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30 September 2009

The Hon Lindsay Tanner MP
Minister for Finance and Deregulation
Parliament House
CANBERRA ACT 2600

Dear Minister

I am pleased to attach for your attention and action our combined response to the Review of Pension Indexation Arrangements in Australian Government Civilian and Military Superannuation Schemes ("The Matthews Report") and to the Government's acceptance of the report's recommendation to continue using the CPI as the basis for adjusting military superannuation pensions.

This response was developed by the Defence Force Welfare Association in conjunction with the Australian Peacekeeper and Peacemaker Veterans' Association, the Naval Association of Australia, the Royal Australian Air Force Association and the Royal Australian Regiment Association. It is endorsed by Defence Families Australia and the Defence Reserves Association.

We welcome Mr Matthews' acceptance, and the Government's unqualified endorsement, of the longstanding fundamental premise that the purpose of indexation should be to maintain the purchasing power of military superannuation pensions.

But we are extremely disappointed by the Review's superficial analysis of the available evidence and by the report's lack of depth, which led to deeply flawed conclusions. The conclusions do not support the Review's fundamental premise. Today's CPI or even the new post-Matthews PBLCI do not of themselves protect pension purchasing power.

We are also disappointed by the Government's endorsement of a demonstrably flawed report.

As the attached response demonstrates, an indexation method including the CPI together with an outlays based living cost index such as the Pensioner Beneficiary Living Cost Index (PBLCI) and reference to a wages based index such as the MTAWE (effectively tied to movements in the CPI or PBLCI or MTAWE, whichever is the greatest) is fair, equitable and reasonable. This method would help protect the purchasing power of military superannuation pensions as it does for today's welfare pensions. We seek no more and no less than this for military superannuants.

Importantly, we do not seek a generous indexation method tied to today's military salaries even though certain other Commonwealth superannuation pensions are very generously tied to today's parliamentary and judicial salaries.

We recognise that pension purchasing power protection comes at a cost. But the Government pays this cost for welfare pensioners and exceeds it significantly for certain other Commonwealth superannuation pensioners. The Government cannot continue to discriminate against Australian Defence Force members, its former members, and their families, on grounds of cost.

We believe unequivocally that the Government has the strongest of grounds to:

- Review its endorsement of the Matthews Report,
- Request the Australian Government Actuary to generate long term liability and related figures upon which all parties can rely, and
- Concurrently and without further delay introduce a fair indexation method that maintains the purchasing power of all military superannuation pensions.

Noting that the Government is still considering the Review of Military Superannuation Arrangements, we look forward to early discussions with you or with the Government's representative on the Government's plans to protect the purchasing power of Australia's military superannuation pensioners.

I commend the attached response to you for your attention and action.

David Jamison AM
National President DFWA
On behalf of the Contributing Ex-Service Organisations

Attachments:

1. Response to the Review of Pension Indexation Arrangements in Australian Government Civilian and Military Superannuation Schemes ("The Matthews Report")
2. Graph – Comparison of MP, Age, and Commonwealth Superannuation Pensions 1989-2008

CC:

The Hon G. I. Combet MP
Minister for Defence Personnel, Materiel and Science

DEFENCE FORCE WELFARE ASSOCIATION
Patron-in-Chief: His Excellency Mr Michael Bryce AM AE

NATIONAL OFFICE

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30 September 2009

RESPONSE TO THE REVIEW OF PENSION INDEXATION ARRANGEMENTS IN AUSTRALIAN GOVERNMENT CIVILIAN AND MILITARY SUPERANNUATION SCHEMES (THE "MATTHEWS REPORT")

This response was developed by the Defence Force Welfare Association in conjunction with the Australian Peacekeeper and Peacemaker Veterans' Association, the Naval Association of Australia, the Royal Australian Air Force Association and the Royal Australian Regiment Association. It is endorsed by Defence Families Australia and the Defence Reserves Association.

EXECUTIVE SUMMARY

The purchasing power of military superannuation pensions has slowly but inexorably fallen over the last two decades. It continues to do so.

Rather than accept all or even any of the recommendations of six previous parliamentary reviews, the Government in June 2008 appointed Mr Trevor Matthews to conduct a seventh review. He submitted his report in December 2008. The Government released the report on 21 August 2009.

Mr Matthews made four recommendations. In essence, he supported the status quo. The Government supported the review's findings and recommendations.

DFWA strongly contends that the Government was poorly advised. DFWA objects to the Review's interpretation of its terms of reference, its methodology and superficial analysis, its selective use of facts, its misleading presentation of certain cost data, and the conclusions drawn.

Today's CPI is a measure of inflation, not purchasing power or cost of living, but the Review uses these terms interchangeably. Saying that today's CPI protects pension purchasing power is comprehensively wrong. So is the contention that military superannuation pensions are generous.

The conclusions do not support the fundamental premise accepted by the Review, the Government and DFWA that indexation's purpose is to maintain pension purchasing power. Nor do conclusions follow from evidence available to, but not necessarily analysed or even recognised by, the Review. The Review's four recommendations are not, therefore, supported by all the facts or by analysis.

The Review fails to recognise that actions already taken by government to maintain the purchasing power of Age and other welfare pensions by fair indexation of those pensions can and should extend to maintaining the purchasing power of military superannuation pensioners.

The Review highlights the (questionable) unfunded cost of fair military indexation but is silent on the unfunded cost of fair indexation for extant welfare pensions and for certain other Commonwealth superannuation pensions not the subject of this Review. Meanwhile, it ignores the key fact that successive governments *chose* to operate unfunded superannuation schemes for their ADF members, which is not the fault of ADF people or of those they leave behind.

The Review expects serving and former ADF members and their dependants to bear cost burdens resulting from the choices of successive governments, an unconscionable and indefensible situation. Mr Matthews condemns each military superannuant to further erosion of his or her superannuation pension's purchasing power, as is clearly and simply demonstrated by the attached graph.

DFWA contends that a hybrid indexation method including the CPI together with an outlays based living cost index such as the new PBLCI and with reference to a wages based index such as the MTAWE (effectively tied to movements in the CPI or PBLCI or MTAWE, whichever is the greatest) is fair, equitable and reasonable. This method would help protect the purchasing power of military superannuation pensions as it does for today's welfare pensions. DFWA seeks no more and no less than this for military superannuants.

DFWA does *not* seek linkage to today's military salaries.

DFWA contends unequivocally that the Government has the strongest of grounds to review its endorsement of the Matthews Report, to request the Australian Government Actuary to generate long term liability and related figures upon which all parties can reasonably rely, and concurrently to introduce a fair indexation method that maintains the purchasing power of all military superannuation pensions without further delay.

Assumptions

"DFWA" where appearing includes the views of all organisations that contributed to, or endorsed, this response.

