



EVIDENCE BASED FAIRNESS

**SUBMISSION TO THE PENSION
INDEXATION REVIEW SECRETARIAT –
DEPARTMENT OF FINANCE AND
DEREGULATION**

17 JULY 2008

ABOUT SCOA

The **Superannuated Commonwealth Officers' Association (Federal Council) Inc. (SCOA)** is 84 years old, apolitical, not for profit and financed entirely by its members.

It represents the interests of:

- retired Australian and Territory Government employees and Government business enterprise employees;
- people in the public service who will receive a Commonwealth superannuation benefit (or lump sum) on retirement;
- former employees who have deferred (preserved) their pension entitlement; and
- spouses/dependents of the above.

SCOA has a national (Federal Council) office in Canberra and separate branches in each State and the ACT. Its branches are staffed by volunteers. SCOA has links with Defence and State superannuant organisations and with other key organisations which represent the interests of older Australians.

SCOA's objectives are to:

- improve and safeguard the retirement interests of its members
- protect the value of members' superannuation entitlements and related benefits;
- ensure that its members who have work related injuries or illnesses receive their correct compensation entitlements.
- secure fair and equitable treatment compared with other retirees and pensioners, and
- provide information to members on issues such as superannuation, taxation, Age and other Social Security and Veterans' Affairs benefits, health and aged care, concessions, compensation, employment of older workers and general investment matters.

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SECTION 1 - INTRODUCTION

1.1 The Superannuated Commonwealth Officers' Association welcomes the opportunity to present its case for a fairer means of pension indexation for its constituency. Our submission supports the points SCOA made in submissions to three separate Senate Inquiries on this matter. The reports from each of those Senate inquiries that recommended fairer indexation for Commonwealth superannuants are:

- April 2001 – *A “Reasonable and Secure” Retirement?*
- December 2002 – *Superannuation and standards of living in retirement*, and
- March 2008 - *A decent quality of life.*

A BASIS IN FAIRNESS

1.2 After pursuing fairer pension indexation for at least ten years, SCOA states most strongly the view of our constituents that **this is a matter of fairness and equity**. The now Prime Minister made many references to fairness and decency during the election campaign last year. Those affected are yet to see fairness applied to their retirement income either by the former or the present Government and their resultant standard of living has been significantly eroded as a consequence. They say that they don't deserve this treatment.

1.3 A survey of SCOA's constituency has not surprisingly found that they rate pension indexation as their highest priority across a wide range of retirement issues.

FAIRNESS FOR SOME

1.4 To its credit, the present Government has demonstrated fairness in introducing a fairer, wage-based index for the formerly CPI indexed part of Veterans' T&PI pensions and for War Widows' pensions. It has also shown its fairness in removing the discrimination experienced by members of same sex couples with regards to reversionary superannuation benefits.

The Government was understandably able to justify the correction of the unfairness experienced by these Australians. It now has the opportunity to do the same for its former employees and former members of the Defence Force.

WHAT COMMONWEALTH SUPERANNUATION PENSIONERS WANT

1.5 Commonwealth superannuants are not asking for special or favoured treatment.

What they want is to have their pensions increased by the same percentage as applies to the Age Pension, i.e. the community standard.

THOSE AFFECTED

1.6 This submission provides evidence regarding an issue that affects more than one million Australians. These Australians comprise:

- i) #130,129 Commonwealth civilian superannuation pensioners,
- ii) #107,844 former Commonwealth/Territory public servants who have left the public service but have preserved their superannuation benefits,
- iii) #163,525 Commonwealth and Territory public servants who are contributors to the CSS and PSS superannuation schemes,
- iv) #181,660 members of the various Defence schemes, including pensioners, deferred beneficiaries and those still contributing, and
- v) The *349,895 wives/partners who are, or will be, dependent on the superannuation pensions of those in i) to iv) above. (* Estimated as 60% of the addition of i), ii) iii and iv).

Numbers as at 30 June 2007.

Commonwealth superannuants, (including Defence superannuants), receive an average pension of less than \$23,000, (June 2007).

1.7 SCOA understands that many MPs mistakenly believe that this is primarily a matter that affects Canberrans. Labor MPs have actually informed SCOA that most of their colleagues mistakenly believe this to be so. It is not. For example, in 2007 **almost two thirds of Commonwealth Public servants worked outside of Canberra.**

1.8 Those affected by this issue were employed by successive Governments to provide a vast range of essential services throughout the whole of Australia.

1.9 For example, some of them worked in Repatriation Hospitals as cooks, labourers cleaners and gardeners, others worked in Government factories producing clothing, munitions, rifles etc for our Defence Force, as Customs Officers they prevented the illegal entry of drugs and dangerous flora and fauna into Australia and some delivered our mail.

1.10 Many of these people worked in relatively lowly paid jobs. They are not, as is too often believed, your typical Canberra public servant who by contrast mostly received higher wages. Their wage is a primary ingredient in the formula used to calculate their retirement pension which helps explain why their pensions average \$23,000, (as at 30 June 2007).

