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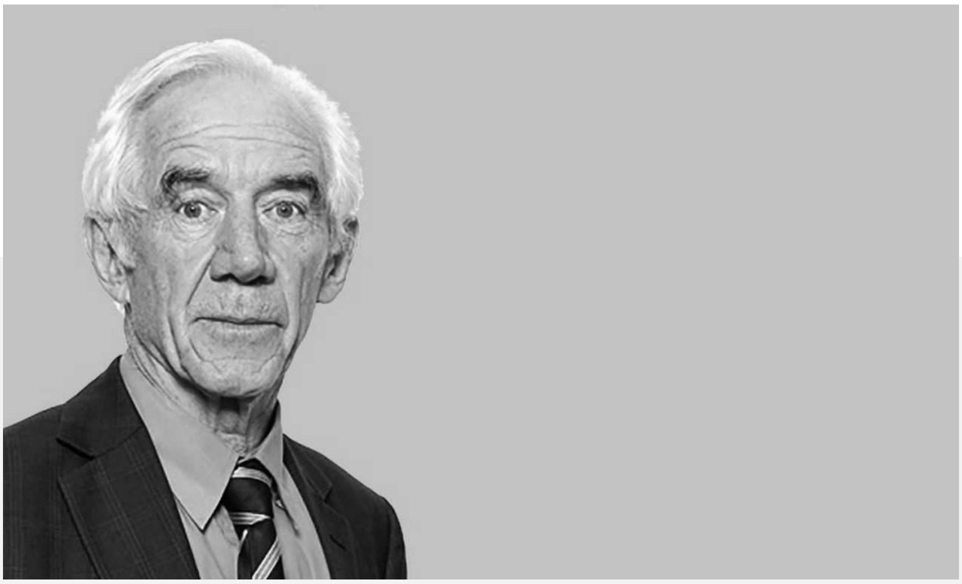
Atchison on solving the retirement riddle



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The issue of retirement income has arguably become far too politicised in recent years, with rational debate seemingly scarce.

While the focus inevitably falls on the political football that is superannuation, the Age Pension doesn't get the attention it deserves. The federal government's retirement income review, released late last year, showed that the pension will remain affordable for the government, and that most seniors will still rely on it into the distant future. But there are still irrational fears about the age pension.

While the role of the age pension within the retirement income system is clear – to provide a base retirement income and longevity insurance – investment consultancy Atchison Consultants says the problem is that the pension is not well-integrated with the other two "pillars" of retirement income, compulsory superannuation (which provides enhanced retirement income and the family home/savings, with the home, for most households aged 65 or over, representing the main asset in retirement, and of net wealth.

A primary philosophy behind the Australian taxation system is that it is a progressive system. Individuals earning higher incomes pay higher rates of tax.

Unfortunately, each of the three pillars "deliver mixed messages and complicate the progressive tax system," says Atchison Consulting principal Ken Atchison. He advocates introducing a flat system for age pension and superannuation, and applying a progressive system through the taxation system – and further, for the age pension, removing it from the social security system altogether.

Atchison says this could be done by explicitly funding a universal age pension, with responsibility for managing the funding pool handed to a body resembling the Future

Atchison proposes that the government funds the age pension through the issue of inflation-linked bonds (ILBs). "Each individual's entitlement to the pension would be represented by a certain amount of these ILBs, which would go into their account, held by the Age Pension Fund. That pool of assets would fund a universal pension," he says.

In a similar way to how the government handed the unfunded superannuation problem to the Future Fund, it could effectively hand the funding of the age pension to the Age Pension Fund. "The new Fund would set up an investment policy structure and asset allocation for that pool. It could outsource the investment part of it if it chose. It could partially pay for the draw-down from interest or other investments," says Atchison.

"The super fund, the SMSF or the Age Pension Fund would receive the ILBs, and they could sell them and buy shares," says Atchison. "In any given year, the Commonwealth pays out about $60 billion in the age pension.

"That would still be paid out in cash, however, it would be paid out from the pool of assets that is now sitting there. It would be partly drawn-down and paid from interest or other investments – it would be paid out of the fund where the ILBs are held. So, it would be paid not directly by the Commonwealth government, but be paid out of the fund," he says.

In Atchison's proposal, the retirement income account would be a separate account to a person's superannuation account. "Ultimately, it becomes integrated – so you've got your Age Pension amount sitting there and you've got your superannuation amount sitting there, and they both get taxed.

"Applying a progressive system through personal taxation would simplify the system greatly. It would still be concessional for retirees: the first $25,000 would still be tax-free – but that's done through the tax system, not through the social security system," says Atchison.

He says the proposal addresses inter-generational inequity, which is most prevalent in the payment of age pensions on an emerging-cost basis. "Superannuation is funded but the age pension is not. The inter-generational burden in favour of the aged is immense."

But arguably the greatest benefit of the proposal is that each individual would be aware of the assets available to fund their retirement.

"The Retirement Income Review report indicates that Australians are not utilising assets in retirement appropriately. They are generally reluctant to draw-down savings in retirement, because of the fear of outliving savings," says Atchison.

"However, universal longevity insurance – provided through the age pension – would remove this aspect of concern over drawing on savings. And aggregation of the age pension and superannuation may encourage greater utilisation of the capital," he adds.

James Dunn

James Dunn has been a finance and business journalist since 1988, operating across the entire spectrum of these areas, from personal investment to high-end institutional finance. Within that spectrum James has developed a wide range of knowledge of the financial markets, investment asset classes, the global economic environment and most importantly, how these all coalesce.

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