DFWA assumes that a reader of this response is familiar with, or has access to, Mr Matthews' 80 page report dated 24 December 2008. It is at www.finance.gov.au/superannuation/pension-indexation-review.html

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Introduction

This response should be read in conjunction with Mr Matthews' report.

DFWA welcomes Mr Matthews' acceptance, and the Government's unqualified endorsement, of the longstanding fundamental premise that *"…the purpose of indexation should be to maintain the purchasing power of pensions…"*[1]

But DFWA is extremely disappointed by the superficial analyses and lack of depth in, and the conclusions of, the report. The report does not support the accepted fundamental premise. And Mr Matthews draws conclusions that a reasonable person is highly unlikely to draw from the fundamental premise and from all the evidence available.

DFWA is also disappointed by the Government's endorsement of a demonstrably flawed report.

In particular, Mr Matthews bases his case on the assertions of two other actuaries, Professor Pollard and Mr Melville, in 1973 & 1974[2]. But Mr Matthews does not seem to accept[3] that the 2008 CPI is different (as discussed later in this response) from the Pollard/Melville CPI of 1973-74.

Nor does Mr Matthews take into account[4] the six parliamentary inquiries held before and after Pollard/Melville, all of which recommended a form of wage based indexation[5].

DFWA notes that the Chair of one recent Senate inquiry[6] said that "*It is hard to explain to Commonwealth superannuants why their pensions, to which they contributed during their working life, should fall behind the pension increases of those who have generally not made provision for their retirement.*"

DFWA applauds the better Age and other welfare pension provisions of recent years. It merely questions, as did the inquiry Chair and his multi-party colleagues, why military and other Commonwealth superannuation pensioners are not treated at least equally with welfare pensioners. The Review addresses this particular dichotomy but does not attempt to resolve it in terms of purchasing power, hardship, fairness, equity or any other aspect except cost and unfunded liabilities. Mr Matthews, specifically and astonishingly, rejects fairness and equity outright.

And the statements of unfunded liabilities[7] in the report are questionable in regards to both their veracity and their presentation. Their presentation is designed to shock the reader, not to inform[8].

The Government could have accepted the findings of any or all of the six previous parliamentary inquiries. It could have dispensed with the time and expense of yet another review. Its

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1 Matthews Report, page x (Executive Summary).
2 Matthews Report, p 12.
3 Matthews Report, Chapter 6.
4 Except dismissively (Matthews Report, pp 14-15)
5 Although Matthews does not entirely dismiss fair indexation for retirees aged 55 and over. In relation to RMSA (Matthews Report, p 15) he says correctly that the Government is still considering its response.
6 Senate Standing Committee on Community Affairs on the effect of cost of living pressures on older Australians (2008) chaired by Senator Gary Humphries.
7 Such as p 15, p 41, p 42, Appendix J.
8 Particularly because no comparisons are made with other unfunded liabilities and contingencies over the same 45 *year* projections used in the report. See Appendix J, p 65. The reader has no benchmarks or points of comparison.

commissioning of a single actuary – as opposed to a review team or committee with multi-disciplinary professional expertise – flagged to all interested parties that the review would be far more concerned with "*the…cost to the Commonwealth*"[9] than "*the occupational nature of those [superannuation] schemes*"[10]. And so it has proved.

The Government and Mr Matthews again overlook the very significant fact that governments across the decades have *chosen* to have unfunded superannuation schemes for their military and civilian dependants. And yet governments expect their dependants, not themselves, to bear the many financial burdens[11] that result from the Governments' own choice. That's wrong by any measure.

From the outset, the Matthews review set an agenda in favour of the status quo.

Background

Military and most Commonwealth civilian superannuation pensions are indexed to the Consumer Price Index (CPI). CPI is a measure of inflation but not of purchasing power or cost of living.

Age and Service pensions are indexed to the greatest of movements in the CPI, the new Pensioner and Beneficiary Living Cost Index (PBLCI) or Male Total Average Weekly Earnings (MTAWE) [12].

Superannuation pensions for federal Members of Parliament elected before the 2004 election are effectively indexed to increases in parliamentary salaries. Certain Commonwealth judicial superannuation pensions are also indexed to salary increases[13].

No Commonwealth superannuation pensioner has been compelled to pay more into[14], and receive less from, their superannuation scheme than members of the Australian Defence Force (ADF).

Six[15] parliamentary reviews since 1972 recommended fair indexation for military superannuation pensioners. No government has seen fit to implement a fair method despite the precedents set by the judicial and pre-2004 parliamentary scheme and, more recently, by age and other Commonwealth funded welfare pensions.

The purchasing power of military superannuation pensions has slowly but inexorably fallen further and further behind over the last two decades[16]. It continues to do so.

Rather than accept the recommendations of all or any of the previous six parliamentary reviews, five of which took place since 2001, the Government in June 2008 appointed Mr Trevor Matthews, an actuary, to conduct a "Review of Pension Indexation Arrangements in Australian Government Civilian and Military Superannuation Schemes". Mr Matthews submitted his report to the Government in December 2008. The Government released the report on Friday 21 August 2009.

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[9] Matthews Report, p 48, Terms of Reference.
[10] ibid, p 48.
[11] Indexation is but one of these financial burdens, albeit the most significant one.
[12] Welfare pensions are now subject to three indexation 'washes' in order to set the new rate without eroding pension purchasing power, viz. CPI, then the new PBLCI , then MTAWE.
[13] Parliamentary and judicial superannuation pension schemes were excluded from Mr Matthews' review.
[14] ADF members compulsorily paid 5.5% of pay to the DFRDB scheme. Public servants compulsorily paid 5% to theirs.
[15] Joint Select Committee on Defence Forces Retirement Benefit Legislation ("Jess Committee") (1972), Senate Select Committee on Superannuation and Financial Services (Feb 2001, Apr 2001, Dec 2002), Review into Military Superannuation Arrangements (RMSA) (Jul 2007), Senate Standing Committee on Community Affairs (2008).
[16] The same applies to Australian Public Service (APS) superannuation pensions. See attached graph.

Mr Matthews made four recommendations. In essence, he supported the status quo.

The Minister for Finance and Deregulation said on 21 August 2009 that *"…the Government fully supports the findings and recommendations of the review…"*

DFWA strongly contends that the Government was poorly advised. DFWA objects to the Review's interpretation of its terms of reference, its methodology and superficial analysis, its selective use of facts, its misleading presentation of certain cost and statistical data, and the conclusions drawn.

CPI Has Changed

The report fails to recognise and adequately analyse[17] the multidimensional changes that have occurred in (not least) the CPI over time. CPI in 2008-09 is a different creature from 1973-74.

