



ALLIANCE OF DEFENCE SERVICE ORGANISATIONS

30 June 2011

Fair Indexation for Military Superannuation Pensioners

FAIR INDEXATION FAQ

1. What exactly does the Alliance of Defence Service Organisations want?

We want our military superannuation pension purchasing power protected.

It once was protected. It no longer is.

A fair indexation regime must replace the present unfair CPI-based regime, which *erodes* the purchasing power of our military super pensions.

2. How can purchasing power be protected?

Remembering that all we want is an indexation regime that again protects our military super pension purchasing power, and that the present Age pension indexation regime does no more and no less than just that, we want the Age pension indexation regime.

It's that simple. And it's fair.

Importantly, we do *not* seek the very generous indexation that applies to certain taxpayer-funded super pensions even though a strong case can be made for doing so. We do not believe it is fair to the taxpayer for the purchasing power of our military super pensions to increase faster than the cost of living, as is the case with these other taxpayer-funded super pensions.

3. But aren't you confusing the Age pension with military superannuation pensions, even though the two are quite different?

No.

It is the *indexation regime* that matters, not the *purpose* of the various pensions.

The indexation regime applying to the Age pension protects the purchasing power of the Age pension. This fair indexation regime would protect the purchasing power of *any* pension or similar payment.

The indexation regime applying to military super pensions does not protect the purchasing power of military superannuation pensions. That's why we want the fair indexation regime that applies to the Age pension.

It is not possible to claim that CPI indexation protects military super pension purchasing power while simultaneously claiming that only CPI/PBLCI/MTAWE indexation can protect Age pension purchasing power.

There is no linkage between a workers' *superannuation* pension to which its members compulsorily contributed and a non-contributory *welfare* pension whose purpose is to alleviate hardship. But it is clear that the indexation regime of one must apply to the other because only *one* indexation regime can protect the purchasing power of *any* pension.

4. What's wrong with CPI indexation?

CPI indexation alone does not protect the purchasing power of any pension. If it did, all taxpayer-funded pensions of all types – Age or superannuation – would still only use CPI.

But, as the Australian Bureau of Statistics says (2001), CPI is a measure of inflation, not purchasing power. Purchasing power is a different thing.

This difference is at the heart of indexation reform. It is not mere semantics.

It is true that CPI was once a reasonable measure of purchasing power, particularly during the time of the Accord in the '80s where CPI had primacy in wage and related negotiations.

But CPI changed. The name is still the same but the measure is now different, and has been for well over a decade.

Today's CPI does not measure purchasing power. That's why CPI indexation was abandoned in 1998 for Age and other welfare pensions. That's why ADSO wants fair indexation for military super pensions now – thirteen years and counting since the purchasing power of Age and other welfare pensions was protected.

5. But is fair indexation affordable?

Yes.

1. If fair indexation that protects pension purchasing power is affordable for 3.3 million Age and other welfare pensioners, and

2. if very generous salary-based indexation is affordable for certain other taxpayer-funded superannuation pensions, then

3. Fair indexation that protects military super pension purchasing power is affordable for 63,000 former servicemen, servicewomen, and those whom servicemen and women leave behind.

Conversely, if fair indexation is unaffordable for military super pensions then it must be unaffordable for all other taxpayer-funded welfare and superannuation pensions.

6. Can you be more specific on the cost?

Yes.

The Government says (May 2011) that fair indexation for DFRDB super pensioners aged 55 or older will cost \$175M over the forward estimates period (four years). It also says the “fiscal cost”, an accounting device, will be \$1.7B and that the total cost is \$6B. But we do not know the assumptions it makes to arrive at numbers that only scare and confuse.

Instead, let’s look at facts. The latest (2009-10) DFRDB Annual Report says that total *real* expenditure on *all* DFRDB superannuation pensions in FY2009-10 was \$1.285B. Meanwhile, the Australian Government Actuary (AGA) tells us to use a CPI ‘per annum’ rate of 2.5% and a wage growth rate of 4% for military superannuation pension forecasts, meaning that the additional cost of fair indexation if linked *directly* to wage growth would be 4% minus 2.5%, or 1.5%.

This means that the first year additional cost of fair indexation is $\$1.285B \times 1.5\%$. That’s \$19.275M. Call it \$20M. The second year additional cost of fair indexation is $\$20M + (\$20M \times 1.5\%)$. That’s \$20.3M, but let’s round it way up to \$21M. Similarly, the third year is \$22M and the fourth year is \$23M if the cost is always rounded up. (These simple sums do not account for new beneficiaries entering, who add to the cost, or for current beneficiaries dying, who reduce the cost. Nor do they account for twice-yearly indexation rests.)

So even if the additional cost of fair indexation is always rounded up, the four year forward estimates cash cost is around $\$20M + \$21M + \$22M + \$23M$. That’s only \$86M, a gross figure *before* “clawback” or other offsets. And that’s for *all* DFRDB pensioners, not just those aged over 55 years.

Other researched four year estimates of the cost of fair indexation range from the Podger Review (\$85M in 2008; up to \$95M now?), the Coalition (\$98M), and Thornton (\$112M using his 2% assumption; around \$90M using the AGA assumption of 1.5%).

\$86M over four years may be wrong. *But it and all other estimates, except the Government’s, are similar.* And are so distant from the Government’s \$175M that even the most feral of those opposed to fair indexation must take pause.

