADF at an earlier age, they will normally be on these pensions longer than a typical retiree.

The Government refers to the DFRB and DFRDB Schemes as unfunded superannuation. Such loose terminology fails to tell the full story and adds yet another dimension of confusion in the ongoing debate over indexation. Almost all superannuation schemes are funded partly by member contributions and partly by employer contributions, and the DFRB and DFRDB Schemes are no different in this regard. As explained above, all ADF members compulsorily contribute to their superannuation scheme throughout their service lives (\$22.362M in 09/10), so there can be no doubt that they have partly funded their superannuation benefit. The fact that the government has chosen to:

- place their contributions into consolidated revenue (and thereby have use of the members' contributions for the operations of Government) rather than a dedicated fund; and
- not fund its liability on an annual basis as an employer contribution to an investment fund⁵;

.... is a matter outside the control of ADF members. It is therefore misleading for the Government to promote the misconception that the military superannuation schemes are *unfunded*. They are not.

⁵ The creation of the Future Fund is recognition of the need to rectify this situation.

Changes in the CPI

At the time of the introduction of the DFRDB Scheme, the CPI was an important tool for wage fixing, and it was an appropriate mechanism for ensuring the purchasing power of the Military Superannuation Pension was maintained; but in the late 1980s, the CPI methodology began to change. The Government responded to these changes by progressively increasing the Service and Age Pensions as well adjusting the indexation method to maintain their purchasing power. Currently the age pension is indexed to the higher of, CPI or PBLCI and benchmarked to the MTAW. However, over the past two decades, the Government has been content to quietly pocket a CPI dividend by denying an equivalent justifiable increase to the indexation of Military Superannuation Pensions.

There are strong grounds to suggest that the Government has knowingly breached the terms of its employment contract with most of today's DFRDB recipients as their employment conditions on enlistment included a superannuation package that unambiguously provided an indexed pension that maintained purchasing power (original CPI).

The evidence that the CPI today is a vastly different creature from the CPI in 1973-74 is irrefutable. The Australian Bureau of Statistics (ABS) is on record with the following statements:

"...the CPI [historically] was developed with the principal purpose of providing input to the highly centralised wage and salary determination process then existing in Australia", and that:

"Successive CPI reviews have served to ensure that refinements to the index have resulted in a measure increasingly more suited to its principal purpose."

But the ABS concluded in 1997 that *"the tight nexus between movements in the CPI and wage and salary adjustments no longer exists."*⁶ And even more definitively, the First Assistant Secretary Economic Division of the ABS said in 2001 that:

*"...The first observation is that the CPI is not a measure of the cost of living. It is a measure of inflation and there are differences between these two things."*⁷

And in 2005 the ABS, states in its publication [6440.0 - A Guide to the Consumer Price Index: 15th Series, 2005](#), that the *"CPI is not a purchasing power or cost-of-living measure"*.

In other words, the current CPI is different in its principal purpose from the pre-1997 CPI. Clearly, the changes made to the CPI since the late 1980s have failed to protect and maintain the purchasing power of retired military pension recipients from erosion over time.

If the Authority that created the CPI says that it is no longer a measure of cost of living (or purchasing power), then it is disingenuous at best, and deliberately deceptive at worst, for the Government to pretend that it continues to be a satisfactory index for Military Superannuation Pensions.

⁶ The ABS concluded in 1997 that *"the tight nexus between movements in the CPI and wage and salary adjustments no longer exists. Outcome of the 13th Series Australian Consumer Price Index Review 1997*, para 36.

⁷ Evidence to the Senate Select Committee on Superannuation and Financial Services 15 Feb 2001

In the debate over the efficacy of the CPI as a suitable pension index, there is a propensity to incorrectly use the terms ***inflation*** and ***cost of living*** interchangeably. They are very different measures, and to suggest that today's CPI (inflation measure) protects pension purchasing power is comprehensively and demonstrably wrong.

The financially damaging effects on purchasing power caused by the inappropriate use of the CPI as a cost of living measure have been, and remain, a principal complaint of military retirees, serving ADF members of the schemes and their various representatives, including ADSO. This has also been acknowledged in each of the post-2001 Parliamentary inquiries with recommendations for changes to the indexation of Military Superannuation Pensions in line with changes to the Age Pension. The Alliance seeks no more and no less than the same hybrid indexation method for military superannuants as the only effective way of maintaining purchasing power in keeping with historical precedents.