1.11 The long term effect of the considerable disparity between the various indexation methodologies applied to these three groups of senior Australians is best demonstrated in the graph at **Attachment A.**

It is not difficult to understand why they say they are being treated as second class Australians.

1.12 The following table clearly shows that the vast majority are in receipt of quite modest pensions, pensions that are being steadily eroded because of unfair indexation.

**ANNUAL PENSION PAYMENTS IN MULTIPLES OF \$10,000
RECEIVED BY COMMONWEALTH CIVILIAN AND DEFENCE
SUPERANNUATION PENSIONERS**

As at 30/6/2007

| \$'000 | No. | % | Cum. % |
|---------------|----------------|------------|---------------|
| <10 | 24,012 | 12.39 | 12.39 |
| 10 – 19 | 70,093 | 36.16 | 48.54 |
| 20 – 29 | 55,500 | 28.63 | 77.17 |
| 30 – 39 | 25,882 | 13.35 | 90.52 |
| 40 – 49 | 11,241 | 5.80 | 96.32 |
| 50 – 59 | 4,525 | 2.33 | 98.66 |
| 60+ | 2,604 | 1.34 | 100.00 |
| Total | 193,857 | 100 | |

Almost 80% received a pension of \$ 29,000 OR LESS with almost 50% receiving \$19,000 OR LESS.

1.13 These senior Australians had to compulsorily contribute to a superannuation scheme that they believed would provide them with a secure and reasonable income in retirement. Some sacrificed the higher wages often available in private enterprise because they believed that Government employment would enable them to retire with the confidence that they would receive an adequate pension **and that it would maintain relativity with the wage for the position they held on retirement.** They were mistaken.

1.14 When contacting SCOA, our constituents have made the following observations:

- Retired Federal MPs received an annual **7%** increase in their pensions in 2007.
- Age Pensioners received a **2.5%** increase in March 2007 and a **2.4%** increase in September 2007.
- Commonwealth superannuants received a **2.5%** increase in January 2007 and a **zero increase in July 2007.**

NOTE: Federal MPs' pensions are indexed once a year. The Age Pension is indexed in March and September and Commonwealth superannuation pensions are indexed in January and July.

COST OF LIVING PRESSURES ON OLDER AUSTRALIANS

1.15 In March this year, the Senate's Legislative and General Purpose Standing Committee released its report of an inquiry into the cost of living pressures on older Australians. That report, "**A decent quality of life**", recommended that

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| <p><i>"the Government review and standardise the indexation methodology of pensions, social security and other government retirement benefits to ensure they maintain their relative levels."</i> Pg XV, para 8.35(i)</p> |
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1.16 The report went on to recommend that;

“while the review is undertaken and to ensure immediate relativity, the Government should index Commonwealth funded superannuation benefits and the military pension to Male Total Average Weekly Earnings or the Consumer Price Index, whichever is the higher, as is currently the practice with the age pension.” Pg XV, para 8.35(iii).

1.17 To support that recommendation, the report noted in its Conclusion, page 135, para 8.1,

“Further, the indexation methodology underlying government benefits, payments and concessions can have a substantial impact on the affordability of the cost of living of older people, especially in an increasingly user-pays environment,” and at page 140, para 8.28,

“The failure to index adequately - and in some cases index at all – benefits and payments has an often detrimental impact on the real level of these benefits and the disposable incomes of social security beneficiaries and older persons.”

1.18 In presenting the Committee’s report to Parliament, Senator Humphries, who was the initial Chairman of the Inquiry, said,

“There was one aspect of the inquiry which was less ambiguous and that was the question of the living standards and income security of older Australians who are dependent on Commonwealth superannuation pensions, particularly retired public servants and members of the Defence Force. The relative position of these retirees has been deteriorating as against age pensioners. Frankly, it is hard to understand because both groups are dependent on Commonwealth policy for their security or the quality of their lives.”

EVIDENCE BASED POLICY

1.19 The Prime Minister is known for his strong belief in evidence based policy.

Since the former Government formally improved the indexation of the Age Pension in 1998, those pensions have rightly increased by 51%. The pensions of the Government’s former employees have increased by only 29% over that same ten year period. However Governments have, since 1993 invariably adjusted the age pension by an index more favourable than the CPI.

1.20 The March 2008 Senate Inquiry referred to above was preceded by two Senate inquiries, all making consistent recommendations to index the pensions of the Government’s former employees by the community standard. All three Senate Committees comprised Senators from all the major political parties and there was bi-partisan support for the recommendations made by those committees. Senator the Hon Nick Sherry was the Deputy Chairman of the first two inquiries.

1.21 The Graph at **Attachment A** demonstrates most vividly how far behind other senior Australians’ pensions the pensions of retired public servants and former members of the Defence Force have fallen.

