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OPINION

8 October 2013 – published in the Mercury

1304 – SUPERANNUATION – The Real Story

Soon there will be a state election. And with elections come promises. Promises are all about spending money. But this time, the question is "What money?" Because this time around the cupboard is bare. In fact, present state government cash reserves are nil, with pre-paid Federal grants for hospital construction and other programs being used for operating cashflow. This in itself is concerning.

However, the issue is more complex than monies in (less) and monies out more). There is the troubling issue of liability, and the biggest of these is superannuation. Superannuation – the topic is complex and confusing. Trouble is, it's playing havoc with the State's finances. Please bear with me while I try to explain why.

Stripped bare, there have been two different concepts at play regarding superannuation arrangements for state public servants.

The state superannuation scheme was, up until 1999, a ***defined benefit*** scheme. What that means is that you put your money in, (the scheme was managed by the Retirement Benefits Fund, or RBF), and depending on how long you were an employee, etc, you got a predetermined amount back, as a pension indexed to the CPI. The more you contributed, the longer you worked, the higher your salary, the more generous the pension.

Trouble was that the pensions paid out were greater than the moneys earned by the fund, so the government (ie the employer) continued to pay the difference when the payments fell due. The government made NO contribution during the working life of the employee. In other words it was an ***unfunded*** scheme. Given that most benefits are in the form of pensions, the call on the government can be for a very long time after the public servant has retired.

This was an extraordinarily generous arrangement. So generous it was colloquially known as the golden handcuffs. Public servants could not afford to leave the public service even if they wanted to, because of the generous nature of their retirement benefit. And it was very difficult to move people on, as they decided to linger on in their employ.

In 1999, the government, recognising the problem of an increasing liability, closed the fund. No new employee could join the scheme (actually there were a number of schemes, but all had a similar structure). However, existing members of the scheme could continue in the scheme and contribute to the scheme. Some 8000 government employees still enjoy membership of these unfunded defined benefit schemes.

After 1999 new employees could join a new scheme, whereby their payments were invested by the RBF and at the end of their employment, they would receive their money back together with any accumulated benefit from the investment. The amount was not defined – the amount received varied with the success of the fund. This is called an ***accumulated benefit*** scheme and is fully funded by the contributors, so there is no ongoing government liability.

Over the past 10 years or so, the government determined that it should pay a premium on top of employee contributions into the accumulated fund and apply those funds to reduce its level of ongoing liability into the ***unfunded defined benefit*** scheme. This money was put into a special reserve account, called the SPA account, held in Treasury, and it began to accumulate significant funds. However, last year, the SPA account was closed, with no funds remaining. Where had it gone?

Over a period, the government had "borrowed" from this fund to cover shortfalls in its general revenues, and to allow for increased expenditures elsewhere. Instead of reserving this money to pay for the liabilities of the unfunded schemes, the government chose to use that money to cover general revenue shortfalls.

The government has now decided that the borrowings from the SPA account don't have to be repaid and as there is no further need for the account, it was closed. However, the unfunded liability remains.

The government was quite entitled to do what it did – there is no impropriety here. However, the funds were diverted to cover what was essentially an unsustainable budget situation. They were treated as general revenue, allowing governments to spend more than what they had received. Drawing on these reserves is like dipping into one's savings. It cannot go on forever and it is fast getting to crunch time. There are no more reserves to tap.

The level of the unfunded liability on the previous schemes should be of concern. Although they are closed to new members they are still being utilised by existing contributors, and of course those who have retired on those pensions.

And the benefits are extraordinary. Not only is a pension paid on the basis of one's last period of employment (a three-year average) but a partner continues to receive a benefit after the contributor has died. With declining mortality rates, increasing rates of pay and people taking advantage of being more highly paid in their last three years, the level of liability relative to GSP is actually increasing – from 10% in 2000 to over 21% in 2012 – while annual payments have remained in the vicinity of 4-5% of budget receipts (see attached table).

Last year the government paid out $219m to meet its annual liability and budget papers suggest this figure will grow over the next four years to $272m. Overall liability is estimated to be around $5 billion. That is a lot of money!

As people die, the liability will slowly fall, however, any exodus of people from the public service, due to retirement or redundancy, will significantly increase the burden on the state budget.

The government could stem the haemorrhaging by closing the defined benefits scheme completely. Employees could transfer benefits for existing employees across to the new accumulated benefits scheme, or alternatively, leave the funds in escrow until their retirement, at which point the existing pension arrangements would kick in. Continuing employment would be subject to the accumulated scheme.

It risks disaffection from the 8000 existing employees who would be impacted. However, considering it has over 40,000 employees all up, it might be regarded as a risk worth taking. After all, there is a significant inequity in the present arrangements.

Recently we have witnessed cities in the US going broke – declaring bankruptcy – because of their inability to meet the pension entitlements of retired employees. It's possibly not going to reach that degree of calamity here but the situation is serious.

Future governments will need to confront this issue. Ignoring the problem won't make the problem go away; it will only fester and make funding the provision of essential services far more difficult.

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Data from Treasury Budget papers and ABS. Data in yellow are estimates.

at end jun	**Super. Liability**	**GSP**	%	**Super. payments**	**State revenues**	%
	$'m	$m		**$m**	**$m**	
2000	1257.1	12335	10.2%	94.3	2137.7	4.4%
2001	1284.1	12756	10.1%	98.5	2290.8	4.3%
2002	1799.3	13748	13.1%	104.7	2325.4	4.5%
2003	1901.0	14710	12.9%	97.4	2852.4	3.4%
2004	2034.0	16368	12.4%	110.8	2951.4	3.8%
2005	2132.7	17363	12.3%	112.5	3090.5	3.6%
2006	3010.5	18543	16.2%	116.2	3412.3	3.4%
2007	3630.6	20709	17.5%	128.3	3531.7	3.6%
2008	3675.3	21913	16.8%	142.0	3746.6	3.8%
2009	3885.9	22095	17.6%	168.2	4131.3	4.1%
2010	4493.8	23490	19.1%	183.9	4215.8	4.4%
2011	4356.1	24218	18.0%	181.8	4562.5	4.0%
2012	5175.7	24175	21.4%	219.0	4617.8	4.7%
2013	5566.2			215.8	4631.5	4.7%
2014	5722.2			236.1	4792.1	4.9%
2015	5869.8			246.7	4953.4	5.0%
2016	5641.3			264.6	5187.6	5.1%
2017	6124.1			272.2	5309.3	5.1%