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Retirement Incomes: Increasing Inequity, Not Costs, across Generations Is the Intergenerational Problem

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Key points

- The 2021 Intergenerational Report (IGR), like its predecessors, tries to find reasons for concern about rising costs of retirement incomes as the population ages, but the evidence is striking about how well Australia has done to contain those costs even while greatly improving the incomes retirees will receive.
- Indeed, Australia's affluence-tested flat-rate pension, combined with pre-funded income replacement, generates projected retirement transfer outlays that decline over time as a percentage of GDP.
- There is little evidence that the IGRs have contributed much to improvements to retirement income policies: most of the improvements in both sustainability and effectiveness preceded the first IGR in 2002.
- Successive IGRs have switched the 40-year projections from a substantial increase in pension costs as a percentage of GDP to a substantial reduction.

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- The 2021 IGR suggests this will be offset by increasing superannuation tax expenditures, an assessment the authors consider to be highly deceptive.
- By focusing only on fiscal costs, the report fails to explore broader intergenerational policy issues including the likelihood of the deep inequality that exists within generations growing over time.
- To avoid this outcome, further reforms to the retirement income system are needed particularly to ensure superannuation savings are directed efficiently and effectively to deliver secure retirement incomes and to provide more adequate support to those with limited superannuation who do not own their own homes. Other possible measures include reviewing aged-care funding, exploring inheritance taxes and exploring land taxes.

Introduction

Increasing life expectancy and declining fertility throughout the developed world has generated widespread concern about the costs of retirement income provision, which in many countries is generated by a pay-as-you-go social security system. Australia is a fortunate exception as its affluence-tested flat-rate pension, combined with pre-funded income replacement, generates projected retirement transfer outlays that decline over time as a percentage of GDP.

In this chapter, we begin by documenting the history of retirement income policy in Australia, particularly in the light of an ageing population, and then discuss the projections reported in successive intergenerational reports (IGRs). We then highlight how projections of the costs of pensions have changed dramatically over the IGRs since 2002 from a substantial increase (as a percentage of GDP) to a substantial reduction.

We then review the 2021 IGR's attempts to downplay this change by projecting an increase in superannuation tax expenditures, suggesting that these more than offset the projected reduction in pension costs. We find this assessment highly deceptive, greatly exaggerating the level of tax expenditures and their projected growth and providing a misleading picture of their distributional impact.

The chapter then examines some intergenerational policy issues not explored by the 2021 IGR, which focuses only on fiscal costs. The fiscal perspective can help to draw attention to potential intergenerational inequality, but a broader review would identify the deeper and more pernicious inequality that exists within generations now and that is likely to grow over time.

The chapter ends with a discussion of a range of tax and transfer measures that would address this more serious policy concern, highlighting those that may be more politically feasible in the short and medium term. The latter include strengthening the efficiency and effectiveness of superannuation in delivering secure incomes in the retirement phase, addressing the complex interaction between superannuation and the pension means test and providing more adequate support for those with limited superannuation who do not own their own homes.

Retirement income policy and the ageing population: A brief history

While the Organisation for Economic Cooperation and Development (OECD) expressed concerns about the financing of the welfare state following the stagflation problems of the 1970s, it did not at that time draw attention to future demographic pressures (OECD 1981; Podger 1981). That only came later as Japan's rapid ageing became apparent and Europe's falling fertility rates suggested many other OECD countries were likely to follow suit. The United Nations held its first 'World Assembly on Aging' in 1982, mentioning the need to consider trends in population growth, age distribution and demographic structure, but not highlighting the budgetary pressures from ageing populations (United Nations 1982).

Despite Australia's relatively young age profile, questions began to be raised in Australia in the early 1980s that future dependency ratios might be adversely affected not only by the ageing 'baby boomer' generation but also by falling fertility rates and increasing life expectancy. Until then, Australian Bureau of Statistics projections had not factored in possible reductions in mortality rates among the aged (i.e. that those over 65 might live longer, as well as more people reaching age 65). This likelihood was raised by the Social Welfare Policy Secretariat (Myers 1980; Dixon and Foster 1980, 1982), which highlighted projected dependency ratios and the associated challenges for funding age pensions. Others questioned the seriousness of the

concerns raised citing Australia's modest age pension arrangements (flat-rate and means-tested), the reduced financial costs of young dependants and the likelihood of increased capacity to pay with economic growth over the ensuing 30 years or more (e.g. Newton 1980). Nonetheless, the narrative of a major demographic challenge took hold in the 1980s (e.g. EPAC 1988), pursued also by the OECD, who worried in particular about the costs of the unfunded defined benefit superannuation schemes that most member countries operated (e.g. Hagemann and Nicoletti 1989; OECD 1998).

