

CHAPTER 6 : ECONOMIC IMPACT

The present government has a policy of substantially lifting retirement incomes over the next forty years or so. It has deliberately chosen to 'front load' the costs (and 'back load' the benefits) to the Budget of meeting this target: Tax concessions are paid now to achieve lower aggregate Budget support for retirement incomes in thirty years' time. In considering the merit of the Government's approach it is important to resist the temptation to focus only on the front loaded budgetary costs. Succumbing to this temptation runs the risk of losing sight of the substantial retirement income funding problem emerging over the next three or four decades (due in large part to the ageing of the population, but also to the legitimate objective of increasing over time the retirement benefit of all retirees). For these reasons the counterfactual cost to the Budget against which the SGL should be assessed is not a 'no policy change' scenario, but rather an alternative policy which returns the same increases in retirement incomes.¹

6.1 This chapter discusses the possible macro-economic effects of the SGL. The chapter is divided into six parts:

- increase in superannuation contributions due to the SGL and the effect of the SGL on national savings;
- increase in retirement benefits due to the SGL;
- increase in superannuation tax concessions due to the SGL;
- the effect of the SGL on Budget pension outlays;
- the effect of the SGL on Budget outcomes; and
- the effect of the SGL on employment and inflation.

6.2 The discussion is constrained because only two studies have been completed on the projected economic effects of the SGL. The first by Dr Vince FitzGerald and Professor Ian Harper examined the effects of the SGL and the 'Fightback!' proposals. The second, by the Treasury, was in response to a number of questions put by the Committee. Both studies have used the National Mutual Retirement Incomes Policy Model which:

... generates, given a set of economic and other parameters, the flows between individuals and their employers on the one hand and superannuation funds on the other, including inflows of contributions and fund earnings and outflows of benefits on retirement, death, disability or termination of employment. The model also covers all the main interactions between the government budget and the superannuation system, including tax deductions

and taxes on contributions, fund income and benefits. It also measures impacts on outlays for age pensions as determined by the income and assets test.²

6.3 However, the specifications used by Treasury differed from those used in the earlier study by FitzGerald and Harper so that the results given in the simulations are different. In particular, Treasury assumed employee contributions of three per cent and a real earnings rate of 2½ per cent, whereas FitzGerald and Harper undertook their modelling on the basis of the SGL timetable announced in the 1991-1992 Budget and factored in variable real earning rates. This serves to illustrate that modelling exercises cannot be regarded as forecasts and that projections over forty year periods are highly speculative because of changes in key economic variables.

6.4 The Committee notes the need for detailed data on the economic effects of the SGL and other retirement income issues, and to this end, it further notes that the Government has recently announced the formation of a Retirement Incomes Modelling Unit. The Unit will be used to evaluate different policy options for the Government but the Committee has been required to report on the SGL Bills and the effect of SGL on national savings before the Unit's work is available.

Increases in superannuation contributions due to the SGL

6.5 The Treasury advised the Committee that the SGL would produce a substantial increase in projected superannuation contributions. The results of the Treasury modelling are reproduced in Table 6.1.³

Table 6.1

Additional Superannuation Contributions Due to the SGL			
Year	Nominal	Present Value (a)	Percentage growth in superannuation contributions due to SGL
	(\$million)		
1992-1993	413	328	2.94
1993-1994	1 281	942	8.21
1994-1995	1 894	1 289	11.26
1995-1996	2 637	1 662	14.28
1996-1997	3 511	2 049	17.29
1997-1998	4 425	2 390	19.63
1998-1999	6 398	3 200	26.39
1999-2000	8 466	3 921	31.90
2000-2001	11 181	4 795	39.14

(a) Nominal discount rate equal to the assumed fund earnings rate of eight per cent per annum.

6.6 The impact of the SGL on national saving can be calculated by:

- the increase in net private superannuation saving (measured as contributions plus earnings, less fund payouts);

² FitzGerald and Harper, *Super Preferred or Level Playing Field?*, pp 21-22.

³ SG sub no. 32.

- contribution in other forms of private savings;
- plus the reduction in age pension outlays; and
- less the increase in the cost of the superannuation tax concessions.

6.7 Treasury also estimated that the SGL will increase saving in the form of private superannuation by about two per cent of GDP within 15 years, increasing to more than 2.5 per cent of GDP by 2020, before levelling off.⁴ Treasury assumed that half of this increase in superannuation saving would remain in private sector saving.⁵ The net increase in private sector saving due to the SGL is estimated to reach about 1¼ per cent of GDP in about 25 years from now.⁶ Assuming that, in the absence of the SGL, the social security pension would increase to a level to provide the same level of benefits provided by the SGL, it is estimated that the SGL will increase national saving by three per cent of GDP by 2020.⁷

6.8 FitzGerald and Harper estimated that gross saving through superannuation would rise from about six per cent of GDP in 1991 to about nine per cent in the year 2000 and would peak at over 11 per cent fifteen years later. On a net basis, saving through superannuation rises from three per cent of GDP in 1991 to six per cent in the year 2000, peaking ten years later at about seven per cent of GDP.⁸

6.9 FitzGerald and Harper estimated that under the 'benchmark' scenario (in which award superannuation coverage and contribution rates continued as just prior to the 1991 Budget) gross saving through superannuation would rise from six per cent of GDP to almost seven per cent by the year 2000 and peak at about 7.5 per cent nine years later. On a net basis, the rise is projected to be from three per cent in 1991 to just over four per cent in the year 2000, peaking at most 4.5 per cent of GDP around the year 2005 and moving back to present levels around 2030.⁹ Figures 6.1 and 6.2 show the projected patterns of private saving through superannuation.

6.10 FitzGerald and Harper concluded that:

Assessing how much of the increased superannuation saving under the SGL would remain in total private saving is difficult, although there are grounds to believe, given how much of it is forced saving from low to middle income households, that much of it would. We judge that perhaps half and possibly more would remain in aggregate private saving well into the future. Even allowing for the offsetting rise of around 0.5 per cent of GDP in reduced public sector saving through the increased budget cost of the tax concessions,

⁴ SG sub no. SG.34, p 3.

⁵ *ibid.*

⁶ *ibid.*

⁷ *ibid.*

⁸ *op. cit*, p 27.