Additionally, the report fails to recognise or understand the nuances and underpinnings that indisputably influenced Pollard/Melville's 1973-74 determinations. This is because in their day, as noted by the Australian Bureau of Statistics (ABS):

"…the CPI [historically] was developed with ***the principal purpose of providing input to the highly centralised wage and salary determination process then existing*** *in Australia"* (DFWA emphasis) and that:

"Successive CPI reviews have served to ensure that refinements to the index have resulted in a measure increasingly more suited to its principal purpose."[18]

But the ABS concluded in 1997 that "*the tight nexus between movements in the CPI and wage and salary adjustments no longer exists."*[19]

And even more definitively ABS said in 2001 that *"…**CPI is not a measure of the cost of living**."*[20] (DFWA emphasis)

In other words, the post-1997 CPI was and is different in its principal purpose from the pre-1997 CPI. It is not a measure of cost of living or purchasing power. Mr Matthews' report seems to miss the rationale that flows from this very salient and fundamental point.

CPI was an extremely important mechanism to centralised wage arbitration in 1973-74. This CPI subsequently helped arrest the erosion of Commonwealth retirement benefits not only from the ravages of the high inflation of the times but, indirectly, from the erosion of community wide purchasing power relativities. Clearly, the changes made in 1997 failed to protect and maintain the purchasing power of retired military and other Commonwealth people from erosion over time[21].

Today's CPI is a measure of inflation, not purchasing power or cost of living, but the Review seems to use these terms interchangeably. Saying that today's CPI protects pension purchasing power is comprehensively and demonstrably wrong.

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[17] Although an inadequate attempt is made in Chapter 6 (pp 30-31).
[18] ABS, *Outcome of the 13th Series Australian Consumer Price Index Review 1997*, para 19, p 5.
[19] ibid, para 36, p 9.
[20] Senate Select Committee on Superannuation and Financial Services 15 Feb 2001.
[21] i.e., the post-1997 CPI has failed to maintain relativity with either contemporary Commonwealth & military salaries or, more broadly, even with community wide income standards (as was previously the case).

The damaging effects on purchasing power caused by the CPI change have been, and remain, a principal complaint of military and other Commonwealth retirees and their various representatives, including DFWA. While generally recognised by the post-2001 parliamentary inquiries, the Review entirely misses[22] this vital point.

And Mr Matthews does not say why or even if he rejects Pollard's 1973 recommendation to index military superannuation pensions to 1.4 times the increase in CPI, capped at the growth in Average Weekly Earnings[23]. In today's terms, this equates with an indexation method capped to movements in the CPI or the new PBLCI or MTAWE, whichever is the greatest, per today's welfare pensions.

DFWA seeks no more and no less than this method for military superannuants because, unlike CPI alone, it will maintain the purchasing power of military superannuation pensions.

CPI Not Dismissed by DFWA

In addition, and contrary to the report's criticisms[24], most individuals and representative bodies such as DFWA have *not* dismissed the CPI as an important component for indexation purposes. While CPI on its own is clearly inadequate to protect purchasing power, it has a role to play as a component part of an indexation methodology.

DFWA and most other bodies have instead recognised over many years that a hybrid indexation mechanism was and is needed to maintain purchasing power in line with historical precedents[25]. Separate parliamentary inquiries have each essentially said much the same[26].

Bananas and the CPI

While CPI is one important and generally stable component input to help protect the purchasing power of pensions, the Review also fails to acknowledge that CPI can be vulnerable to significant price swings in any one element of the index, which can significantly skew the final result.

This was clearly evident in July 2007 when military retirees received a zero percentage increase in indexation because the price of a single item, bananas, decreased so dramatically compared with the previous period that it effectively offset all the price rises of other index items, notably petrol.

The banana skew caused significant and enduring damage to the purchasing power of military superannuation pensioners and reversionary beneficiaries[27]. The damage compounds over time and is irretrievable. A hybrid indexation mechanism would have avoided this patently silly outcome.

Mr Matthews does not address this issue.

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[22] Matthews Report, Chapter 6, pp 28-38, except to say (p 33) that he is "…not convinced that there is a correlation between the…change [to] Age Pension methodology in 1997 and the performance of the CPI." He inexplicably offers no substantial evidence for his 'conviction'.
[23] Matthews Report, p 12.
[24] Matthews Report, Chapter 6.
[25] This is the reason why most proponents argued for a CPI / MTAWE / AWOTE hybrid solution, with most requesting an indexation measure of CPI or MTAWE, whichever is the higher. PBLCI is a post-Matthews development.
[26] Although there are, of course, differences. To reiterate Footnote 5 in this response, 2007's Review of Military Superannuation Arrangements confined its recommendations for fair indexation to recipients over age 55, which Matthews recognises at p 15. He says there that the Government "…is considering its response to the [RMSA] recommendations" which leaves the door open for a government interim solution even though Matthews makes no recommendations of his own. DFWA assumes the Government is still "considering its response" to RMSA.
[27] Principally defence widows.

National Productivity

The issue of national productivity is an adjunct to the CPI issues above. Mr Matthews' report adheres to Pollard's 1974 assertion that:

"National productivity gains would only be a necessary criterion for adjusting superannuation pensions if it were established that such gains generally flowed to all retired persons throughout the community through the medium of superannuation pension updating"[28].

This was a fair call in 1974 because only 24% of people in the private sector had superannuation cover, compared with 58% in the public sector.

But the private sector situation progressively improved over time. By June 1988, 51% of employed persons were covered by superannuation. By June 2007, superannuation assets totalled $1,153bn – representing 119% of GDP – and covered 90% of the working population[29].

With this in mind, national productivity gains increasingly became an integral part of the superannuation landscape, particularly since the introduction of salary sacrifice arrangements. A solid case can therefore be made for linking military superannuation pension indexation to today's military salaries in accordance with the Pollard assertion above.

But DFWA only seeks indexation that maintains purchasing power, not one that links to today's military salaries.

Private Sector Superannuation Benefits and NECR

Whilst not strictly "pension updating" per se, the tax effective nature of salary sacrifice together with the tax-free treatment of private super benefits after age 60 gives the private sector a significant multiplier effect in the value of its superannuation benefits.

These favourable taxation arrangements encourage Australians to fund their own retirement. But they directly reduce government revenues and its ability (based on gross tax receipts) to fund social security payments such as age and other welfare pensions. And yet private sector retirees are eligible to draw maximum welfare benefits if they remain within the assets and income thresholds.

This very point and the method of funding payments to military retirees negate the report's assertion that the Government's Notional Employer Contribution Rate (NECR) for Commonwealth benefits is high by private sector standards, because it fails to recognise that salary sacrifice arrangements together with the Superannuation Guarantee have directly and indirectly increased the private sector NECR over time[30] .

In fact, one could argue that these tax effective arrangements have created a situation where the Commonwealth has inadvertently assumed a portion of the private sector's NECR. One could further argue that the Government decision not to allocate employer contributions to a fund from annual appropriations results in an unnecessarily high level of employer contribution to these schemes when it comes to paying entitlements to scheme members.