Cost of Funding Indexation Change

From discussions we have had with a range of parliamentarians across the political spectrum, there would appear to be no disagreement between the parties that ADF personnel should be treated fairly in their retirement and that military superannuation pensions should maintain their purchasing power. The central issue is funding to implement fair indexation or, as the Minister for Finance and Deregulation (Senator Wong) states, 'fiscal responsibility'. Senator Wong goes on to state that this Bill will impose \$1.7 billion fiscal cost over four years and increasing the Commonwealth's unfunded liability by \$6.2 billion. But in a telling rebuke of the Government's attempt to hoodwink us, the Opposition spokesman for Defence Personnel (Senator Ronaldson) in the Senate quotes Mr Burt, the Government actuary:

*"Fiscal balance figures are used for accrual accounting purposes. They are also mandatory for cabinet submissions. However, great care should be exercised when using fiscal balance figures for decision-making purposes, particularly in the area of unfunded superannuation arrangements. It is important to note there is **no direct relationship between the fiscal balance results and the total cost of the benefit improvement other than in the first year of the projection.**"*⁸

"So", said Senator Ronaldson, '*the \$1.7 billion figure has been blown out of the water*'. Senator Ronaldson also repeated another quote from the Actuary:

"The expenditure is shown in nominal dollars and it has not been discounted to give a present value."

This Senate debate confirms what the Alliance has always known. Government spokespeople for many years have never shown a genuine interest in revealing accurate and verifiable costings nor their assumptions and basis for calculating their figures for appropriate indexation for Military Superannuation Pensions. Their figures have focused attention on unfunded liabilities over 45 years, taking no account of any form of clawback through increased GST revenue, personal tax and reduced outlays on social security. Furthermore, they have chosen to ignore the fact that members' contributions have been taken into consolidated revenue and used for everyday operations of government. Importantly, government responses ignore any role of the Future Fund; a fund established for the express purpose of meeting Government superannuation liabilities from 2020 onwards. Nevertheless recent events indicate a new willingness from DOFD to engage with us in discussions on the financial implications of fair indexation which we welcome.

⁸ Hansard Senate Chamber Thursday 24 Mar 11

ACTUARIAL ASSUMPTIONS UNDERPINNING ANNUAL COST AND UNFUNDED LIABILITY COST ESTIMATES OF FAIR INDEXATION

The latest and yet further revised estimates available to the Government on the annual and long term unfunded liability costs are underpinned by a number of actuarial assumptions. Despite the Department of Finance and Deregulation's claim that they received third party independent actuarial advice confirming the reasonableness of the Government Actuary's advice; the advice the third party actuary gave was that "they were not asked to review the appropriateness of the base assumptions used by the Government's actuary."

Drawing upon other Independent actuarial resources, the advice received indicates⁹.

- **Percentage differential between CPI and increases in single rate Age Pension.**

One key assumption that significantly impacts the quantum of the cost estimates for fair pension indexation is the difference between the assumed rate of indexation over the next 40 years and that for fair indexation based on movements in the single person base rate Age Pension.

The Government actuary has assumed that the difference between the existing rate of indexation and what it would be if aligned with percentage movements in the base rate Single Person Aged Pension, is 1.5%. Our independent actuary has advised that the differential is more likely to be closer to one per cent. In the ten years prior to the preparation of the Government's 2008 Long Term Cost Report for Commonwealth superannuation, the CPI had averaged closer to 3%. However the Government's actuary, Mercers, assumed a CPI rate of only 2.5% and gave as their reason that this was the Reserve Bank's target inflation rate! The Government's actuaries have once again assumed the more conservative CPI percentage of only 2.5%.

A change to the assumption of a 1% versus a 1.5% differential between existing and proposed indexation rates could reduce the estimated cost of indexation by around 30%.

- **Cost Clawback – Unfunded Liabilities**

In considering the budgetary cost of any proposed Government policy the cost clawback is taken into consideration. It was pleasing to note that the Government's latest cost estimates for improved indexation included a clawback figure for reduced Age Pension expenditure of 15% and a further cost clawback figure of 15% for increased income tax revenue, **bringing total cost clawback estimates to 30%**. Cost clawback is clearly a significant factor that should influence decisions regarding the granting of fair pension indexation and the Committee is urged to acknowledge its existence, in its deliberations.

Whilst it would only be relatively small, there would be some additional GST revenue generated from improved pension indexation.