⁹ *ibid*, p 28.

it is then reasonable to expect that there will be left a gain of something like one per cent of GDP, possibly more, in national saving.¹⁰

Figure 6.1

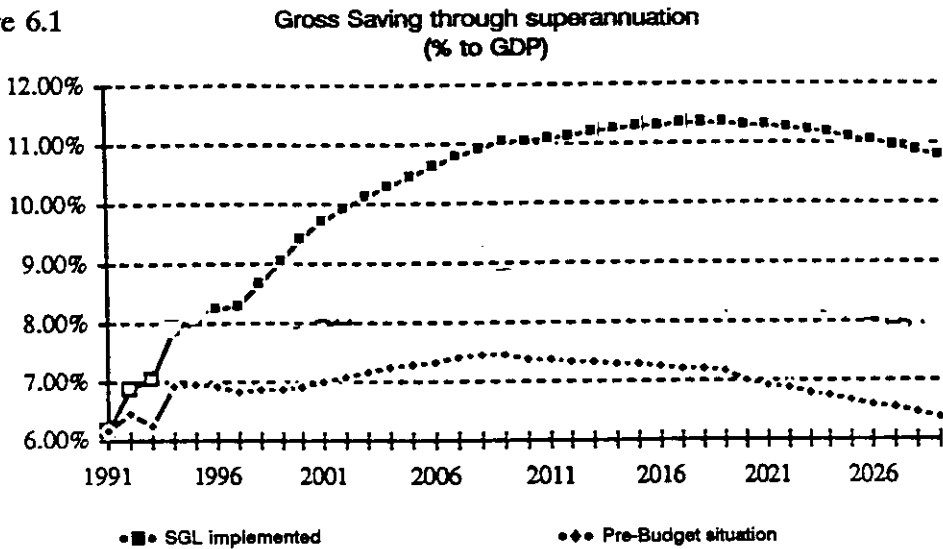
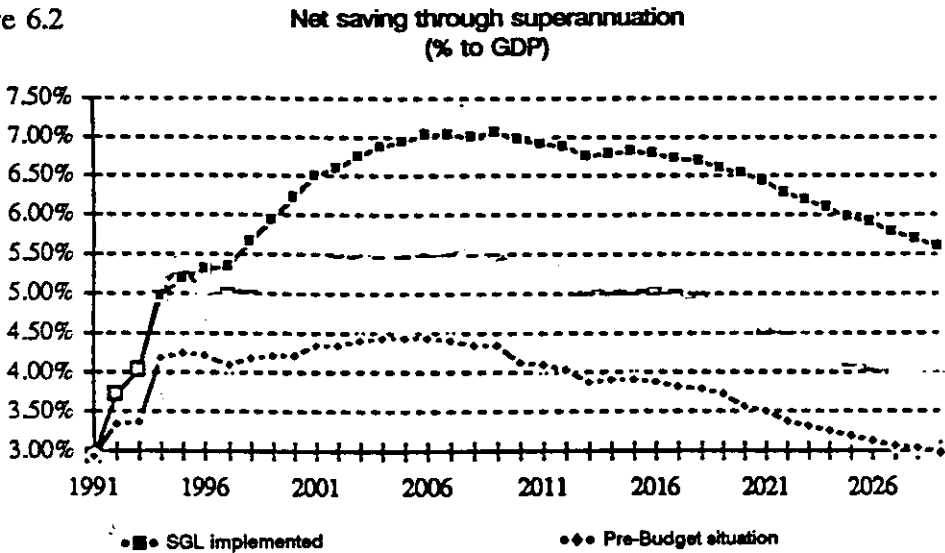


Figure 6.2



6.11 The Confederation of Australian Industry (CAI) argued in its submission to the Committee that if total savings are to increase then total consumption must fall.¹¹ The CAI stated that the SGL is regressive in the sense that the heaviest burden will fall on those for whom employer contributions rise to the greatest extent, ie the lower paid.

¹⁰ *ibid*, p 28.

¹¹ SG sub no. 15, p 11.

Table 6.2 shows the distribution of household wealth in 1986 by form and superannuation cover.¹²

Table 6.2

Average household wealth by form and superannuation cover (Wealth \$000, per cent in brackets; super cover – percentage of population in percentile group with superannuation cover)					
Percentile Group	Total wealth	Wealth in the form of house	Wealth in the form of equities	Wealth in the form of interest	Super cover
0-29	0	0 (-)	0 (-)	0	19
30-39	1	0 (-)	0 (-)	1 (96)	36
40-49	10	5 (48)	1 (6)	4 (44)	48
50-59	36	32 (89)	1 (2)	3 (7)	48
60-69	56	51 (92)	1 (2)	3 (6)	45
70-79	75	68 (91)	1 (1)	4 (6)	38
80-89	103	88 (85)	3 (2)	10 (9)	44
90-100	322	165 (52)	99 (31)	33 (10)	45

6.12 The CAI argued that there is a possibility that the total level of saving may actually fall as a result of the introduction of superannuation because financial intermediation involves transaction costs. The CAI argued that:

The immediate transfer is from business retained earnings to superannuation funds. Thus, the transfer is from one form of saving into another. There is no increase in the total level of saving as a result. Indeed, the possibility is that the total level of saving may actually fall as a result of the introduction of superannuation ... The administrative charges of superannuation funds will eat into the capital transferred, lowering the aggregate level of investable savings.¹³

6.13 The joint submission from the Women's Economic Think Tank (WET Tank) and the Women's Electoral Lobby (WEL) noted that 62 per cent of women in full-time wage and salary positions earn below AWE.¹⁴ The submission argued that:

... this whole [SGL] exercise can be seen as being targeted at the pockets of those earning between \$25 000 and \$30 000. On Treasury's own estimates these are the only group whose change in savings behaviour might substantially decrease their dependency on government expenditure. Those on incomes below this bracket cannot save enough to make major difference and those above are in the 30 per cent or so who currently do not draw pensions.¹⁵

6.14 Commenting on Treasury figures relating to the increases in retirement benefits due to the SGL, the submission went on to argue that:

¹² Cited in FitzGerald & Harper. Dilnot (1990), highest decile aggregated.

¹³ *op cit.*

¹⁴ SG sub no. 24, p 1.

¹⁵ *ibid.*

... the lower the income of the contributor, the greater justification for compulsory flat rate contributions must be given.¹⁶

6.15 With respect to the effect on national savings, Wet Tank and WEL noted that:

... in effect, ... the Commonwealth is tying up substantial tax concessions for the next three decades, in the hope that savings will come. Apart from the vagaries of markets and the possibility of wage and inflation outcomes affecting the earnings, the fact that this period covers a possible dozen elections makes this plan nonsensical.¹⁷

6.16 The submission argued that if the current superannuation tax expenditure was added together with the increased tax expenditures due to the SGL, the value of the tax concession would be over \$5 billion, or around 50 per cent of current pension expenditure. The submission maintained that:

... it would seem preferable to allocate this sum over the next few decades to an accumulation fund, together with the tax concessions, and use this for paying a universal pension.¹⁸

6.17 ACOSS considered the impact of superannuation on savings is often over stated because government support is required to counter the inflexibility of superannuation as a savings vehicle.¹⁹

6.18 ACOSS told the Committee that the current tax concessions substantially reduce public saving and that compulsion will improve national savings to the extent that it forces people to save who would not otherwise save.²⁰ The group most likely to be affected was low-income earners and families who have reached a stage in their life-cycle where their income needs are greatest.

6.19 ACOSS argued that:

... a fairer approach would be to encourage long-term saving generally, or at least to remove some of the disincentives to save in the taxation system ... Another option is to raise our comparatively low level of taxation in order to improve the social security system.²¹

Increase in Retirement Benefits due to the SGL

6.20 The interim retirement income target implied by the SGL is 40 per cent of pre-retirement income compared to the current age pension target which is 25 per cent of

¹⁶ *ibid.*

¹⁷ *ibid*, p 3.

