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Editorial

Every country develops differently. Each takes a unique path guided by its leaders, its institutions, its people, its rules and regulations, its taxes and incentives and ... that awkward word bandied around which is difficult to define ... its culture. In last week's release of the **Reserve Bank** Review, the most informative sections are not about the marginal changes in the number of economists involved in setting interest rates. The preoccupation with this headline-grabbing change is misplaced.

Rather, it is the description of the culture of the central bank which is most revealing, defined as follows:

> *"High-performing institutions have a culture that is aligned with their strategic direction. Culture is the shared values and beliefs that guide how members of an organisation approach their work and interact with each other (Department of the Prime Minister and Cabinet 2019). It lies at the heart of how organisations work. Important drivers of culture include the structure, systems (including governance), organisational policies and leadership of the organisation. Strategy focuses the organisation's actions and decision making."*

A substantial section of the Review is devoted to culture, and there are so many criticisms of leadership styles and hierarchy that it is difficult to see how **Philip Lowe**, at the Reserve Bank for 43 years and Governor since 2016, can implement the changes required. The Review even describes confusion between responsibilities for monetary policy and running the institution:

> *"formal roles and responsibilities relating to risk governance are somewhat unclear, with responsibility split between the Governor, the Reserve Bank Board and the Payments System Board."*

The interviews with staff identified:

> *"- risk aversion, which in this context shifts accountability or blame for potential mistakes*
> *- lack of clear accountability*
> *- a culturally ingrained deference to authority*
> *- incentives that reward individuals for analytical output and those who appear to be across technical issues, resulting in resistance among some managers to genuinely delegate and empower team members."*

The Review also says decision-making is *"highly concentrated in the Governor with limited board oversight"* and:

> *"The Reserve Bank Board has not voted against a recommendation of the RBA executive in at least the last decade."*

We focus on this most important part of the Review, the [Reserve Bank's '**culture club**'], where decisions are made at the top and different views are discouraged. Philip Lowe wants to stay as Governor when his term ends in September 2023, and while he may be asking (to quote **Boy George**) "*Do you really want to hurt me?",* **Treasurer Jim Chalmers** is most likely to respond *"Precious people always tell me that's a step, a step too far."*

A second article this week also dives into the Reserve Bank Review from a different perspective than other parts of the media, and while no less critical, disagrees with my article on the merits of some changes. You be the judge. **Isaac Gross from Monash University** is especially scathing of the lack of oversight by the Board, and the quality of its decisions, quoting:

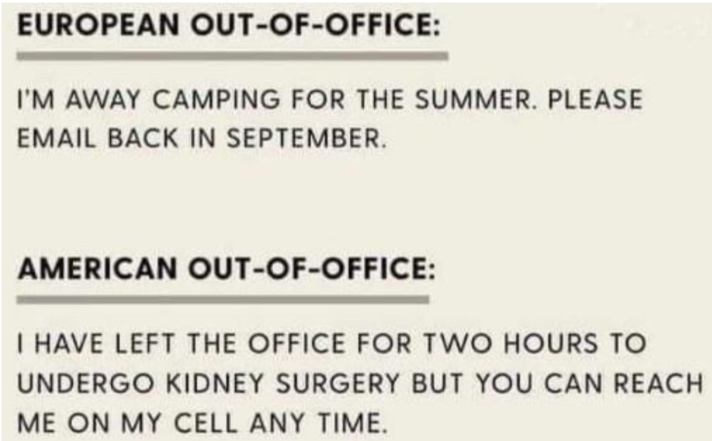
> *"The Reserve Bank Board did not receive any written briefings proposing calendar-based forward guidance before it was introduced by the Governor in a speech in mid-October 2020."*

As an aside, we have received several comments saying that while the Reserve Bank was wrong to hold rates low until May 2022, nobody was criticising them in late 2021. I'd like to point to at least one piece I wrote on 2 December 2021:

> *"Prudential regulators allowed the market to run too strongly over late 2020 and this year with 2021 house prices up around 26% in Sydney, Brisbane and Canberra. Financial stability should not be a boom and bust which pushes thousands out of the housing market while making others even wealthier, and encouraging those who enter the market to take on vast amounts of debt and struggle to withstand rate rises."*

France protests, Australia relaxes on age pensions

While we are looking at culture, it is now a notable point in time when the eligibility for the age pension in Australia is about to increase to 67 (for people born after 1 January 1957) with few if any protests, while there is massive disruption and property damage in France as **President Macron** pushes through an increase in eligibility age from 62 to 64. We are running a quick survey question on why the French are protesting while Australians are sanguine. Are we more American than European in our commitment to work harder and longer?

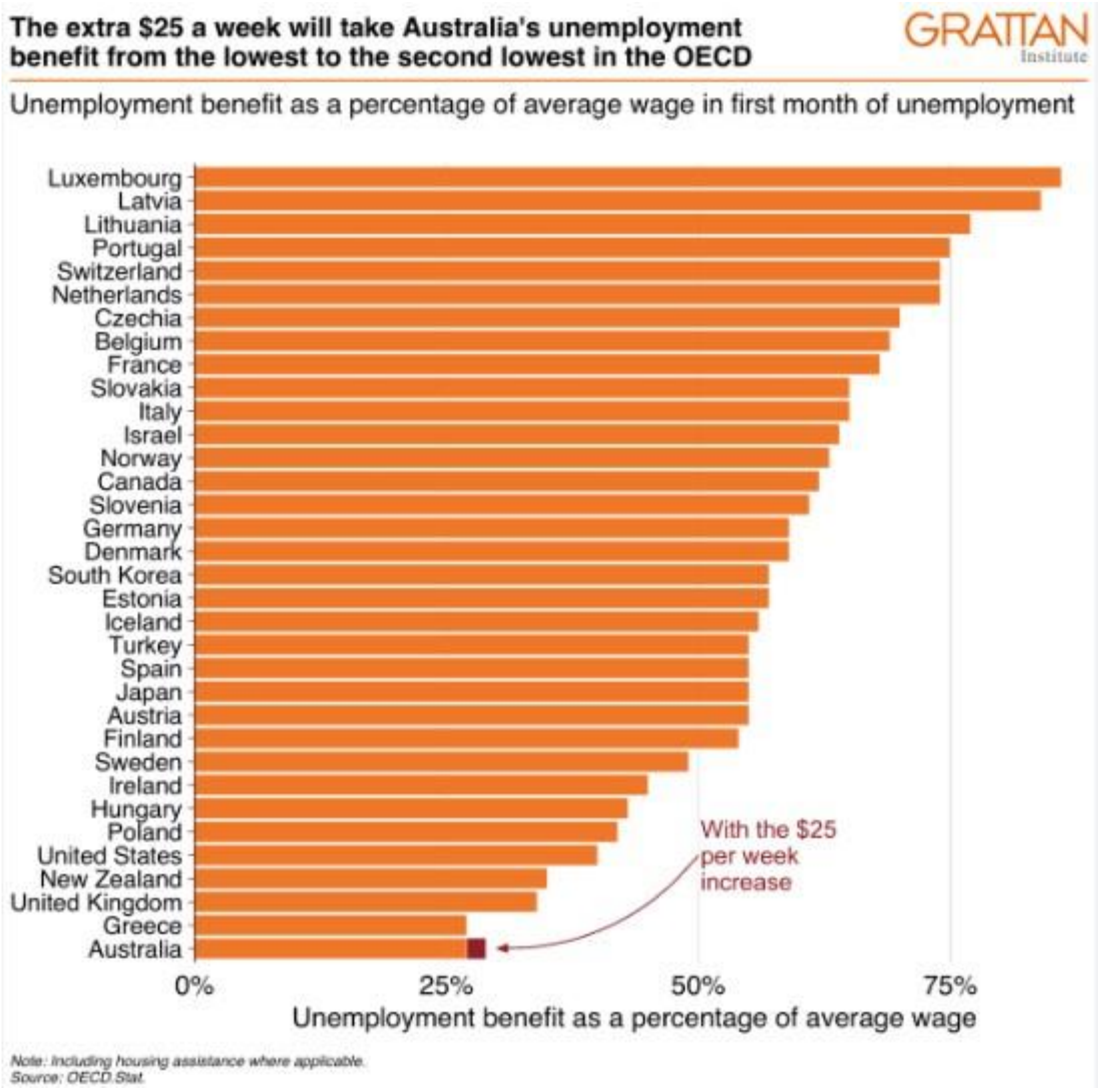


And we've thrown in a third question, which asks about a suitable level of unemployment benefit (JobKeeper or the dole) in Australia.

It's strange that a Labor Government, able to find funding for submarines, missiles, a football stadium in Hobart, war memorials, art galleries, Stage 3 tax cuts ... they seem to announce a new spending programme every day ... plays hard ball on unemployment benefits. The Government's own **Economic Inclusion Advisory Group** recommended that JobSeeker increase to 90% of the age pension from 60%, a rise of $18 a day. Former Treasury Secretary Ken Henry calls the current rate 'cruel'. **The Australian Financial Review** reports:

> *"Four federal Labor MPs have broken ranks to join calls for the government to increase the JobSeeker payment by $24 billion (over four years) at next month's federal budget. The move came as the Government hinted it may increase the $50-a-day payment by a little in the May 9 budget, but not to the levels demanded by the welfare sector."*

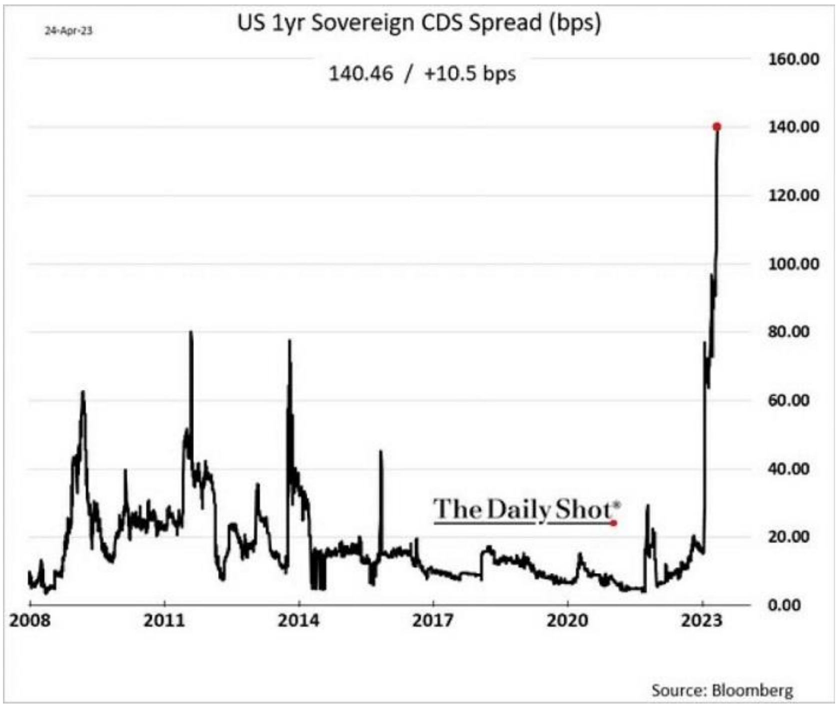
A **Resolve Strategic** Poll in **Nine**'s Sunday papers last weekend found on raising the amount paid to unemployed people: 43% support, 31% oppose, 26% undecided. Let us know what you think in the third question in our survey. If Grattan's numbers are correct, we seem mean on global standards, although international comparisons are notoriously difficult. Is this a reflection on the Australian 'culture'?



Three more significant charts this week.