Those affected by this issue are asking how much more evidence is needed to demonstrate why their pension indexation needs changing and when they will receive indexation fairness

BETTER SUPER

1.22 Those affected by the unfair indexation of their Commonwealth superannuation pension saw a glimmer of hope when the *Better Super* initiative was announced by the former Government in 2006. Their hope was short lived once they learned that because of the operation of the *Senior Australians Tax Offset* as detailed later in this submission, the *Better Super* arrangements would do little if anything to assist those at the lower end of the superannuation ladder.

AFFORDABILITY OF A CHANGE

1.23 Historically Commonwealth superannuation payments have been met from annual revenue collections. These payments have been made without the need to draw on a special fund, such as the Future Fund. Despite such payments being made from annual revenue collections, there have been large budget surpluses for the past several years. These surpluses have been achieved notwithstanding a period of high expenditure on large overseas Defence deployments.

1.24 Representations by SCOA to the former Government drew responses that routinely referred to the cost as being a major factor for not approving a change to the indexation methodology of its former employees' pensions and former Defence Force members' pensions.

1.25 The 2001 Senate Committee said in its report *A "Reasonable and Secure" Retirement?*

".....However, the Committee considers that under favourable fiscal conditions the cost of such a change could be absorbed."

UNFUNDED LIABILITIES

1.26 The former Government's responses continued to refer to the impact of the cost of a change on unfunded superannuation liabilities. The reference to unfunded liabilities served only to distort the annual cost to budgets and alarm those who were not conversant with the cumulative, forty year nature of unfunded liabilities.

1.27 Successive Governments have invariably been able to find funds to meet large cost blow-outs on a range of Government programs. This comment is not made to challenge the worth of those programs but rather to demonstrate the capacity to fund important Government programs.

1.28 Neither the former Government nor the then Opposition balked at the cost of introducing fair indexation for the Age Pension and most other Government pensions in 1998. Similarly, they did not balk at the cost of recently improving the indexation of some Veterans' Affairs pensions.

FURTHER DISCRIMINATION

1.29 Besides failing to understand why their pensions are so poorly indexed, those affected cite further examples of how they have been unfairly treated compared to other senior Australians.

Taxation

1.30 When the GST was introduced Commonwealth and Defence Superannuants received no one-off bonus payment that was rightly paid to Age Pensioners to help offset GST driven price increases. This occurred even though their pensions averaged less than the married rate of Age Pension.

1.31 They also notice that whereas an Age Pensioner couple each receive a pension in their own right and are therefore taxed separately, their pension, which mostly supports both members of a couple, is paid to one member of the couple. This results in their paying a considerably higher rate of tax for the same amount of retirement income than that paid by an Age Pensioner couple.

Limited Benefits from Better Super

1.32 Whilst SCOA constituents welcomed the introduction of the former Government's *Better Super* arrangements, their joy was soon dashed when many learnt that the 10% tax offset that *Better Super* provided would not benefit them or that they would not receive the full 10% offset. Please refer to the accompanying report from the National Centre for Social and Economic Modeling at the University of Canberra, **Attachment B**.

Further, the Better Super arrangements discriminately affect the tax treatment of any non-super income received by our constituents.

1.33 Members of a taxed fund, mostly people who worked in private enterprise, pay no tax on their superannuation on reaching age 60. Any non-super income they receive is taxed in isolation of their superannuation income. However our constituents, who do pay tax on their superannuation income, must add their non-super income to their superannuation income to determine their marginal tax rate.

The differential treatment of non-superannuation income between these two groups of senior Australians is particularly unfair and demonstrates yet again how the Government's former employees are unfairly treated.

1.34 Had their employer, the Government, contributed to a superannuation fund to pay their superannuation as did most other employers, they would receive the same tax treatment as those who belonged to a taxed superannuation scheme. They are being penalised because of a decision over which they had no control. Successive governments made this decision because they knew that they could meet their superannuation liabilities to their employees from annual revenue collections and there is nothing that we are aware of to suggest that this will change.

Residential Aged Care Fees

1.35 Residents of Government funded residential aged care facilities have their fees/charges increased by indexation percentage increases in the Age Pension. This discriminates against residents of those aged care facilities who are Commonwealth civilian or Defence superannuation pensioners because their pensions are indexed by the lower, CPI index. Because the payments they are required to make comprise such a large part of their pension, the small amount they have left after paying those fees is considerably eroded. This reduces their standard of living at a time in

their lives when they deserve to have sufficient monies to meet important expenses such as family Christmas and birthday presents and enjoy social outings etc.

THE CONSUMER PRICE INDEX - CPI

1.36 Prior to seeing the review's terms of reference, SCOA believed that the new Government would now be convinced that the use of the CPI as an indexation tool was no longer fair or appropriate. However, as the terms of reference indicate otherwise, we provide the following details to refute the CPI's relevance as an indexation tool.

