SENATE FINANCE AND PUBLIC ADMINISTRATION

LEGISLATION COMMITTEE

Inquiry into the Defence Force Retirement and Death Benefits Amendment (Fair Indexation) Bill 2010

SUPPLEMENTARY SUBMISSION

Submission Number:	**7a**
Submission Details:	**Alliance of Defence Service Organisations**

The Alliance of Defence Service Organisations

ALLIANCE OF DEFENCE SERVICE ORGANISATIONS SUPPLEMENTARY SUBMISSION TO THE SENATE FINANCE AND PUBLIC ADMINISTRATION COMMITTEE INQUIRY INTO THE DEFENCE FORCE RETIREMENT AND DEATH BENEFITS AMENDMENT (FAIR INDEXATION) BILL 2010

Introduction

On 14 April 2011, the Alliance of Defence Service Organisations (ADSO)[1] made a detailed and considered submission to the Senate Finance and Public Administration Committee Inquiry into the Defence Force Retirement and Death Benefits Amendment (Fair Indexation) Bill 2010.

Subsequent to the ADSO submission, and after the closing date for submissions, the Department of Finance and Deregulation (DoFD), having had the opportunity to view all other submissions posted on the Committee's website, made its own submission to the Inquiry. This late submission from DoFD, intrudes into the political arena and is a crude attempt to refute the arguments made in the ADSO submission in support of the Indexation Bill.

Without an opportunity to appear before the Committee, ADSO feels compelled to address some of the misconceptions in the DoFD paper. It is abundantly clear that DoFD's only agenda is to defend an increasingly untenable policy position to deny fair indexation to military superannuation pension recipients and deceive the reader into believing the unbelievable – that military superannuation pensioners have such a *generous* retirement scheme they don't need fair indexation.

The Mathews Review (DoFD Submission Paras 4, 5 & 6)

The DoFD submission draws heavily on information from the Matthews Review to support the argument for no change to indexation (paragraphs 4, 5, 19, 20, 23 and 24 refer). This is the **only** inquiry to recommend no change to indexation out of a total of **seven** inquiries. **Every other inquiry has supported indexation change.** DoFD should be providing full, frank and objective advice to the Committee so why is such relevant information concerning the other inquiries omitted? And what else is DoFD not telling the Committee?

[1] 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.

Paragraph 4 of the DoFD submission highlights that the Matthews Review was *independent* as if it was worthy of some special recognition. However, the Review into Military Superannuation Arrangements was also independent, as were all of the previous Parliamentary Inquiries, so there is nothing special about the Matthews Review in this regard. After careful analysis, the Matthews Review was widely discredited within the ESO Community because of its flaws, inaccuracies, omissions and superficial approach to important issues. These shortcomings were reported to the then Minister for Finance in a detailed ex-service community response to the Matthews Report on **30 September 2009** to which the Minister failed to respond.

DoFD Comments on the Bill

Higher Employer Contribution Rates (Paras 7 & 12-14)

The DoFD submission suggests that "*higher employer contribution rates and death and disability arrangements*" are sufficient recognition of the unique nature of military service. However, the submission fails to mention that the employer contribution rates are **notional** not actual rates. They result from the Government's decision not to fund the annual "employer contribution" into a fund for investment but to pay its liability for annual military superannuation pensions from consolidated revenue as they fall due.

Effectively, there is no "employer" contribution in the accepted sense. In addition by paying employee contributions over the years of the ADF member's service into consolidated revenue the Government gains a significant financial benefit. This political decision, in denying the opportunity for investment income, results in the artificially high notional "employer contributions" detailed in the DoFD late submission. It is a unique feature of the Commonwealth schemes and one that could be fairly described as fiscally irresponsible. It is unreasonable to expect the members of both the DFRB and DFRDB schemes to be penalised for a deliberate policy decision that arguably does more to benefit Government than retired military members.

Further, the premise that a small increase of around 1% in indexation would lead to an increase in the notional employer contribution rate from 33.4% to 40.6% as suggested at paragraphs 13 and 14 of the submission is not backed by credible detail, and raises questions about the veracity of the assumptions underpinning the DoFD financial advice.

Advantages of Defined Benefits Funds

DoFD made a point that DFRDB pensions are not affected by downturns in the economy, such as occurred during the global financial crisis. However, the submission did not state that many superannuation funds have provided members with double digit annual returns over many years. Indeed a former junior finance minister, Senator Sherry, is on record (Dec 2008) saying that despite the downturn since Nov 2007, accumulation schemes have returned about 5% **above** inflation for 30+ years.

As far as death benefits are concerned, these are not unique to the military schemes and DoFD again fails to acknowledge that if a retired member dies without having a recognised partner, the Government has another windfall as the deceased estate receives nothing in terms of residual benefits. Contrast this unique benefit with normal Defined Contribution Schemes found in the civilian sector!