It is a concern that those advising successive Governments have failed to properly acknowledge and adequately report on the impact of cost clawback on the gross cost of fair pension indexation, instead, preferring to comment on the cost in predominantly unfunded liability cost terms rather than in annual budget cost terms. That method of reporting the cost has grossly distorted the annual budget costs of fair

⁹ Source Superannuated Commonwealth Officers' Association (SCOA)

indexation. It has been most misleading and has no doubt influenced the opinion of many members of Parliament and the public on what fair indexation will cost. The committee is urged to see unfunded liabilities for what they are – 40 year cumulative estimates and estimates that never show cost clawback as described above. Unfunded liabilities are a Government accounting convention that requires their production to indicate costs of running government funded programs. They will by their very long term nature be big numbers which can be conveniently but also inappropriately used to influence Government decision making. Unfunded liability estimates are not produced for far greater cost items such as the Age Pension, (approximately 6 times greater than total Commonwealth superannuation costs) or Medicare, the Pharmaceutical Benefits Scheme, Aged Care, etc.

Taking all of these matters into account – the estimated costs of alternative indexation could be reduced by as much as 50% (20% for investment return and 30% for clawback effect).

ESTIMATED BUDGET FIGURES BEFORE CLAWBACK

Implementation of the community standard of indexation, as adopted for the Age and Service pensions applied to all components of DFRB/DFRDB/MSBS military superannuation pensions, including the total reversionary pension for partners of deceased military superannuation pensioners and preserved employer benefits, is estimated not to exceed \$16M in FY 2011-2012 and an additional \$176M over the forward estimate period before any clawback.

How Could Fair Indexation be Funded?

The Future Fund has been established to support the unfunded superannuation liabilities of the Government and to provide for the payment of Commonwealth superannuation liabilities from the Future Fund rather than from the budget, once fully funded – or by 2020 if earlier. At December 2010, the Future Fund held \$71.76 billion against a Target Asset Level of \$106.7 billion.

It is important to understand that the Target Asset Level for the Future Fund is based on unfunded superannuation liabilities that assume an investment return of only 6% were these liabilities to be funded from investments. However, the Future Fund's target rate of return on investments is 7.2%, 1.2% higher than the 6% long term bond rate; and some 4.5% above CPI. A target that the Chairman of Guardians believes is achievable.

The Future Fund assets can be estimated to grow to around \$140 billion by 2020, even at the Fund's assumed earnings rate of 7.2% p.a.

At an assumed rate of growth of 8.0% the Future Fund assets would grow to \$150 billion by 2020.

The differential of 1.2% between the basis for the unfunded superannuation liabilities and the target rate for Future Funds earnings is significant. This differential must clearly be recognised when considering the Future Fund's capacity to not only fund unfunded superannuation liabilities based on existing indexation arrangements, but also that Fund's capacity to meet the cost of fair indexation if introduced in the short term, e.g. from 2011/12. The above information indicates that the assets in the Future Fund look to be well on track to cover Commonwealth superannuation liabilities by the 2020 target date. In fact there is a reasonable chance the assets will exceed the target level at 2020.

Further the Future Fund has potential to earn returns above the assumed 7.2% for the next ten years, given it is unencumbered by the need to remain liquid (as other superannuation and investment funds are) and the need to respond to member investment choice. As a long term fund of substantial size and with a fairly open investment mandate, it has the opportunity to invest to a relatively higher proportion in alternative asset classes (infrastructure etc) and so earn a premium return over other fund managers.

The maintenance of “fiscal responsibility” as a Government imperative is more than possible with the inclusion of the Future Fund in analysing how funding of fair indexation can be achieved. We believe fair indexation for all military superannuation pensions can be funded without any (or an insignificant) impact on the budget bottom line.

Market-Linked Accumulation Funds vs “Generous” Military Benefits

There is a perception that the fixed benefits paid to military retirees are generous. This was highlighted in the Matthews Report, in part, because of losses attributed to market-linked accumulation funds during the global financial crisis. But according to the previous Minister for Superannuation Senator Nick Sherry in December 2008, the reality is that superannuation funds on average rose by around **5% above inflation** each year for the past 35 years – through good economic times and bad. And he made this statement a full year after the global financial crisis.