We have previously highlighted the fall in money circulating in the system and its impact on inflation, economic activity and interest rates, and levels we are now seeing normally lead the major slowdowns.

And we have never seen traders willing to pay so much (1.4%) on a Credit Default Swap (CDS) to protect against the US Government not meeting its debt repayment obligations as they fall due. This is not a highly liquid market compared with the US Treasury market, but it reflects concerns about the political impasse on the US debt ceiling, which is usually worked through.



Finally, the **Federal Reserve Bank of New York** (one of the 12 Federal Reserve Banks in the US) runs a recession probability model and it is now at its highest since 1982. A cheery thought to end on.

On the Reserve Bank meeting next week to decide on the cash rate, economists seem split 50/50 on whether this week's fall in inflation is enough to continue the pause. Either way, the current cash rate is 3.6% and the three-year bond rate is below 3%, so the market thinks rate reductions are only a matter of time.

Graham Hand

Also in this week's edition ...

We lead this week with **James Gruber**, who asks the question: should you give your children their inheritance before you die? It's a touchy subject that's likely to get discussed more often as Baby Boomers in Australia grow older, die richer, leave behind larger bequests and the Bank of Mum and Dad is required to finance more homes. James investigates the pros and cons of the debate, including a review of a recent book advocating that people should 'die with zero'.

There's nothing income-oriented investors love more than high-yielding stocks, although **Karen Watkin** and colleagues at **AllianceBernstein** warn that these stocks may not offer the best returns through the market cycle. Traditional dividend stocks tend to be more defensive, with relatively stable business models and stronger balance sheets. These are great qualities during periods of market stress yet not as beneficial when markets turn.

Superannuation has been receiving plenty of negative press recently, but **Ross Clare and ASFA** suggest it's serving Australia well. It's substantially improving retirement incomes for nearly two million retired Australians by providing regular income streams. And it's also easing the burden on the government to fund retirements.

A recent Treasury Department statement on tax spending includes franking credits, which may be a coincidence or something more ominous. **Tony Dillon** isn't sure which, yet he makes the case for why the Labor Government shouldn't target refundable franked credits to raise revenue.

Curated by James Gruber and Leisa Bell

Nine rules to guide you to die with zero

James Gruber

In my broader family, an issue that's come up for recent discussion is about parents gifting their children money before they die instead of leaving it until after they die. As you can imagine, it's a thorny issue. The parents reflexively believe that the money should be given through inheritance after they pass away. The children, or at least some of them, think the money would be of more value if it were given to them before that time. To them, it would be more compassionate, and might also avoid any quarrelling between the children after their parents' deaths.

The issue doesn't make for pleasant dinner table conversation but it's one that's likely to be aired more often as Baby Boomers in Australia get older, die richer and leave behind larger bequests. The Productivity Commission says Boomers – those born between 1946 and 1964 – are expected to pass on an estimated $224 billion each year in inheritance by 2050, a fourfold increase in bequests.

The question for many parents is whether to make their children wait for their inheritance or not. Today, we'll go through the pros and cons of the issue, as well as the legal and tax implications.

The nine rules

My family discussions on inheritance have coincided with the reading of a book by a former fund manager, Bill Perkins, called *Die with Zero*. As the title of the book implies, Perkins believes all of us should aim to die with nothing in our bank accounts.

Why? Because for him life is about having experiences rather than accumulating money:

> *"Those are two very different goals. Money is just a means to an end: Having money helps you to achieve the more important goal of enjoying your life. But trying to maximize money actually gets in the way of achieving the more important goal."*

By aiming to die with zero, Perkins thinks you'll forever change your autopilot focus from earning and saving and maximizing your wealth to living the best life you possibly can:

> *"Why wait until your health and life energy have begun to wane? Rather than just focusing on saving up for a big pot full of money that you will most likely not be able to spend in your lifetime, live your life to the fullest now: Chase memorable life experiences, give money to your kids when they can best use it, donate money to charity while you're still alive. That's the way to live life."*

Perkins outlines nine rules for achieving the aim of dying with zero:

Rule 1: Maximise your positive life experiences

Perkins reckons you should start thinking about the life experiences you'd like to have, and the number of times you'd like to have them. This will get you to focus on meaningful and memorable experiences:

> *"Unlike material possessions, which seem exciting at the beginning but then often depreciate quickly, experiences actually gain in value over time: They pay what I call a memory dividend."*

Rule 2: Start investing in life experiences early

If life is the sum of your experiences, then everything that you do in life adds up to who you are. Yes, you'll need money to survive in retirement, but the main thing you'll be retiring on is your memories. Therefore, Perkins thinks you should invest in life experiences, and start as early as you can.

Rule 3: Aim to die with zero

Perkins says that though you may not succeed in dying with zero, that should be your goal:

> *"People who save tend to save too much for too late in their lives. They are depriving themselves now just to care for a much, much older future self—a future self that may never live long enough to enjoy that money."*

Rule 4: Use all available tools to help you die with zero

Perkins addresses the fears of many people that they'll run out of money before they die. He thinks if that's a concern for you, then you need to investigate various tools including annuities – financial products that offer a guaranteed income stream.

He suggests that the other, more important part of the equation is how not to waste your life energy by underspending.

Rule 5: Give money to your children or to charity when it has the most impact

Perkins says the peak utility for money – the time when it can bring optimal usefulness or enjoyment – is around 30 years of age. Yet, the average age for inheriting money is close to age 60 for Americans and 50 in Australia (though most receive it between ages 55 and 59):

> *"Putting your kids first means you give to them much earlier, and you make a deliberate plan to make sure what you have for your children reaches them when it will make the most impact."*

Rule 6: Don't live your life on autopilot

Perkins isn't saying that you shouldn't save for the future. Instead, he's saying that it needs to be balanced with spending on the present.

He makes a good point that many experiences depend on your physical health. If you've been biding your time to go on that hiking trip, it's best to do it now rather than later.

Rule 7: Think of your life as distinct seasons

To get more out of the present, Perkins advocates dividing your life into time buckets. That is, draw a timeline of your life from now to the grave, then divide it into intervals of five or ten years. Think about the key experiences – activities or events – that you definitely want to have during your lifetime.

Rule 8: Know when to stop growing your wealth

Often, your net worth peak – where it's the highest that it will ever be - happens well before retirement. Perkins believes that's the time to start spending down, or de-accumulating.

Rule 9: Take your biggest risks when you have nothing to lose

Perkin's view is that you're better off taking more chances when you're younger. You're less likely then to let irrational fears get in the way of making choices that reflect your priorities.

An older theory

Perkins' book is a modern take on an old theory. In the 1950s, economist Franco Modigliani, who went on to win a Nobel Prize, created the idea of the Life-Cycle Hypothesis. The hypothesis says that people should manage their spending and saving to get the most out of their money across their life span. Put another way, making the most out of your money throughout your life requires that wealth declines towards zero by the time of death.

As for the fear that you might run out of money, Modigliani says that to be safe, you should think about the maximum age that a person can live. He believes a rational person will spread their wealth across all the years up to the oldest age to which they might live.

The Australian dilemma

The issue of inheritance or to 'die with zero' is becoming more relevant in Australia as the population ages.

A 2021 Productivity Commission report found that Australians are currently passing on $120 billion each year – 90% as inheritances and the rest as gifts – with an average inheritance netting the recipient $125,000.

The report projected a fourfold increase in the value of inheritances between 2020 and 2050 "partly driven by rising wealth among older age groups" with housing wealth a significant factor, along with unspent super.

It also estimated that the ageing population will see a doubling in the number of deaths by 2050, with older people making up a larger share, and falling fertility rates meaning fewer children to leave wealth to in the future.

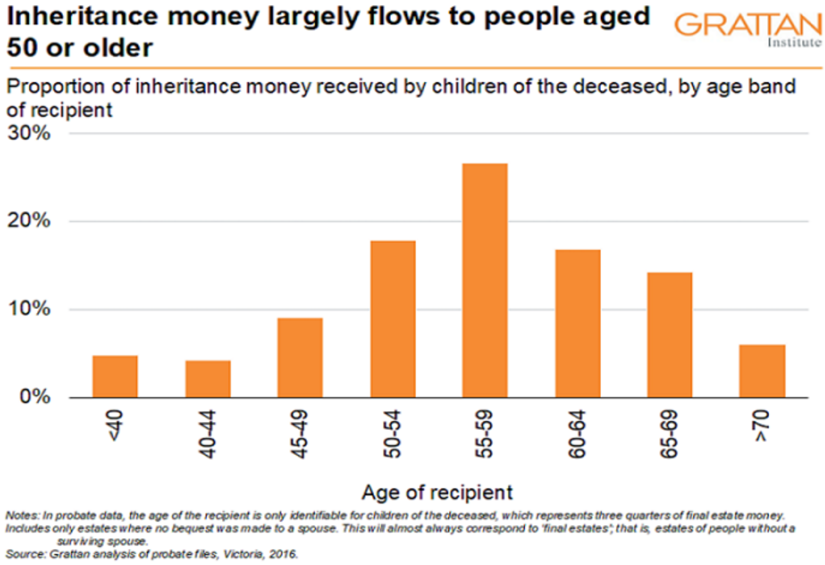
Productivity Commissioner, Lisa Gropp, commented that:

> *"By the time people receive inheritances, they'll usually be well into middle age — about 50 years old on average. This limits the impact inheritances have on opening up lifetime choices and opportunities about career and family."*

And the report concluded that Australia's taxation system is geared towards encouraging intergenerational transfers of housing wealth, as the family home is exempt from the pension assets test.

An earlier [report from the Grattan Institute](#) found that in Victoria, the median estate is worth around $500,000. About 20% are worth more than $1 million, and 7% are more than $2 million. Property is the largest component, accounting for half of the average value.

The main beneficiaries of 'final' estates – estates without a surviving spouse – are children, who get about three quarters of all inheritance money. And average inheritances are growing about 2% above the rate of inflation each year, and that's expected to accelerate in future.



More than 80% of money passed down from parents goes to people aged 50 years and over. The most common age bracket in which people get an inheritance from parents is 55-59 years of age.

The pros and cons

The question then goes back to whether parents should consider giving their money to their children before they die. Perkins' book over-simplifies the choices that people must make. There are numerous things to examine before making a final decision. Here is a list of pros and cons:

Pros:

1. You get to see it. If you give money to your children early, you will get to see the fruits of that. Whether it's a holiday, purchase of a home or the funding of education, helping loved ones like this can't be overstated.

2. You may be able to give money when your children most need it. As Perkins mentioned, the peak utility for money is around 30 years of age. Instead of children inheriting it at age 50 or above, when they often don't need it so much, it might be better to give the money to them when they require it most.

3. Potential tax benefits. Australia is one of only eight developed countries that don't tax inherited wealth. However, there is a 17% tax on superannuation passed to a non-dependant, which is an important part of estate planning as strategies are required to take the money out of super before death. Given the current government's crackdown on super tax breaks for the wealthy, it wouldn't be surprising if inheritance taxes were looked at in future.

Cons:

1. You might run out of money. Despite all the research suggesting that Australians spend little of their retirement money, there's always the fear of running out of money. And it's understandable: you must plan and save for the future, including for unexpected spending events/decisions.

2. Tax issues. If you give money to your children, they won't have to pay tax on that gift. But if you sell an investment to fund the gift, there may be tax consequences such as capital gains on any profit that you make on the sale.

If you decide to finance a future expense such as a grandchild's education, you may need to consider the tax implications, as minors are subject to penalty taxes on investment income.

An alternative option that may avoid tax complications is to loan rather than gift money to your children. With a written loan agreement, you can set the terms to benefit and protect people according to your wishes.

