

***AUSTRALIA AND INTERNATIONAL PENSION REFORM:
LESSONS FOR THE UNITED STATES***

**SPEECH TO THE JOINT FORUM OF THE BROOKINGS
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Introduction

It's a pleasure to be here today.

Thank you for that introduction William, our host this morning. *[Mr William Gale, Vice President and Director of Economic Studies, Brookings].*

I would also acknowledge today's panel members – David John, Principal of the Retirement Security Project, and a good friend of Australia; Mark Iwry, Senior Advisor to the Treasury Secretary – congratulations on your recent appointment; Dallas Salisbury, President and CEO of the Employee Benefit Research Institute; and, David Harris, Managing Director of Tor Financial Consulting.

The Brookings Institution and the Heritage Foundation are two of the world's great policy institutes – while you obviously come at policy challenges from quite different perspectives, it is this diversity that gives the policy debate here in Washington such strength.

Both bodies sit at the core of a range of global policy debates and through your advocacy and policy development work you shape both today's and tomorrow's big issues, indeed our Prime Minister Kevin Rudd addressed Brookings here in March last year.

This week in Washington is dominated by health care reform, financial regulatory reforms and of course Judge Sotomayor's confirmation hearings, so it might appear challenging to engage policy thinkers on anything else.

But that's what we're here to do.

Through the Retirement Security Project, an innovative joint effort of Brookings and Heritage, we are here today to engage on another great

policy issue facing the world – retirement incomes, public and private components, and how to sustainably fund our ageing populations.

This morning I will update the Retirement Security Project on the current state of Australian public policy and reform initiatives in these areas.

Before I do however, I think it worthwhile to touch briefly on how we are faring economically back in Australia as we all deal with the challenges thrown up by the global recession.

Australian responses to the global recession

To begin, I would like to emphasise the importance of Australia's relationship with the United States.

The association between our two countries has been long and runs deep on both sides.

It transcends political parties and administrations on both sides of the Pacific and is designed to respond to any situation.

We do face, economically, the greatest challenge in 75 years.

The global economy is experiencing the sharpest synchronised economic downturn since the Great Depression, with global output expected to contract in 2009 for the first time in six decades.

It is worth referring here to some observations made by Australia's Prime Minister Kevin Rudd just last week in Berlin.

The Prime Minister compared several key metrics of the current global recession and the Great Depression to show just how serious the dimensions are of the challenge we face today.

He compared, the twelve months since the recent peak of world output in April 2008 with the twelve months following the peak in June 1929.

In the twelve months at the start of the Great Depression, global stock markets fell by just over 20 per cent.

In the equivalent twelve months most recently, global stock markets have fallen by more than 40 per cent.

On other fronts the comparison is also extremely sobering.

Global trade fell by 17 per cent in the first twelve months of the current global recession, compared to a 10 per cent fall in the first twelve months of the Great Depression.

On these metrics at least, the current global recession is in several critical respects of a comparable magnitude to the Great Depression.

The story of how we got here is well known to all those in this room.

Before I move directly to today's topic, I would take the chance to point out to this audience several key facts about just how well we in Australia are faring on an international comparative basis.

Australia is now the only OECD economy not in recession.

Of the 33 economies the IMF classifies as advanced, Australia recorded the strongest quarterly growth in real GDP in the March quarter 2009.

Beyond the operation of the robust automatic stabilisers in our Budget, the Government has put in place a comprehensive stimulus package that is timely, that is targeted and that is temporary and is already having positive effect.

Our fiscal position is the soundest in the developed world, our central bank has moved decisively to reduce official interest rates by 425 basis points to 3 per cent since September 2008 to further stimulate aggregate demand and consumer sentiment is up markedly during the past two months.

Our financial system has been directly bolstered by guarantees of banking deposits, bank wholesale funding and State Government borrowings.

Australia's four largest banks are among a group of only 8 – yes, only 8 – of the 100 largest banking groups in the world rated AA or above by Standard & Poor's. Meaning a full half of the world's top rated banks are located in Australia.