Meanwhile, Military Superannuation Pensions were adjusted by the CPI alone, noting that the ‘rise’ was zero at each of the 30 June 2007 and 30 June 2009! Additionally, benefits from accumulation funds are tax free in the hands of recipients aged over 60. Military superannuation benefits are taxed regardless of the recipient’s age. Notwithstanding the rebate of 10% for those over 60, military superannuation is taxed at the member’s marginal rate and it is noted that this discriminatory taxation treatment also flows on to other Commonwealth superannuation schemes. Further, the surviving spouse of an accumulation fund member receives the balance of the member’s lump sum upon the member’s death. A military surviving spouse, usually a widow, receives 62.5% of the military member’s DFRB/DFRDB uncommuted fortnightly benefit; and remains liable for tax.

The Government has attempted to *spin* the line that “a lifetime indexed pension” (which has inbuilt diminishing purchasing power over decades) is “generous” when compared with the long term nature and benefits of market-linked superannuation investments. This is a further example of inexcusable deception. It is position that typifies the Government’s reckless disregard for the “national covenant” with current and former members of the ADF in respecting and acknowledging the unique nature of military service.

Government “Triple-Dipping” of Military Superannuation

It is not widely recognised that the Government “triple dips” military superannuation to the financial detriment of ADF members by:

- compelling them to pay after-tax contributions into a compulsory government superannuation scheme;
- discriminating against them with an unjust tax on benefits received in retirement until the day they die, unlike the retired population generally;

- requiring them to pay full marginal tax on income in retirement¹⁰ ; and
- having Commonwealth superannuants face discrimination in the way their superannuation pension is treated for the purposes of the Age Pension income test, compared to the treatment of superannuation for people who belong to a taxed superannuation fund.

The reality is that not only do Military Superannuation Pensions lack the *generosity* professed by Government, but they also face deliberate legislative discrimination in tax policy which financially disadvantages Military and Commonwealth civilian superannuation pensioners when compared with the general retired population.

It is indeed a peculiar way for the Government to *show* the people of Australia how it honours its obligations for the unique nature of military service rendered by those who have committed their working lives to defence of the Nation.

Conclusions

In summary, the Alliance of Defence Service Organisations:

- **agrees** that the purpose of indexation is to maintain purchasing power and agrees with the ABS (the relevant Authority on this issue) that the Consumer Price Index has changed significantly, and by itself, no longer represents an adequate index for measuring purchasing power;
- **condemns** the Government for failing to acknowledge that today's CPI does not protect the purchasing power of Military Superannuation Pensioners (and hasn't done so for over two decades), and for its hypocrisy in accepting the inadequacy of the CPI for other Commonwealth Pensions such as the Service and Age Pensions, but not for those who have loyally served their Nation in uniform;
- **condemns** the Government for its deceptive scare tactics by not being transparent in its calculations of the net costs of fair indexation;
- **contends** that an indexation method including the CPI, together with an outlays based living cost index such as the new PBLCI, and with reference to a wages based index such as the MTAWWE is fair, equitable and reasonable;
- **seeks** no more and no less than this method in order to protect the purchasing power of Military Superannuation Pensions. We do not seek the generous indexation methods applying to certain other Commonwealth superannuation pensions; and
- **believes** the Government should look to the potential of the Future Fund to fund fair indexation.

The Alliance believes unequivocally that the Senate should fully support the Fair Indexation Bill before Parliament, and should go further to acknowledge other military superannuation pensions also require fair indexation, with a commitment to address these issues in subsequent legislation as a matter of priority.

¹⁰ An outcome of the Simpler Superannuation Review where the Commonwealth Government Superannuation Schemes were deemed to be untaxed schemes and normal superannuation was deemed a taxed scheme. Under the new rules, "taxed" schemes provided for tax free pensions after the age of 60 whereas "untaxed" schemes were denied this benefit. The convention at the time was that the Government did not tax itself, and as a result of this Government *wisdom*, recipients of Military Superannuation pensions have to pay tax at their marginal rates.

GOVERNMENT AND PARLIAMENTARY INQUIRIES RELATING TO INDEXATION

1. Joint Select Committee on Defence Forces Retirement Benefit Legislation (Jess Committee) 1972

Recommendation (5)

That the terms Pension and Pensioner be discontinued; that the title of a member who becomes a recipient under the proposed DFRB scheme be referred to as retired pay or Invalid Pay; that a person contributing to the scheme be referred to as a contributing member, and that the recipient be referred to as a recipient member.

Recommendation 6.

That retired pay and invalid pay be expressed as a percentage of final pay and be adjusted annually so that relativity with average weekly earnings is maintained. A possible method of achieving this would be to maintain the relativity of benefits of current pay for the rank held on retirement.

