Fix retirement system before spraying cash around

Super debate
Joe Hockey's idea for spending super ignores just how much work the system needs to make it fit for its primary purpose of funding retirement.

Geoff Carmody

Treasurer Joe Hockey has suggested super should be made more flexible, allowing savers to use some of it for non-retirement incomes purposes such as buying a house.

Why? To provide adequate retirement incomes and cut age pension dependence and associated budget costs, for most people current super savings are considered inadequate. More super is needed for retirement, not less.

In releasing the latest intergenerational report, the Treasurer rightly stressed that longer-term budget deficits will build unless we act. An older population (thus higher age pension costs to the budget) and rising health costs are key causes.

But, Treasurer, super savings can only be used once.

Every dollar spent for non-retirement purposes means many more dollars unavailable to reduce age pension and related budget costs. You can't "cut, and come again". There is no "magic pudding". (Paul Keating should note that this was never the case – as attested by his own concern in these columns on Monday about the loss of compounded savings.)

Hockey's floppy idea distracts attention from many important policy issues involved in fixing our present retirement incomes policy, which is not working efficiently, effectively, or fairly.

Some examples follow.

- **Workforce participation by seniors.** Are the super preservation and pension ages too low as longevity increases? Should they at least be more closely aligned? Is the population dependency ratio sustainable (using 65 years as the working age cut-off)? A rise in this ratio is likely to produce increased demand for older workers. But on the supply side, is the age pension withdrawal rate under the income test "taper" a significant disincentive for older people to continue working?
- **Retirement incomes sustainability.** Is "longevity risk" mitigated by increased use of annuities? Are these efficiently and attractively priced to encourage take-up? How do retirees using them cover against investment risk if the supplier goes belly-up or suffers major losses? How do retirees insure against "sequencing risk"?
- **Reducing pension dependence.** Even assuming a 40-year working life and only 20 years on average in retirement, conservative real net earnings assumptions imply a retirement starting "nest egg" of between $700,000 and $800,000 to earn enough income to fail the age pension income test.

To accumulate this "nest egg", doesn't that require super contribution rates that are high relative to current income – and which is impossible for lower- and middle-income earners? Do we need a "reality check", lowering aspirations, expectations and performance claims for super?

- **Policy stability.** Retirement incomes policy, and especially superannuation policy, is chopped and changed too often. Are there "sovereign risk" or "policy risk" perceptions for those considering voluntary super contributions? How can we reduce such perceptions?
- **Compulsory superannuation.** Should we continue with the Superannuation Guarantee (SG) at all? Should it apply to nearly everybody? What about lower income groups? These workers enjoy lower or zero income tax rates but still generally face the same flat SG contribution rate (and a 15 per cent contributions tax on that).

If the SG increases saving mainly by forcing poorer contributors – the so-called "liquidity constrained" – to save when otherwise they would not or could not, is this fair? Is it fair over their own life cycles? What are the merits of a universal age pension, plus no SG, plus no tax concessions on (100 per cent voluntary) super contributions? Would this package have a lower Budget cost than the current system? Could it help break the inappropriate link between broken employment periods and retirement income needs?

- **Super fund performance.** Is the super/finance industry sufficiently competitive? Is it too cosseted by the guaranteed (and rising) inflow of SG contributions and contributions tax concessions favouring higher income earners, compared with other investments? How could problems here be addressed?
- **Super taxation fairness.** Can't we agree that the tax treatment of superannuation contributions is unfair, at least compared with "standard" income tax on investments earning interest income? Those below the current tax-free threshold (which is $18,200) face a zero personal tax rate but a 15 per cent tax on (mainly SG) super contributions. Some higher income earners can face marginal income tax rates (including Medicare levy plus NDIS levy plus deficit levy) of 49 per cent, but only 15 per cent, or, at worst, 30 per cent, on super contributions. What should be done about this?

Many retirement incomes policy questions need answers. These questions should be considered holistically, allowing for interactions between policy instruments and their effects.

One thing is clear to me. Neither spraying super savings across non-retirement objectives, nor governments raiding existing super savings balances to finance their own excessive current spending, are answers to any of these questions.

A policy stating that super is exclusively for retirement incomes is an essential starting point.

Super preservation and pension ages may be too low as longevity increases. PHOTO: JAY CRONAN

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As critics write it off, China shows there is life in the Party

Economy
It's not clear in the latest missive from the China doomsters, but deep reforms to push the economy from investment to consumption are taking hold as private business and investment begin to expand.