While the concerns in Australia were tempered by its more modest pension system, the ageing population did frame much of the discussion about how more adequate retirement incomes might be provided, preserving retirees' living standards as well as protecting them from poverty. Past attempts to introduce a social insurance-based national superannuation scheme such as that proposed by Hancock (1976) would no longer be advocated by either side of politics, but alternative ways developed that might not impose undue costs on future generations. Initially, these focused on reforms to occupational superannuation (promoting preservation, vesting and portability and constraining tax concessions), then steps were taken to widen superannuation coverage by defined contributions that employers were mandated to make in exchange for lower wage increases (in the 1986 National Wage Case). While the accumulating superannuation savings would in most cases supplement age pension entitlements, the additional retirement incomes would not rely upon future taxpayers; indeed, they would reduce future taxpayer support to some extent through the age pension means test.

This new model was set out in the Hawke government's 'Better Incomes: Retirement Income Policy into the Next Century' statement (Howe 1989). The subsequent shift from an industrial relations agreement to mandate the employer contributions to a statutory superannuation guarantee was explained in the Keating government's 'Security in Retirement: Planning for Tomorrow Today' statement (Dawkins 1992). The SG (superannuation guarantee) was then legislated to steadily increase to 9 per cent. It was around this time that Treasury began to model the impact over time of the emerging retirement incomes system (Gallagher and Preston 1993).

The emerging 'pillars' system involved a means-tested, general revenue-financed, flat-rate age pension as Pillar 1, aimed to alleviate poverty; a defined contribution, fully funded superannuation Pillar 2 to help maintain living standards in retirement; and other savings (essentially home ownership)

as Pillar 3 providing added security. In 1994, the World Bank effectively endorsed the Australian approach as best practice in its publication, 'Policies to protect the old and promote growth' (World Bank 1994), noting how the second pillar would increase national savings and could fund additional investment while avoiding costs for future generations. The OECD also indicated support for the model emerging in Australia (OECD 1998). Australia had also drawn attention to the capacity of the second pillar to contribute to national savings (Fitzgerald 1993). (For a fuller description of the emerging Australian system compared to those in other countries, and a summary of debates over different 'pillar' arrangements, see Podger et al. 2014.)

In the meantime, the Hawke government had dropped (Commonwealth of Australia 1983) previous bipartisan support for universal age pensions, which had led to universal pensions for those over 70, and reintroduced (Commonwealth of Australia 1984) an assets test to complement the income test.

This action to contain age pension costs was extended in 1995 by the Keating government's decision to phase in an increase in the age pension age for women from 60 to 65 (to be the same as for men) and to phase out eligibility for wife's pension and Class B widows pensions (for 'widows' without dependants).

By the time the *Charter of Budget Honesty Act* was passed in 1998, projected Pillar 1 costs were already being wound back (notwithstanding the Howard government legislating the rate of the pension at 25 per cent of average weekly earnings) and the Pillar 2 contribution rate had increased to 6 per cent, promising significant improvements to most Australians' retirement incomes without burdening future taxpayers. By the time of the first IGR (Commonwealth of Australia 2002), the SG had increased to 9 per cent and the phasing out of pensions for women under 65 was well advanced; no new major measures had been taken to address the claimed costs of an ageing population.

By the time of the second IGR (Commonwealth of Australia 2007), two new measures had been taken, one addressing ageing pressures positively, the second exacerbating remaining pressures. In 2006, the Howard government established the Future Fund, drawing on revenues from the sale of Telstra and budget surpluses, to build a capital base to meet the costs of remaining unfunded public sector defined benefit superannuation schemes

(Costello 2006a). Associated with this was the closure of the largest such schemes to new members, replacing them with defined contribution schemes (the scheme for the military was not closed to new members until 2015, despite a report recommending closure in 2007 (Podger et al. 2007)).