¹⁸ *ibid*

¹⁹ SG sub no. 23, p 5.

²⁰ *ibid*, p 5.

²¹ *ibid.*

AWE. The Treasury advised the Committee that the increase in annual post-tax private retirement benefits due to the SGL would be in the order of 26 per cent after 40 years (see Table 6.3 below). The increased benefits generated by the SGL are 'back loaded' (i.e. they increase over time) due to the effects of compounding contributions and earnings and the phasing in of the SGL minimum.²²

Table 6.3

Increase in Annual Post-tax Private Retirement Benefits Due to the SGL; Cash Flow Basis (a)			
Years from 1989	Nominal	Present Value (b)	Percentage (c)
	(\$million)		
5	30	21	0.61
10	375	173	5.18
15	1 394	439	11.68
20	3 677	789	17.05
25	7 843	1 145	20.34
30	15 296	1 520	25.44
35	28 862	1 952	30.48
40	50 401	2 320	25.92

(a) Projected lump sum retirement benefits paid from superannuation funds, including benefits used to purchase annuities.

(b) Nominal discount rate equal to the assumed fund earnings rate of eight per cent per annum.

(c) Per cent of benefits received in the absence of the SGL.

6.21 Table 6.4²³ illustrates Treasury's claims about the progressive impact of the SGL on the pattern of retirement benefits. For somebody on three-quarters of AWE, for example, the SGL increases projected post-tax retirement income by 17 per cent of pre-retirement income. By comparison, somebody on twice AWE experiences no increase in retirement income.

6.22 The Committee asked the Treasury to undertake further analysis of the retirement income benefits flowing to individuals with broken labour force participation. These figures are reproduced in Chapter 4 and show that, even allowing for the effects of fees and charges, there is an increase in post-tax private retirement benefits.

6.23 However, WET Tank, ACOSS and Coles Myer disputed the progressive nature of the SGL for part-time and casual employees.²⁴

Increase in Superannuation Tax Concessions due to the SGL

6.24 The estimated tax expenditures through retirement and other employment termination tax concessions was \$3.59 billion in 1990-91.²⁵ In calculating the estimated

²² SG sub no. 32.

²³ *ibid.*

²⁴ SG sub nos 24, 23 and 4.

²⁵ Tax Expenditures Statement, The Treasury, 1991, p 52.

tax expenditure Treasury uses the savings benchmark. Treasury describes this benchmark as having the following features:

- remuneration in respect of employment is deductible to taxable employers and fully taxed to the employee;
- savings are normally financed out of after-tax income;
- investment income on savings is normally taxed in the income year it is derived; and
- dissaving of amounts (including interest) accumulated and already taxed is not taxed again.²⁶

Table 6.4

Increase in Retirement Benefits Potentially Available to Hypothetical Individuals (a)						
Present Income	Multiple of AWE					
	.5	.75	1	1.5	2	3
Assumed contribution rates (b)						
(i) Employer						
No SGL	0.00	0.03	0.03	0.05	0.10	0.15
SGL	0.09	0.09	0.09	0.09	0.10	0.15
(ii) Member						
No SGL	0.00	0.00	0.00	0.03	0.05	0.05
SGL	0.03	0.03	0.03	0.03	0.05	0.05
Annual retirement benefit (c)						
No SGL	50%	45%	35%	37%	57%	66%
SGL	81%	62%	52%	47%	57%	66%
Increase	31%	17%	17%	10%	0%	0%
Age pension entitlement (Full, Part or None)						
No SGL	F	P	P	P	N	N
SGL	P	P	P	N	N	N

- (a) Post-retirement benefits for single retiree assuming 40 year accumulation with retirement age 65 and private retirement income in the form of a five per cent-indexed annuity, taking account of the pension income and assets tests.
- (b) Proportion of member earnings. SGL rates assume that the measure is fully phased in. No SGL assumes three per cent award superannuation and additional employer support for higher income earners.
- (c) Per cent of pre-retirement income. This is the average value (NPV) of annual net income in retirement expressed as a percentage of gross final salary.

6.25 Professor Knox considered that an alternative to the single year approach used by Treasury was the establishment of a discounted cash flow model which projects cash flows over several years and thereby provides an estimate of the long term cost to

Government revenue.²⁷ Professor Knox also argued that the Treasury analysis overstated the value of the tax concessions.²⁸

6.26 Treasury provided the Committee with an estimate of the increase in the net value of the superannuation tax concessions due to the growth of superannuation under the SGL which are detailed in Table 6.5.²⁹

Table 6.5

Present Value of the Increase in Tax Concessions Due to the SGL							
Decade 1 Year	(\$m)	Decade 2 Year	(\$m)	Decade 3 Year	(\$m)	Decade 4 Year	(\$m)
1	0	11	1 737	21	1 712	31	1 523
2	0	12	1 806	22	1 693	32	1 487
3	96	13	1 794	23	1 667	33	1 446
4	233	14	1 765	24	1 641	34	1 412
5	319	15	1 769	25	1 617	35	1 377
6	409	16	1 753	26	1 593	36	1 342
7	504	17	1 733	27	1 596	37	1 313
8	585	18	1 716	28	1 545	38	1 271
9	962	19	1 697	29	1 518	39	1 236
10	1 341	20	1 676	30	1 487	40	1 199

6.27 The Treasury noted that while the implementation of the SGL will invariably mean a higher aggregate value of superannuation tax concessions, it should also mean a more equitable distribution of those concessions.³⁰ Table 6.6³¹ shows for individuals at different multiples of AWE, likely tax concessions included in retirement benefits, both before and after the full phasing in of the SGL. The table shows that the increase in tax concessions for lower income individuals generally exceeds that available at higher incomes. The Treasury claimed that the progressivity of the SGL is enhanced by the fact that the proportion of the workforce with award only superannuation is higher at income levels below AWE.

6.28 FitzGerald and Harper estimated that the net cash flow budget cost of the superannuation tax concessions following implementation of the SGL rises from under 0.5 per cent of GDP in 1991 to around one per cent in the year 2000, then peaking at 1.1 per cent of GDP before slowly declining.³² The benchmark case is that in which the coverage and contributions rates applying just prior to the 1991 Budget continue indefinitely. The outlook is for a net budget cost of superannuation going no higher than

²⁷ Attachment to sub no. 52, *Tax, Super and The Age Pension : The Issues of Equity and Incentives*.

²⁸ *ibid.*

²⁹ SG sub no. 32.

³⁰ *op cit*, p 11.

³¹ SG sub no. 32.