3. May lead to more family drama. Giving money to children before you die may seem like it will reduce the prospects of inflaming family drama, yet that might not be the case. Early giving may cause resentment among loved ones who don't receive the most of your generosity.

There can be other complications. Say you gift your child money, and they buy an apartment with the funds. They later break up with their partner, who could ask for half of the money that was put into the property purchase.

4. It can affect your age pension. Centrelink has special gifting rules to prevent people from giving money away to qualify for the age pension. It says you can only give away $10,000 in one year, or up to $30,000 spread over five years, without any effect on your pension.

For amounts exceeding this, you will still be treated as though you have held onto the money for five years. The excess over the limit will be included in your assets for the pension assets test, and you will be deemed to have earned income on it for the pension income test.

Can you get around the gifting rules by selling your home or other assets to your children at a reduced price? Centrelink says gifting also includes assets that are sold or transferred for less than their market value. If you own a home worth $600,000, and sell it to your children for $300,000, it says $300,000 will be regarded as a gift and used in calculating your pension entitlement after allowing for the permissible $10,000 gift.

Note that these gifting rules don't apply to those not on an age pension, who can gift as much as they like.

This isn't an exhaustive list of pros and cons, and if you want to receive professional advice on the issue, please consult a financial advisor and an estate/tax lawyer.

James Gruber is an Assistant Editor for Firstlinks and Morningstar.com.au. This article is general information.

Reserve Bank's culture club: do you really want to hurt me?

Graham Hand

Give me time to realise my crime
Let me love and steal
I have danced inside your eyes
How can I be real?

Do you really want to hurt me?
Do you really want to make me cry?
Precious kisses, words that burn me
Lovers never ask you why

In my heart the fire is burning
Choose my colour, find a star
Precious people always tell me
That's a step, a step too far

- Extract from the lyrics of Culture Club's, Do You Really Want To Hurt Me?

The wish to *"Give me time"* is unlikely to be granted by the Treasurer, Jim Chalmers, when the term of Reserve Bank Governor, Philip Lowe, finishes in September 2023. It's more likely that *"Precious people always tell me that's a step, a step too far"* is the Treasurer's thinking, and there are many *"words that burn me"* in the Reserve Bank Review for the Governor to consider.

Large sections of the Review are devoted to the need for its leaders to drive institutional and cultural change away from a risk averse and hierarchical structure. Despite his obvious dedication and talents, someone who has been at the Reserve Bank for 43 years and effectively 'Chief Executive Officer' of the 'business' since 2016 is probably not the best person to drive the change. It was not even clear who was responsible for monetary policy and running the institution:

> *"formal roles and responsibilities relating to risk governance are somewhat unclear, with responsibility split between the Governor, the Reserve Bank Board and the Payments System Board."*

Governor rejects criticisms of culture

Although Philip Lowe told a press conference on Thursday, following the release of the Review, that he was not taking its conclusions personally, he must have at least squirmed at parts of it. He has conceded and apologised for errors of judgement in the past, but he said last week that the description of the Board's operations "*didn't really resonate with me*". On page 124 is an example of an important section he disagrees with:

> *"However, many consulted by the Review were concerned that the Reserve Bank Board as currently set up can provide only limited challenge to the view of the RBA executive. The Reserve Bank Board has not voted against a recommendation of the RBA executive in at least the last decade (RBA 2022g). Current and former Reserve Bank Board members themselves described the Reserve Bank Board's role in various ways, ranging from providing real-time feedback on the economy, to an informed second opinion, to a 'pub test' of how decisions might be understood by the public. These explanations centred on the external members providing a non-expert challenge to the RBA executive's proposed monetary policy approach. That leaves the underlying economic and financial judgements with insufficient external scrutiny or challenge and represents a missed opportunity."*

Lowe went further in underplaying the Review's findings, and despite the extensive coverage the Review has received espousing the significance of the changes, he said:

> *"It's not correct to say a different decision-making structure would make fundamental differences. We're talking about improvements at the margin."*

Get that ... *"at the margin*'. He was supported by Reserve Bank Board member, Mark Barnaba, in an interview the next day, where he also said:

> *"Notwithstanding the length of the report and the number of recommendations, in substance the changes are more marginal than appear."*

It is tempting when opening the 294-page Reserve Bank Review to go straight to page 17 and read the recommendations, but most of it is pedestrian. They include the familiar, such as "*The RBA should continue to have operational independence for monetary policy*", many ways to explain decisions better, and even "*continuing to …*". The most material change is the establishment of a separate Monetary Policy Board.

But then comes Chapter 4 on poor cultural practices at the Reserve Bank, and the real gravity of the Review is in the damning revelations of how Australia's central bank operates. It is what is often described somewhat awkwardly as 'culture' that will hurt Lowe the most. From page 155 is devoted to addressing considerable shortcomings in culture and an attempt to define it:

> *"Culture is the shared values and beliefs that guide how members of an organisation approach their work and interact with each other (Department of the Prime Minister and Cabinet 2019). It lies at the heart of how organisations work. Important drivers of culture include the structure, systems (including governance), organisational policies and leadership of the organisation. Strategy focuses the organisation's actions and decision making."*

Do you really want to hurt me?

If there is one sentence in the Review which undermines Lowe, it is this:

> *"The Reserve Bank Board did not receive any written briefings proposing calendar-based forward guidance before it was introduced by the Governor in a speech in mid-October 2020."*

So the most consequential and often-quoted statements by the Governor about no increase in cash rates until 2024, which encouraged thousands of borrowers to buy residential property in the boom of 2021 and which he admits was serious error, had not received any written analysis by the Board. And yet the Reserve Bank Board then ran with it.

> *"This language was updated in February 2021: 'The Board will not increase the cash rate until actual inflation is sustainably within the 2 to 3 per cent target range. … The Board does not expect these conditions to be met until 2024 at the earliest.' The Reserve Bank Board maintained this calendar-based component of forward guidance until November 2021. It continued state-based forward guidance until May 2022."*

A close second in incriminating evidence is the lack of dissent and independent thought, and says the Review (p124):

> *"The Reserve Bank Board has not voted against a recommendation of the RBA executive in at least the last decade."*

There is no dodging how critical the Review is of the Reserve Bank leaders, and it places Jim Chalmers in a clear position. For example, on page 164 under the heading, "*Greater delegation and empowerment of staff members*", it says:

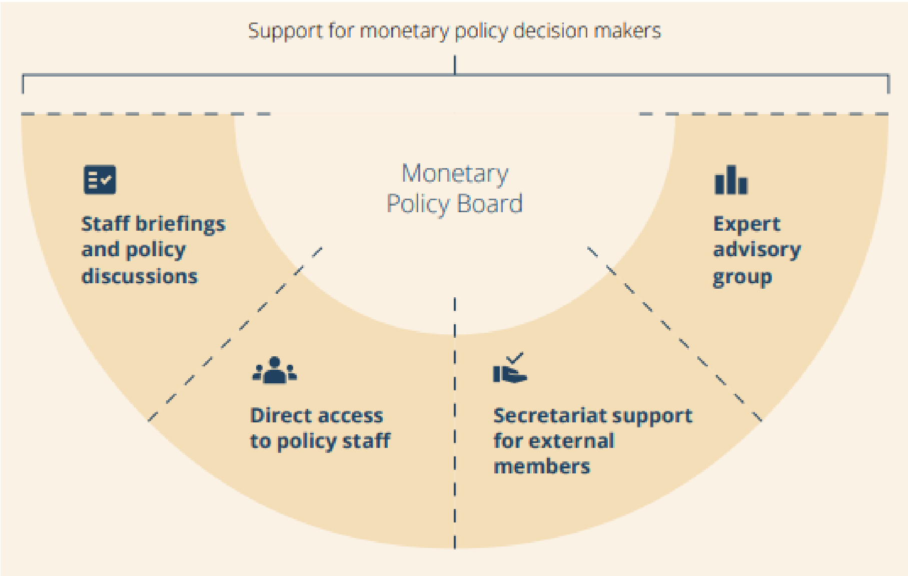
> *"RBA staff members frequently raised decision making, delegation, and hierarchy as areas for improvement. The Review heard from staff members that decisions tend to be pushed up to or retained exclusively at more senior levels. Others relayed that delegation was inconsistent across teams or could change at short notice, creating risk. Staff members identified various drivers for this including:*
>
> *- risk aversion, which in this context shifts accountability or blame for potential mistakes*
> *- lack of clear accountability*
> *- a culturally ingrained deference to authority*
> *- incentives that reward individuals for analytical output and those who appear to be across technical issues, resulting in resistance among some managers to genuinely delegate and empower team members."*

Does an army of economists lead to better decisions?

Another recommendation about the new Monetary Policy Board is generating unwarranted excitement. Is there an expectation because more economists are involved in decisions, that some magic potion will be sprinkled over the Australian economy? This new Board will still wield only one extremely blunt instrument, interest rates, and there is little evidence that similar boards overseas made superior decisions in recent years.

In any case, the existing Board has three economics PhDs, two others with masters degrees in economics and another with financial economics. That's six members of the nine-member Board with suitable qualifications, and hundreds of combined years in financial markets, as well as senior business executives. Plus support from 1,500 Reserve Bank staff including an army of well-qualified economists. The Governor and the Treasury Secretary will continue to sit on and guide the Monetary Policy Board and select the other members.

And on it goes. Another recommendation is: *"The Monetary Policy Board should convene and engage with an expert advisory group on monetary policy."* And within the Reserve Bank itself, policy formulation should be improved by *"establishing a monetary policy strategy team"*. It's becoming a cast of thousands. There is even "*The RBA and Treasury should develop an Australian Macroeconomic Policy Research Program …*"



How many experts opinions do we need? Or want?

Even within the Reserve Bank itself, there is criticism that the place is '*run by economists for economists*'. Staff members are quoted as saying:

> *"Many staff members remarked to the Review that the RBA has a long history of transferring professional economists from policy departments into senior corporate roles. A common remark the Review heard was that the organisation was 'run by economists for economists'. Asked about what they would like to change about the RBA's culture, staff members' observations included: 'There are economists everywhere in the Bank where they shouldn't be, and their opinion is weighed higher than all others. Employing them removes the opportunity for subject matter experts to actually improve and innovate.' 'I think there is a fundamental bias in the RBA's culture to promote economists even though there are staff who have years of operational experience. Due to this, I've seen operational staff with a lot of corporate knowledge leave the bank.'"*

Another consequential recommendation is that the Monetary Policy Board should communicate more frequently than the current Board. For example, Recommendation 10 is headed "*Strengthen monetary policy transparency and accountability". It includes steps for the Governor to present to the public more often, such as:

> *"The Governor should hold a press conference after each decision meeting to explain the Monetary Policy Board's view of policy and economic developments."*

and

> *"External Monetary Policy Board members should be expected to discuss the decisions and thinking of the Board publicly, including through at least one speech or public engagement a year."*

Philip Lowe already makes regular speeches and most of them repeat previous points. I listen to or read all of them and the repetition of questions and answers and responses is tiresome, but that's not Lowe's fault. He says it's possible to communicate too much.

The major change is now we will know whether some Board members dissented (and it's likely that they will more often given the Review's criticisms of passive members), especially since they will be encouraged to make their own public presentations. That's eight other Monetary Policy Board members making at least one public speech a year each, plus all the Governor's announcements.

There will be so much content on interest rates out there that the market, investors and the public will be thoroughly confused. Or bored.