The other measure involved removing remaining taxes on post-retirement benefits and earnings where tax had been paid on contributions (Costello 2006b) and relaxing caps on contributions. The caps were changed six times in the period from 2006 (Bateman 2018), the initial relaxation leading to a huge injection of funds into superannuation, almost certainly driven to avoid tax rather than for genuine retirement income purposes (Chomik and Piggott 2018). The ongoing costs of tax breaks for superannuation were significantly increased and it took another decade to effectively unwind this measure.

It was not until the 2010 IGR that further policy measures were taken to contain future costs, or at least to offset the costs of increasing the maximum rates of age pensions. These measures were not directly influenced by the IGR but by the Harmer Review, which questioned the adequacy of the single rate of pension particularly for those renting privately (Harmer 2009). The Rudd government announced a significant increase in both the single and married rate of pension in the 2010 budget, together with some tightening of the income test and the phased increase in age pension age from 65 to 67 for both men and women (Swan 2009).

The 2015 IGR was the first used directly to support proposals to limit the future costs of retirement incomes. The Abbott government, in its 2014 budget, proposed replacing wage-based indexation of age pensions with CPI indexation and phasing in further increases in the age pension age to 70 (Hockey 2014). The measures, advocated by a Commission of Audit (Shepherd et al. 2014), were not agreed by the parliament, but the 2015 IGR set out spending projections based on two main scenarios—the legislated policies and those the government had proposed. The first projections revealed significant increases in spending on pensions as a per cent of GDP, while the second revealed a slight reduction. The second, of course, involved a significant reduction in the value of the pension as a per cent of average earnings (though the projection assumed a return to wages indexation from 2028–29). In the event, the Abbott government did not pursue the measures, though it did substantially tighten the assets test instead in order to achieve the planned savings in the immediate four-year Forward Estimates (Morrison 2015).

In 2017, the Turnbull government amended the superannuation tax arrangements, effectively winding back the 2005 concessions and drawing on the 2010 Henry Report (O'Dwyer and Morrison 2016). The reforms introduced a progressive tax on contributions and firmly tightened contribution caps and limited the 15 per cent tax on fund earnings to those with accumulated savings below \$1.6 million.

This brief history demonstrates that, while the IGRs and the Charter of Budget Honesty may have contributed to a general atmosphere of public concern about the costs of an ageing population, most of the measures taken concerning retirement incomes preceded the IGRs and were aimed at both enhancing retirement incomes and limiting the costs for future generations.

Changing IGR projections

The 40-year projections of pension costs as a percentage of GDP in the IGRs have steadily declined, with a remarkable turnaround overall from the 2002 IGR's finding of an increase from 2.9 per cent to 4.6 per cent to the 2021 IGR's finding of a decrease from 2.7 per cent to 2.1 per cent (Table 5.1).

Table 5.1: IGR 40-year projections of age and service pension costs.

	Starting cost (year) % of GDP	40-year projection % of GDP
2002 IGR	2.9 (2000–01)	4.6 (2041–42)
2007 IGR	2.5 (2006–07)	4.4 (2046–47)
2010 IGR	2.4 (2008–09)	3.9 (2049–50)
2015 IGR — current policy	2.9 (2014–15)	3.6 (2054–55)
2015 IGR — proposed policy	2.9 (2014–15)	2.7 (2054–55)
2021 IGR	2.7 (2020–21)	2.1 (2060–61)

Source: Commonwealth of Australia (2002, 2007, 2010, 2015, 2021).

The shift is related in part to changes in the denominator (GDP) including because of changes in population assumptions (particularly migration), workforce participation assumptions and terms of trade. More significant, however, have been revisions to the numerator because of changes to projected retirement income savings and their impact on pension entitlements via the means test. The key policy changes affecting the projections have been

the legislated increase in the SG from 9 per cent to 12 per cent (2008), the increase in pension rates (2010), the phased increase in the age pension age from 65 to 67 (2010) and the tightening of the assets test (2017).