We've supported the RMBS market and we've acted decisively on a range of market regulatory issues, such as by banning naked short selling and regulating credit rating agencies.

We've moved all remaining regulation of financial services and consumer and mortgage credit to the Federal level, meaning we now have comprehensive, simple, standard national regulation across all fields – a significant national achievement.

I could go on, as the list of steps we've taken, as you have here in the US, is both long and complex.

The final broader point to make is this – in Australia, we have a very strong system that is well regulated and functioning as effectively as anywhere else in the world.

Australian retirement in the 21st century

A key element in support of this success has been an innovative approach to retirement incomes and pension policy.

Like many other countries, Australia's population is ageing and spending pressures in health, age pensions and aged care are projected to increase.

According to Treasury's 2007 Intergenerational Report, over a quarter of Australians will be 65 or older by 2047.

This compares to 13 per cent in 2007.

In 2007 there were approximately 5 people of working age (15 - 64 years) to support every person aged 65 and over.

By 2047, this will halve to 2.4.

Lifespans continue to stretch longer and longer – what is described as "longevity risk" – making the post-retirement challenge that much more difficult.

As many of you know, I personally have had a very long-term engagement in our system and on global retirement incomes policy. I should note however that as of about 6 weeks ago I had the great honour to be made Australia's Assistant Treasurer with responsibility for revenue, tax reforms and a wide range of linked issues.

Our new Minister for Superannuation is my extremely able Ministerial colleague Chris Bowen, with whom I remain in close discussion on these matters, and who is also a good friend of the United States.

Australian system

Australia has a three-pillar approach to retirement income, which is considered fiscally sustainable in the context of an ageing society.

The three pillars encompass:

- the age pension (non-contributory safety net);
- compulsory superannuation (the Superannuation Guarantee); and
- voluntary savings, including superannuation.

The first pillar – our social security pension system differs in many key respects from yours here in the United States.

Access to our payments is means tested and the funding for payments is made directly off Budget rather than through a separate individual contribution accrued over time.

The second pillar and most of the third pillar, revolve around our "superannuation" system.

This private savings vehicle is a tax preferred mechanism to encourage individuals to privately save, to either supplement or replace the age pension.

The core of the compulsory pillar is the Superannuation Guarantee (SG) which I was involved in introducing back in July 1992.

It requires employers to make superannuation contributions to eligible employees' complying superannuation funds.

The required rate of contributions gradually increased to reach 9 per cent from July 2002.

Before the mid-1980's only around 40 per cent of Australian employees had superannuation coverage.

The latest surveys show superannuation coverage now extends to almost 98 per cent of traditional full-time employees.

In addition employees and the self-employed are also encouraged to voluntarily contribute to their superannuation fund directly, with substantial tax incentives, and in some cases matching contributions.

An additional average of 4-5% contributions result.

In all, this system has seen total assets in our system grow to over \$1.1 trillion, making Australia's the fourth largest pool of funds under management after the US, France and Luxembourg, and ensuring our financial system punches far above its otherwise expected weight.

Improvements to the Australian retirement system

But we have never been willing to rest on our laurels and as the previous Minister I have been concerned for some considerable time that we had further work to do on the micro-reform of our system to ensure its operational efficiency is improved to maximise the savings outcomes for individuals, which is in their best interests.

Equally, long-term reform is vital in achieving the ambitious goal of having a tax and transfer system that is simpler, provides security for retirees and positions Australia to deal with the challenges it faces in the future.

That is why the Government has established two important processes – one, the Australia's Future Tax System review, and two, the Cooper Review into the structure, operation, efficiency and governance of our system.

Both reviews are independent of Government, although their terms of reference were established by the Treasurer and myself respectively.

Australia's Future Tax System review

Among many other things, the tax review is examining what I call the retirement income system inputs – levels of contributions, adequacy, transfer payments, incentives.

The Cooper Review is examining the mechanics of the system – how does it cope as a compulsory system. It was in many respects previously a voluntary system, to which we have simply added layers of new tasks and new complexity.

Two months ago, the tax review reported on the strategic issues for the retirement income system in Australia.