Changing the Reserve Bank culture

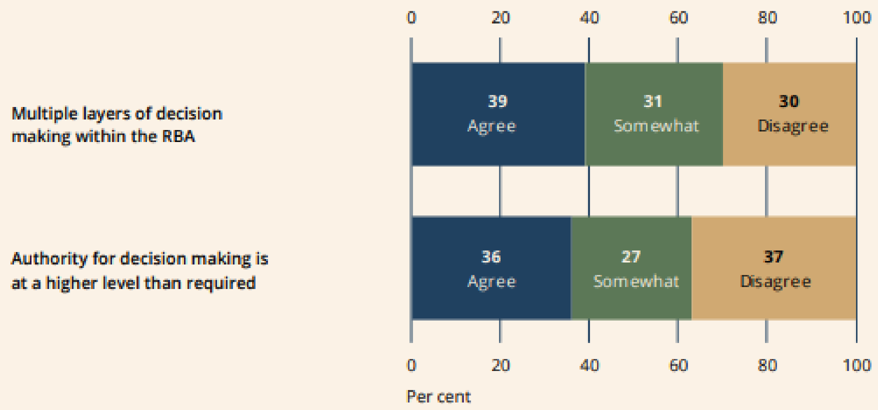
According to the Review, a complete overhaul of the way different opinions reach senior levels is required. The Review begs for a sweeping broom to come in from outside and completely change the hierarchy.

There are many comments on empowering staff and raising the dynamism of the organisation. The recommendations to improve leadership are critical, such as in Section 11.2:

- mandatory leadership training for all managers
- annual externally facilitated 360-degree feedback mechanisms for managers with subsequent leadership coaching services
- ensuring its leaders are assessed for how effectively they deliver performance management and development processes that capture both the business outcomes and how those outcomes were achieved.

A survey of Reserve Bank staff revealed many consider there are significant barriers to them performance at their best.

Chart 4.3: Staff perceptions of barriers to them performing at their best (decision making)



Source: RBA Review Staff Survey (2022).

Note: Response scale was 'to a very great extent', 'to a great extent', 'somewhat', 'very little', 'not at all'. Agree includes 'to a very great extent' and 'to a great extent'. Disagree includes 'very little' and 'not at all'.

Here is a selection of other quotations from the Review:

Page 39: *"The evidence gathered by the Review suggested that there was not a sufficiently deep ongoing debate around the strategy of accepting gradual progress towards the Reserve Bank Board's targets. The Board papers contained only limited consideration of alternative strategies, whether because the executive chose not to put them forward or the Board did not ask for this material."*

Page 43: *"The Reserve Bank Board was not provided with, and on the available evidence did not demand, enough information in advance to fully debate and challenge the key design choices for the tools proposed by the RBA executive."*

Page 47: *"In contrast to most of its peers, the RBA offered guidance over a long time-horizon and did not update its guidance as the economic outlook changed. This made the RBA particularly vulnerable to unexpected (positive) economic developments."*

Page 48: *"The RBA projects that the cumulative financial cost of the bond purchase program to its underlying earnings over the next decade is likely to be large, at between $35 billion and $58 billion (RBA 2022b). The RBA provided information to the Review indicating that the cost of the Term Funding Facility is also likely to be large, in the order of $8 billion."*

Page 169: *"Many staff members remarked to the Review that the RBA has a long history of transferring professional economists from policy departments into senior corporate roles. A common remark the Review heard was that the organisation was 'run by economists for economists'. Asked about what they would like to change about the RBA's culture, staff members' observations included: 'There are economists everywhere in the Bank where they shouldn't be, and their opinion is weighed higher than all others. Employing them removes the opportunity for subject matter experts to actually improve and innovate.' 'I think there is a fundamental bias in the RBA's culture to promote economists even though there are staff who have years of operational experience. Due to this, I've seen operational staff with a lot of corporate knowledge leave the bank.'"*

The work starts now

There are so many details for the Government and the Reserve Bank to trawl through, including new committees, new programmes, changes in structure and cultural overhaul that an entire chapter is devoted to implementation. An effective date for new appointments is 1 July 2024, notably beyond the expiry term of the current Governor.

But on culture and leadership, the Review suggests immediate action in 2023:

> *"Priority recommendations for the RBA in 2023*
>
> *Strengthen the RBA's management, culture and operations (Recommendation 11), including appointing a Chief Operating Officer, implementing mandatory leadership training, assessing leaders on their promotion of challenge and debate, and establishing a monetary policy strategy team."*

So there's no time to waste for the 1,500 staff of the Reserve Bank, and a bevy of new appointments, mainly aimed at the elusive goal of guessing an appropriate level of a blunt instrument.

Five years from now, there will be another Review, with much focus on whether the culture club was successfully changed to bring in fresh and new ideas. It will require a major overhaul with plenty of risks.

Do you really want to make me cry?

Graham Hand is Editor-at-Large for Firstlinks.

Review exposes the blunders of a broken structure

Isaac Gross

The cornerstone of the Reserve Bank of Australia [(RBA) Review] is the recommendation that monetary policy powers be taken from the RBA Board and instead be given to a dedicated monetary policy committee staffed mostly by external experts.

Some commentators have criticised this recommendation as a mere rearrangement of deck chairs, taking the decision of monetary policy from one bureaucratic committee and giving it to another, leaving little impact on the interest rates that Australian households end up paying.

I think this view reflects a profound misunderstanding of the RBA Review's findings. In fact the Review spells out in great detail why members believe the current structure has led to multiple policy errors that a panel of experts would almost surely not make.

In this article, I unpack just one part of the Review: the evidence for why the Board is so badly broken.

The broken guidance

The decision in October 2020 to issue a prediction that interest rates would stay at 0% for the next three years is the most universally agreed upon error by the RBA in recent times. Everybody including the Governor himself now admits it was a mistake.

So, how did this policy error get made? The RBA Review examines this decision in detail and finds that:

> *"The Reserve Bank Board did not receive any written briefings proposing calendar-based forward guidance before it was introduced by the Governor in a speech in mid-October 2020."*

So despite receiving no advice proposing the idea the Board decided to implement it anyway. Even worse, the Board had been *actively* warned about the risks involved in calendar-based forward guidance only one year earlier.

> *"The lack of written briefing for the Reserve Bank Board at the outset is notable given the RBA's advice on forward guidance to the Board in 2019 which focused on the drawbacks and risks of calendar-based guidance."*

The Review concludes that

> *"… the introduction of calendar-based guidance was not treated in the same way as other policy shifts, and there was no documented discussion of the risks and implications of this shift. The lack of consultation reduced the opportunity for the Reserve Bank Board to debate, challenge and collectively own the decision."*

This is a stunning indictment of the current Board.

Despite being warned about the dangers of the three-year guidance, they implemented it anyway while failing to debate or discuss the very real risks around the policy - namely that that inflation would rise quicker than expected and they would be forced to break the guidance.

Which of course is exactly what happened. This decision was a massive unforced monetary policy error. How would this have been different under a board of expert monetary policy makers?

Well there are plenty of studies on the risks of time-based forward guidance if you know where to look. Any expert in monetary policy or macroeconomics would have known this. Moreover a committee of experts would have taken staffs' advice placing more weight on staff recommendations and, if they disagreed with them, couched their disagreement using empirical evidence or macroeconomic research. If the Board had listened to the expert advice they had received they would never have given that guidance and would have avoided misleading the Australian people.

By contrast a monetary policy committee of experts would likely have avoided the most universally-loathed mistake the RBA has made in recent years.

270,000 jobs destroyed

The three-year forward guidance mistake, while high profile, ultimately harmed the RBA's reputation more than it did the economy. A more costly mistake was the decision to keep interest rates too high over the period 2016-2019, a mistake which destroyed 270,000 jobs.

This was an error many years in the making, not in the heat of the Covid-19 crisis. Surely, this additional time would have enabled the Board to debate ways to solve the inflation undershooting and to get the unemployment rate back down to the NAIRU?

> *"The evidence gathered by the Review suggested that there was not a sufficiently deep ongoing debate around the strategy of accepting gradual progress towards the Reserve Bank Board's targets. The Board papers contained only limited consideration of alternative strategies, whether because the executive chose not to put them forward or the Board did not ask for this material."*

I guess not. Despite killing hundreds of thousands of jobs, neither the RBA executive nor the external members of Board seriously entertained the idea of changing course.

The Review reports that in 2017, the RBA hired an independent overseas expert who:

> *" ... equipped Reserve Bank Board members with the necessary information to genuinely explore and debate alternative viewpoints on the appropriateness of the policy strategy".*

Sounds promising! The expert report even acknowledged the costs of the approach of "Leaning against the Wind", the underlying reason why the RBA destroyed so many jobs. So now that there were armed with a crash course in macroeconomics, did the Board turn the ship around and stop the RBA from suffocating the Australian economy?

> *"There is limited evidence in Reserve Bank Board papers or meeting Minutes that the question was re-examined in a meaningful way over the next 2 years."*

Oh well. Of course, the RBA did have access to a large internal source of expertise and dissent did exist among the RBA staff at this time. But alas:

> *"Alternative views among RBA employees and alternative policy choices – and their costs and benefits – were rarely presented."*

What a monumental policy error, driven by a completely broken policy process.

Would external experts have helped? Of course they would have. We know this because:

1. The *internal* experts had diagnosed the problem, but were being muzzled.
2. External experts were calling out the RBA in the press at the time.
3. The only politician who held the RBA to account Andrew Leigh, was also the only former academic economist in parliament.

This is a clear example of a time when the RBA made a serious and persistent policy error, and we have evidence of who was the canary in the coal mine. It was academic macroeconomic experts who were the first to call out the RBA for making what was a profound policy error.

Ignoring the yield control problem

Perhaps the greatest evidence of Board failings is how the RBA executive ignored it during the collapse of Yield Curve Control. In October 2021, the RBA decided to effectively abandon the yield peg as it came under sustained pressure from financial markets. But amazingly, the Governor did not even check with the Board before pulling the plug on the programme and stopping all interventions! The Review states that:

> *"This raises governance concerns regarding … the ability of the Governor to stop implementing a decision of the Reserve Bank Board without first consulting them."*

The RBA was even aware of risks building up in their policy months earlier, but didn't convey them to the Board.

> *"The Reserve Bank Board was not made aware of the views of some senior staff members shared with the Governor that the RBA should exit the yield target in mid-2021."*

Another example of internal experts being ignored, so that the Board could blunder into another policy error in their ignorance.

The list goes on

I am more forgiving of errors made in March 2020. It was a hectic time for everyone, central bankers included. But it would be remiss to not mention that the people who had access to all the internal documents *still* considered the policy process to be deeply flawed during this period.

There was little discussion of the risk involved in implementing yield curve control

> *"However, the Reserve Bank Board written materials gave little attention to how unusual a yield target was internationally or the fact that there was no international precedent for exiting from a yield target. The written materials also did not consider the plausible risk that the yield target might make it more difficult to change course if economic circumstances changed quickly."*

Meanwhile the risk seemed readily apparent to even a humble academic such as myself per my blog post from November 2020.

Or when it came to the design of the Term Funding Facility

> *"The Reserve Bank Board was not provided with, and on the available evidence did not demand, enough information in advance to fully debate and challenge the key design choices for the tools proposed by the RBA executive. For example, the term funding facility option presented to the Reserve Bank Board proposed to offer banks funding at a fixed interest rate. It was acknowledged in written materials that this approach carried some interest rate risk. But the risk was said to be small and warranted and was not quantified. The paper did not explore the option of offering an attractive floating interest rate, such as in the Bank of England's otherwise similar program."*

Did this limited discussion matter? I am sure that academics would be far more familiar with the policy design used by other central banks compared to business executives whose experience is largely confined to the Australian economy.