Mr Matthews does not address these issues.

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[28] Matthews Report, Chap 3, p 13.
[29] http://www.aph.gov.au/library/pubs/BN/2009-10/Chron_Superannuation.htm
[30] Notwithstanding Footnote 20 of the report, the private sector NECR will be greater than the 9.5% stated in the report.

Market Linked Accumulation Funds vs "Generous" Military Benefits

The report asserts that "*military schemes provide features that recognise their members' contribution to their country*"[31]. This assertion is at best disingenuous.

Some, including Mr Matthews, think the fixed benefits paid to military retirees are too generous[32], in part because of the losses of the last 20 months or so to market linked accumulation funds.

Mr Matthews says that "*All of the schemes include generous features when compared with the superannuation available to Australian employees generally; in particular, access to a lifetime indexed pension. This compares favourably with the superannuation available for most Australian workers, which is wholly at risk to investment markets.*" [33]

But the truth is that according to previous superannuation minister Nick Sherry in December 2008, a full year after the global financial crisis hit, superannuation funds on average rose by around 5% above inflation each year for the past 35 years – through good economic times and bad.

Meanwhile, military superannuation pensions rose by an alleged measure of inflation (CPI) alone, noting that the 'rise' was zero at each of the 30 June 2007 and 30 June 2009 rests. So much for maintaining purchasing power and for generosity.

Mr Matthews believes that "a lifetime indexed pension" that has been going backwards in terms of purchasing power for decades is "generous". And he seems unaware of the long term nature and benefits of market linked superannuation investments.

Additionally, benefits from accumulation funds are tax free in the hands of recipients aged over 60. Military superannuation benefits are taxed regardless of the recipient's age.

Further, the surviving spouse of an accumulation fund member receives the balance of the member's lump sum upon the member's death. A military surviving spouse, usually a widow, receives 62.5%[34] of the military member's uncommuted fortnightly benefit.[35] And is liable for tax.

Mr Matthews also says that "*…DFRDB pays benefits on retirement after 20 years irrespective of the member's age.*"[36]

He seems unaware of the reason why serving DFRDB contributors compulsorily paid 5.5% of their salary to DFRDB, not the 5.0% paid by APS contributors. ADF people were told, whether correct or not, that their higher compulsory contribution helped pay for their "generous" earlier pension. DFWA is unaware of any other explanation for the higher military contribution.

As far as DFWA is aware, no other Commonwealth or state[37] defined benefits scheme contributor was compelled to pay a higher percentage of salary than were members of the ADF.

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[31] Matthews Report, Chapter 8, sub-section 8.2, p 44.
[32] Matthews Report, pp 15 and 44.
[33] Matthews Report, p 44.
[34] Surviving spouses of pre-2004 MPs receive 83% of the deceased MP's pension. DFWA has never seen an explanation for this clear discrimination against military surviving spouses (usually widows).
[35] If a member dies with no dependants, his or her estate receives no benefits.
[36] Matthews Report, p 44, footnote 138.
[37] For example, the Queensland defined benefits schemes for parliamentarians, public servants and police through QSuper required a contribution of only 2 to 5% of salary. And benefits after age 60 are tax free.

Additionally, Mr Matthews neither recognises nor acknowledges that there was never an expectation by ADF members or by any government that members leaving military service around the 20 year mark, perhaps aged around 40 years, would or should live on their small military superannuation pension for the rest of their lives. These skilled people were expected to get another job, which is what the overwhelming majority did. That's one reason why 58.0% of all military superannuation pensioners receive less than $19,999 while only 46.3% of APS superannuation pensioners do likewise[38].

Military people left the service earlier and paid more for their smaller superannuation pension than did their APS colleagues. That's fine up to a point because ADF service is a young person's game; it is in the interests of the nation for most military people to separate from their occupation earlier in life than most APS people. But military people paid more to receive less, which is not fine. DFWA could say more on this issue but surely the point is made.

Mr Matthews' treatment of all these issues is either superficial or nonexistent. The Review adds no value here to discussions on the decreasing purchasing power of military or other Commonwealth superannuation pensions.

Military Salary Sacrifice and MBL

Military people who are members of MSBS were not generally afforded salary sacrifice facilities until well after the wider community, that is, not until earlier this decade. And MSBS members are heavily penalised by Maximum Benefit Limits (MBL) that are fixed well below those applying to the Government's civilian employees or to the wider Australian community, yet another discriminatory penalty applied only to ADF members.

Mr Matthews does not address this issue or its deleterious effects on the purchasing power of subsequent military superannuation pensions.

Government Indexation Whims

The Government in 1986 targeted military and APS superannuation pensioners by significantly and arbitrarily discounting their indexation for economic reasons. Mr Matthews mentions this only in an obscure footnote[39] which says, incorrectly, that "*…the level of pensions was restored in November 1989*." These superannuation pensions have not been "restored" to the level they would have been if the discounting had not occurred. Mr Matthews' statement is at best ambiguous.

Mr Matthews chooses not to discuss the tangible and intangible effects that arbitrary government whims can and do have on the purchasing power of military and APS superannuation pensioners and their families, a disadvantage that does not apply to members of non-government accumulation funds. Clearly, the 1986-89 whim had a compounding deleterious effect on the purchasing power of all those receiving military and APS superannuation pensions at the time.

The Review chooses only to talk of "generous" military and APS defined benefits. There is but one side to the Matthews coin. While not suggesting that Mr Matthews was biased, DFWA believes that his treatment, or rather lack of treatment, of this specific indexation issue yet again demonstrates the superficiality of his review.

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[38] Matthews Report, p 7, Tables 2.2 and 2.3.
[39] Matthews Report, p 12, Footnote 27.

Government "Triple-Dipping"

DFWA believes it is not well known that the Government "triple dips" former ADF members by compelling them to:

- pay full marginal tax,
- pay compulsory after-tax contributions into a compulsory government superannuation fund[40], and
- continue to pay tax on benefits received in retirement until the day they die [41].

Mr Matthews does not address this issue or its effect on pension purchasing power in any depth.

Military Salary Data and History

While the report mentions that reduced salaries were a concern[42] Mr Matthews says[43] he was unable to verify these claims.

DFWA concedes that it was difficult for an individual respondent to obtain military salary data within the submission period[44] but it is not credible for Mr Matthews to imply that historical data were unavailable during the six month period of his review.

Military salary data may not have been readily available but the Review could have easily extracted broader Commonwealth salaries data from the ABS. These data were/are used in part for the construction of MTAWE and AWOTE indices[45].

Mr Matthews appears incurious here and elsewhere about obtaining data. He seems satisfied with data presented to him but not gathered by him. His report is demonstrably less credible as a result.

Low Military Salaries

Historical salary data would have confirmed what was generally known and accepted over time: that Commonwealth and military salaries were well below that of the general community for many years, which resulted *inter alia* in some government employees (particularly serving military personnel) drawing welfare payments because they were assessed as being below the poverty line.