Recommendation 10.

That the existing DFRB Fund be transferred to the Commonwealth. The question of whether the present investments are maintained or future contributions invested as a basis for a future welfare account is a matter for the Government to determine.

2. Senate Select Committee on Superannuation and Financial Services Thursday, 15 February 2001

The benefit design of Commonwealth public sector and defence force unfunded superannuation funds and schemes Statement by HARPER, Mr Peter William, First Assistant Statistician, Economic Accounts Division, Australian Bureau of Statistics.

“The fundamental question is: what is the purpose of indexation? That is obviously a question on which the committee will come up with some views. I would make some observations from the perspective of the use of the CPI in indexation calculations. The first observation is that the CPI is not a measure of the cost of living. It is a measure of inflation and there are differences between those two things.”

3. Senate Select Committee on Superannuation and Financial Services April 2001

The benefit design of Commonwealth public sector and defence force unfunded superannuation funds and schemes: A reasonable and Secure Retirement

Recommendation 1—Chapter 3, para 3.

The Committee recommends that the Government examine the feasibility of adopting an indexation method other than the Consumer Price Index (CPI) for Commonwealth public sector and defence force superannuation schemes, to more adequately reflect the actual increases in the cost of living.

2.37 This conclusion was based on the fact that, at the time of the review, wage increases were running at twice the rate of the CPI. The Joint Select Committee referred the matter to the Department of Defence, pending decisions on the future of service pay, but concluded that regular rather than ad hoc indexation of the benefit should take place, and that this should be related to average weekly earnings. This will ensure that the man in retirement will be able to maintain his position in relation to rising community standards and that he will obtain those increases when they are needed.

2.40 The legislation did not reflect in entirety the Jess recommendations, with the Whitlam Government rejecting indexation to the AWE, and the CPI being adopted. Announcing the method of adjustment, the Government explained that it was an interim measure to pass on an increase to DFRB pensions, which had not been adjusted since 1971.

4. Senate Select Committee on Superannuation Dec 2002. Superannuation and Standards of Living in Retirement

16. The Committee recommends that the Government consider indexing Commonwealth funded superannuation benefits to Male Total Average Weekly Earnings (MTAWE) or the Consumer Price Index (CPI), whichever is the higher, in order that recipients share in the increases in living standards enjoyed by the wider community. (para 14.28)

5. Report of the Review into Military Superannuation Arrangements 31 July 2007

Recommendation 14

If the Government is willing to go beyond the envelope of current costs, it should consider indexing DFRDB/DFRB pensions for those over 55 on a similar basis to that applying to age pensions. Because of the costs involved, this option does not warrant the priority attached to the other recommendations. An alternative option the Government could consider is to limit this change to pensions paid from age 65.

6. The Senate Standing Committee on Community Affairs 2008. A Decent Quality of Life: Inquiry into the Cost of Living Pressures on Older Australians

Recommendation 2

8.35 The committee recommends that:

- i. The Government review and standardise the indexation methodology of pensions, social security and other government retirement benefits to ensure they maintain their relative levels. In particular, the Government should note limitations highlighted during the inquiry about the use of the Consumer Price Index (CPI), as well as other possible indexation mechanisms such as the Australian Bureau of Statistics' Household Expenditure indices.
- ii. The review should also address the particular financial disadvantage of single women, many of whom have had a life of broken working patterns and an inability to access superannuation arrangements.

- iii. While the review is undertaken and to ensure immediate relativity, The Government should index Commonwealth funded superannuation benefits and the military pension to Male Total Average Weekly Earnings or the Consumer Price Index, whichever is the higher, as is currently the practice with the age pension.

7. The Matthews Review

The four recommendations of the Matthews Review were:

Recommendation 1:

That pensions from the Australian Government civilian and military superannuation schemes continue to be indexed against the effects of inflationary price increases.

Recommendation 2:

That the same indexation methodology continue to apply to all civilian and military pensions.

Recommendation 3:

That pensions from the Australian Government civilian and military superannuation schemes **continue to be indexed by the CPI as the most suitable index** to protect pensions against inflationary price increases available at this time.

Recommendation 4:

That, if a robust index which reflects the price inflation experience of superannuants better than the CPI becomes available in the future, the Australian Government should consider its use for indexing Australian Government civilian and military superannuation pensions.