Of course that expertise to consider these policy programs, and the risks involved, did exist

> *"The RBA developed a set of internal papers outlining more detail on the design of the yield target and term funding facility, but these materials were not provided to the Reserve Bank Board."*

But it was considered too hard for the Board.

> *"The RBA considered these materials to have a level of technical detail that was not required for the Reserve Bank Board's decision."*

And it wouldn't be an Australian institution if we didn't have a case policy cultural cringe, this time in response to creating a quantitative easing programme of our own:

> *"The RBA highlighted in Reserve Bank Board papers that Australia stood out among its peers in not having an asset purchase program across the yield curve. The Review heard in consultations that part of the motivation for implementing the bond purchase program was to match its peers."*

You might think that we need to follow our peers to prevent the currency being depreciated, and you'd be right that was motivating factor:

> *"The RBA in part motivated decisions about [QE] in the context of the impact on the exchange rate."*

But did the Board see any modelling on the bond purchases impact on the exchange rate?

> *"However, no supporting analysis was provided to the Reserve Bank Board."*

I think we've seen enough.

The status quo must go

If you care at all about good economic policy, or even just good policy processes more generally, then the Review makes for eye-opening, depressing reading.

Time and time again, RBA staff members warned about impending dangers, but the RBA executive decided to keep their Board in the dark. In turn, the Board consistently failed to ask for further information or more detail about the risks involved until inevitably something went wrong and another unforced policy error surfaced.

Fortunately, we now know the truth and have a Government that seems willing to fix the problem. The status quo is broken and change cannot come soon enough.

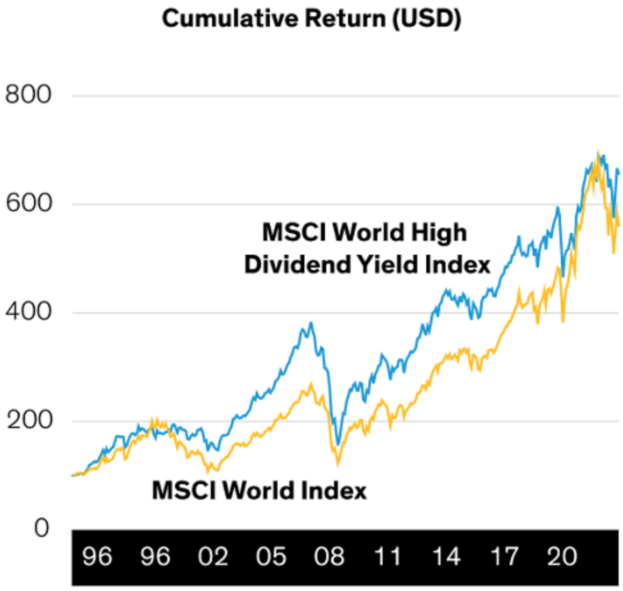
Zac Gross is an Economics Lecturer at Monash University. This article is general information and the opinions are personal and not those of the University.

Where to hunt for dividend paying stocks

Karen Watkin

Dividend-income strategies can be effective provided they're designed to tap into a wider opportunity set beyond traditional dividend payers alone.

Dividend stocks: Long-term outperformance, but episodic returns



2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Growth 16.1	Momentum 29.7	Min Vol 11.4	Min Vol 5.2	Value 12.3	Momentum 32.1	Min Vol −2.0	Quality 36.1	Growth 33.8	Quality 25.7	**Dividend −4.7**
Size 16.1	Quality 27.1	Quality 8.4	Momentum 4.1	**Dividend 9.3**	Growth 28.0	Momentum −2.8	Growth 33.7	Momentum 2.83	Value 21.9	Value −6.5
Value 15.5	Growth 26.7	Momentum 6.5	Quality 3.7	Size 8.8	Quality 26.0	Quality −5.5	Momentum 27.7	Quality 22.2	Growth 21.2	Min Vol −9.8
Momentum 14.1	Value 26.6	Growth 6.1	Growth 3.1	Min Vol 7.5	Size 23.3	Growth −6.7	Size 23.9	Size 9.6	**Dividend 15.8**	Size −16.8
Quality 13.0	Size 26.0	Value 3.7	Size −1.5	Quality 4.6	**Dividend 18.1**	**Dividend −7.6**	Min Vol 23.2	Min Vol 3.6	Size 14.9	Momentum −17.8
Dividend 12.2	**Dividend 21.9**	Size 2.9	**Dividend −3.2**	Momentum 4.2	Min Vol 17.3	Value −10.8	**Dividend 23.2**	**Dividend 0.0**	Momentum 14.6	Quality −22.2
Min Vol 8.1	Min Vol 18.6	**Dividend 2.5**	Value −4.8	Growth 2.8	Value 17.1	Size −12.2	Value 21.7	Value −1.2	Min Vol 14.3	Growth −29.2

Past performance does not guarantee future results. As of December 30, 2022. Source: MSCI and AllianceBernstein (AB).

Traditional dividend stocks: the risks of a narrow focus

Dividend-income strategies play an important role for multi-asset income portfolios. But they can also run the risk of being too narrowly focused, which can limit both income potential and upside participation when equity markets rise.

Traditional dividend strategies tend to be more defensive, outperforming when economies slow. That's because companies able to pay high and consistent dividends are often more mature, with relatively stable business models and stronger balance sheets, which can help them navigate periods of market stress.

However, investing solely in traditional dividend-paying companies could sacrifice returns through some parts of the cycle. Dividend-payers tend to have value traits and, as a result, are natural competitors to high-growth companies that reinvest profits to expand their business instead of returning them to shareholders. Therefore, when growth is more rewarded, dividend payers tend to lag.

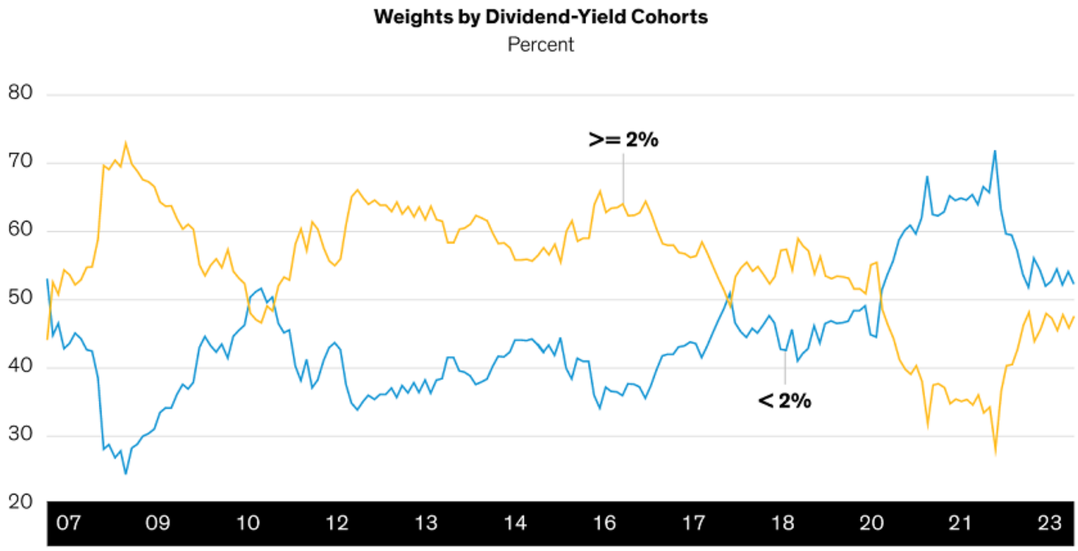
For these reasons, we believe a more thoughtful and diversified approach to dividend investing makes sense.

The dividend income universe faces a growing challenge

Recent market dynamics have also highlighted how leaning purely into high-dividend stocks can come with larger-than-usual unintended risks that need to be carefully managed.

For instance, the rise in market capitalizations of fast-growing, often tech-focused companies has created an environment where less than half of the global universe is paying a dividend over 2%. This has shrunk the opportunity set for traditional dividend investors—we think this underscores the need for income seekers to expand into other areas of the equity market.

Less than half of global stocks pay a dividend of over 2%



Past performance does not guarantee future results. As of February 28, 2023. Source: MSCI and AB.

This large divide between high-growth companies and traditional dividend payers is changing the behavior of the dividend-stock universe, which is acting more defensively than usual, with steadily declining sensitivity to the broader equity market. This trait helped in 2022's challenging market but is likely to reduce upside participation when markets deliver strong returns. This was true in 2020's growth-led rally, when dividend stocks underperformed by around 16%; a similar downtrend is also unfolding in 2023.

We believe that the approach to dividend investing in today's market should be designed to counter some of these challenges.

Beyond payouts: Factors help expand the dividend-investing universe

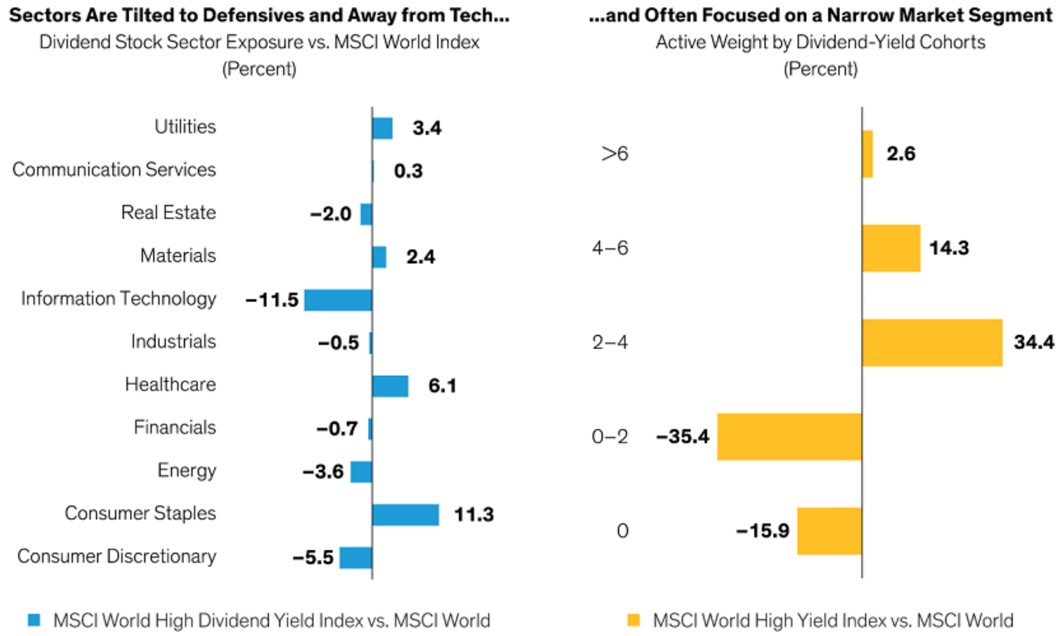
In our view, a quantitative-driven process can be an effective way to include stocks that would typically be beyond the universe of traditional dividend strategies. A more systematic approach can better harvest yield across countries, styles and sectors. It also helps to assess stocks based not just on dividend yield, but also on additional risk premia like price momentum, quality and earnings strength, which can help build a more well-rounded portfolio.

Casting a wider net may help to avoid unintended concentrations in style factors, sectors and narrow ranges of dividend levels, an increasingly likely result when focusing on traditional dividend payers alone. Big swings in sector returns can be more common, and their dispersions dominate most other factors in investment performance. This trend accelerated with the COVID-19 pandemic "winners and losers" of 2020 and 2021, with technology dominating all other sectors; in 2022, concerns of high inflation and rising interest rates took center stage, leading energy to outperform, while more defensive sectors such as healthcare and consumer staples retreated far less than others.