Evidence of low military incomes is implied (when compared on average with Commonwealth retirees) in the Notional Employer Contribution Rate (NECR) figures detailed in Table 2.4[46] and in the final benefits now being paid to military superannuation pensioners as depicted in Table 2.3[47].

It is a sad indictment that after 20 or 30 years of military service the median benefit received by military retirees is little better than the single rate of the old age pension[48]. Other Commonwealth retirees covered by the Review are better off in percentage terms, but not by all that many dollars.

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[40] ADF members do not have a choice of super fund, unlike other Australians.

[41] Full marginal tax is paid but a 10% offset is applied at age 60. However, this is no substitute for receiving a tax free income stream as afforded to the rest of the Australian community.

[42] Additional to Dr Knox's testimony, this issue was raised in an individual submission, mainly re military salaries.

[43] Matthews Report, p 37.

[44] Historical military salary data was not readily available to the individual (footnote 42) from the Defence Force Remuneration Tribunal, the Department of Defence or the ABS.

[45] Military salary data is explicitly excluded from these indices because, historically, Defence would not release the information to the ABS due to the quaint notion that the information was classified.

[46] Matthews Report, p 9.

[47] Matthews Report, p 7.

[48] Matthews Report, table 2.3 (p 7).

And most military retirees support two people with one (taxed) superannuation pension. (The *mean* DFRDB superannuation pension is $21,286[49] whereas a couple's age pension is $24,900[50]. But, worse, the *median* DFRDB pension is well below $20,000[49], a fact Mr Matthews ignores. DFWA can but speculate why the Review chose to use an inflated mean rather than a purer median here.)

Mr Matthews does not appear to recognise the direct link between low military salaries and the low value of later military superannuation pensions. And his review's presentation of pension statistics is at best questionable and at worst misleading.

Features of Foreign Military Superannuation Schemes

Chapter 4 looks at some foreign public sector schemes in an attempt to broaden the report's analysis using an international perspective[51]. The report refers to a number of US military and civil service schemes, and states that the indexation of those schemes was by CPI only[52].

While Mr Matthews is technically correct, his review fails to provide any depth. He fails to acknowledge that US military personnel were not required to contribute to their retirement pension schemes *and* that these US schemes generally paid 50% of final salary at 20 years and up to 75% after 30 years of effective service.

Meanwhile, ADF people were compelled to pay 5.5% of their salary into DFRB/DFRDB[53]. But ADF retirees only received 35% of final salary after 20 years with 51.25% achievable after 30 years of effective service. There were no additional benefits for ADF people.

Further, if ADF members of the DFRB/DFRDB schemes did not complete a minimum of 20 years service then they normally received nothing back except their contributions without interest[54].

Even further, ADF commissioned officers under these schemes also suffered a severe additional impost (assuming they qualified in the first place) by incurring a "detriment" of 3% of their military superannuation pension for each year they retired before their prescribed notional retiring age.

Matthews also fails to mention that most US military retirees have lifetime access to free medical services, PX and Commissary facilities, and free international travel on USAF aircraft on a "space available" basis[55]. Australian military retirees enjoy none of these benefits. They have no special universal benefit that is not available to other retired Australians.

The US Civil Service Retirement System (CSRS) did require employees to contribute to the CSRS but employees were, in turn, not required to contribute to US Social Security. DFWA presumes that the US Government has a conscientious objection to "double dipping" its employees.

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[49] December 2008 (Matthews Report, p 62). The mean MSBS pension is only $18,400. The Review seems to use unweighted means, which misleadingly inflate pension values well above median figures (which give a truer picture).
[50] Before the significant increase paid from 20 Sep 2009.
[51] Matthews Report, Chap 4, Pages 18-19. Matthews stated a need to make some comparison because there were limited examples of defined benefit schemes within Australia from which to draw an analysis.
[52] The Report does make some cursory but important observations in the notes about structural adjustments to some of the later schemes (i.e. a base rate adjustment in REDUX at age 65), which seems to elude Matthews in his final deliberation of the fairness of Australian military schemes.
[53] MSBS does not easily equate to the older US military pension schemes.
[54] Matthews Report, Appendix D, Note 147, p 53. Matthews' note is a little misleading in that interest did not accrue for contributions made. However, interest was payable on the productivity benefit component of a members account.
[55] Commissary and PX facilities let military personnel shop for goods and services at 'wholesale' prices, free of US state and federal taxes. International 'Space A' travel is afforded to retired personnel and/or their families.

DFWA does not see how these penalties and omissions, which are mostly ignored in Mr Matthews' report, can justify his assertion that "*military schemes provide features that recognise their members' contribution to their country*" or are in any way "*generous*".

A less superficial review would have considered these cash and non-cash benefits and their effects on the comparative purchasing power of foreign and Australian military superannuation pensioners.

Reliability of Department of Finance & Deregulation Advice

The report appears to give great credence to the advice offered by actuaries, particularly from the Department of Finance and Deregulation (DOFD). It discounts the opinion of representative bodies such as DFWA and the Superannuated Commonwealth Officers' Association (SCOA) and/or other independent investigations that have been commissioned.[56]

DFWA does not begrudge Mr Matthews' seeking expert opinion but is greatly concerned by the questionable unfunded liability projections that emanated from DOFD and from its commercially contracted consultants[57]. DFWA can empathise with responsible Ministers who are presented with large inconsistent figures that do not necessarily tell the whole story.

DOFD has a track record of providing inconsistent, incomplete and incorrect advice. DFWA questions how Mr Matthews could accept DOFD advice at face value without undertaking his own independent research, particularly when much of his work stands or falls on estimates of liabilities. Because of this conflicting or contradictory advice from DOFD, Mr Matthews' report cannot be accepted at face value as being either consistent or accurate.

As a case in point, Senator Conroy in a 2003 Senate Estimates Committee[58] expressed considerable concern about the figures derived in the 2003 budget papers. A lengthy debate ensued over the *"actuarial revaluation" / "error"* of unfunded superannuation liabilities, which had been revised up by $4.6bn. That is a $4.6 *billion* error. Hansard indicates that it is fair to say that the Committee did not obtain a straight and consistent answer from DOFD on that day.

In another cogent and very relevant example, the *"2008 Long Term Cost Report of the CSS and PSS"* states that the discrepancy in the unfunded liability figures between 2005 and 2008 was due in part to a *"change in calculation methodology"* and *"using actuarial assumptions that differ from those used at the last actuarial investigation"*[59].

It is extraordinary that the long term cost of unfunded liabilities for the PSS and CSS supposedly exploded from $67bn in 2005 to over $80bn in 2008. That's nearly a 17% differential "error" in three years on the basis of changes in assumptions and calculations. Given the consternation resulting from Estimates in 2003, DFWA can but speculate upon the reactions of Senator Conroy and his parliamentary colleagues to this later $13bn difference.