Geoff Raby

Chinese Communist Party delegates to the country's current parliamentary "twin sessions" may have been reminded of Mark Twain's quip "Reports of my death have been greatly exaggerated" if they saw the op ed in last Saturday's *Wall Street Journal* by respected China expert David Shambaugh.

Entitled "The Coming Chinese Crack-up", Shambaugh's article, timed to correspond with the National People's Congress, declares the Communist Party's rule is in its death throes. The last of the five reasons which he advanced for that – systemic economic failure – seems a world away from reality on the ground in China and from the policies outlined in the Premier Li Keqiang's work report to the Congress. With Shambaugh's article and the work report, we encounter parallel universes.

The work report is a strongly reformist document and takes forward the reform policies set down in the 60-point decision on economic reform at Third Party Plenum in October 2013. The key policy guidance from that document was that the market would play a "decisive role" in driving the economy and that the "private sector" would be on the same level as the state-owned sector. These policy themes run throughout the work report.

Three areas in the report stand out indicating that, rather than a creaking economy stuck in the past, the Chinese economy continues to be dynamic.

First, the services sector now accounts for over 48 per cent of GDP, compared with 46 per cent two years ago when it became the largest sector for the first time in China's history. Next year, services are likely to account for more than half of China's GDP.

The work report also looks towards faster growth of the e-commerce industry and associated logistics and express delivery services. In a curious turn of phrase for a usually staid government report, we are told that in the e-commerce sector creative entrepreneurs are "coming thick and fast" and these industries are developing with "great vitality".

> *Xi's anti-corruption campaign is both changing behaviour and broadly popular.*

As is to be expected from services accounting for a bigger share of GDP, energy intensity of GDP last year fell by 4.8 per cent, compared with a year earlier.

Structural adjustment that has long been called for is now well advanced. Last year, consumption accounted for more than half (51.2 per cent) of China's GDP growth, up from just 40 per cent a few years ago. China's economy is an increasingly consumption driven, services-based economy.

Second, as foreshadowed in the Third Plenum policy document, the non-state private sector continues to grow rapidly. Over the past year, the number of private enterprises increased by over 45 per cent which the report describes as a "fresh surge of entrepreneurial activity".

As has been the case for the past decade, more jobs were created in the private sector than the state-owned sector, which Li's report notes "fully demonstrates ... the tremendous power of reform and the endless potential of markets". Hardly the language of an embattled, ossified Communist Party. Unleashing the dynamism of the private sector has been a high priority for Li. Mixed ownership of state-owned enterprises is to be encouraged. Significantly, the report looks towards state owned enterprises being relieved of their obligations to provide social welfare. Until now, this has a major constraint on SOE reform.

Third, considerable progress continues to be made in financial sector reform, including gradual opening of the capital account, encouraging private financial institutions and allowing more foreign participation in the financial sector.

On investment, the intention is to move to a negative list, so that only investments explicitly excluded will require prior government approval while the rest can proceed on commercial grounds.

It is intended to attract more foreign direct investment by cutting by half the number of industries requiring approval for foreign investment, adopting a system of notification, and "pre-establishment national treatment plus a negative list".

If these are implemented, it would be a sea-change in China's stance on foreign investment.

Meanwhile, the RMB will be allowed to "float more freely", and convertibility for the capital account will be expanded.

The report also contains much on progress in cleaning up the environment, providing social welfare, improving medical services, expanding agricultural production, narrowing the gap between rural and urban incomes, and winding back the household registrations system (hukou) which had discriminated against temporary labourers from the countryside in cities.

There is no shying away from the significant problems the economy faces – the well known list including rapid build of local government and shadow banking debt, over-supply of apartments and the need to let air out of multiple property bubbles, deflation and declining total factor productivity.

The report's policies will be implemented at best in part and even if they were fully implemented, much would still need to be done. But the policy settings and reforms are all in the right direction. Economic policy is also free of ideological baggage.

Beyond imminent economic failure, Shambaugh highlights greater authoritarian control, supposed capital flight, bored officials and corruption.

Increased authoritarian control is real but has not gone so far as to create a generalised sense of repression, though it clearly carries risk and could prove counter-productive. Capital flight probably mainly arises because of low returns to property now the Chinese market is cooling. Bored officials are nothing new. Meanwhile, Xi's anti-corruption campaign is both changing behaviour and is broadly popular.

Ultimately, the Party's longevity will be about the economy and it is quite clear that the work report is intended to stretch its tenure well into the future. China's economy is already undergoing deep structural change.

A policy program which emphasises the role of markets and the private sector, deregulation and opening up further to foreign participation, does not look as if it is about to "Crack-up" any time soon.

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