The growing shift in sector composition between the broad equity market and traditional dividend payers, along with the greater dispersion in industry leaders and laggards, has led to larger than usual differences in short-term performance between high-dividend and broad market indices. For some investors focused purely on income, this could mean their returns will deviate more than usual from core equity performance.

A more systematic approach to dividend-investing can help to reduce sector differences, most notably with a lower structural overweight to consumer staples and—crucially—a minimal underweight to technology, which can help to minimize tracking error versus the broader equity market.

Traditional dividend approaches could lead to unintended exposures



Past performance does not guarantee future results. As of February 28, 2023. Source: MSCI and AB.

The dynamics of dividend investing in an income strategy

Dividend stocks are one of many important building blocks in a multi-asset income strategy. Investors should constantly weigh how a dividend-income allocation complements other building blocks as market patterns evolve. For example, investors should consider the relative yield advantage between stocks and bonds when assessing the role of dividend equities.

Just 18 months ago, high-dividend equity yields were more than double those of high-quality bonds and generating almost the same income as high-yield bonds. Today, bonds offer considerably more income than equities: high-yield bonds offer twice the yield of stocks, while high-grade bonds offer a yield advantage of more than 1%. In this environment, it's more important than ever for equities to provide room for capital appreciation alongside their dividend income.

We believe that by taking a more systematic approach and thoughtfully combining stocks across the income spectrum while also balancing sectors and other types of risk premia, investors can capture an attractive level of dividend income without sacrificing return.

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The impact of superannuation on retirement outcomes

Ross Clare

(This article is an extract from a longer report linked at the end).

Superannuation is substantially improving retirement incomes for nearly two million retired Australians by providing regular income streams. Australian Bureau of Statistics (ABS) data also indicate that in 2019-20 around 580,000 households, encompassing over 1 million Australians, were mainly dependent on payments from superannuation. This is nearly double the number of households mainly dependent on superannuation in 2009-10. For those dependent on superannuation income, around 75% of such households have less than 20% of their income from government pensions. Many more retirees also have benefitted by taking lump sum benefits either at retirement or during retirement.

Putting super income payments into context

By 2021-22, there was a total of $59 billion in superannuation income payments in retirement, (Table 1), which is greater than the annual Age Pension expenditure of around $51 billion in that year [*DSS 2021-22 Annual Report*].

Table 1: income stream payments from APRA funds and SMSFs (a)

Income year	SMSF income stream payments ($ billion)	Total income stream payments for APRA funds with greater than four members ($ billion)
2021-22	18.4	40.4
2020-21	18.1	38.5
2019-20	19.3	40.9
2018-19	22.7	39.2
2017-18	24.4	36.4
2016-17	36.2	34.5

(a) Figures from APRA Annual Superannuation Bulletin June 2022, Excel version Table 2

Historically the Age Pension has been the main source of income for most retirees in Australia. Government pensions and allowances were the most common main source of income for the 3.9 million retirees in Australia in 2018–19 aged 45 and over (49% for men, 44% for women), followed by superannuation (30% for men, 17% for women).

Yet this is beginning to change with increasing superannuation balances and with more retirees relying mainly on superannuation. As shown by Table 2, in 2021-22 (for funds with more than six members) there were around 1.37 million people who received regular income from account-based income streams. There also were 99,000 people receiving annuity payments (both term and lifetime) along with 159,000 individuals receiving defined benefit pensions, (mostly related to former public service employment). The total amount of pensions paid by funds with more than 6 members increased from $28.4 billion in 2014-15 to $40.4 billion in 2021-22.

A further 81,000 people received transition to retirement pensions in 2021-22. These pensions have become less popular due to changes in their taxation treatment. In 2016-17 there were 162,000 individuals receiving such pensions from funds with more than four members.

Table 2: Superannuation income streams, 2021-22 (a)

	Total account based	Annuity	Defined benefit pensions
Number	1,370,000	99,000	159,000
Average annual payment	$20,353	$47,294	$25,426

(a) Payments from funds with more than 6 members. Source: APRA Annual Superannuation Bulletin

There also are very substantial numbers of people (over 330,000 in 2019-20) receiving income stream benefits from Self-Managed Superannuation Funds (SMSFs). SMSFs have a substantial proportion of their membership in the retirement phase.

The average income stream benefit paid by an SMSF was around $47,900. This is significantly higher than the average for APRA regulated funds, reflecting the higher average account balances in SMSFs. Income stream payments in 2019-20 would also have been affected by the temporary reduction in minimum draw down rates. The minimum annual payment required for account-based pensions and annuities, allocated pensions and annuities and market-linked pensions and annuities was reduced by 50% for the 2019–2023 financial years.

Vast majority draw down almost all super

The evidence available indicates that in most cases individuals draw down entirely on their superannuation during retirement rather than leaving a substantial amount for a spouse or children. The Association of Superannuation Funds of Australia (ASFA) 2021 paper findings are confirmed by more recent ABS data which indicate that in 2019-20 for those aged 75 and over, only 41.7% of males and 29.5% of females had a superannuation account balance or were receiving income from superannuation (which would include receiving a defined benefit pension which cease on death).

Table 3: Percentage of older Australians with superannuation

	2017-18			2019-20		
Age	Males	Females	Total	Males	Females	Total
65-74	62.3	50.6	56.3	62.7	53.8	58.0
75 and over	33.8	25.8	29.5	41.7	29.5	34.9
Total 65 and over	51.3	40.0	45.4	54.1	43.4	48.5
Total	74.4	69.5	71.9	78.0	70.9	74.4

(a) Includes persons with a superannuation account balance above zero and/or receiving regular income from superannuation and/or who received a lump sum superannuation payment in the last two years
(b) The number of persons with superannuation coverage expressed as a percentage of total persons in the corresponding group (age and sex)

ATO sample file data indicate that in 2019-20 for the 2.9 million Australians aged 70 and over, only 540,000 had more than $1,000 in superannuation, around 310,000 had more than $200,000 and only 180,000 had more than $500,000. Most of the higher balances are held by members of SMSFs. In 2019-20 there were around 115,000 members of SMSFs aged 70 and over receiving income streams and with balances over $500,000.

However, overall, 90% or more of those aged 70 and over pass away with little or no superannuation, having drawn down on their balances after their retirement.

That said, some individuals do have significant balances in superannuation. In 2019-20 around 35,000 individuals had more than $3 million in superannuation, with around 90% of them in SMSFs. The number is expected by Treasury to grow to around 80,000 by 2025-26.

Growing super assets ease burden on government

As well, the large and growing pool of superannuation assets is positively influencing both adequacy of retirement incomes and sustainability of government expenditure on the Age Pension.

As a result of increasing superannuation account balances, at Age Pension eligibility age an increasing proportion of retirees have substantial private incomes, which increases retirement incomes, decreases the proportion of retirees who receive a full Age Pension and increases the proportion who receive no Age Pension at all.

Already there has been a fall in the percentage of new Age Pensioners who are on the full Age Pension and an increase in the percentage who at the time of retirement are fully self-funded.

As shown by Table 4, only around 40% of the age group 66 to 69 currently receive the Age Pension.

Take-up rates vary between each State and Territory, largely driven by differences in average superannuation balances. For instance, in the Australian Capital Territory coverage of superannuation and average superannuation balances are higher than the national averages. There also is a relatively high incidence of defined benefit pensions in the Australian Capital Territory.

Table 4: Age Pension recipients by state and territory by age group, December 2021

State	% of age group 66-69 receiving Age Pension	66-69	70-74	75-79	80-84	85-89	90 and over	Total
ACT	25%	3,471	6,490	5,936	4,569	2,800	1,556	24,822
NSW	40%	128,234	212,236	183,079	136,428	84,753	48,810	793,540
NT	36%	2,374	3,442	2,224	1,379	595	281	10,295
QLD	44%	89,115	145,626	120,786	82,250	46,869	25,459	510,105
SA	45%	35,344	57,820	49,693	36,656	23,255	13,980	216,748
TAS	47%	12,605	20,399	16,891	11,888	6,701	3,366	71,850
VIC	38%	93,749	159,547	139,243	105,798	67,158	37,993	603,488
WA	41%	41,107	66,419	54,366	40,299	24,238	13,131	239,560
Total	42%	415,034	694,215	594,107	436,816	266,719	149,172	2,556,063
% of age group receiving Age Pension		42%	63%	77%	83%	84%	71%	65%

Source: Department of Social Services Demographic Data, ABS Population Estimates

In 1997, the take-up rate for the Age Pension and the age-related Veterans Pension for those aged 65 and over was 79%. By 2007, this had fallen to 75%. As shown by Table 4, it is now around 65% for those eligible by age to receive the Age Pension. If the take-up rate for the Age Pension in 1997 applied to the Age Pension in 2021 there would be around 550,000 extra Age Pensioners, increasing the cost of providing the Age Pension by about 20%.

As people age, their receipt of the Age Pension generally increases. This makes sense as older age groups had less or no time in the compulsory superannuation system. Superannuation balances also generally decline with age as balances are drawn down.

However, greater wealth is associated with longer life expectancy so there is a small decline in the relative incidence of accessing the Age Pension after age 90 for the relatively low number of Australians in that age category. As well, most individuals aged over 90 are single and subject to the relatively tighter asset test for singles.

The take-up rates for the Age Pension will decrease further as superannuation balances increase and if the trend for more people to remain in paid work after age 65 continues. The decrease in take-up will be particularly marked for those in their late 60s.

Currently just under 20% of those aged around 67 are still in paid employment with a further 40% or so self-funded (or at least not eligible for the Age Pension).

Currently around 30% of couples and singles reach or exceed the ASFA Comfortable Standard and projections indicate that the superannuation system as it matures will play a crucial role in improving retirement living standards. By the year 2050 ASFA projections indicate that around 50% of retiree households will be able to afford expenditure at the level of ASFA Comfortable or above.

Australia relies less on the Aged Pension than other countries

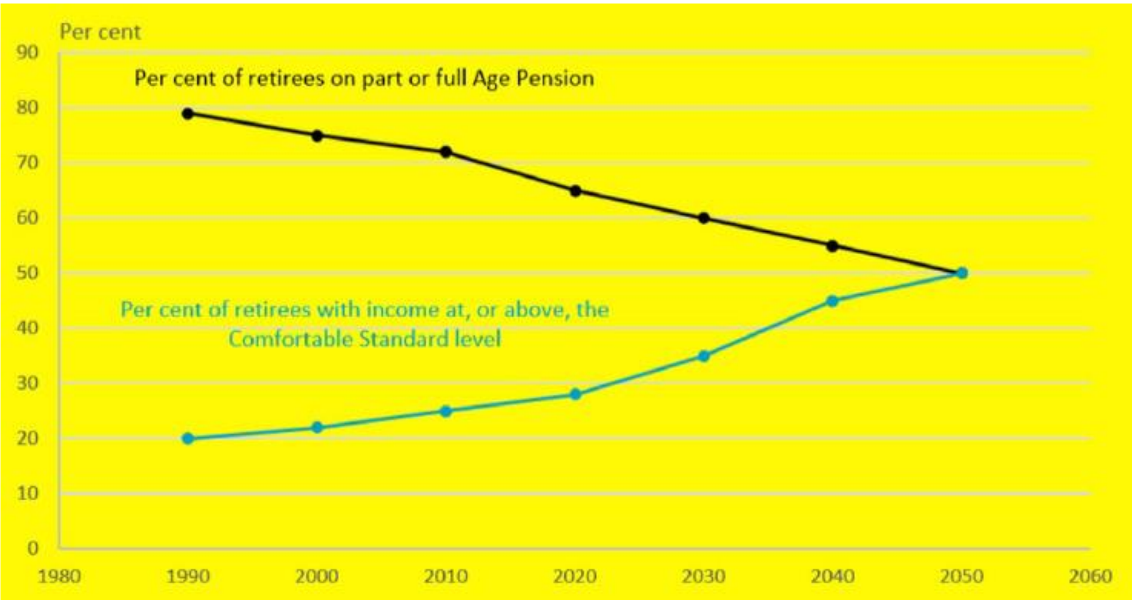
Consistent with ASFA projections, projections published by the Retirement Income Review (RIR) indicate that by the year 2060 around 50% of the Age Pension population group will be totally self-funded. Of the 50%, around 40% will be part-rate pensioners. In comparison, currently only around 35% of the total Age Pension population are self-funded with only around 32% Age Pension recipients on a part-rate pension.