And, as far as DFWA can tell, the DOFD costs quoted in Mr Matthews' report do not include the significant sums appropriated by the Government from contributors in the early '70s when DFRDB and CSS were receiving very large contributions and paying out very little. This significant costing

[56] Such as the 2002 NATSEM Report commissioned by SCOA. Also, Dr David Knox contributed to the Review of Military Superannuation Arrangements and represented certain issues, particularly low salaries, to the Matthews review.
[57] It appears that the Department of Finance relies heavy on Mercer Australia Pty Ltd for the bulk of their analysis.
[58] Hansard, Finance & Public Administration Committee – Estimates, dated 28 May 2003, page F&PA 503.
[59] *PSS and CSS Long Term Cost Report 2008 – Mercer,* Para 1.4, p 3.

factor clearly does not suit the arguments of the Department or the Government. Mr Matthews may not have even known about it.

DFWA sees no reason for a high level of confidence in the unfunded liabilities figures provided by DOFD and accepted without question by Mr Matthews. This is a major criticism of the report because Mr Matthews puts so much stock into the long term unfunded liability numbers.[60]

"Clawback" and DOFD

"Clawback" is the amount returned to government as revenue after increases (in this instance) to superannuation pensions. If a military superannuation pension rises, the Government "claws back" higher tax revenue (income tax[61] and GST) than before. In addition, government welfare pension outlays will reduce because most retirees who receive military superannuation pensions are also age or service pension recipients. A higher superannuation pension means a lower age pension.

DOFD is quoted[62] in the report as saying that "clawback" would only amount to 15% if military and other Commonwealth superannuation pensions are adjusted using the same index that is used for age pensions. But in 2005 the Australian Government Actuary (AGA) estimated that "clawback" would be approximately 25%[63]. The National Centre for Social and Economic Modelling at the University of Canberra (NATSEM) calculated a figure of 37-58% in 2002[64].

All the review could say is that it could not say if the NATSEM figures were correct. Mr Matthews did not accept even the AGA figure. He did accept the figures that best supported his position. But DFWA believes that the review was supposed to quantify the "full [net] cost" of indexation in order to comply with the last item of Mr Matthews' Terms of Reference (TOR).

Mr Matthews does not address clawback or its implications for long term liabilities. He merely says that "*A current estimate of clawback …was not available to the review.*"[65]

DFWA finds it extraordinary that an issue with significant implications for long term liabilities was dismissed so superficially.

Future Fund and DOFD Discrepancies

The actuary for the Future Fund is required to report the Target Asset Levels[66] of the Fund per Schedule 3 of the Act. Dr David Knox provided the following figures on 8 May 2008[67]:

- *2007-08 - $90.1 billion,*
- *2008-09 - $93.2 billion*
- *2009-10 - $96.3 billion*

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[60] Not to mention the method of presentation of the numbers. Lay readers have blanched at the billions quoted because there are no benchmarks for comparison. It is an exercise in spin. A similar exercise for age pensions would see numbers in the multi-trillions of dollars. Conversely, if the costs of fair military indexation were expressed as a percentage of 2009-10 budget expenses, DFWA estimates a figure of 0.000064%. And that's before "clawback"!

[61] Because military super pensioners pay income tax on their pension even if aged over 60, unlike other Australians.

[62] Matthews Report, Appendix J, p 67.

[63] Matthews Report, Appendix J, p 68.

[64] Matthews Report, Appendix J, pp 67-68.

[65] Matthews Report, Appendix J, p 68.

[66] The target asset level represents the amount that is expected to offset the present value of projected unfunded superannuation liabilities.

[67] Future Fund Actuary Letter, *Target Asset Level Declaration,* dated 8 May 2008

These Future Fund actuarial figures were derived using actuarial data from all of the major Commonwealth funds, including actuarial projections for the Parliamentary Contributory Superannuation Scheme, the Judges' Pension Scheme, and the Governor-General Pension Scheme as well as the military and APS schemes included in Mr Matthews's report. However, Matthews quotes DOFD as stating that:

"As at 30 June 2008 the Australian Government's unfunded superannuation liabilities totalled $100.3 billion."[68]

But the Future Fund on 8 May 2008 said $90.1 billion. How can a 10% differential error, $10.2bn, occur within a mere six weeks when the two actuarial entities are supposedly using the same data and assumptions? DFWA believes that Dr Knox is closer to the mark. And he used a larger data set than was analysed by Mr Matthews' review.

This significant discrepancy reinforces DFWA's low level of confidence in DOFD estimates and in Mr Matthews' unquestioning acceptance of them.

Australian Government Actuary (AGA)

With regard to the "*change in calculation methodology*" (apparently due to the adoption of the Australian Accounting Standard AASB 119), the AGA had this to say in 2005:

"The valuation methodology and assumptions required under AASB 119 differ in some respects from the methodology and assumptions used in this report. In particular, the AASB 119 requirement to use a Government bond rate at the reporting date as the interest rate is likely to result in changes in economic assumptions from year to year. All else being equal, movements in interest rates will lead to volatility in reported liabilities under AASB 119.

"The current report is focused on the financial implications of the military superannuation arrangements over the long term and, in my view, is a more appropriate document for this purpose than the Department of Defence Financial Statements."[69]

The AGA reaffirms this in his 2009 report for the 2008 Long Term Cost Report (LTCR) of MSBS and DFRDB where he states:

"The purpose of the triennial reviews is to assess the financial position of the schemes over the long term. Estimates of the net present value of the unfunded liabilities have also been produced on an annual basis for inclusion in the Department of Defence Financial Statements. These annual estimates are calculated in accordance with Australian Accounting Standard AASB 119 and are not directly comparable to the estimates provided here."[70]

The AGA's statements together with his methodology for calculating and presenting information on the unfunded actual and projected liabilities as a percentage of GDP seems the most unambiguous and pragmatic approach yet seen.

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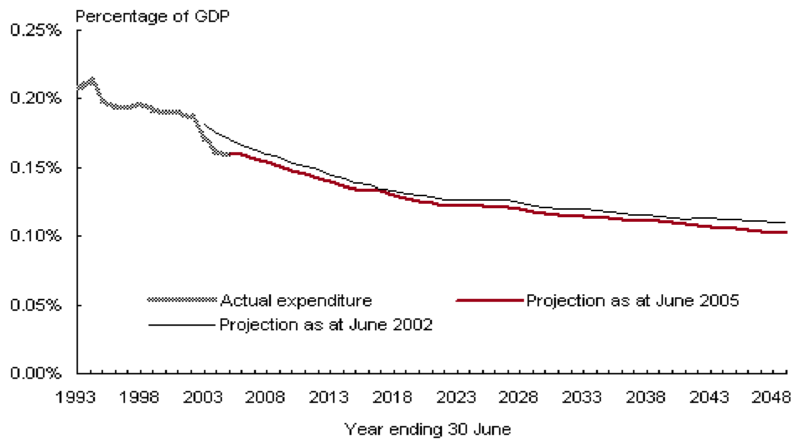
[68] Matthews Report, Chap 7, Para 7.4, p 42.
[69] Australian Government Actuary – Summary – 2005 *Long Term Cost Report for MSBS & DFRDB*, p viii, dated 30 June 2006.
[70] Australian Government Actuary – Summary – 2008 *Long Term Cost Report for MSBS & DFRDB*, Ch 1, Para 1.5, p 2, dated 30 June 2009.

