The Real Cost of the SGC

The costs of the SGC are much higher than its purported future savings, argues **Tapen Sinha.**

WITH THE PRONOUNCEMENTS OF the 1992 Superannuation Guarantee Bills, the age of universal superannuation was ushered into Australia. With the staunch opposition of the Coalition, the Labor government had a rough time getting the superannuation guarantee charge into law. In early 1993, most people (including government bureaucrats) were not expecting another term for the Labor government and the Coalition had promised to freeze the superannuation guarantee charge at three per cent. As a result businesses were not expecting the cost of superannuation to rise beyond three per cent. Thus the increase of the SGC over the next nine years has not had the thought and discussion it deserves.

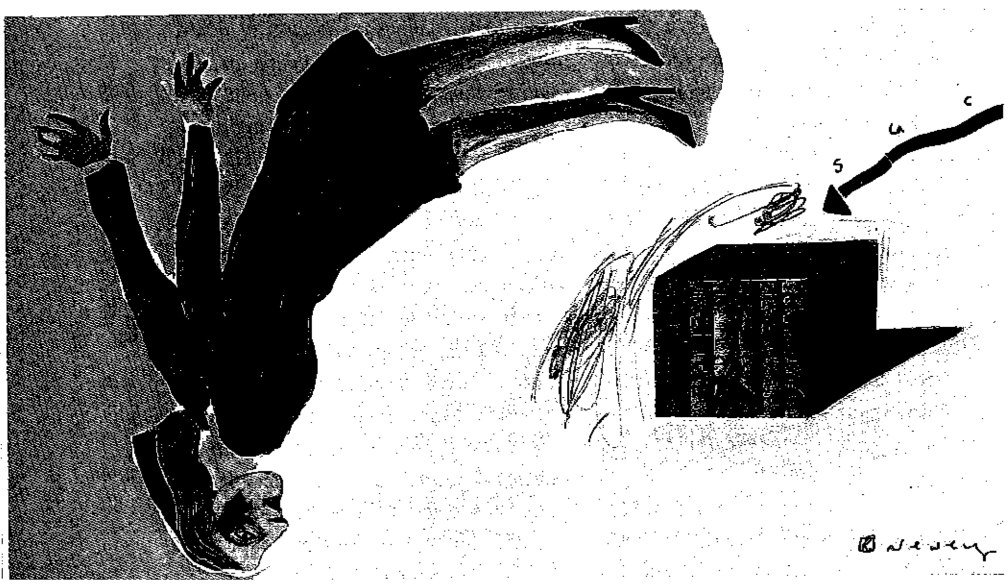

Illustration: Regina Newey

THE UNTOLD STORY

There have been many discussions about the increasing cost burden on businesses due to the introduction of the SGC (e.g. Benedict and Sinha, forthcoming). There have also been many discussions about how much benefit will actually flow to the future retirees, especially low income workers, as charges eat up superannuation benefits (Senate Select Committee Report, 1993). Some discussions have centred around the tax cost to the government in terms of lost revenue because the tax rate on superannuation benefits is lower than the rate that would have prevailed on that income (e.g. Brown, forthcoming).

One consequence of the universal superannuation that has never been discussed seriously is the increase in unemployment as a direct result of the SGC. There have been only a few attempts to deal with this issue, such as the questionnaire sent out by the Confederation of Australian Industries in 1992.

At the time, the executive director of the Australian Chamber of Commerce and Industry, Mr Ian Spicer, was quoted in the *Australian Financial Review* saying that if the SGC were introduced, there would be 60,000 to 100,000 jobs lost or not created as a direct consequence. Later, this issue was further probed in Sinha and Benedict (1993). They estimated that a three per cent rise in superannuation leads to job loss (or, more accurately, jobs that would have been created had there been no SGC) of the order of 100,000 to 200,000.

THE COST TO SOCIETY

How do we compute this cost in dollars and cents? First, as a direct result of unemployment, the lost wages will constitute a direct cost to society. However, when superannuation is introduced in the first place, its cost is calculated in terms of its effects on government budget and affordability in the future. Specifically, it is argued that an increased dependency ratio due to the aging of the population will result in greater demands on government resources in the form of age pensions. How does this cost compare with the cost that we are incurring today due to increased unemployment caused by superannuation?

In 1992, direct unemployment benefits amounted to $8733 for a single person. To keep the calculations simple, I will provide all the calculations for single persons. No doubt some of these figures will change when we consider families. However, the magnitudes will not vary dramatically. Moreover, in my calculations, I have not taken into account source of the other benefits enjoyed by the unemployed, such as rent subsidy or subsidy for prescription drugs.