1.37 The use of this tool as a cost of living measure has, for good reasons, almost been eliminated. Whereas it once was recognized as a basis for determining cost of living increases, its modification by successive Governments rendered it unsuitable for that purpose. Its failure to encompass productivity gains is a further factor rendering it unsuitable as an indexation tool.

1.38 Similarly, there is a growing move by State and Territory Governments to increase utility charges by movements in wages as opposed to the CPI. This not only demonstrates the recognition that the CPI is no longer an adequate means of increasing fees to cover the cost of providing basic public utilities, it also has the unintended impact of penalising those whose incomes continue to be indexed by the CPI.

1.39 In 1998 the former Government, whilst not abandoning the CPI altogether as the indexation tool for most Government pensions, introduced legislation to ensure that the Age Pension would always be at least 25% of Male Total Average Weekly Earnings and said,

"The Government has undertaken that the maximum basic single rate of Age Pension will always be at least 25% of Male Total Average Weekly Earnings. This ensures pension rates remain in line with the cost of living, and that pensioners share in improvements in community living standards as measured by wages."

Centrelink Publication "News for Seniors, Autumn Issue 61"

1.40 The Australia Bureau of Statistics, the Government agency responsible for the CPI says in its publication, *A Guide to the Consumer Price Index: 15th Series – 2005*,

"CPI is not a purchasing power or cost-of-living measure."

1.41 It goes on to say,

"Although the CPI is also commonly referred to as a measure of changes in purchasing power or cost of living index, in an economic context these terms are not strictly interchangeable with a measure of price inflation. Their measurement would require separate, purpose built indexes. A single index cannot be expected to adequately fulfill all these roles."

An index designed to measure changes in the purchasing power of household incomes would need to be concerned with changes in the costs of all expenditures made from household income. Such a measure would include items like income tax and interest payments."

A true cost-of-living index, amongst other things, would need to be concerned with changes in standards of living and with the substitutions that consumers make in order to maintain their standard of living when faced with changing market conditions (for instance, buying chicken rather than beef when beef prices are high.)”

SECTION 2 – TERMS OF REFERENCE

2.1 We have noted the Terms of Reference and will address those in detail. In doing so we have discussed taxation which whilst not specifically mentioned in the Terms of Reference, is of such a direct and profound relevance to this review that to exclude it would compromise the review’s ability to make fair, proper and fully researched recommendations to Government.

2.2 Our comments against the terms of reference are as follows.

i) THE OCCUPATIONAL NATURE OF THE SCHEMES

2.3 Commonwealth Superannuation pensions are calculated at the time of retirement with reference to **salary**, age and length of service. It follows that those pensions should maintain relativity with the **salary** being paid for the recipient’s former position.

2.4 An example of how this relativity with salary has not been maintained is demonstrated by a SCOA member who has advised that it is less than six years since he retired. At the time he retired, his pension was equivalent to approximately 60% of his salary. Today his pension represents slightly less than 50% of his salary and that significant erosion has occurred in less than seven years. The erosion will of course only widen as he ages. We know that this story is not uncommon.

2.5 Most other Government pensions are indexed to the higher of the CPI and 25% of MTAW. This contrasts sharply with the indexation arrangements for Federal MPs whose pensions are linked to movements in parliamentary salaries and allowances. Please refer to **Attachment A**. A relativity with wages exists for these retirees; why shouldn’t it also apply to the Government’s former employees and former serving members of the Defence Force?

Whereas Commonwealth superannuants can justifiably ask for their pensions to maintain relativity, throughout retirement, with the salary for the position they held at retirement, they are asking for no more than an increase that is equivalent in percentage terms to that applied to adjust the Age Pension.

2.6 Former Labor Governments have generally been regarded as model employers, and have been keen to ensure appropriate wages for all Australians. That recognition of the need for a reasonable wage should be applied to their former employees and former serving members of the Defence Force in their retirement.

2.7 Commonwealth Civilian and Defence pensioners had to compulsorily contribute to superannuation, thereby reducing the amount of Age Pension they could receive on reaching Age Pension age because their superannuation pension is counted in assessing their Age Pension entitlement. Other Australian workers did not have to do so and could, if they chose to do so, enjoy a lifestyle throughout their working life that ensured they were eligible for the maximum rate of Age Pension.

2.8 Working Australians share in productivity benefits as do Age Pensioners and other Government pensioners. A significant number of Commonwealth superannuation pensioners are being productive through their participation in voluntary work and are at the same time saving the Commonwealth considerable expenditure. Why should these senior Australians be denied the productivity benefits enjoyed by other senior Australians? They deserve equal treatment because they also contributed to building the Australia we all enjoy today.

2.9 The compulsory contribution to the 1922 Act scheme, the CSS and PSS left no/little choice for Commonwealth employees to join other superannuation schemes. They are therefore disadvantaged because under the *Better Super* arrangements they do not enjoy tax free superannuation income after age 60. Ref. NATSEM report, **Attachment B**.