Also, despite their complexity, the AGA unlike DOFD seems not averse in taking into account offsets such as "clawback" and Future Fund assets to provide a net estimate of the long term costs as a percentage of GDP. The graph below clearly shows the trend of actual expenditure and the future projection of unfunded liabilities over time[71].

Actual and projected Commonwealth outlays as a percentage of GDP - 2005[72]



By comparison, the information presented by DOFD over the years and particularly for this review is demonstrably rubbery and inconsistent.

This brings further into question the credibility (and oversight) of those undertaking and reporting on such matters[73] and, by implication, the Review's credibility in accepting these data without performing its own due diligence.

DFWA contends that the Government should commission the AGA to run the sums and produce a single set of consistent and realistic projections that all interested parties can consider and, most importantly, rely upon.

Wider Military Issues

The Review does not consider the wider military conditions of service issues that affect not only retired military people but also those still serving. Mr Matthews may have believed these issues were outside his TOR. But military superannuation is clearly a major "conditions of service" issue.

Mr Matthews is, rightly, careful to distinguish between "Australian Government employees" and "military personnel"[74] although he does not say what the essential differences are or why he makes the distinction. His report treats each group as "employees" in an industrial relations sense and does not identify, or comment upon, the unique nature of military service[75].

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[71] Australian Government Actuary – Summary – 2005 *Long Term Cost Report for MSBS & DFRDB*, p 26-27, dated 30 June 2006.

[72] AGA – *2005 Long Term Cost Report for MSBS & DFRDB,* p 21, dated 30 Jun 2006.

[73] It is revealed in the 2008 report that one Lead Consultant compiled both reports. This then begs the question as to why there has been such a large discrepancy.

[74] See the Executive Summary (Para 2, page x) for example.

[75] Except to dismiss it in 11 lines pp 37-38.

Mr Matthews does not address issues unique to a calling that requires its members, upon lawful command and with serious sanction for disobedience, deliberately to kill other human beings and deliberately to place themselves in situations where they may themselves be killed or wounded. He argues[76] that such issues were outside his TOR although he was required to have regard for *"the occupational nature of those [superannuation] schemes"*[77]. Maybe his TOR could be construed as ambiguous so perhaps Mr Matthews could, generously, receive the benefit of the doubt.

But, egregiously in DFWA's view, he does say that *"…the [RMSA] which was required… to consider the unique nature of military service as well as pension indexation…recommended a targeted change…for some members of the older military schemes, but only if the government was prepared to increase its superannuation costs."*[78] No mention here of what the "targeted changes"[79] were or the service-related rationale behind them. Only the cost. Just the cost. Always the cost.

In any case, Mr Matthews is not a defence professional. Nor is he a parliamentarian with accountabilities to the Australian people. He is an actuary, and actuaries cannot be expected by those who appoint them to comment on matters beyond their professional expertise.

DFWA has no quibble with Mr Matthews' concentration on matters within his expertise, always with the caveats expressed earlier in this response that his report is, in DFWA's opinion, shallow even in its treatment of actuarial matters.

Mr Matthews delivers what one would expect from an actuary, albeit superficially. Among other things, his report does not consider the fact that servicepeople are *members* of the ADF, not *employees* of the ADF, an important legal and industrial relations occupational distinction that puts special and onerous obligations on the Australian Government.

These special and onerous obligations do not apply to any other government dependency.

Nor does he consider recruiting, retention, morale, moral responsibility, duties of care, political issues, a government's wider obligations, or the national defence interest in a rapidly changing world.

All these occupational issues and more have an impact on conditions of service, including the ADF's military superannuation schemes.

And the treatment of yesterday's servicefolk now fading away is noticed by today's sharp young navy, army and air force men and women. They are observant.

It is germane to consider a series of matters related to the wider military issues outlined above:

1. If Mr Matthews could not consider the wider military issues because in his view they were outside his Terms of Reference, and
2. if the Government (which wrote his TOR) specifically intended to exclude them, and
3. if no government will accept all or even any of the fair indexation findings of the six previous parliamentary reviews that did consider the unique nature of military service and recommended an indexation method that protects purchasing power, then

[76] Matthews Report, page 37.
[77] Matthews Report, page 1, Terms of Reference.
[78] Matthews Report, pp 37-38.
[79] Review into Military Superannuation Arrangements 31 July 2007, Recommendation 14.

4. it is reasonable for DFWA to question why the Government commissioned Mr Matthews to report on military superannuation schemes at all.

DFWA does not want to believe that the Government would commission a review with a TOR element that it wanted the reviewer to ignore. But one must conclude that either this was the case or, alternatively, that the reviewer chose not to analyse the "occupational nature" of superannuation schemes that members of the military "occupation" are compelled to join.

Other Sensitivities

DFWA has commented in other forums about the Government's insensitive, indeed contemptuous, release of Mr Matthews' report on a Friday afternoon as the Parliament rose for recess, too late for the news cycle. And after eight months delay, and then a couple of days before its announcement of the new PBLCI – with no reference to military superannuants.

While the Government's unacceptable treatment of its military retiree constituency is strictly speaking separate from the outcome of Mr Matthews' review, it is DFWA's view that the two are closely linked. DFWA sees no other reasonable explanation for the Government's acceptance of Mr Matthews' recommendations[80] and rejection of all other earlier parliamentary inquiries. DFWA does not want to appear cynical but finds it difficult to reject the notion that successive governments kept on having inquiries until one of them produced the outcome that governments always sought.

An Inconvenient Truth

A consequence of Mr Matthews' report is the clear moral obligation (and perhaps a legal obligation) on the Government now to cut the salary based indexation mechanisms afforded to the judicial and pre-2004 parliamentary pension schemes without reservation or delay.

This inconvenient truth arises because Mr Matthews asserts that government should not afford retired members of Commonwealth schemes *"a share of productivity increases"*[81] earned by current and future employees. The Government accepted this assertion when Minister Tanner said on 21 August 2009 that the Government fully supports the findings of the Review.

The Government cannot, therefore, in conscience or as a matter of policy or possibly in law, continue to allow retired judges and MPs a share of the "productivity increases"[82] earned by past, current and future judicial and parliamentary members while simultaneously denying a much cheaper form of purchasing power protection to former members of the ADF.