As a result, according to the RIR report, Age Pension expenditure as a percentage of GDP is expected to fall moderately over the next 40 years, from 2.5% in 2020 to 2.3% in 2060. This is despite the population over Age Pension eligibility age being expected to grow faster than the working-age population, leading to fewer working-age people for each person of Age Pension eligibility age.

Across the OECD, expenditure on publicly funded pensions averages 8.8% of GDP and is projected to increase to 9.4% by 2050. Some European countries already have four times the level of Australian expenditure, with this projected to rise further. Those countries where expenditure on public pensions is expected to increase (in the absence of reform) include Canada, Germany, New Zealand, the United Kingdom and the United States. In contrast, as noted earlier, Australian expenditure is already relatively low as a percentage of GDP and is expected to decline.

As shown by Chart 1, the growth in the percentage of retirees reaching ASFA Comfortable (largely through the growing maturity of the compulsory superannuation system) is accompanied by a fall in the percentage of retirees who receive a part or full Age Pension.

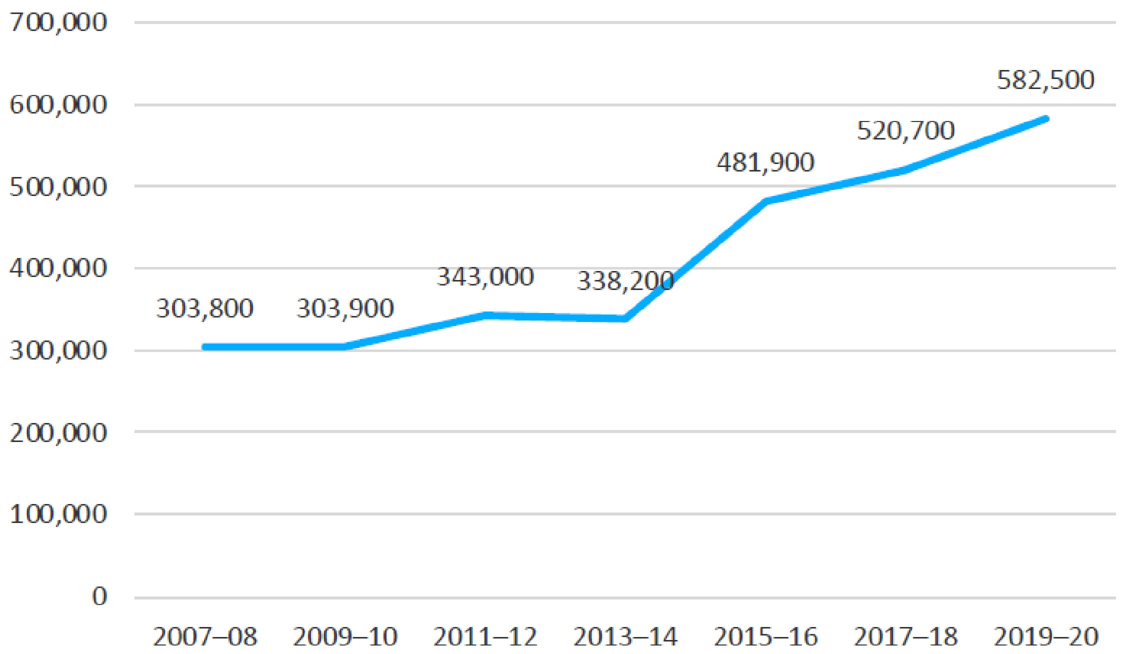
Chart 1: Projections of reliance on the Age Pension and also for reaching ASFA Comfortable Retirement Standard



Source: Department of Social Services demographic data and ASFA estimates. Note: Per cent of retirees on Age Pension and per cent achieving ASFA Comfortable do not necessarily add up to 100%. Some retirees at ASFA Comfortable or above will receive the Age Pension after drawing down on their superannuation.

Consistent with this, the maturing compulsory superannuation system has led to a substantial increase in households that are mainly dependent on superannuation rather than being mainly dependent on the Age Pension (Chart 2).

Chart 2: Number of households mainly dependent on superannuation income



The impact of additional tax on super balances over $3 million

The tax concession enjoyed in relation to investment earnings for high balance members is substantial for large accounts. Based on ATO data, in 2019-20 there were around 35,000 superannuation fund members with balances within superannuation of over $3 million. Treasury projects the figure will be around 80,000 in 2025-26. Some of these funds have balances of some hundreds of millions of dollars, well in excess of retirement needs. The Treasury estimates suggest that the average additional tax paid by the individuals affected would be $25,000 a year.

While the current caps on superannuation contributions limit the ability for members to build up excessive balances in the future there is a real question regarding the appropriate treatment of high balances that were achieved in the context of more generous contribution caps in the past. Large capital gains on business and/or real property asset holdings are also an issue, particularly for SMSFs. These have not been impacted to a great extent by changes to contribution caps as the increase in account values has been driven by capital gains rather than contributions.

The Transfer Balance Cap regime limits the amount a member may take into pension phase. However, 'excessive' balances may still be present in accumulation accounts and therefore will be subject to a current tax concession of up to 30% of the tax on earnings (that is, 45% personal tax rate less 15% tax on fund earnings).

Treasury has estimated that changing the taxation treatment of investment earnings related to total superannuation balances in excess of $3 million would lead to additional revenue of around $2 billion a year, although the exact amount raised would depend on how excess balances were invested after they were withdrawn from the superannuation system. This figure of $2 billion would reduce the total tax concession applying to superannuation contributions and investment earnings by around 4.5%, and by 9.5% in regard to investment earnings alone. This clearly is a substantial impact.

In regard to who would be affected by such a cap, broad demographic information on holders of large superannuation accounts is available from the ATO sample file for 2019-20 and from SMSF taxation statistics.

These statistics indicate that around 65% of those affected by the proposal are male. Those affected are relatively old, with around 50% aged over 70 and around 90% aged over 60.

Even though the age groups affected are relatively old, only around 50% are retired, with around 30 receiving wage or salary income.

Labourers and unskilled workers are not represented in those affected by the measure. The ATO statistics suggest that of those likely to be affected around 20% currently identify as managers, around 10% as a professional, around 5% clerical or administration, around 2% as consultants. However, as noted above many of those affected are retired with no data available about former occupations.

Those likely to be affected are relatively affluent on a number of measures. Around 25% owned a rental property, around 25% received dividends of over $40,000 a year and around 15% had total income for tax purposes of over $500,000.

The majority of those likely to be affected live in Sydney and Melbourne, but there are significant proportions living in Brisbane, Perth and Adelaide. Only a relatively small proportion of those likely to be affected live in regional areas of Australia.

Ross Clare is Director, Research and Resource Centre at [The Association of Superannuation Funds of Australia Limited]() (ASFA). Read the [full report here](). This article is general information and does not consider the circumstances of any person.

Survey: French fight pension age rise while Aussies work on

Graham Hand

There is a fascinating contrast in age pensions in Australia and France. In a few months from now, the eligibility age in Australia rises to 67 years. There is no marching in the streets in protest. In France, there are violent objections against increasing the age from 62 to 64 years. Wild mobs set fire to Bordeaux's town hall, invaded the stock exchange building in Paris and constructed brick walls across major roads. Tons of garbage are piling up on the streets of Paris as workers campaign against plans to increase their retirement age from 57 to 59, lower than the national average due to the physical effort. Yet in April 2014, the Federal Liberal Treasurer Joe Hockey announced an intention to increase Australia's eligibility age to 70, although this was scrapped in 2018.

Australia, as high as 70 years (but not for now), France as low as 57 years. What's going on?

French police fight protesters as roads blocked during pension violence

Source: Twitter

Australia at 67 years on 1 July 2023

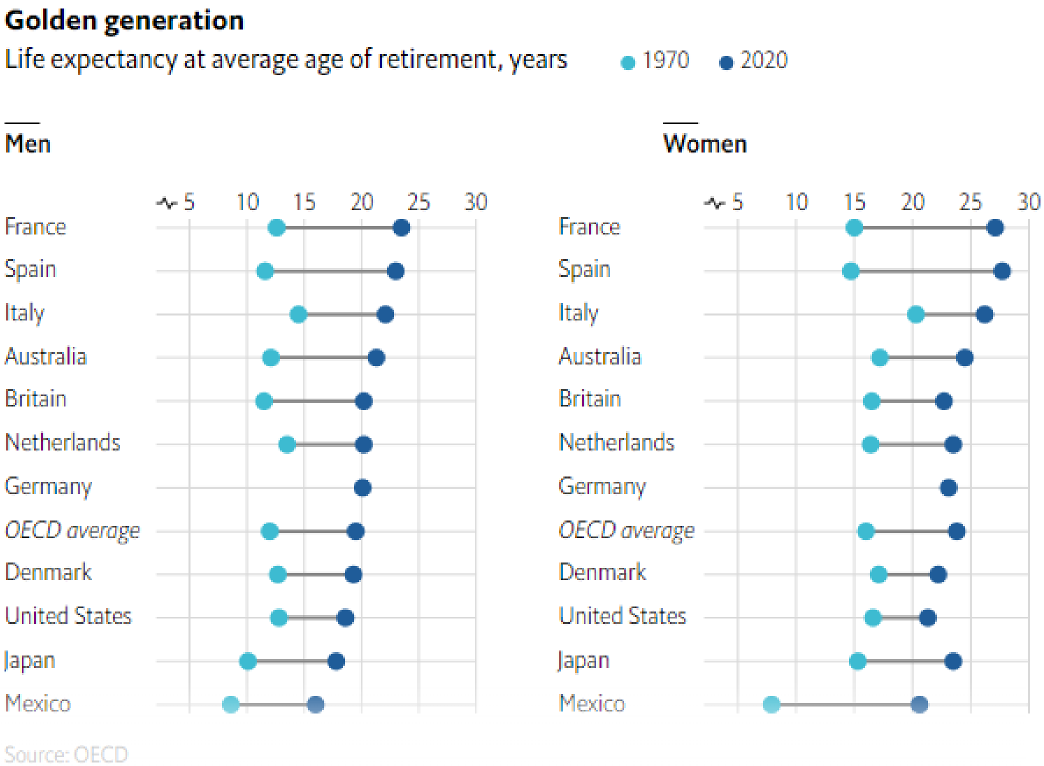
The age pension was first introduced in Australia in 1909 with an eligibility age of 65, and it was not until 100 years later in 2009 that the Rudd Government introduced a schedule for a gradual increase.