2.10 Similarly, because their superannuation pension is taxed, they pay a considerably higher marginal tax rate on any non super income compared to senior Australians who contributed to a taxed superannuation scheme.

ii) THE FORM AND VALUE OF THE BENEFITS PAYABLE UNDER THOSE SCHEMES

2.11 Our submission has not provided information on the form and benefits of the Commonwealth schemes as this information is provided in some detail in the 2001 Senate Select Committee's report, *A "Reasonable and Secure" Retirement?* – pages 7 to 43. There is little we can add to the detail in that report and ask that the report be examined in the course of this review.

2.12 Whilst few Commonwealth superannuants would consider their retirement pension schemes to be below standard during the accumulation stage, they would hasten to say that the value of their schemes has been seriously eroded because of the way they are indexed.

2.13 The 2001 Senate Committee's detailed report referred to above, did not see the need to make comparisons with other defined benefit superannuation schemes except for State Government schemes and in doing so recommended a fairer, wage-based indexation tool for those schemes. Senator the Hon Nick Sherry was Deputy Chairman of that committee.

2.14 The Committee's Chairman, Senator John Watson, said in the 2001 Inquiry report's Preface,

"But the central issue was the disparity between the indexation methods used for the age pension and for Commonwealth benefits. The benefit design specifies the use of the Consumer Price Index (CPI) to adjust the value of the benefits on an annual basis. In keeping with the original intention, the CPI as "a measure of inflation" was expected to maintain the "real value" of the benefits. The Australian Bureau of Statistics stated that the CPI is not a measure of the cost of living. Because of the CPI's proven inadequacy to keep abreast with actual costs of living, the age pension is now adjusted bi-annually through a wage-based indexation mechanism. Given this, it was the erosion of pensions through the use of the CPI indexation method that became the focal point of the inquiry."

2.15 In 2002 the Senate Select Committee on Superannuation, of which Senator Nick Sherry was again Deputy Chairman, conducted a wide ranging inquiry into virtually all aspects of

superannuation covering all Australians. That inquiry also looked at the issue of the indexation of Commonwealth superannuation schemes. That inquiry provided the opportunity to make comparisons with other defined benefit schemes. However once more it apparently saw no need to do so. That inquiry's report, page 194, para 14.25 said,

“The Committee notes the evidence it has seen, in both the current and previous inquiries, that Commonwealth public sector and defence force superannuants are having their living standards eroded through the use of the CPI alone, rather than the higher of the CPI or a wage based index such as AWOTE or MTAWA.”

2.16 The committee's report also,

“notes that the Reserve Bank of Australia's Officers Superannuation Fund Board of Trustees has recently reviewed the method of indexing the pensions of its members, and that the RBA has changed from an annual indexation linked to the CPI to half yearly indexation based on the change in MTAWA . The Committee commends the RBA on this initiative.”

Tax Treatment of Superannuation Pensions

2.17 The real value of unfunded schemes is eroded under the new *Better Super* arrangements. Consecutive Governments' decisions to not fund these schemes for their former employees has denied scheme members the tax relief provided to members of funded schemes who, on reaching age 60, **pay no tax on their superannuation.**

2.18 Members of unfunded defined benefit schemes receive a far less generous 10% tax offset. However, the real effect of this offset is significantly diminished and non-existent for many members of unfunded, defined benefit schemes because the majority of Commonwealth superannuant pensioners receive such a low pension that they already pay little if any tax due to the operation of the Senior Australians Tax Offset. Those benefiting from the 10% tax offset are at the higher end of the superannuation pension ladder and they are in the minority, e.g. **only 23% of Commonwealth superannuants received a pension greater than \$29,000 as at 30 June 2007.**

2.19 A further significant penalty paid by members of unfunded defined benefit schemes is that any non-superannuation income they receive is taxed at a much higher marginal tax rate than that for members of taxed defined benefit, funded schemes. That is because the latter's pensions are non-taxable on reaching age 60. Any non-superannuation income they may receive, e.g. bank interest, is not added to their superannuation pension to set the marginal tax rate for that non-superannuation income.

2.20 However, because members of untaxed schemes do pay tax on their superannuation pension, their pension is added to any non-superannuation income to arrive at the marginal tax rate for that non-superannuation income.

iii) INDEXATION ARRANGEMENTS IN SIMILAR DEFINED BENEFIT SCHEMES IN AUSTRALIA

2.21 SCOA considers that the review's comparison with the indexation arrangements of other schemes should be limited to those schemes that are paid pensions from Commonwealth revenue. As far as we are aware, that would cover the civilian Commonwealth and Defence schemes, the Reserve Bank scheme and the Parliamentary Superannuation scheme for Federal MPs.

2.22 Our reasons for this are the Commonwealth is not responsible for either:

- the cost of superannuation schemes for other than its employees and Federal Politicians, or
- the method of indexing those other defined benefit scheme pensions.