Additionally, given that the Review is concerned mainly with cost, is it not discriminatory for the Government to index parliamentary and judicial pensions by far more generous methods than those that apply to welfare pensioners, let alone military superannuation pensioners?

DFWA again draws attention to the attached graph, which clearly and simply illustrates the unacceptable effects of an indexation method that has not and does not maintain the purchasing power of military superannuation pensions.

[80] But not Matthews' Recommendation 4, despite the announcement of PBLCI immediately after the release of Matthews.
[81] Matthews Report, Para 4, p 46.
[82] Or does the Government take the view that these salary based indexation methods exist *only* to maintain the purchasing power of judicial and parliamentary pensions? If so, DFWA's case for fair military indexation rests.

Conclusions

Mr Matthews' report:

- Fails to recognise and endorse the actions taken by government to protect the purchasing power of Age and other welfare pensions through fair indexation of those pensions, and to extend those same provisions to military superannuation pensioners,
- Draws conclusions that are not necessarily supported by either facts or analyses, and
- Ignores the significant and unconscionable fact that although successive governments *chose* to operate unfunded superannuation schemes for its ADF members those same governments all expect former ADF members and their dependants to bear the many financial burdens that result.

The Defence Force Welfare Association:

- Agrees with Mr Matthews that the purpose of indexation is to maintain purchasing power and that the Consumer Price Index has changed significantly,
- Regrets that Mr Matthews does not recognise that today's CPI does not protect pension purchasing power and that he offers no solution other than the status quo, despite his Recommendation 4, thus condemning each military superannuant to further erosion of his or her superannuation pension's purchasing power,
- Contends that an indexation method including the CPI together with an outlays based living cost index such as the new PBLCI, and with reference to a wages based index such as the MTAWE, (effectively tied to movements in the CPI or PBLCI or MTAWE, whichever is the greatest) is fair, equitable and reasonable.
- Seeks no more and no less than this method in order to protect the purchasing power of military superannuation pensions as is the case for today's welfare pensions. DFWA does not seek the generous indexation methods applying to certain other Commonwealth superannuation pensions.

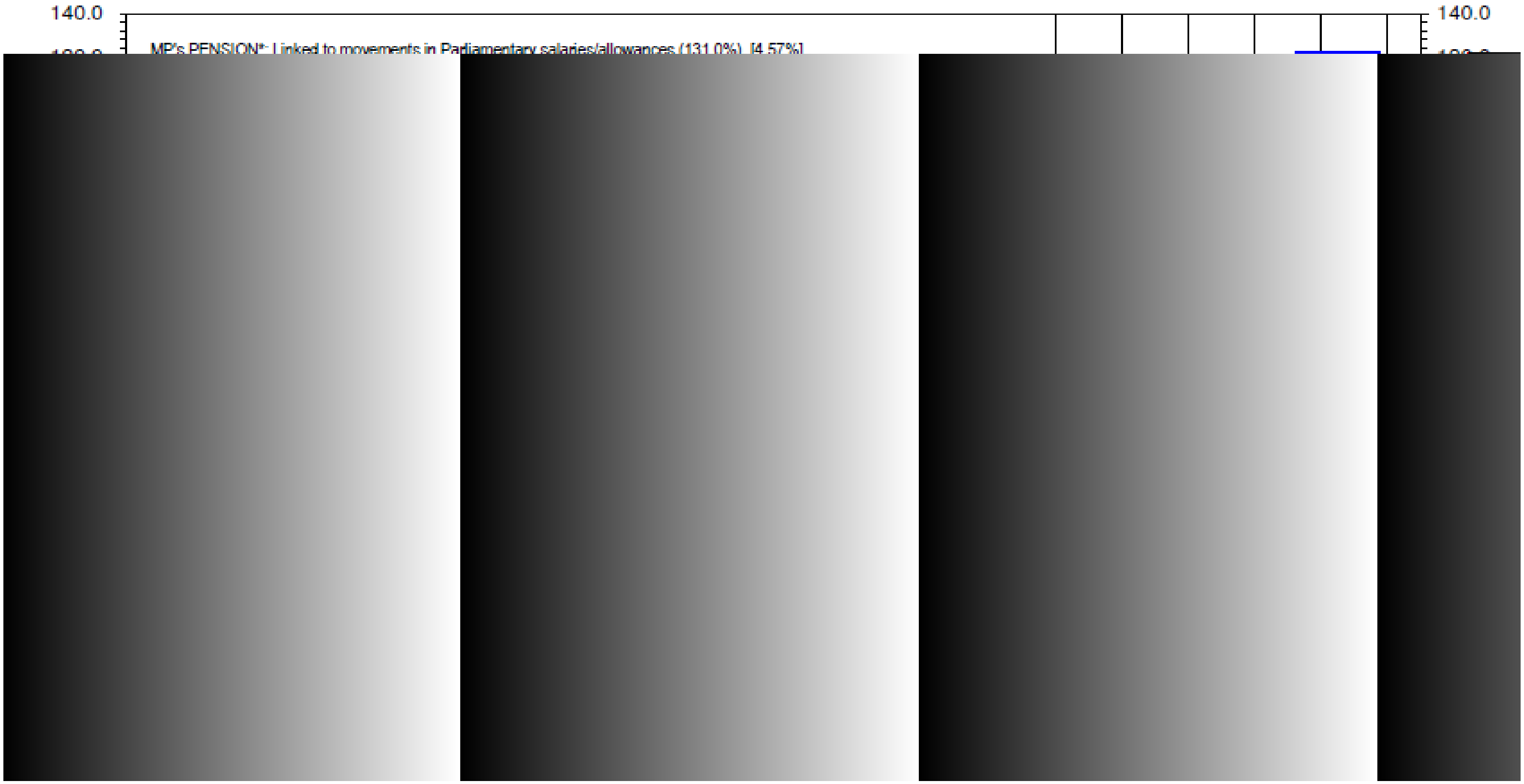
DFWA believes unequivocally that the Government has the strongest of grounds to:

- Review its endorsement of the Matthews Report,
- Request the Australian Government Actuary to generate long term liability and related figures upon which all parties can rely, and
- Concurrently and without further delay introduce a fair indexation method that maintains the purchasing power of all military superannuation pensions.

Noting that the Government is still considering the Review of Military Superannuation Arrangements, DFWA looks forward to early discussions with the Minister for Finance and Deregulation or another Government representative on the Government's indexation plans for Australia's military superannuation pensioners.

Attachment:
Graph – Comparison of MP, Age, and Commonwealth Superannuation Pensions 1989-2008

CUMULATIVE % INCREASE IN: AGE PENSION, C'WEALTH SUPER PENSIONS, MP's PENSION*



Note: Single age pension now linked to 27.7% of MTAWE