The shift is also demonstrated by the projected changes in the proportion of older Australians eligible for a full, part or no pension. The 2002 IGR did not refer to the proportions in 2001–02 nor those projected in 2041–42, but the main shift expected from increasing superannuation savings was from full-rate to part-rate pensions (the actual proportions of people over 65 receiving full, part or no pension in 2002 were 55 per cent/26 per cent/19 per cent (Chomik et al. 2018)). The 2010 Henry and 2009 Harmer Reports assumed around 80 per cent of those over 65 would continue to be eligible for some pension into the long-term future, albeit most on part-rate pensions. This seems to be the position implied by the 2010 IGR, which projected increased pension costs (albeit lower than previously). By 2015, however, the proportion of age pensioners (not including service, carer and disability pensioners over 65) had already fallen to 70 per cent, 42 per cent receiving the full pension and 28 per cent a part pension; adding in the other pensioners over 65 would raise the total to about 75 per cent, still well below the 81 per cent in 2002. The 2015 IGR projected a further reduction to 67 per cent (under existing policy) but did not mention how many of these would be full- or part-rate pensioners—presumably most would be part-rate. The 2021 IGR projected ratios of 25 per cent/35 per cent/40 per cent by 2060–61 from the existing 2020 ratios of 48 per cent/26 per cent/26 per cent.

These ratio changes reflect, of course, the improved retirement incomes that the majority of Australians can expect as a result of the expanding and maturing Pillar 2 superannuation scheme, which is essentially self-funded.

2021 IGR projections

Superannuation tax expenditures

The 2021 IGR questions this last point—that Pillar 2 is essentially self-funded—and any conclusion that the costs of the retirement income system to future generations of taxpayers will decline, despite the projected fall in age pension costs. Reference had been made in the 2015 IGR to the ‘tax expenditures’ involved in the tax treatment of superannuation, but

it was not until the 2021 IGR that these were projected over the 40-year period. The 2021 IGR claims these ‘tax expenditures’ will rise from around 2 per cent of GDP to 2.9 per cent and that therefore the total cost of the retirement income system will increase from around 4.5 per cent to 5.0 per cent of GDP. The report of the Retirement Incomes Review similarly refers to an increasing level of tax expenditures (Callaghan 2020).

This assessment is highly deceptive, and contrasts with the more balanced discussion of the concept and level of superannuation ‘tax expenditures’ in the Treasury’s 2017 Tax Expenditures Statement (Commonwealth of Australia 2017). This followed comments in a review of previous Statements by the House of Representatives Standing Committee on Tax and Revenue (2015:45) that the public misuses and misunderstands the estimates and suggesting that ‘the warnings in the document are not sufficiently clear to inform enough of its users’. The criticisms were not new; in 1992 when mandatory superannuation was first introduced, Bateman and Piggott (1992:48) wrote that ‘in the debate over appropriate tax treatment of superannuation saving, there is perhaps no issue which generates more confusion than that of revenue costs’. In its 2017 document, Treasury highlighted that identifying ‘tax expenditures’ is not a simple matter: it requires identifying a standard treatment that would or should apply were there no ‘concessions’ and considering likely behavioural impacts of the ‘concessions’ (e.g. on working or saving or the form of saving). It also directly cautioned against combining (adding or subtracting) the ‘expenditures’ from different ‘concessions’.

Importantly, the 2017 document provided two sets of estimates of the superannuation ‘tax expenditures’ against two different possible standards: a Schanz-Haig-Simons comprehensive income tax standard (where contributions and fund earnings would be taxed at the individual’s marginal rate of personal income tax, but benefits would be tax free—or TTE) and an expenditure tax standard (where contributions would be taxed but both fund earnings and benefits would be tax free—or TEE). It mentioned but did not provide estimates against an alternative expenditure tax standard (where benefits are fully taxed, but contributions and fund earnings are not—or EET), even though this is the more common approach internationally for taxing superannuation (OECD 2018). The two estimates provided were radically different: in particular, the ‘tax expenditures’ from exempting fund earnings switched from a positive \$20 billion to a negative \$10 billion! Almost certainly, using an EET regime as the standard would have revealed

a further large negative ‘expenditure’ because contributions are currently taxed (at 15 per cent) and the negative ‘expenditure’ involved would be only partly offset by the failure currently to fully tax benefits.

Subsequent Tax Expenditure Statements (with varying titles) in 2018, 2020 and 2023 (Commonwealth of Australia 2018, 2020 and 2023) have not repeated the careful discussion in 2017 nor provided two sets of estimates: the only benchmark used is TTE, which is the one also used in the Callaghan Retirement Income Review Report (Callaghan 2020). Yet not only is TTE not applied to the majority of savings in Australia (including owner-occupied housing), but it has also repeatedly been criticised as inappropriate for any savings, most recently by the Henry Review (Henry 2010), and is certainly not used internationally for superannuation. The key reason why it is inappropriate is that it would greatly distort decisions about when to consume income that is earned, penalising the deferment of consumption when the whole purpose of the retirement income system is to facilitate the spreading of lifetime incomes. When deferment is compulsory, as is the case with the SG, TTE would amount to a hefty penalty against both current and deferred consumption.