2.23 Three separate Senate Committee inquiries were consistent in not making comparisons with other defined benefit schemes. Instead, they rightly limited their comparisons of the indexation of the Government's former employees' pensions with that of other Government funded pensions. The only exception to this was as already mentioned, a congratulatory reference to the Reserve Bank's superannuation trustees for introducing a wage-based index for their employees' pensions.

2.24 The indexation arrangements for several other defined benefit schemes are significantly better than that applying to the Commonwealth schemes. For example as already mentioned in this submission, the Reserve Bank's superannuation scheme has for some years, (post 2001), used a wage-based, (Male Total Average Weekly Earnings) MTAW index to adjust the pensions of its members.

2.25 Retired Federal Politicians have their pensions indexed primarily by movements in parliamentary salaries and allowances.

The graph at Attachment A vividly demonstrates the wide and growing disparity between movements in Federal MPs' pensions, the Age Pension and Commonwealth superannuation pensions due to varying indexation arrangements.

Comparison with State Government Schemes

Commonwealth Superannuation Scheme pensioners receive less from CPI pension increases than those receiving pensions from State Government Superannuation Schemes.

2.26 Our understanding is that most State Government defined benefit superannuation schemes also index their pensions by CPI. However, as most State schemes are taxed superannuation schemes there is no tax deducted from pensions for those who are aged 60 and over. As a result, pensioners of State Government defined benefit schemes receive the full value of the indexing of their pensions whereas many Commonwealth pensioners lose a quarter or more of their pension increase through tax.

2.27 State Government defined benefit schemes were able to utilise pre 1 July 1988 funding credits. A good description of pre 1 July 1988 funding credits can be found at paragraph 9.2,

Chapter 9 of the Explanatory Memorandum to the Tax Laws Amendment (2006 Measures No. 3) Act 2006, where it states:

9.2 Since 1 July 1988 most contributions (eg, employer and other deductible contributions) to superannuation schemes have been subject to a 15 per cent tax. Funding credits were granted to unfunded superannuation schemes so that contributions made after 1 July 1988 to fund benefits that accrued prior to 1 July 1988 are not taxed. This ensures equity with funded superannuation schemes which only pay tax on contributions from 1 July 1988.

2.28 However, for some reason that is not apparent to us, Commonwealth defined benefit superannuation schemes were not able to access pre 1 July 1988 funding credits. As a result Commonwealth pensions miss out on this arrangement that is designed to ensure equity between taxed and untaxed superannuation schemes.

Therefore, the taxing of Commonwealth superannuation pensioners is not equitable when compared to pensions paid from taxed superannuation funds.

2.29 As a result, when there is a CPI increase to pensions, State Government pensioners receive the full CPI increase. Commonwealth superannuation pensions that are in the 30 per cent marginal tax bracket with income less than the upper threshold of the low income tax offset lose a quarter of their CPI increase in tax. This is because tax of 25.5 cents is paid on every additional dollar of income (30 cents in tax plus 1.5 cents in the Medicare levy plus a reduction of 4 cents in the amount of the low income tax offset less 10 cents for the untaxed pension tax offset).

As Commonwealth superannuation pensioners do not receive the full value of CPI pension increases compared with other defined benefit superannuation schemes, it is only fair that Commonwealth pensions are indexed by an indexation method that provides an increase that reflects movements in salary and wages.

iv) THE INTERACTION WITH GOVERNMENT SAFETY NET BENEFIT SCHEMES IN AUSTRALIA

2.30 As mentioned at page 9 of this submission, Commonwealth superannuants did not receive the one-off safety net payment made to Age Pensioners when the GST was introduced. For some reason the then Government mistakenly believed that Commonwealth superannuants would not be affected by price rises resulting from the GST.

2.31 The Government recently announced the likely effects on prices of the carbon trading scheme and the resultant need to protect the incomes of lower paid workers. SCOA is concerned that as with the one-off GST payment to Age Pensioners, Commonwealth superannuants will be denied this same protection. Whilst the payment of any such protection may not fall within the ambit of this review, SCOA asks the review to take account of the strong likelihood that Commonwealth superannuants stand to be disadvantaged yet again.

2.32 SCOA has established that some Commonwealth superannuants who would qualify for the Age Pension have not sought it. We are unsure of all the reasons this is so. However we believe that a good number are simply unaware that they are eligible to receive both a Commonwealth superannuation pension and a part or whole Age Pension. Our member survey of a few years ago

clearly showed that there was a reasonable percentage of respondents whose income/assets would enable them to receive at least a part Age Pension but they were not receiving such.

2.33 It is reasonable to conclude that some Commonwealth superannuants have not applied for the Age Pension because they believed at the time they joined the public service that their superannuation pension would be all that they needed and all that the Government was willing to provide for their retirement income.

