Retirement Incomes and Indexation Anomalies

ASHORT DISCUSSION PAPER

February 2021

Most retirees have multiple sources of income. A few rely on only private investments. Some are drawing from a superannuation balance accumulated while they were working. Some will have a public sector defined benefit pension. Many that meet the age and income/asset requirements will be claiming a whole or part Age Pension, often in addition to a mix of these other sources.

A big issue for all retirees is how their income keeps pace with the relentless increases in the cost of living. Retirees relying on private investments or on an accumulated superannuation balance hope that their equity will grow in value with changing market circumstances. Retirees relying on a public sector defined benefit pension or the Age Pension are at the mercy of government chosen indexation arrangements. The average Commonwealth superannuation pension was about $38,000 at June 2020 and it often supports both members of a couple. The issue discussed in this paper therefore affects a large number of retirees relying on what can only be described as a modest pension.

Three Senate Inquiries have recommended on three separate occasions that the Government consider an alternative indexation methodology to the CPI for Commonwealth and State superannuation pensions. Those recommendations have been steadfastly ignored with one exception. In 2015 in response to a strong

campaign by members of the Defence Force Welfare Association and other military welfare organisations the then Abbott Government rightly provided an indexation method for the older closed military superannuation schemes, (DFRB and DFRDB) that better enabled those pensions to keep pace with real world prices. Despite this decision it denied the same fairness to the almost 20,000 current (MSBS) military superannuants.

The main purpose of this paper is to question why someone who has devoted their working life to delivering a public service, at the Federal or State levels, and compulsorily contributed to a superannuation scheme should have their public sector defined benefit pension indexed by a demonstrably inadequate CPI when the Age Pension available to all Australians, some of whom may have never voluntarily contributed to superannuation, has indexation that is markedly more appropriate.

In fact, the CPI is the most inadequate form of indexation in an extensive patchwork of indexation arrangements that apply to a wide range of government payments and income/asset eligibility thresholds. Some of these payments are adjusted by wage indices such as Male Total Average Weekly Earnings (MTAWE), or the Wage Cost Index (WCI),or for some retired MPs the movement in the parliamentary salaries and allowances.

In December 2019 a Commonwealth requirement was made law that clearly mandates that CPI on its own is not designed to keep up with prices people actually have to pay. The Australian Securities and Investment

Commission has mandated that when the superannuation industry estimates the worth of future superannuation payments, or other retirement products such as an annuity, it must take into account a default inflation rate of 3.2% which rightly reflects CPI of 2% and real wage growth of 1.2%, the latter to reflect the cost of meeting increases in community living standards. Why does the Government think it can ignore that requirement when it indexes the pensions of its own servants? (See “Can You Trust the CPI” on this web site.)

The CPI on its own is a most unfair way to adjust any income because it does not measure the movement in real-world prices we all have to pay. That’s because for many years those prices have been adjusted vigorously, mostly downwards, to reflect quality improvements in all goods and services. A price increase that can be attributed to an improvement in quality is not a price increase for the purpose of calculating the movement in the CPI. Quality improvements are what drive improvements in living standards and are unavoidable to real world consumers.

In the past 30 years, the Age Pension has rightly increased by over 200%. In the same period, Commonwealth defined benefit pensions have increased by just over 100%. How can that be fair ?