Those advocating a more consistent tax treatment of savings (e.g. Varela et al. 2020) do not suggest a TTE regime but at most a TtE regime where the tax on fund earnings would be modest, well below most individuals’ marginal tax rate (hence the use of lower case ‘t’ for the tax applying to earnings), indeed somewhat lower than the 15 per cent currently applying to superannuation fund earnings for those in the accumulation phase. Against such a standard, the majority of the ‘tax expenditures’ identified in the 2021 IGR would disappear. Chomik and Piggott (2018), using a TEE expenditure benchmark, calculated that the total tax expenditures attributable to an average earner are about 6 per cent of the tax expenditures using the TTE standard; for a worker earning twice the average earnings, the figure is still just 11 per cent of the TTE regime figure. Against an EET regime, the tax expenditures would almost certainly disappear altogether. Gallagher (2016) suggests the current complex ttE regime (the lower case ‘t’ referring to the application of lower tax rates to contributions and earnings than most taxpayers’ marginal tax rate) is broadly equivalent to an EET standard at most income levels.

Precisely because Australia has a progressive personal income tax system, the Treasury TTE approach suggests the claimed tax expenditures are heavily skewed to those on high incomes. That also is misleading. As discussed

further below, current arrangements do raise important equity issues not mentioned in the IGR. But if the claimed inequity of the current tax treatment of superannuation were to be addressed as implied by imposing a TTE regime, the whole of the retirement income system's Pillar 2 could well be destroyed.

Finally, the 2021 IGR ignores the caution in the 2017 Tax Expenditures Statement not to combine the different elements of 'tax expenditures'; indeed, it goes much further not only combining the (questionable) elements but adding them to pension expenditure estimates. All this seems designed to avoid drawing the most obvious conclusion that should be drawn from the IGR: that Australia's retirement income system does not face any serious cost pressures for future generations.

Other assumptions in the 2021 IGR

While the inclusion of dubious superannuation tax expenditures wrongly suggests a rising total cost of the retirement income system, the assumptions behind the projection of pension costs may have somewhat overstated the likely reduction in costs as a percentage of GDP. The assumptions are that income and assets test thresholds will increase by movements in the CPI. In fact, there is currently no automatic indexation of these thresholds, but past history suggests they are likely to be adjusted from time to time having regard not to price movements but movements in pension rates (which are tied to wage movements) and movements in the assets of average pensioners. There is no formal policy in this regard and the last change in 2017 was part of a broader change to the assets test. To the extent CPI indexation is below future adjustments to maintain relativities, the IGR projections will have slightly overstated future cost reductions, understating the likely number of full-rate pensioners and overstating the proportion not receiving any pension.

Intergenerational policy issues not explored in the 2021 IGR

The Intergenerational Report reveals some growth in the burden of government expenditures between generations, though as shown above this is not the case regarding retirement income costs and, as the report suggests, the increased burden projected is manageable and less than projected in

previous IGRs. Inevitably, the overall picture presented has led to continued calls to address intergenerational inequality. But by focusing on fiscal costs and associated intergenerational inequality alone, it obscures the deeper and more pernicious inequality that exists within generations and that, because of government policy, is likely to grow over time. The IGR is completely silent on this key issue.

That older people are wealthier is the norm, not the problem. Society expects citizens to work hard, save and be financially comfortable in old age when they cannot or are not expected to work. A society that encourages savings and hard work is productive and innovative.

Young people who work hard should likewise be able to look forward to these same advantages of hard work and savings. It is likely that in the future, however, wealth at older ages will be determined less by hard work and thrift and more by birthright. If one's parents have assets, one will be well-off. If not, while hard work is likely to still pay off, certain assets may be out of reach for some even among the hard-working and thrifty. This appears at odds with the Australian principle of equality of opportunity for all.

Fundamentally, there are two policy areas that have created this problem. The first is counter-cyclical, macro-economic policy. The second is the broader area of tax and transfer policy. We will mostly discuss this second set of policies, but will briefly mention the first.