³² FitzGerald and Harper, *op cit*, p 23.

the present level of just under 0.5 per cent of GDP, falling slightly below it in some years in the 1990s and beginning a steady but slow decline in the mid 2000s.³³

Table 6.6

Increase in Superannuation Tax Concessions Potentially Available to Hypothetical Individuals (a)						
Present Income	Multiple of AWE					
	.5	.75	1	1.5	2	3
Assumed contribution rates (b)						
(i) Employer						
No SGL	0.00	0.03	0.03	0.05	0.10	0.15
SGL	0.09	0.09	0.09	0.09	0.10	0.15
(ii) Member						
No SGL	0.00	0.00	0.00	0.03	0.05	0.05
SGL	0.03	0.03	0.03	0.03	0.05	0.05
Value of tax concessions (c)						
No SGL	0%	8%	8%	24%	45%	61%
SGL	16%	26%	28%	34%	45%	61%
Increase	16%	18%	20%	10%	0%	0%

- (a) Tax concessions embedded in retirement benefits for single retiree assuming 40 year accumulation with retirement at age 65.
- (b) Proportion of member earnings. SGL rates assume that the measure is fully phased in.
- (c) Per cent of pre-retirement income. This is the average value (NPV) of the superannuation tax concessions expressed as a percentage of gross final salary.

6.29 ACOSS believes that the present superannuation system is unfair, wasteful and economically inefficient.

It is unfair because high income-earners receive greater government support though tax concessions than low income-earners, and substantially higher superannuation benefits on retirement ... The system is wasteful because government subsidies are directed towards replacing a proportion of each retiree's previous income. As other nations have found, this is a very expensive approach, and the support provided bears no relationship to the need of the recipient ... It is economically inefficient because the generous tax concessions for high income earners reduce public savings without necessarily increasing private savings.³⁴

6.30 ACOSS argued that the SGL will require low income earners to forego wage increases, and to make contributions directly for their retirement but with little or non-existent increases in their retirement benefits. ACOSS went on to note that:

... it cannot seriously be disputed that such a requirement would have an adverse impact on wage outcomes, whether it be immediate or somewhat delayed ... Many low-income

³³ *ibid.*

³⁴ SG sub no. 23, p 1.

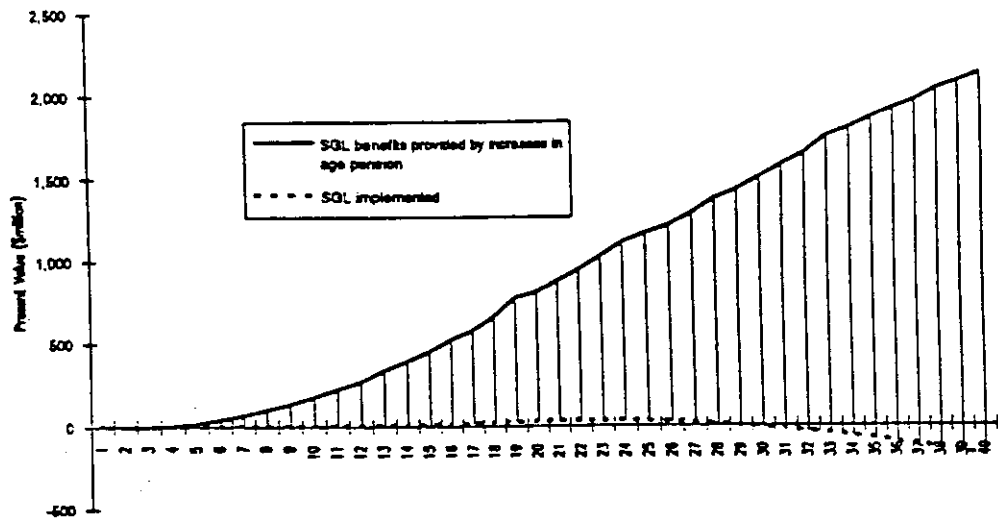
people simply cannot afford to be deprived of wages which they badly need for day-to-day living, especially when the longer-term tax benefit of doing so is insubstantial.³⁵

6.31 In this context, ACOSS, Mr Daryl Dixon and others argued that the current taxation arrangements, particularly as they affected low income earners, required changes to ensure that the superannuation taxation regime was more progressive.³⁶

Impact on Budget Pension Outlays

6.32 The Treasury argued that the additional superannuation benefits generated by the SGL will reduce age pension outlays because of the interaction of the SGL with the age pension income and assets tests. Figure 6.3³⁷ shows Treasury's estimate of the amount by which pension outlays (net of any tax claw back) under the SGL are lower than they would otherwise have to be in order to achieve the Government's interim retirement benefits target of 40 per cent of pre-retirement income.

Figure 6.3 Projected Saving in Present Value of Pension Outlays



6.33 Treasury noted that its figures probably overstate the budgetary costs of the SGL.³⁸ Professor Knox disputed this claim in his evidence to the Committee on three accounts. Firstly, Treasury assumed that all individuals would accrue benefits over a 40 year period. Professor Knox observed that this assumption ignored employees with broken labour force participation, particularly women. Secondly, Treasury assumed that only \$30 000 of the lump sum benefit would be dissipated at retirement. Professor Knox argued that more than \$30 000 would be dissipated unless people were forced into pensions and annuities. Thirdly, the original Treasury calculations made no allowance for

35 *ibid*, p 3.

36 SG sub nos 23 and 18.

37 *ibid*, p 15.

38 SG sub no. 32.

administrative expenses and Professor Knox argued that net retirement benefits would be lower than those portrayed by Treasury.³⁹

6.34 The Committee asked Treasury to model the effects of administration changes and the cost of death and disability insurance. On the specified assumptions of administration fees of 70 cents per week and \$1 per week and assuming an insurance premium of \$1 per week, the modelling showed that, whilst fees have a negligible impact on a person's average level of net retirement income, a higher level of fees does result in a small increase in age pension eligibility for lower income earners.⁴⁰

6.35 FitzGerald and Harper argued that the SGL would reduce the costs of aged pension outlays as a percentage of GDP (presently just over four per cent) until approximately 2014 then the costs would rise to a peak at about 4.3 per cent in the mid 2020s and then begin to ease.⁴¹ These results reflect a number of different assumptions from the Treasury model, principally that the age pension will remain at the current level of 25 per cent of AWE. FitzGerald and Harper also constructed a model estimating the impact of three policies which they claim would be more effective if the major goal of superannuation policy were to reduce the future public budget costs of retirement. These were:

- full alignment at 65 of the pensionable ages for men and women, phased in at one year of age per two years from 1995;
- setting the effective tax rebate on all contributions (employer or individual) to 15 per cent (net of the contributions tax) at all income levels and making all tax-supported contributions subject to preservation, the tax on fund income remaining at the present 15 per cent; and
- increasing the proportion of benefits taken as annuities to 50 per cent by the mid 1990s.

6.36 The impact of these measures on the public budget costs of retirement are illustrated in Figure 6.4.⁴² Because the modelling does not capture any major difference in dissipation of lump sum before pensionable age, the annuities case has a modest and slow to build up effect. The FitzGerald and Harper model shows that the pension measure, on the outlays side, and the set of tax measures, on the revenue side, are each capable of reducing the total budget costs of retirement by over 0.5 per cent of GDP.⁴³

³⁹ SG evidence, p 166.