Differential Tax Treatment

2.34 Commonwealth superannuants are unfairly treated compared to Age Pensioners because of the way their superannuation pensions are taxed. Whereas an Age Pensioner couple each receive a pension in their own right and are therefore taxed separately, a Commonwealth superannuant couple has their main source of income, their superannuation pension, paid to one member of the couple.

This results in a higher, discriminatory marginal rate of tax for Commonwealth superannuants receiving the same amount of retirement income as an Age Pensioner couple.

v) THE FULL COST TO THE COMMONWEALTH

2.35 SCOA is aware that the first year's cost of a change to the higher of the CPI and MTAW for civilian pensioners is \$20 million. That is the figure provided by the then Department of Finance and Administration at the May 2007 Senate Estimates Committee hearing to Senator the Hon Nick Sherry, the then shadow spokesperson on superannuation. We are aware of course that this figure will compound over time.

2.36 Our opinion on the cost of a change is that it is insignificant in comparison to the cost of introducing in 1993, fair indexation for the Age Pension and most other Government funded pensions. The then Labor former Government, supported by the then Opposition, did not let the cost of changing the indexation of Age Pensions and most other Government pensions deter them from approving this most worthwhile initiative.

The cost of those pensions is five to six times that of Commonwealth superannuation pensions.

2.37 That decision was made at a time when annual budgets were not producing the large surpluses that have existed for the past few years and for those that are forecast for some years to come. There is strong evidence that the resources boom that is driving budget surpluses is likely to continue for some years.

2.38 At the hearing for the Senate Community Affairs Inquiry into the *Cost of Living Pressures on Older Australians* in Brisbane on 8 February 2008, the then Chairman of that committee, Senator Humphries said,

“But, in a sense, the question of cost is irrelevant because you are in the same boat as other people, such as age pensioners, who are dependent on the policy of the Commonwealth as to how much they receive. The other group receives more generous indexation and you do not.”

Cost Clawback

2.39 The gross cost of a change will generate significant cost clawback. That clawback will come from increased income tax and GST revenue. The other source of clawback will come from a reduction in Age Pension expenditure. Due to the low average superannuation pension received by most Commonwealth superannuants, many qualify for at least a part Age Pension. If their superannuation pension increases, their Age Pension will reduce.

2.40 The National Centre for Social and Economic Modeling, NATSEM, at the University of Canberra, a highly respected body that produces in depth analysis and reports for the Federal Government, has produced a report, **Attachment C** that shows that,

this clawback will, at a minimum be 37% of the gross cost and could be as high as 58%.

2.41 SCOA is aware that the estimated income tax clawback is understated in NATSEM's report because it had to assume that all Commonwealth superannuants currently pay the lowest marginal rate of income tax. Some would not.

2.42 Applying a minimum clawback figure of say 40%, the first year's net cost of the **civilian schemes** will be approximately \$12 million.

This amount is significantly less than one tenth of one per cent of the 2007/08 budget surplus.

2.43 If we are correct in our belief that the former Government's costings were based on AWOTE rather than MTAW, then these cost figures will be considerably less.

The Future Fund

2.44 The former Government's claim that the Future Fund was established to fund unfunded Commonwealth superannuation liabilities is grossly misleading.

2.45 Historically these pensions have been funded from annual Government revenue collections. There is no evidence that we are aware of that suggests that the capacity to continue payment of these pensions from annual revenue collections will cease.

2.46 The former Government's claim that the Future Fund was created to cover Commonwealth superannuation unfunded liabilities was found wanting when it refused SCOA's suggestion to vest the Fund's monies into a superannuation scheme which would ensure its claimed use.

The then Government's 2007 Intergenerational Report said that as a percentage of GDP, Commonwealth superannuation unfunded liabilities would fall from 0.56% to 0.32% by 2046/47.

2.47 The main reason for this reduction is that over the longer term, these pensions will be paid from funded schemes. Unfunded Commonwealth superannuation schemes were closed to new entrants to the Commonwealth public service from July 2005. Similarly, the unfunded Federal MPs' superannuation scheme was closed to newly elected MPs from the 2004 election.

2.48 The Productivity Commission's March 2005 report, *Economic Implications of an Ageing Australia* also forecasts a significant fall in unfunded superannuation liabilities over the longer term, but highlighted the need to make provision for proportionally higher health and aged care expenditures which will grow from 5.69% of GDP in 2002/03 to 10.28% of GDP in 2044/45.

2.49 No unfunded liabilities are estimated/reported for Government programs such as Medicare, the Age Pension etc. where the cost of these programs is massive compared to that for Commonwealth superannuation.

2.50 In any event, according to the Australian Financial Review late in 2007, the former Treasurer stated that the Future Fund already holds sufficient funds to meet long term Commonwealth superannuation unfunded liabilities, which we understand won't materialise until approximately 2020.

2.51 Given that the Future Fund's monies will not be called on until 2020, that fund will grow significantly before it is used to pay for Commonwealth superannuation pensions.