The standard mantra of responding to shocks is now 'go hard, go early and go [cash to] households'.² What this has meant in Australia, both in response to the global financial crisis and to the economic downturn induced by the COVID-19 pandemic, is injecting large amounts of money into all households, including those who are well-off. Breunig and Sainsbury (2023) show that the Australian government's COVID-19 response over-compensated people on average and document the odd outcome that average incomes actually increased in 2020. While this supported consumption and provided protection for those directly affected by public health restrictions and the less well-off, it may also have contributed to asset price booms for the wealthier. Surging asset prices driven mostly by low interest rates have grown much faster than wages, resulting in less well-off wage and salary

2 See Chris Uhlmann's interview with Ken Henry about lessons learned from past economic shocks and the Australian response to the Global Financial Crisis: www.youtube.com/watch?v=N5UHT2hBGdk.

earners falling increasingly further behind in their attempts to enter asset markets such as the housing market. The short- and long-term impacts of the government's COVID-19 stimulus policies are still being assessed and it will be some time before we fully know the costs and benefits and their distribution.

Inter vivos transfers have been contributing to inequality in younger generations during the COVID-19 period as cashed-up baby boomers transfer assets to their children to enter the housing market. Those without wealthy parents to provide low-interest loans or gifts are left behind. This will likely spill over into other areas beyond home ownership such as quality education and medical care. This is the inequality that we should be worried about, particularly as it is likely to increase over generations.

In supporting current consumption, macro-economic policy has also (of course) increased government debt. Whether or not the policy was 'over-done', the IGR projects deficits over the whole 40-year period, with net debt in 2060–61 still over 30 per cent of GDP. Accordingly, today's young will pay throughout their lives for the benefits citizens mostly older than them received. The burden of Australia's debt will rest heaviest on the non-wealthy, those whose income derives solely from salary and wages. This is driven by Australia's heavy reliance on income taxation—both corporate and personal—that fall particularly heavily on those who are economically active.

Australia's taxation system's reliance on income tax is in fact increasing and enabling wealth once accumulated to be held beyond the reach of taxation—principally by storing it in the family house and tax minimisation devices such as trusts. The disconnect between taxable income and wealth is growing: anyone earning more than \$22,000 in 2022–23 (taking the Low Income Offset into account) is liable for income tax, while it is possible for Australians holding wealth valued in the tens of millions to have zero taxable income. Sainsbury and Breunig (2020) point out this possibility and discuss the difficulty in determining the degree to which this occurs in the Australian system.

More specifically, the tax and transfer system is exacerbating these problems in two ways: the retirement income system currently encourages inefficient risk management that tends to leave more savings to the next generation than retirees consciously plan, and the very uneven treatment of different savings vehicles tends to encourage investment in housing and its eventual transfer to the next generation.

Un-remedied, today's age-wealth disparity will augment societal inequality within age cohorts and in turn contribute to a larger age-wealth disparity in the next generation. And so on.

There are four key policy areas where government could consider addressing these inequalities: improving the efficiency of the retirement income system; aged-care funding; inheritance taxation; and land tax. In an ideal world, these changes would be part of a broad-based reform of the tax and transfer system.

Making the retirement incomes system more efficient and effective

While the retirement income system is successfully increasing the savings available to people at retirement so they can achieve adequate retirement incomes (broadly maintaining their pre-retirement standard of living), it does not yet encourage efficient management of the risks retirees face in the pensions phase. Those risks are real—how long they will live, inflation, investment risks, future healthcare requirements and sovereign risk (uncertainty about future government policies relating to the age pension, Medicare and aged care, in particular). The resulting precautionary behaviour is leading to people leaving more savings to the next generation than they consciously plan.

The government has foreshadowed reforms that would guide retirees towards purchasing retirement income products that more efficiently address most of these risks (APRA 2022). Funds would be mandated to offer the products the trustees consider would be in the retirees' best interests. Such products are likely to become the new default, replacing the current default of the minimum drawdown rules. In most cases, the products would include pooling of some savings to fund lifetime annuities instead of retirees inefficiently trying to address their longevity risk on their own.

But designing such products will require the funds to calculate their members' likely eligibility for the age pension. The pension means test needs to reinforce and complement the risk management approach built into the recommended product design, guiding funds and retirees towards the best approach to deliver secure and adequate total retirement incomes. A simpler, merged means test (combining the current separate income and assets tests) might improve the retirement income system's cohesion, balancing

the core objective of concentrating assistance on those most in need with the objectives of retaining reasonable rewards for saving and working and encouraging sensible use of savings (Podger and Breunig 2021).