⁴⁰ SG sub no. 47, p 2.

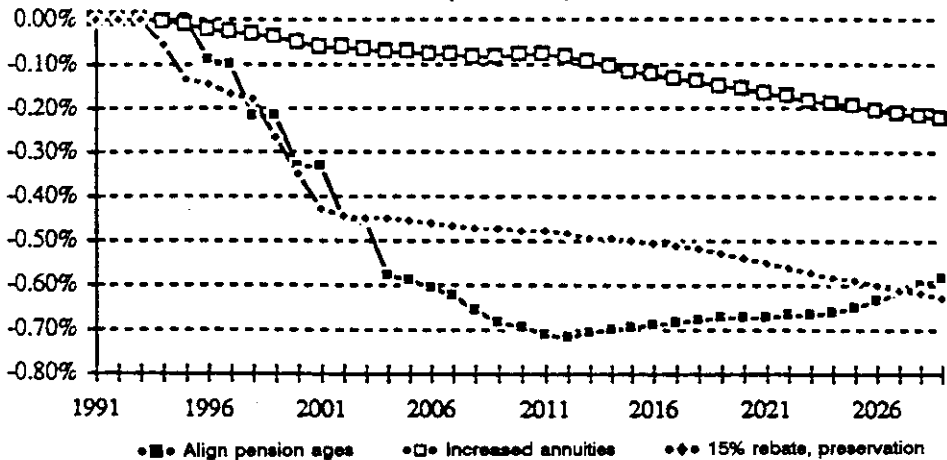
⁴¹ Fitzgerald & Harper, *op cit*, p 24.

⁴² *ibid*, p 24.

⁴³ *ibid*, p 24.

6.37 ACOSS argued that the cost of funding the age pension for a growing proportion of aged people next century is frequently over-stated.⁴⁴ It pointed to work undertaken in 1988 by the Economic Planning and Advisory Council (EPAC) which suggested that under the policy settings at that time, social expenditure devoted to aged persons would rise by around 2.5 per cent of GDP from 1988 to 2025.⁴⁵

Figure 6.4 Effects on total budget costs of retirement (% to GDP)



Impact of the SGL on Budget Outcomes

6.38 The impact of the SGL on the Budget is estimated by comparing the projected increase in superannuation tax concessions – which are front loaded in their impact – with the projected reduction in age pension outlays – which are back loaded in impact. Treasury estimates show that the SGL does not produce favourable Budget outcomes for about 30 years. The estimates are shown in Table 6.7.⁴⁶

Table 6.7

Present Value of the Impact of the SGL on the Budget (\$ million)			
Years from 1989	Increase in value of tax concessions	Reduction in age pension outlays (a)	Impact on Budget balance (b)
10	1 341	173	-1 168
20	1 676	789	-887
30	1 487	1 520	33
40	1 199	2 320	1 121

- (a) Against the counterfactual of increased pensions matching improved benefits provided under the SGL
- (b) A negative indicates a deterioration.

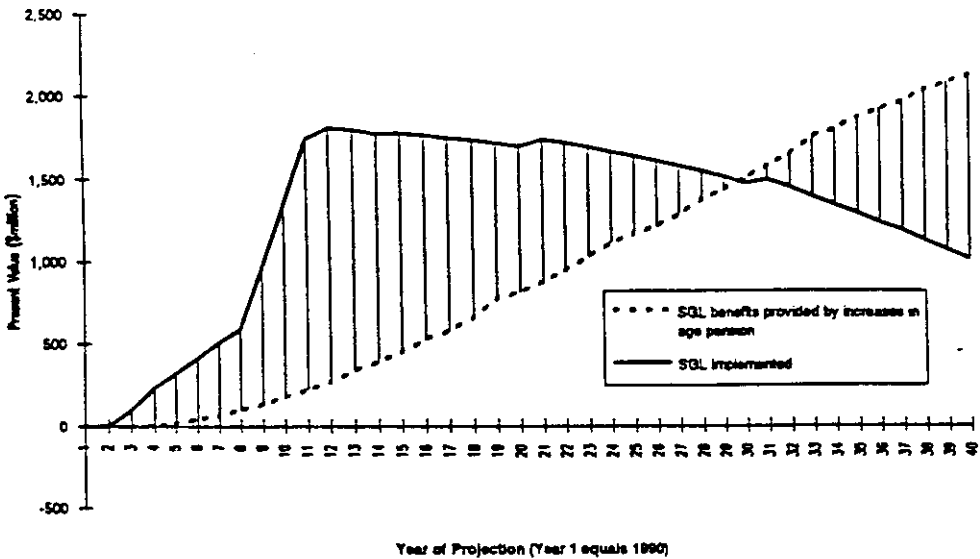
44 SG sub no. 23, p 3.
45 *ibid.*
46 SG sub no. 32.

6.39 The Treasury also provided the Committee with the chart (Figure 6.5)⁴⁷ which compares two alternative means of increasing the total value of retirement incomes to the Government's interim retirement income target: use of the SGL (and associated superannuation tax concessions) versus increases in the age pension. It reveals that in years three to 29 of the projection the cost of the SGL exceeds the latter, but that the picture is reversed in subsequent years.

6.40 Treasury pointed out that the chart illustrated some important issues concerning inter-generational equity and affordability.⁴⁸ In essence, the alternative policy of providing the interim retirement benefits target of 40 per cent of pre-retirement income through the age pension rather than the SGL means that Budget outlays are back loaded. Hence, there is reason for concern that future generations of working people may have some difficulty supporting a rapidly increasing aged population which raises the prospect of a future Government having to reduce the real value of the age pension.⁴⁹

Figure 6.5

Projected Increase in Present Value of Budgetary Cost of Retirement Income Policy



6.41 The Treasury concluded by noting that:

... the SGL proposal should not be judged on its own merits alone. Its true worth can only be revealed by comparing its impact with the consequences of an alternative policy which might be available in the absence of the SGL. In making such a comparison it would be particularly important to assess the projected retirement benefits available

⁴⁷ *ibid.*

⁴⁸ *ibid.*

⁴⁹ *ibid.*

under the alternative, and their net budgetary costs and profile, against those implicit in the SGL proposal.

The Effect of the SGL on Employment and Inflation

6.42 A range of views was received on the effect of the SGL on employment. The Committee also notes that all employer groups, as well as the superannuation industry itself, were concerned about the complexity of the administrative arrangements envisaged in the Bills and potential 'double jeopardy' faced by employers because the SGL would operate independently of the award system.