Assuming that the unemployed person would have earned an amount equal to the average weekly earning for Australians in 1992 ($26,278), this person would have paid $5705 in taxes.

Therefore, in 1992 a single unemployed individual cost the government at least $14,438. One component of this cost actually shows up in the Commonwealth budget in the form of higher unemployment benefits paid. The other part is an opportunity cost, and therefore it does not show up in the books at all. Nevertheless, to evaluate the SGC we have to take both these components into consideration.

If a three per cent SGC costs 100,000 to 200,000 jobs, and if we assume that there is a linear relationship between cost of production and jobs lost, it follows that the SGC of nine per cent (which is due to come into effect in 2002) will lead to a job loss of 300,000 to 600,000.

What we have to evaluate is the cost of a permanent job loss of 300,000 to 600,000 against the additional SGC benefits in the future when these people actually retire and cease to depend on unemployment benefits.

Is it reasonable to assume that this job loss will be permanent? Given that we are a long way from full employment, the answer is yes. Had the unemployment rates been very low to begin with and had the economy been operating near full capacity, the results would have been different.

Each of these 300,000 to 600,000 persons will cost the government $14,438 a year for their working lives. Assuming a working life of 40 years and a three per cent real interest rate, the total cost for each person will be $1,088,643. Therefore, the true cost of the SGC is quite substantial when we take into account the jobs lost due to the increased levy on businesses.

We can quantify the benefits that would be received by someone with a retirement fund contribution of $14,438 per year for 40 years. Assuming a retirement of 20 years, the amount is $73,174 per year with a real interest rate of three per cent. In other words, the money that the government is paying now as a cost of the SGC would have comfortably funded the retirement of these people. Note that I have assumed a real interest rate of three per cent. This means that the figure of $73,174 is not inflated. It is in 1992 dollars.

To see the future cost of lost opportunity due to lost employment, we need to look at the rising cost of the age pension due to the ageing of the population. The Australian Bureau of Statistics estimates that the proportion of Australians aged 65 and over will rise from 17 per cent to 32 per cent of the population between 1991 and 2031.

In 1992 there were 1,482,644 people receiving a total age pension of $9,924,395,000. According to the Department of Social Security, two-thirds of them received the full age pension. Let us subject these figures to the same set of projections as before. We assume that in real terms pension benefits will increase by three per cent per annum and that the number of recipients will increase from 17 per cent to 32 per cent of the population. The annual age pension entitlements will rise to $60,938,826,000 in 40 years.

If we calculate the $73,174 benefits for between 300,000 and 600,000 people, it will amount to between $21,952,200,000 and $43,904,400,000. Thus, the cost of lost opportunity due to increased unemployment benefits paid for by the SGC will amount to somewhere between 36 and 72 per cent of the cost of the age pension 40 years later. Is it worth it? How much will the SGC contribute to the cost of the age pension? These figures are not readily available.

A SIMPLE ALTERNATIVE

One simple alternative is to give a pay rise to the workers now instead of increasing the SGC. If the economy is not overheating from inflation (and there is no sign that it is) the extra spending power of the workers will create new jobs and reduce unemployment and therefore make it less likely that an individual will need to apply for the age pension at retirement. More importantly, the pay rise will be in line with the rise in productivity. Rises in SGC are legislated long before the actual economic condition is known. That is, the SGC is set without regard for economic conditions and, as a result, it can be detrimental to growth.

THE SINGAPORE MODEL

Whenever Australia's compulsory superannuation is discussed, the case of Singapore's compulsory Central Provident Fund (CPF) is mentioned as a model. I have argued elsewhere why the Singapore model is not the right one for Australia (Sinha, 1992). There is an important point of comparison: Singapore has raised its CPF substantially – in a few years the employers' contribution rose from five to 25 per cent. Therefore, why didn't the problems that I have just discussed arise in Singapore? There are two reasons. First, unlike Australia, Singapore has no system of generous unemployment benefits. Thus, the cost of unemployment benefits does not arise in Singapore. Moreover, the unemployment rate itself has been very low for the past 25 years. Therefore opportunity cost from lost tax revenue does not arise either. Second, income tax rates in Singapore are very low compared with those in Australia. This means that the proportion of revenue generated from income tax is also very small.

In my estimates, I have taken into account only the unemployment benefits and taxes lost because of higher unemployment. There are other costs of the SGC that arise from tax concessions given to contributions by employers, earnings of funds and tax benefits from lump sum or annuity payments upon retirement. These costs can also be substantial.

Current debates on the SGC are usually based on the premise that the SGC is here to stay. Therefore, researchers have not examined the cost of this option more closely.

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