Greater coherence, and a reduction in distortions over how retirees manage their assets, would also be enhanced if owner-occupied housing was included in the assets test (or merged means test) with a suitably high threshold. This would also be one way to ‘tax’ currently untaxed assets. While illiquidity is sometimes cited as the reason to exclude the home from the test, the government’s recently expanded reverse mortgage scheme provides a way for homeowners to draw on those assets, including if those assets were to limit access to the age pension. Commercial operators could supplement the income from the government’s scheme for those with more substantial home assets (or compete if they can offer more attractive products).

Whether or not home assets are included in the means test, there is a strong case for increasing support for those who do not own their own homes. The Centre of Excellence for Population Ageing Research has reported repeatedly about the inadequacy of support for older Australian renters (e.g. Chomik et al. 2018; Chomik and Yan 2019). Its 2019 research paper refers to research showing that older Australian renters have among the highest relative poverty rates in the OECD (Chomik and Yan 2019:48).

Concern about sovereign risk is entirely legitimate, as the Abbott government’s 2014 proposal to change pension indexation (from wage movements to prices) revealed. Retaining savings in case of future changes in entitlements, however, is adding to the problem of increasing transfers to the next generation. A better approach would be to lock-in the age pension parameters, including about indexation and the means test (see Podger and Breunig 2021) and to clarify the insurance offered by the aged-care system.

Aged-care funding

As aged-care reforms offer people more choice as well as higher quality care, there is a strong case for individuals to contribute more to the costs, particularly when they have substantial accumulated savings. Certainly, they should be expected to meet accommodation and living costs drawing on their retirement incomes and any housing assets. A capped contribution towards the costs of the care guaranteed by government would also seem to be entirely reasonable, the cap providing insurance against the possible need for expensive or extended care.

Knowledge of such a cap would also assist superannuation funds and retirees in designing retirement income products that efficiently manage the risk of aged-care requirements.

Inheritance taxes

If we want to keep a system that allows people to hold large amounts of assets and wealth free from taxation or inclusion in aged care or aged pension means tests (other than the tax on the income that originally funded the assets), then taxing that wealth at death might provide an alternative way to address growing inequality. One of the main drawbacks of addressing inequality through inheritance taxes, however, is that they can often be avoided through tax planning. Looking at other countries, such as the US or France, death duties raise only very small amounts of revenue. Given the extensive and very lightly regulated use of trusts in Australia, a death duty may be ineffective. It would also need to be combined with a gift tax on inter vivos transfers to be effective at dealing with the inequality issues raised earlier.

Land tax

Perhaps the simplest and most elegant reform to address wealth inequality would be a broad-based land tax. A tax based upon the unimproved value of land is highly economically efficient. It would also be progressive as the wealthiest individuals hold the most valuable land. By increasing the cost of holding land, it would reduce inefficient and speculative use of land. And it would also lower house prices and allow young people entry into the market. It is important to note, however, that a land tax does not necessarily make housing more affordable over the lifetime. But by shifting the costs of purchase into the future, it can relieve the credit constraint that many young people face and improve access to the housing market. In this respect, a land tax can be seen as a response to capital market imperfections.

Like inheritance taxes, land tax reform presents formidable political challenges. While the Australian Capital Territory and New South Wales governments have adopted reforms, looking to replace stamp duty with land tax, even this limited reform approach is proving to be difficult to achieve. The ACT has been successful as it combines the functions of a state government and a local authority. The NSW reform is more recent and more modest.

Conclusion

The IGR 2021 exaggerates the problems of future financing of the retirement income system and the risk of intergenerational inequity resulting. At the same time, by focusing only on fiscal costs, it ignores the more important issue of likely increasing inequity within future generations, as wealthy retirees leave more of their savings, often unintentionally, to the following generation. It also ignores the inequity caused by inadequate support for low-income retirees who do not own their own homes.

Future IGRs should address more meaningfully the challenges of rising inequality within future generations and highlight the policy directions needed to limit this risk including, in particular, in the area of retirement incomes.

While more consistent taxation of assets and savings could ameliorate this problem, the political challenges involved would be substantial. More feasible are measures to complete reforms to retirement incomes policies, particularly to guide retirees to more efficient and effective management of the risks they face, to improve cohesion between superannuation and the age pension (and also with the aged-care system) and to provide more adequate support for those who rely upon rental accommodation.

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