Treasury

6.43 Treasury estimated that the impact of the SGL would be equivalent to an aggregate three to four per cent of average earnings on a national accounts basis by the end of the period of its introduction in 2000-01.⁵⁰

6.44 Treasury noted that about half of the impact occurs in the first year of introduction, reflecting:

- the substantial lift in superannuation coverage for those not receiving superannuation; and
- the increase to five per cent superannuation for those currently receiving three per cent award based superannuation.⁵¹

6.45 Treasury also advised the Committee that using an assumption of 1.5 per cent per annum productivity growth over the period the SGL is introduced, would be equivalent to a total increase in productivity of 14 per cent. On this basis, the SGL cost would account for less than one-third of productivity increases over the period of its introduction.⁵²

6.46 Treasury was asked to model the effect of the SGL on employment using the assumption that the SGL would be fully reflected in increased real unit labour costs. Under this assumption, the Treasury estimated that employment losses resulting from the first year implementation of the SGL would be up to 45 000 in the first two years. This would rise to about 100 000 after five years.⁵³ The Treasury further advised that:

... the effect on unemployment would be considerably less. Unemployment rises by about half of any fall in employment with the remaining fall in employment being offset by a fall in the participation rate. On this basis, ... unemployment would rise by up to about 20 000 in the first two years and by up to 50,000 in the first five years.⁵⁴

⁵⁰ Treasury sub no. SG.31, p 1.

⁵¹ *ibid*, p 1.

⁵² *ibid*.

⁵³ *ibid*, p 2.

⁵⁴ *ibid*, pp 2-3.

6.47 Treasury further advised that to assume the SGL would be fully absorbed in increased real unit labour costs was unreasonable and that it expected the 'cost of the SGL will be largely, if not fully, offset by lower growth in other forms of remuneration, especially wages'.⁵⁵

6.48 Treasury was also asked to model the employment effects for 1992-93 if the contribution rate for business with a payroll of \$500 000 came in at four per cent instead of five per cent. Treasury estimated that decreasing the rate from five to four per cent for the employers in question would, in isolation, lower the wage equivalent impact of the SGL by about one third to one half percentage point in 1992-93. Treasury advised the Committee that:

... any estimates of the employment effects of such a change depend crucially on the assumption as to the offset in other wage costs flowing from the SGL. As the Committee has been previously advised, estimates of effects can only be properly identified when a full range of assumptions is provided. An assumption of providing no offset could be viewed as extreme and, as Treasury has previously indicated, it considers it is reasonable to expect that the cost of the SGL will be largely, if not fully, offset by lower growth in other forms of remuneration.

On the assumption of a full offset in wages to the SGL, there would be negligible employment losses under either case.⁵⁶

6.49 Treasury was also asked to model the employment effects of SGL if the threshold were raised to \$1 million or \$1.5 million. Treasury advised the Committee that:

The wage equivalent impact of increasing the thresholds would only be small. Treasury estimates that increasing the employer threshold from \$0.5 million to \$1 million would result in about 250 000 employees being entitled to receive only the lower, rather than higher, minimum rate of employer superannuation support in 1992-93 (ie three rather than five per cent). It is estimated that this would result in a decrease of around 0.05 percentage point in 1992-93 in the wage equivalent impact of the SGL. A further increase in the threshold from \$1 million to \$1.5 million is estimated to have a similar effect.⁵⁷

6.50 Treasury noted that modelling of the employment effects of different thresholds is dependent on the assumptions specified.

Retailers Council

6.51 The Retailers Council submitted that the differential treatment between larger and small businesses in the phasing in of the nine per cent is discriminatory because it differentiates between the labour costs of large and small business.⁵⁸ The Council believes that 'because of the larger number of employees which will be caught in large

⁵⁵ *ibid*, p 3.

⁵⁶ SG sub no. 60, p 1.

⁵⁷ *ibid*.

⁵⁸ SG sub no. 16, p 3.

businesses, the financial and therefore the potential employment impact on large businesses will be greater.⁵⁹

6.52 The Council advised that the additional costs imposed on retailers include:

- the increase in the minimum level of superannuation support to be provided by employers;
- the additional costs associated with extending coverage to those staff currently exempt under award arrangements;
- the costs of changing the vesting scale in company funds to provide for full vesting of five per cent;
- the costs of actuarial assessments which will be necessary in respect of defined benefit funds; and
- the additional administrative costs.⁶⁰

6.53 The Council concluded that:

Whilst it may be argued that the amount per employee is not large, the aggregate cost to employers is significant without any demonstration that this additional tax on employment in this period of unacceptably high levels of unemployment is justified.⁶¹

6.54 The Retailers Council surveyed its membership regarding the SGL. A total of nineteen organisations responded, representing large retail companies carrying on business in two or more states, having 20 or more outlets, and with an annual turnover exceeding \$50 million each.⁶² The survey showed that:

- moving to a five per cent superannuation contribution from 1 July 1992 will cost those retailers almost \$41 million per annum over and above their existing obligations;
- a further cost of \$15 million will be incurred by adding-in award staff not currently covered by award superannuation provisions; and
- another \$1 million will be added to cover the additional 20 000 seasonal staff who work between four and six weeks a year and earn at least \$250 a month.⁶³

⁵⁹ *ibid.*

⁶⁰ *ibid.*

⁶¹ *ibid.*, p 4.

⁶² *ibid.*

⁶³ *ibid.*

6.55 In response to these costs, five companies in the survey said they would increase prices, nine respondents said they would decrease hours available to staff and thirteen respondents said that they would decrease the number of employees.⁶⁴

Coles Myer

6.56 Coles Myer noted in its submission to the Committee that the proposed legislation:

- imposes new and additional requirements in relation to award staff;
- discriminates between large and small businesses when no such differentiation exists by award prescription;
- will impose additional costs, including:
 - increasing the minimum employer liability to five per cent;
 - including staff currently exempt from award superannuation;
 - the inclusion of managerial staff who have elected not to join company funds
 - the costs of changing the vesting scale in company funds for full vesting;
 - costs of additional actuarial assessments for defined benefit funds; and
 - additional administration costs.⁶⁵

6.57 Coles Myer further noted that the award provisions in relation to occupational superannuation, including such matters as eligibility criteria, vary significantly between awards in recognition of the employment patterns and circumstances of the various industries. For example:

- retail industry awards generally include a probationary period before an employee becomes eligible to be enrolled in a superannuation fund. If the SGL legislation continues to calculate employer liability on a monthly basis, seasonal casual workers who may work for six to eight weeks will be entitled to occupational superannuation payments and will then, because they have not accumulated \$500 be entitled to withdraw that money on leaving their employment or alternatively can leave the accrued benefit with the industry scheme and have administration charges deducted.

⁶⁴ *ibid.*

⁶⁵ SG sub 4, p 3-4.