Annex B

The Unique Nature Of Military Service

1. Military service is unique because it is servicemen and women, and only servicemen and women, who, when lawfully directed by the Australian nation through Government, are required to give up their human rights defined in Article 3 of the Universal Declaration of Human Rights in the nation's service even to the point of sacrificing their ultimate human right; their life. It does not matter whether the military person is a volunteer or a conscript, willing or unwilling, man or woman, married or single, young or old. No member of the ADF, not even one, enjoys the inalienable human right to life that is at the heart of Australia's democracy. That is why military service is unique. Within this context, the following paragraphs outline the characteristics of military service which, when taken collectively, distinguish it sharply from employment in broader society.
2. The main characteristics of military service are:
 - liability for combat operations;
 - requirement to apply lethal force to other human beings as part of combat operations
 - a military discipline code;
 - a regimented way of life;
 - long and irregular working hours;
 - statutory retiring ages well below the community norms;
 - high standards of physical fitness;
 - frequent relocation; and
 - separation from family.
3. The principal distinguishing feature of military service is the liability for combat operations. This liability is both compulsory and continuous and includes the very real possibility of being exposed to the risk of physical or mental invalidity or death. No other form of employment has a similar liability. Other special features flow from this liability.
4. ADF personnel are subject to both the civil legal code and a separate Defence Force disciplinary code. The disciplinary code supports the command structures necessary for effective conduct of combat operations and training. The Defence Force disciplinary code imposes restrictions on personal conduct; it demands different standards from those generally acceptable within the community; and it impinges on the individual's family life and leisure time.
5. The discipline code also impacts on the ADF collectively. For example, ADF members are precluded from engaging in industrial action. The creation of the Defence Force Remuneration Tribunal to determine pay and allowances for the ADF is recognition of the ADF's unusual industrial situation.
6. Another industrial aspect of ADF service is the liability to work long and irregular hours. Operational tasks, assistance to the civil community and training activities cannot be tied to set hours. The requirement to work extra hours is unpredictable and often arises at short notice. More importantly, ADF members are obliged to work whatever hours are demanded to complete an assigned task. No overtime is payable but some allowances, particularly Service Allowance, recognise the disability and provide some compensation.

7. Allied to the long working hours is separation from families. The periods of separation can be considerable, particularly for members in operational units. Separation causes stress to both members and families.
8. Another major cause of stress is the necessity to post members at irregular intervals to meet ADF Manning requirements. Not only do postings involve geographical relocations, sometimes to relatively unattractive places, but also employment in positions demanding acquisition and utilisation of new or different skills. The limited capacity to laterally recruit exacerbates the posting frequency and employment in unfamiliar environments. Family life in particular can be adversely affected. Spouse employment opportunities and the quality and continuity of children's education can be adversely affected.
9. Operational tasks and training for combat are demanding activities. Technology in many cases reduces physical effort but ADF service requires that members maintain a high standard of physical and mental fitness. The consequence of failure to satisfy the ADF standard is severe. A member is discharged from military service where any medical condition precludes effective ADF employment.
10. The demands of ADF service also lead to statutory retiring ages which are considerably lower than the community norm. Most ADF personnel can serve to age 60. However, most ADF members resign prior to attaining statutory retirement age as vocational options are perceived to diminish with age. This suits current ADF personnel management practices.
11. Of the major characteristics of military service the liability for combat and the military discipline code are, of course, peculiar to the Defence Force. Other characteristics of military service are derived from or related to these characteristics. Some of these characteristics do also occur in other occupations but only individually. It is the cumulative impact of all the features which constitutes the special nature of the ADF and which distinguishes it from other occupations.
12. The special nature of military service makes it necessary for the ADF to design conditions of service that will continue to attract and retain personnel despite the hazards and hardships of military life. There is a need to compensate members of the ADF for the unique nature of military service through their superannuation, invalidity and death benefits as with their other conditions of service.
13. The unique nature of military service poses challenges for the ADF when recruiting and retaining personnel beyond those encountered by other employers in the economy. The ADF has structured its conditions of service accordingly and those conditions, including the retirement, invalidity and death benefits, are generous relative to normal workforce standards.
14. It is important to maintain that relative distinction so that people considering joining the ADF and those already serving can recognise the adequacy of their conditions, given the additional hardships and risks inherent in ADF service. A diminution in the relative value of these benefits could have adverse effects on the ADF's ability to recruit and retain the personnel it needs to fulfil its functions. This could affect the viability of the ADF workforce as a whole which would have significant implications for the Government's ability to maintain its national security policies.