IT WAS TWENTY YEARS AGO TODAY, MR KEATING SAID WE ALL MUST SAVE

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Just on 20 years ago the Hawke Government introduced the Superannuation Guarantee 1501. Tony Negline says now would be a good time to review the system to make sure it's doing what it should.

Twenty years ago the future ageing of the population and the resultant decline in taxpayers who could pay for a large pool of age pensioners was already recognised.

The purpose of the Superannuation Guarantee (SG) was to provide employees with retirement income so the strain on the public purse would not be so severe.

The SG demands that employers contribute an amount equivalent to 9 per cent of each employee's salary to a superannuation fund. This has seen Australia's super assets explode. It also often makes people think the system is already successful.

I hope the large asset pool - and the work, wealth and prestige that come with it - is not leading us to a false conclusion.

It's true that the SG system seems to be tracking reasonably well. However it's too early to say if it will actually reduce Government age pension outlays for a large enough segment of the workforce. Unfortunately we will have to wait another 20 years to find out if it achieves its stated purpose.

Perhaps this midway point in the policy's life cycle would be a good time to ask the Productivity Commission to conduct a wide-ranging review of the SG system, to determine if it's fit for purpose and operating as efficiently and transparently as possible.

Some might argue that the Cooper Review has already done this work. The starting point of that review was the structure and operation of the super industry. Its purpose was not to look at compulsory super itself and assess if it's still the best way to solve our impending age pension funding problems.

Like any law, the SG rules are not perfect. Here are some issues that need to be thought about:

Low-Income Earners

Employers have to make SG contributions for anyone earning more than $450 in any calendar month and this has not changed for 20 years.

By way of comparison, between June 1991 and June this year, average weekly ordinary time earnings have increased from $560.20 to $1,304.70, an increase of almost 133 per cent. If the $450 figure had been indexed it would now be about $1048 a month.

Most lower-pay workers, once the super preservation rules allow access to their super assets, will be withdrawing lump sums. Because of the way the super tax laws work, these withdrawals will be tax-free. But these lower-paid people are forced into a savings vehicle that has a tax rate higher than their own personal tax rate, which is nil. Super's flat tax rate is 15 per cent for earnings on pre-retirement money.

Taking into account the low-income tax offset, an individual earning more than $48,000 a year will pay about $7200 tax – an average tax rate of 15 per cent. The amount of tax is lower if someone is eligible for a wide range of other tax offsets, such as the family tax benefit.

The Government has proposed that from next year it will hand back up to $500 of the contributions tax for many low income earners. While welcome, this doesn't address the earnings tax and cuts out at a fairly low income amount.

If the Government believes low-income earners must save for retirement it should ensure these savings aren't subject to higher taxes than those applying to a person's take-home salary. For example, their Super Guarantee contributions (and the earnings on those contributions) should be automatically tax-free. If this is not possible from a cost perspective then the system needs to be redesigned.

At a dinner to celebrate the SG's twentieth anniversary, Paul Keating noted that the increases in the SG rate which occurred during its first years did not lead to a blow-out in employers' operating costs because the increases were included in most employees' normal salary increases. In other words, the SG is actually forgone salary. If that is true, then it should be taxed liked salary.

One of the long-term features of the superannuation system has been the concept of tax concessions, which are a form of compensation for the fact that your money is locked away and can't be personally accessed for many years. But as the above shows, there are many wage and salary earners who are forced to save in a vehicle that provides no tax concession for them – in fact, it applies a tax penalty.

Perhaps this situation has been allowed to develop because the combined super, tax and offset processes are so complicated no one can quite work out how much tax they're actually paying.

At the other end of the spectrum we have too much tax being paid by some high-income earners.

The concessional contribution cap for many people is $25,000. Contributions above this threshold are taxed at the highest marginal tax rate.

If someone earns more than $277,777 and their employer automatically contributes 9 per cent of salary into super, they will breach the $25,000 threshold. This means the highest marginal tax rate is paid on those contributions. These contributions will be classified as a taxable component and may face additional tax on withdrawal from super.

Many employers don't realise that once a person earns more than $43,820 in a quarter (or $175,280 a year) they only have to contribute up to 9 per cent of that lower figure.

A more tax-effective approach is to make after-tax contributions, which are classified as part of the tax-free component.

Clearly this is not a problem with the compulsory super system, so much as with the general knowledge of how all the different bits of the system fit together.

The Government should think about allowing higher income earners to opt out of employer contributions that exceed
their concessional contribution cap.

Increasing the sg rate

The Government has a plan to increase the SG rate to 12 per cent of salary by July 2019.

Many people have welcomed these changes but, ideally, the above issues need to be addressed at the same time.

The need for the higher rate to provide retirement income would also be lessened if employees were discouraged from retiring too early and there were more employment opportunities for willing and able older jobseekers.

The policy focus of the SG system is funding income during retirement. But according to Treasury modelling, the much bigger issue from a government budgetary perspective is funding health care for older people. The super system is a good place to enable retirees to save for these unfunded future costs.

The Cooper Review's MySuper suggestion will see the level of fees and charges on super investments fall.

More than 10 years ago some people predicted the internet would change the way Australians shopped. Some naysayers, especially those with a business model not well suited to internet shopping, thought this was rubbish.

Australians have realised that they can buy items for a lot less online. I'm hoping that Australian employees will soon realise that they have been paying too much for their super funds and that these high costs are reducing their retirement future. I'm also hoping they will demand a better deal with their super because recent research has suggested that many people paying adviser commissions on their SG contributions may not be receiving any advice.

In reality most consumers are disengaged from compulsory super. We could spend considerable amounts of time trying to work out why. Part of the attitude stems from the fact that they know it will be years before they can access the money

Constitutional arrangements

My final point involves the Constitutional arrangements that underpin the SG itself. If an employer fails to contribute the 9 per cent of an employee's salary, then a tax - called the Super Guarantee Charge - is raised by the ATO. The ATO then take that tax penalty and put it into a nominated employee's super fund. In short, the SG is made possible by the Commonwealth's taxation power.

The Constitutional arrangements of the SG are currently being challenged before the full bench of the High Court by the Roy Morgan research company. I have no knowledge as to when the High Court will hand down its judgment - but suppose for one moment that the Super Guarantee was deemed to be unconstitutional. Would the Government be able to find a way to make the SG work again constitutionally? Some people have predicted that they would be able to do this, but I'm yet to see what type of revised law would be used.

How many large super funds would survive if the SG ceased to exist as we know it and a long-term solution couldn't be found to start it up again?

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