- retail awards include provisions that establish a minimum standard based on the number of hours worked in a particular time period (generally an average of 12 hours a week over a 4 week period.)⁶⁶

6.58 Coles Myer advised the Committee that one of its subsidiary companies had calculated that an increase in costs of \$1 million translated to an equivalence of 50 jobs.⁶⁷

Metal Trades Industry Association (MTIA)

6.59 The MTIA told the Committee that:

... the Federal Government is seeking to impose a substantial increase in minimum superannuation contribution standards during the most severe and protracted recession we have experienced for some 60 years. The additional cost pressures this will create must result in further business closures, continuing workforce retrenchments and a stifling of investment in industry. Necessarily this will jeopardise many existing programs designed to improve our efficiency and competitiveness to the long term detriment of the nation.⁶⁸

6.60 MTIA was concerned that these problems would be exacerbated in some areas of the traded goods sector as the higher minimum support level for large employers will discriminate against labour intensive companies involved in import competing and exporting. It advised the Committee that in the two years to 31 March 1992, employment levels in the 7 000 member companies of the MTIA had fallen by approximately 15 per cent.⁶⁹ Also, MTIA was concerned about the effect of the proposed fixed timetable of the SGL for international competitiveness.⁷⁰ MTIA observed that:

Subsequent planned increases in minimum contribution levels throughout the balance of the 1990s on a fixed arbitrary timetable ... run the risk of producing additional negative effects on investment, employment and economic growth. In the dynamic, global environment in which Australian industry must compete it is inconceivable that we can even contemplate further cost increases without any meaningful consideration of prevailing economic and political conditions, let alone commit to them in the way the Superannuation Guarantee Charge proposes.⁷¹

Business Council of Australia (BCA)

6.61 The BCA was also concerned about the economic consequences of the Bill. The Council noted that:

⁶⁶ *ibid*, pp 4-5.

⁶⁷ *ibid*, p 5.

⁶⁸ SG sub no. 11, p 2.

⁶⁹ *ibid*.

⁷⁰ *ibid*.

⁷¹ *ibid*, pp 2-3.

... there is an underlying assumption that there will be capacity in the economy to meet the prescribed level of support to the year 2000. There is nothing in current economic forecasts to support that assumption. At a time when unemployment is at unacceptably high levels and predicted to continue for some time, this Bill can only exacerbate that situation.⁷²

Confederation of Australian Industry (CAI)

6.62 The CAI noted that AWE have risen at more than twice the rate of inflation over the last year and this is one of the factors which has depressed the level of economic activity.⁷³ The CAI also noted that SGL will increase the on-cost component of labour. Whilst there are variations between businesses and industries, on-costs represent approximately 30 per cent of the total cost of labour. The CAI argued that the SGL would mean an increase in the cost of labour equivalent to 2.1 per cent or 3.5 per cent in 1992/93 depending on whether the firm was below or above the \$500 000 threshold.⁷⁴ Table 6.8 shows CAI's estimates of the effective annual increase in labour costs.⁷⁵

Table 6.8

Effective Annual Increase in Cost of Labour Due to Introduction of Superannuation Guarantee Levy		
Financial Year	Payroll <\$500 000	Payroll >\$500 000
1992-93	2.1	3.5
1993-94	2.1	3.5
1994-95	2.8	4.2
1995-96	3.5	4.2
1996-97	4.2	4.9
1997-98	4.9	4.9
1998-99	5.6	5.6
1999-2000	5.6	5.6
2000-01	6.3	6.3

6.63 CAI advised the Committee that the direct effects of the increase in labour costs will affect employment and job creation, private sector investment, the level of economic activity, inflation and international competitiveness.

6.64 The CAI argued that significant increases in labour costs associated with the SGL will 'unquestionably reduce the number of persons employed'.⁷⁶ It further argued that:

⁷² SG sub no. 21, p 2.

⁷³ SG sub no. 15.

⁷⁴ *ibid*, p 5.

⁷⁵ *ibid*, p 6.

⁷⁶ *ibid*, p 7.

... the less direct, but more important effect of the higher cost of labour on employment will occur through either a slow-down of recovery or an actual return to recessionary conditions.⁷⁷

6.65 The CAI believes that it is 'a highly unrealistic assumption' that there will be a trade-off of lower wages to finance the higher costs of superannuation. Whilst the CAI agrees that over the long run the level of wages will adjust to compensate for the increased cost of superannuation, it suggests in the short run, the adjustment 'will not occur to a sufficient extent.' The CAI argued that:

No one has suggested that when superannuation costs increase nominal wages should fall. What has been indicated is that over time, money wages will not rise to the extent they would have had superannuation not been introduced. The adjustment process thus requires a wage increase against which superannuation can be off-set. But if employers are already unable to afford higher wages as many of them will be over the foreseeable future, the opportunities for adjustment are extremely limited.⁷⁸

6.66 The CAI went on to argue that:

... attempts to limit wage increases due to legislated contributions to superannuation funds will meet with stiff workplace resistance.⁷⁹

6.67 CAI advised the Committee that it had undertaken a survey of the effects on the Australian economy of the SGL. The CAI acknowledged that the precise estimates of the effect of the SGL on employment were a matter for conjecture; if the SGL is introduced, 'job losses' will be certain and they will be heavy.⁸⁰ It expects that between 45 000 and 60 000 jobs could be put at risk.⁸¹ The results of the survey are shown at Table 6.9 and indicate that employers intend to finance the SGL through increased prices or unemployment.

Table 6.9

Results of CAI Survey	
Means Used to Finance SGL	Proportion of Employees
Fewer employees	77.6%
Higher prices	38.6%
Lower wages	26.6%
Absorption costs	35.6%
Other	6.6%

77 *ibid.*
78 *ibid*, p 9.
79 *ibid*, p 10.
80 *CAI Industrial Review*, p 4.
81 SG sub no. 51, p 20.

Australian Small Business Association Ltd (ASBA)

6.68 ASBA was also concerned about the possible impact on employment if the SGL were to proceed. It advised the Committee that:

The introduction of a compulsory three per cent levy payment by those small businesses currently not meeting their award obligations in regard to superannuation payments will further exacerbate the high rate of small business failures and/or will lead to a substantial reduction in employment throughout the entire small business sector. As this sector is responsible for in excess of 60 per cent of the total private sector work force, unemployment numbers will undoubtedly increase dramatically, causing welfare benefit expenditure increase accordingly, thereby putting more pressure on government revenue, which ultimately will, undoubtedly, result in taxation increases.⁸²

6.69 As with other business groups, ASBA was concerned about the implications for inflation and international competitiveness and suggested that, given the current fragility of the economy, the introduction of the levy at this time was 'irresponsible and ludicrous'.⁸³

ACROD

6.70 ACROD is the national peak council of organisations and associations in the disability field. ACROD advised the Committee that it will be particularly affected by the SGL because most employees are involved in direct support services for people with disabilities where it is not possible to achieve productivity gains through reducing the amount of support without adverse consequences for disabled persons.⁸⁴

6.71 ACROD has asked that the Commonwealth Government top-up subsidies provided under the *Disability Services Act* to allow payment of the SGL but it has not been able to get a definitive response from the Department of Health, Housing and Community Services. If subsidies are not forthcoming, ACROD believes that the levy on voluntary organisations classified as 'public benevolent institutions' should be deferred.⁸⁵

National Association of Personnel Consultants (NAPC)

6.72 NAPC considers that the SGL 'will act as a real disincentive to growth in employment generally, and especially in the temporary, non-permanent sector'.⁸⁶ Its research indicated that, in any 12 months' period:

- one third of temporary employees work on average for two days per employer, and on average will have three employers or assignments during the period;

⁸² SG evidence, p 176.