Period within which a person was born	Pension age	Date pension age changes
From 1 July 1952 to 31 December 1953	65 years and 6 months	1 July 2017
From 1 January 1954 to 30 June 1955	66 years	1 July 2019
From 1 July 1955 to 31 December 1956	66 years and 6 months	1 July 2021
From 1 January 1957 onwards	67 years	1 July 2023

The background to the 1909 introduction was that life expectancy **at birth** was 55 for males and 59 for females, so few people were expected to receive the age pension for long. According to the Australian Bureau of Statistics (ABS), life expectancy at birth in 2021 was 81 years for males and 85 years for females. So Australians expect to live 26 years longer than in 1909 but the eligibility age has increased by only two years. The majority of Australians will receive a full or part pension, even out to 2060, despite the maturing of the superannuation system.

French are retired the longest

According to the OECD, in 2020, the French had the longest life expectancy at their average age of retirement of any OECD country, with Australia a few years behind.



Source: The Economist

What did the Government say in 2009?

Prime Minister Kevin Rudd gave Australians plenty of notice of the coming increases, announcing them eight years before their effective date. He said in 2009:

> *"With the aging of the Australian population, unless we make these changes for the long-term, then its capacity to undermine the overall financial integrity of budgets in the long term ... is a serious problem. To make this fair is to give people lots and lots of warning. This does not start to be phased in until 2017; it doesn't obtain full effect until the year 2023, and therefore in terms of preparing for it we think it's the right thing to do."*

The reaction was mooted, maybe because it was so far ahead. In fact, there were arguments at the time that if the age pension age increases, so should the age for drawing down superannuation pensions. It would be reasonable to expect people already retired not to object, because they benefit the most. Budget improvements due to delayed pensions for other people increase the likelihood that existing pensions can be sustained. Rudd effectively told Australians to 'suck it up', and we did.

Rudd on pension age: get used to it

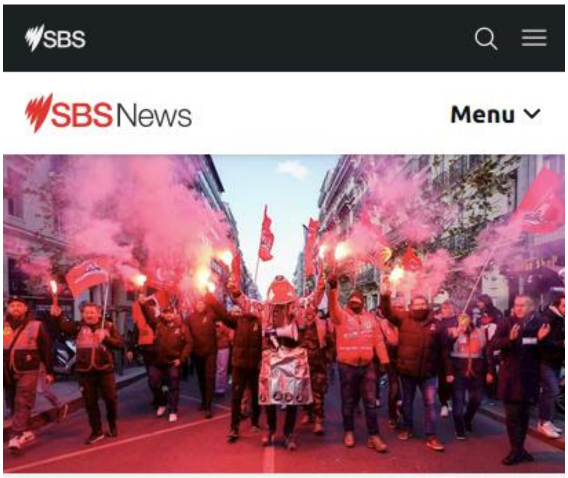
Posted Wed 20 May 2009 at 11:33am

Why are Australians passive when government policies change?

Even if we accept that the French have a long history of protest and working fewer hours, Australians rarely take to the streets to force policy change. Perhaps the closest examples were the campaigns against franking credit changes at the 2009 Federal Election, but it was civilised, with no burning of buildings and blocking of roads. There were some lively arguments in local meetings, then it was off for a cup of tea and a biscuit.

In fact, in Australia, violence may be interpreted as negative to the cause.

A recent Tweet asked 'Anyone know why?" in response to this posting.



Demonstrators in Marseilles rally against proposed French pension reforms Source: AAP / SOPA Images/Sipa USA

Politics

Why aren't millions of Australians marching in the streets like the French?

Given the Firstlinks audience is usually heavily engaged on pension issues, we are running a [Survey](#) to ask the same question. We will publish a range of replies next week, but please keep the comments civil and non-racist.

Here are a few examples in response to the tweet, but we will not include many others here is their tone is bigoted and discriminatory. We want to engage in meaningful insights into the Australia response to government policies, such as on the pension eligibility age. The Twitter responses include:

> *"I think this question is fascinating! Look at how each country took to masking and lockdowns, and injection uptakes, which citizens trust their government and media, I think has a lot to do with it! It's like a huge sociological experiment we are witnessing in real time!"*

> *"We are too busy having fun, don't listen to real news, arrogant but don't understand what is happening or its consequences."*

> *"It must be about more than the retirement age being 64! Australian baby boomers are working into their 70's to support their children and grandchildren doing it tough and getting tougher!"*

> *"We have been programmed to believe that we are the lucky country - she'll be right mate - so we never get upset, we just blindly accept whatever is dished out."*

> *"Are we supposed to be protesting our government not bankrupting the economy with retirement at 62?"*

> *"Because the French still maintain a bond amongst proletariat. A bond of unity that the government have been unable to destroy. Unlike the U.K. and Australia."*

> *"French value their work life balance. In France the mealtimes are very long, it includes groups of people and a lot of conversations. There is no rush to pay the cheque and go. On weekends cafes open towards lunch and fill with people having long lunches with fam & friends."*

Fill in [this survey](#) and tell us what you think.

Graham Hand is Editor-at-Large for Firstlinks.

Are franking credits back in Labor's sights?

Tony Dillon

Much has been written about how tax breaks for superannuation will cost the Federal Budget $52.5 billion in 2022-23, almost equal to the money spent on the age pension. Treasurer Jim Chalmers used this to justify the proposed additional tax on super balances exceeding $3 million.

The tax breaks identified in Treasury's Tax Expenditures and Insights Statement (TEIS) included other big-ticket items such as capital gains tax main residence exemption, and rental deductions, which ran into the tens of billions of dollars.

But putting aside those items where it seems that not collecting more tax is actually a cost to the government, it was notable that franking credits appeared in the 212-page TEIS not as a 'tax expenditure', but as an 'aspect of the personal tax system'. Its presence being for 'distributional analysis' only.

Are franking credits back in play?

Which makes one wonder whether its ominous inclusion in the report places franking credits back in the gun when it comes to refundable franking credits. After all, the removal of franking credits refunded as cash was a centrepiece policy that the Labor Party took to the 2019 federal election, implying that it was a 'tax expenditure'.

Back in 2019, Labor claimed that removing cash refunds on franked dividends would save the budget $58 billion over a decade. They claimed that a $6 billion a year cost of refunding unused franked dividends was unsustainable. The $6 billion claim was based on Treasury analysis of refunded franking credits in the 2014/15 year.

That analysis revealed $47.5 billion of franking credits in total distributed by Australian companies in that year, of which $23.5 billion was eligible to offset tax liabilities. The remaining $24 billion was distributed to Australian companies and foreign investors, both unable to offset against Australian tax due.

The $23.5 billion eligible for tax offset was taken up by individual investors outside super funds, SMSFs, APRA-regulated and other super funds, and income tax-exempt entities. Surplus franking credits remaining after offsetting against tax are refunded. Refunded franking credits totalled $5.9 billion in 2014/15. Distribution of the $23.5 billion franking credits by entity and utilisation (tax offsets and refunds) are as follows:

	($ billion) Individuals	SMSFs	APRA & other super	Tax exempt entities	Totals
Franking credits received	14.7	3.7	4.3	0.7	23.5
FCs used as tax offset	12.5	1.1	4.0	0.0	17.6
FCs refunded	**2.3**	**2.6**	**0.3**	**0.7**	**5.9**

Further analysis of the 2014/15 data revealed for individuals receiving franking credits:

Individuals Taxable Income	($ billion) FCs received	FC tax offsets	FC refunds
< $18,200	0.5	0.0	0.5
$18,200 - $37,000	1.0	0.2	0.8
$37,001 - $87,000	2.6	2.0	0.6
$87,001 - $180,000	3.6	3.4	0.2
> $180,000	7.0	6.9	0.1
Totals	**14.7**	**12.5**	**2.3**

Note, as expected, all franking credits received by individuals were refunded in the tax-free threshold group, with 80% refunded in the next bracket. But perhaps surprisingly, there is some small refundability in the higher tax brackets. That is due in the main to individuals deriving income from foreign sources and receiving foreign income tax offsets reducing their tax liability to less than franking credits received.

The distributional franking credit analysis in the TEIS refers to the 2019/20 tax year.

In summary, $67.0 billion of franking credits were distributed, of which $28.1 billion was eligible to offset tax liabilities. The remaining $38.9 billion was distributed to Australian companies and foreign investors.

Further analysis of ATO data reveals the distribution of the $28.1 billion franking credits by entity and utilisation (tax offsets and refunds) for 2019/20:

	($ billion) Individuals	SMSFs	APRA & other super	Tax exempt entities	Totals
Franking credits received	17.2	3.2	5.6	2.1	28.1
FCs used as tax offset	14.9	1.3	5.5	0.0	21.7
FCs refunded	**2.3**	**1.9**	**0.1**	**2.1**	**6.4**

And the corresponding analysis for individuals by taxable income bracket in 2019/20:

Individuals Taxable Income	($ billion) FCs received	FC tax offsets*	FC refunds
< $18,200	0.52	0.00	0.52
$18,200 - $37,000	0.93	0.18	0.75
$37,001 - $90,000	2.57	1.98	0.59
$90,001 - $180,000	3.90	3.68	0.22
> $180,000	9.22	9.09	0.13
Totals	**17.15**	**14.93**	**2.21**

** estimated according to 2014/15 tax offset proportions by taxable income.*

Tax offset/refund splits were not available for the individuals cohort. This was estimated according to the 2014/15 offset proportions by tax bracket, which would appear to be valid given the distribution of taxable income for those in receipt of foreign income tax offsets was similar for 2014/15 and 2019/20.

Some observations

- Refundable franking credits grew from $5.9 billion in 2014/15 to $6.4 billion in 2019/20.
- APRA-regulated and other super funds receive a far smaller proportion of franking credit refunds compared to SMSFs, because of a higher proportion of member contribution tax to offset against.
- The proportion of SMSF tax offsetting franking credits has increased from 30% at 2014/15 to 40% in 2019/20, probably a result of the introduction of the Transfer Balance Cap in 2017/18, such that tax-free investment earnings have fallen as a percentage of total investment earnings, leaving more tax to offset against. It was estimated that approximately two-thirds of the SMSF refunds in 2014/15 was due to tax-free super.
- The anticipated growth in SMSF franking credit refunds following the introduction of tax-exempt pension phase earnings in 2007/08, has stalled and indeed retreated with refunds falling from $2.6 billion in 2014/15 to $1.9 billion in 2019/20.
- Meanwhile tax-exempt entity refunds grew from $0.7 billion to $2.1 billion, noting that the federal government's own Future Fund is exempt from income taxation, and received just over half of the 2019/20 tax-exempt entity refunds at $1.2 billon.
- Remove the increase in tax-exempt entity refunds and total refunds in 2019/20 would have fallen $0.9 billion from 2014/15, to $5 billion.

Despite the fact that returning unused franking credits to investors is an entirely fair system, no doubt there are those who consider the 2019/20 refunds totalling $6.4 billion as revenue forgone. But those same people do not take into account the top-up tax paid on franked dividends by those individuals on marginal tax rates higher than the corporate tax rate. Because when corporate profit is distributed as dividends, it effectively becomes individual income for tax purposes.

For example, someone on a marginal tax rate of 45% who receives a $70 dividend, must pay $45 tax on the $100 gross dividend ($70 + $30 franking credit). The franking credit offsets $30 of that tax liability, to which they add an extra (45% - 30%) x ($30 / 0.3) = $15 in top-up tax.

Applying the same maths to the franking credit offsets by tax bracket in the last table above, yields total top-up tax paid by individuals in 2019/20 of $5.6 billon. Which makes it hard to argue that the system is one of revenue leakage. And why the inclusion of franking credits in the TEIS for distributional analysis only, should remain just that.

Tony Dillon is a freelance writer and former actuary. This article is general information and does not consider the circumstances of any investor.