The report found that Australia's three-pillar retirement income system should be retained.

The Panel also found that the age pension should be gradually increased to 67 years. A separate review into the adequacy of the Age Pension recommended a lift in the base single and couple pension. We adopted both of these recommendations in our last Budget, when we announced a phased increase in the eligibility age and an increase from this September to the pension of \$32.49 per week for singles and \$10.14 per week for couples.

These increases will take the single pension to \$17,507 a year and the couple rate to \$26,390.

The Panel also raised the issue of longevity risk. As I mentioned earlier, this is the risk that people exhaust their assets before they die. The Panel found that there is a lack of income stream products for retirees to insure against this risk, and this is a structural weakness in our system. It is further considering the range of complex issues involved in improving access to these products.

The Panel also recommended retaining aspects of the current system, with improvements to ensure that key challenges can be met in the longer term.

This includes retaining the current 9 per cent superannuation guarantee, finding it provides an adequate rate of compulsory saving.

The Panel also raised concerns with the sustainability and in some cases, inequity of the tax incentives structures in our system.

As such, the Government has moved to improve sustainability and fairness in the 2009-10 Budget.

Cooper Review

On the other review, the Cooper Review, the Rudd Government will conduct, for the first time in our system's history, a thorough, root and branch review of the governance, efficiency, structure and operation of our system.

This is a landmark process.

The Terms of Reference set down an examination of the **governance** of our system, that is the legal and regulatory framework of the superannuation system. This includes issues such trustee knowledge, skills and training.

In addition, under the governance threshold, the Terms of Reference facilitate a thorough assessment of the risks involved in the use of debt and leverage in superannuation and the development of investment options that might lead to a weakening of the diversification principle, a hallmark strength of the system.

These governance issues are critical considerations that go to the heart of the security of our system and it's time we took a good hard look at them.

On the issue of **efficiency**, the Cooper Review has been asked to be guided by the clear goal of ensuring the most efficient operation of the superannuation system for all its members, whether they be active or passive and whether they are making compulsory or voluntary contributions.

A key element of this is looking for opportunities to remove unnecessary complexities from the system and ensuring, in light of its compulsory nature, that it operates in the most cost effective manner and in the best interests of members.

Next, the **structure** of the system is paramount to issues such as cost, and as such the Review will directly examine how we can promote effective competition in the superannuation system that leads to downward pressure on system costs and upward pressure on system returns. That means more money in people's accounts at retirement, and a better standard of living in retirement.

A structural analysis of our system also means a full examination of all the current add-on features of the system and an analysis of other structural legacy features, including the potential for rationalisation where appropriate.

Finally, the Review will assess the **operational** features of the superannuation system.

This last area is also squarely about maximising returns to members, including through minimising costs. This covers both passive defaulting members, who should receive maximum returns and value for money through soundly regulated default products, and also active selecting members, who should not be negatively impacted by conflicts of interest that may inhibit advice being in the best interests of members.

This is a broad ranging review, but after some 20 years of compulsory superannuation, and the development of many new features, the Rudd Government and the industry itself strongly agree it is time for such a thorough examination to take place.

The Government comes to this important process with no preconceived views in mind, other than a few basic and firm beliefs and those are:

- one, that our system is strong and people should have confidence in it;
- two, that the system, being compulsory in nature, should always work in the best interest of members over the long term; and
- three, that together we can make our strong system even stronger and by doing so significantly boost the retirement incomes of all Australians.

I encourage all of you to contribute to this important work over the coming year.

Conclusion

In terms of what this all means for current thinking around pensions in the United States, I would like now to have an open discussion with the panel and with you in the audience.

You face an immense set of issues – facing an electorate that is resistant to compulsion, is your answer soft compulsion?

Faced with a high degree of fiscal stress, how does the Federal Government incentivise a system to encourage and spread private retirement savings in a sustainable manner?

These are the questions that we need to discuss this morning.

As I said, it's been an honour to be here this morning.

Australian policy makers and political leaders are good friends of America and holding a dialogue such as today's is yet another example of how this relationship continues to grow and assist both countries.