⁸³ *ibid.*

⁸⁴ SG sub no. 12, pp 1-2.

⁸⁵ *ibid*, p 2.

⁸⁶ SG sub no. 8, p 1.

- another third will on average work for eight days per employer, averaging 3 employers or assignments; and
- the final third will work for an average seven weeks per employer, for an average 2 employers or assignments annually.⁸⁷

6.73 On the assumption that these assignments were all worked during a one month period, the NAPC estimated that the level of superannuation support generated in one year would be as shown in Table 6.10.⁸⁸

Table 6.10

Estimate of Level of Superannuation Support in Personnel Industry				
	Hours worked	\$ rate per hour	Gross \$	5% super
Group 1. above	45.6	13.50	615.60	\$30.78
Group 2. above	182.4	13.50	2 462.40	\$123.12
Group 3. above	532.0	13.50	7 182.00	\$359.10

6.74 Regarding the specific structure of the personnel industry, the NAPC advised the Committee that a requirement for employer support to be measured on a monthly basis will increase the strain on members' cash-flow positions.⁸⁹ This was because temporary employees are paid by the majority of members on the Tuesday following the week that they worked and the consultancy carries the financing of the temporary's wage until payment is received from the client. The Committee was advised that around 100 000 people are currently provided with employment through temporary arrangements each week.⁹⁰ It argued that any disincentive to temporary employment would see a dramatic increase in unemployment levels.

States and Territories

6.75 The State and Territory Governments gave evidence that increases in 'on-costs' for employment due to the SGL came during an unfavourable economic climate, and at a time when Government budgets were already stretched to the limit.⁹¹ It was noted that some States:

... may well need to consider a reduction in services and public sector employment in order to offset the increase in budgetary expenses.⁹²

87 *ibid.*
88 SG sub no. 8.
89 *ibid.*
90 *ibid*, p 2.
91 SG sub no. 17, p 2.
92 *ibid.*

6.76 These issues are further canvassed in Chapter 8.

6.77 The States and Territories regarded the Commonwealth's view that increases in remuneration under the SGL legislation would not be a net 'add on' as inadequate for three reasons:

- given current unemployment levels there can be no case for a general rise in employee remuneration as early as July 1992;
- the argument ignores the fact that many employees (including those in voluntary State schemes) already have superannuation benefits in excess of the minimum required by the proposal; and
- by 'guaranteeing' increased benefits in advance, the legislation weakens the ability of employers to negotiate productivity improvements in return for remuneration increases.⁹³

6.78 The States and Territories also noted that unlike private sector employers, they cannot claim the costs as a tax deduction and the Commonwealth should therefore provide some additional funding as compensation.

Aged Care Australia

6.79 Aged Care Australia is an umbrella council of State Associations and represents approximately 900 charitable and benevolent service provider members which provide nursing home and hostel care to almost 90 000 aged and disabled Australians. Members of the Council employ some 57 000 staff and the majority are classified as 'small businesses, although having payrolls in excess of \$500 000 per annum. The Council estimates that the SGL will cause one in every 70-80 employees to lose his/her job or have his/her hours reduced.⁹⁴

ACTU

6.80 The ACTU believes that the Treasury assumption of productivity growth of 1.5 per cent per annum is conservative.⁹⁵ The ACTU believes that productivity growth will be higher than this, particularly over the next two years because:

- historical precedents such as the fact that productivity growth coming out of the 1982 recession was of the order of 4.5 per cent per annum for each of the years 1983-84 and 1984-85; and
- there is clear evidence that some of the largest Australian companies achieved significant productivity gains in 1990 and 1991. The ACTU believes that these

⁹³ *ibid*, p 3.

⁹⁴ SG sub no. 5, p 1.

⁹⁵ SG sub no. 29, p 20.

gains are permanent but will not be fully realised until sales return to their past peak.⁹⁶

6.81 The ACTU advised the Committee that it was committed to policies ensuring low inflation in Australia and that it accepts that 'costs must rise slowly if at all'.⁹⁷ Real unit labour costs include national wage cases, enterprise bargaining outcomes, superannuation costs, and productivity offsets. The ACTU argued that the key issue was the growth in the package relative to productivity.⁹⁸

6.82 The ACTU told the Committee that the ACTU and Government have reached agreement on aggregate wage outcome targets since 1986/87 and that the targets were always achieved.⁹⁹ Such targets not only include wages and salaries, but also supplements and superannuation.¹⁰⁰

6.83 The ACTU considers that enterprise bargaining brings greater uncertainty to aggregate wages growth but not greater uncertainty to unit costs because it is associated with productivity and efficiency in the enterprise.¹⁰¹

6.84 The ACTU noted that real unit labour costs are presently at levels which supported strong employment growth throughout the 1980s. It observed that:

- real unit labour costs have increased in the last two years due to the recession, but will fall with recovery and increased capacity utilisation;
- industry is restructuring and has spare capacity so that as output increases during the recovery, productivity will rise and unit costs will fall; and
- profits will rise.¹⁰²

6.85 Further, the ACTU argued that: '... the key requirement for employers and investors is certainty and predicability at moderate levels where labour cost growth is concerned.'¹⁰³ In its view, the Accord has delivered certainty and predicability in the past and will continue to do so during the implementation of the phased SGL program.

6.86 The ACTU also advised the Committee that executive remuneration has the potential to impact adversely on employment and pointed to the example of Coles Myer,

⁹⁶ SG sub no. 51, p 4.

⁹⁷ SG sub no. 29, p 22.

⁹⁸ *ibid.*

⁹⁹ *ibid.*

¹⁰⁰ *ibid.*

¹⁰¹ *ibid.*

¹⁰² *ibid.* p 22.

¹⁰³ *ibid.* p 23.

where total wage costs fell by 2.7 per cent in nominal terms in 1990-91 whereas directors/executive remuneration increased by 10.5 per cent over the same period.¹⁰⁴

6.87 Commenting on the CAI survey referred to above, the ACTU observed that the results were from only 360 employers and that it 'represents a skewed, biased sample' because there are 350 500 employers in Australia.¹⁰⁵

P C Turner

6.88 The Committee's attention was drawn to the practices of one employer in the service industry who is seeking to reduce the labour cost implications of the SGL. In this particular case employees are not covered by any award, and remuneration is in the form of a structured Target Employment Cost (TEC) package. The employer has written to all staff advising them where superannuation contributions of at least five per cent of taxable income are not part of the TEC package, staff will be required to either:

- vary their total remuneration package so that at least five per cent of taxable income is received in the form of superannuation in order to satisfy the SGL requirements; or
- vary their total remuneration package to reflect the costs of the employer paying the superannuation guarantee charge.¹⁰⁶

¹⁰⁴ *ibid*, p 20.

¹⁰⁵ SG sub no. 51, pp 5-6.

¹⁰⁶ SG sub no. 61, pp 2-3.