The earnings of the Future Fund between now and 2020 will clearly pay for the cost of a fairer indexation methodology for the intended recipients of that Fund's monies and we strongly urge the review to take account of this capacity in its deliberations.

USE OF INCORRECT ASSUMPTIONS IN COSTING A CHANGE

2.52 SCOA believes that the basis of the former Government's calculation of an \$18 billion unfunded liability a change to indexation would cause is flawed. We believe this because the calculations were, we understand, based on the assumption that we are seeking AWOTE rather than MTAW. According to the source of the information used by the Government when quoting the \$18 billion unfunded liability figure, i.e. the Senate Committee's April 2001 report, A "Reasonable and Secure" Retirement? page 35,

the unfunded liability figure for the 1922 Act, CSS, and PSS schemes was then \$6.6 billion.

2.53 In any event, referring to unfunded liability figures is very misleading because too few politicians and even fewer non politicians realise that it is a 40 year cumulative figure and not an annual amount to be paid in any one year. Whilst recognizing that the reporting of unfunded liabilities is a Government accounting convention that applies to liabilities for all Commonwealth employment related conditions, **it serves little practical purpose other than to grossly distort the annual cost to budgets.** If it were so important to Governments then we would surely have unfunded liability estimates for far bigger expenditure items such as Medicare, the Age Pension etc.

2.54 Of course the unfunded liability figure for the Defence superannuation schemes is not included in the \$6.6 billion figure mentioned above. However because expenditure on those schemes is only a fraction of that for the civilian schemes, the aggregate figure for unfunded liabilities cannot be anything like \$18 billion.

Be that as it may, the Government's estimates of both annual costs and unfunded liability figures, presumably undertaken by a qualified actuary, ignore the indisputable clawback that will occur.

2.55 By continually quoting grossly inflated, 40 year cumulative cost figures rather than the annual cost to budgets, the former Minister for Finance and Administration seems to have not only misled his own party, but succeeded in alarming the then Opposition.

SECTION 3 - CONCLUSION

3.1 **The Government's former employees are not asking for special or favoured treatment.** They are merely asking for the community standard for having their retirement incomes indexed. They are well aware that three Senate Committees have unanimously recommended that they should have their pensions indexed by the community standard **and they are asking for it in an economic climate that has ample capacity to fund it.**

3.2 They remember well the words of **the now Prime Minister** in letters to them in the run up to the election last year, viz.

".....In 2001 a Senate Select Committee concluded "Commonwealth public sector and defence force superannuates are having their living standards eroded through the use of the CPI alone, rather than the higher of the CPI or a wage-based index."

This statement has been highlighted by the failure of those on a Comsuper pension to gain any CPI increase from 1 July 2007. On 24 April 2007 the Australian Bureau of Statistics (ABS) announced a CPI change of -0.06% which Comsuper has used to calculate your bi-annual increase, in this case zero.

To make matters worse, the CPI has risen by 1.2% in the June quarter but Comsuper recipients may not gain an increase until 2008, the next assessment date. In the meantime these superannuants will need to suffer through rising prices (petrol 9.1% and food 1.7% in the June quarter) without any increase in their pension....."

3.3 The **now Deputy Prime Minister** also said to Commonwealth superannuants in February 2007 when responding to their request for fairer pension indexation,

".....I greatly appreciate the time and effort you put into compiling the information and understand your concerns. I understand that you feel very concerned about the current system of indexing your superannuation, despite two Senate committees recommending a change. You have presented your ideas with conviction, and it is important for the Australian Labor Party to be aware of the circumstances of all Australians, and how we can better serve them....." (Our emphasis.)

3.4 More recently, the Minister for Families, Housing, Community Services and Indigenous Affairs said, in announcing the Government's review of retirement incomes,

" We accept and acknowledge the extraordinary contribution that senior Australians have made, and continue to make, to the Australian community through their

experience and insight, through the care they provide for partners, friends and relatives and through their mentoring and volunteering.

The Government knows that many pensioners are finding it tough to make ends meet. Cost of living pressures like groceries, bills and petrol mean it is harder and harder to make ends meet.”

“This Government wants pensioners to be able to rely on more than the electoral cycle to give them financial security.”

3.5 We urge the review to have due regard to the fact that even when Commonwealth superannuants’ pensions are more fairly indexed, whilst such an improvement will enable them to better meet rising living costs, it will not restore the significant erosion that has occurred to their base pension.

3.6 They are tired of being treated as second class Australians and fail to understand how, with all the available evidence, their pensions continue to be indexed by a methodology that has been abandoned in most other quarters for at least a decade. For them to receive an improvement without delay, they will expect this review to expeditiously recommend the change they deserve and will expect that change to be funded in the 2009/10 Federal Budget.

Their expectation to have their pension indexed by the same percentage as that for the Age Pension is most reasonable.

3.7 On their behalf we ask that the Prime Minister’s pre-election promise of fairness and his belief in evidence based policy be honoured because ***what they are seeking is fair, affordable and long overdue.***