Retrospective Upgrade (Paragraph 15)

The DoFD submission argues that implementing fair indexation… *"…… would be a retrospective upgrade to the terms and conditions of service …"* This statement is fundamentally wrong, and is one that infuriates DFRB/DFRDB scheme members as well as ADSO and its supporters.

The clear intention of the DFRDB Scheme from the outset (i.e. the "employer" promise) was to provide an indexed pension that would maintain purchasing power – as indeed the original CPI did in the 1970s. The "*terms and conditions of service*" that existed for many years included a superannuation pension that unambiguously maintained purchasing power with appropriate indexation. Today's CPI does not maintain pension purchasing power.

All the ADSO is seeking is a <u>restoration</u> of <u>previously eroded</u> conditions of service. That is NOT a ".. retrospective upgrade ..." !

Better Indexation than the Age Pension (Paras 21 & 22)

The DoFD submission presents the idea that the Bill "a*ppears" to provide* for better indexation arrangements than those currently applying to Age and Service Pensions. We believe this is a red herring. ADSO understands that the intent of the Bill is to provide the same indexation of DFRB/DFRDB superannuation pensions as the Age and Service Pensions.

We understand that the age pension and military superannuation pension are provided for different purposes (paragraph 22); however, it is i**ndexation** of the pensions that is the central issue not the purpose of each. Both categories of pensions need regular adjustment to reflect changes to the cost of living in order to retain their purchasing power. The Government has recognised that indexation with CPI alone does not maintain the purchasing power of the age and service pensions but contends that it does for military superannuation pensions. To any objective observer, this is an indefensible proposition.

DoFD Confuses Inflation with Living Costs (Para 24)

DoFD confuses inflation with living costs which as we pointed out in our first submission are recognised by the Australian Bureau of Statistics as two different things. The Department also refers to Mr Matthews's novel way of introducing "productivity" which he uses in a vain attempt to discredit the adoption of a fair indexation arrangement for Military Superannuants. This Bill seeks to do no more than compensate DFRB/DFRDB members 55 years of age and older for rising living costs in the same way as Age and Service Pensioners.

Costings & the Future Fund (Para 25 - 29)

ADSO contends that as written, these paragraphs of the DoFD submission only serve to mislead, especially those who do not have a good understanding of economics, actuary knowledge or the budget process. Indeed the words of the previous Finance Minister (Mr Tanner) [the Inquirer section of The Australian newspaper April 30 - 1 May 2011] would seem to bring some light to the whole purpose of the DoFD submission:

> *"…'misuse of government spending information is a favourite artifice………as a shadow minister and Minister for Finance I became adept at these dark arts using some of what are now the standard tricks employed to maximise political appearances: switching between cash and accrual accounting; using nominal, real or proportion of gross domestic product indicators of spending according to which indicator suited the argument better; classifying yearly spending as capital; making commitments beyond the forward estimate years…….."*

An additional quote from Mr Tanner is relevant:

> *"The lesson is simple: whenever a politician cites spending figures to show what a fine job he or she is doing, examine the fine print very carefully."*

Paragraph 25 of the DoFD submission offers the reader a choice of three costings for the provisions of the Bill:

- Unfunded superannuation liability of $6.2bn
- Fiscal impact of $1.667bn
- Cash impact across the forward estimates of $175M.

The chasm between $6.2bn at one extreme and $175m at the other demands a more thorough explanation, and without it, the figures must be treated with extreme caution. ADSO's own research indicates that the DoFD numbers are inflated and based on flawed assumptions, particularly the fiscal impact and unfunded liability figures. For example, the accrual based unfunded liability figures span the period out to 2050 and beyond, and the smallest changes in assumptions today can have a major effect on such long term accrual costs. Importantly, the Australian Government Actuary has cautioned the Government on using unfunded liability figures in policy decision making because of their irrelevance to actual costs.

Furthermore, DoFD has chosen not to provide any detail on clawback which, according to DoFD estimates, is expected to deliver a 30% reduction in the gross cash cost of indexation change. There is also no acknowledgement of the $20M per year that the Government receives from the contributions of current members of DFRB/DFRDB scheme.

We can only conclude that the lack of explanation of these matters in the DoFD submission is deliberate.

In discussing the Future Fund, the DoFD submission provides no convincing data to suggest that our conviction that the fund is more than able to meet the costs of fair indexation for all Commonwealth superannuants in the now closed schemes, is in any way flawed.

Conlusion

DoFD has once again presented distorted arguments and an array of figures in such a way as to make any objective scrutiny virtually impossible.

The Committee may well ask why?