We do not know why the Government numbers, provided to it by the Department of Finance & Deregulation, are around double everybody else. Finance does not expose its assumptions to scrutiny. Perhaps Finance used accrual accounting methods instead of cash accounting methods? Or is it just an error; another figure done in haste?

7. What is “clawback”?

Military superannuation “defined benefits” pensions, unlike modern “defined contributions” superannuation pensions, are taxed. A small (10%) taxation offset applies.

This means that an increase in military super pensions generates an immediate higher income tax liability for all military super pensioners regardless of their age or other factors. That’s “clawback”, because the Government “claws back” part of any increase it provides.

The Government also “claws back” more money from the military super pensioner through GST and, in many cases, through reduced Age or other welfare pension payments. When military super pension payments go up, welfare pension payments go down.

“Clawback” means that the net cost to the taxpayer of a military super pension increase is less than the gross cost.

8. What does “clawback” mean in dollar terms?

The answer depends on whom you ask.

Researched estimates for the 2008 Matthews report ranged from a low of 15% to a high of 58% (Matthews pp67-68). Most conservative estimates were around 30%, with the notable exception of the Department of Finance & Deregulation’s 15% “clawback”.

Mr Matthews chose to ignore all “clawback” estimates. All costings in the Matthews report are in gross dollars only, which may well lead the lay reader to believe that the costs of fair indexation are significantly higher than is really the case.

But even Finance now (2011) admits that “clawback” is around 30%. This means that most interested parties now agree that gross dollar costs for fair indexation should be discounted by 30%.

9. I read somewhere that fair indexation will cost \$40 billion. Is that true?

No.

This scare number is from Finance’s input to the discredited Matthews review (page 65, & p66 Table J2). It is the highest of the numbers stated. It *includes* taxpayer-funded civilian super schemes except for the pre-2004 Parliamentary Contributory

Superannuation Scheme and the judicial super scheme, *and* is a projection for 45 years. It is far from the cost of indexation reform for the two military super schemes.

It is in Finance's interests to promote a high *gross* number so parliamentarians will be dissuaded from pursuing indexation reform even though the real *net* cost after "clawback" is at least 15% lower (using Finance's own estimate at Matthews p67) or 25% to 58% lower using other estimates (Matthews pp67-68). Even Finance now (2011) says that "clawback" will be 30%, another back flip from its 15% assertion in Matthews less than three years ago. \$40B is wrong to the point of misleading the Parliament, a statement not made lightly.

And Finance's assumptions (Matthews p64) are incomplete and, at best, questionable. This means that independent observers such as parliamentarians have little basis from which to judge the veracity of these numbers. Finance has been proven significantly wrong by MPs on both sides (evidence available) many times over many years.

Finance says (Matthews p66) that reforming *military* super pensions using a pre-PBLCI age pension methodology will cost \$10.3B over 45 years, some 25% of its headline number. But even \$10.3B is also plain wrong. Apart from conveniently overlooking "clawback", Finance also wrongly assumes (Matthews p64) that MSBS will continue indefinitely when in fact the Government years ago flagged that MSBS would be replaced by a defined contributions scheme, perhaps in the near future. When the new military super scheme starts, Finance's rubbery figure will again fall immediately and significantly.

An objective observer can say with 100% confidence that the real cost of fair indexation for military super pensions over 45 years will be far, far less than \$10.3B.

Military super pension indexation reform will come at a cost to the taxpayer, as did welfare pension indexation reform in 1998 and 2009. The cost is, obviously, insignificant when compared with welfare pension reform.

More significantly and relevantly, the real cost to the taxpayer of fair indexation is far less than Finance's demonstrably wrong projections. The taxpayer deserves the whole truth, not merely the bits that Finance chooses to promote.

Why is Finance, and by extension the Government, so economical with the facts?

10. What else about fair indexation is the Government hiding?

We don't know.

But, given the Department of Finance and Deregulation's track record in advising governments of both colours, it is reasonable to conclude that service people and the taxpayer – and MPs – are not fully informed.

Consider these points in relation to the Bill affecting DFRDB people, now (June 2011) before the Parliament:

- The Department of Finance and Deregulation, and by extension the Government, is demonstrably tardy and economical with the facts. The Government took six months to answer six simple questions-on-notice asked in the Senate on 16 November 2010. And the answers did not advance anyone's understanding of the fair indexation issue.
- "Clawback" through increased taxation and reduced Age/Service pension payments will lower the net cost of fair indexation significantly. Why does Finance not spell out the whole truth about "clawback" and its effects?
- All DFRDB contributors *compulsorily* paid 5.5% of their pre-tax pay to consolidated revenue. Where does Finance account for this very significant offset over the life of the DFRDB scheme?
- DFRDB closed to new entrants way back in 1991, meaning that the number of serving ADF people compulsorily contributing to DFRDB declined while the number compulsorily contributing to the new MSBS rose. But DFRDB's remaining 4,246 uniformed people *still* compulsorily contribute \$22.3M pa (2009-10). Why does Finance conceal even this offset?
- DFRDB/MSBS unfunded liabilities will fall significantly when the Government replaces MSBS with a new defined contributions scheme. Where do Finance's projections acknowledge this?
- And even if Finance's (or any other) number is correct, the Australian Government Actuary says that unfunded DFRDB/MSBS liabilities as a percentage of Australia's Gross Domestic Product will in 2048 fall to around 75% of the 2008 level *even if MSBS is retained*. Fair indexation adds infinitesimally to this. Why won't Finance say so clearly and unambiguously?

What else is Finance hiding from servicemen & women – and from taxpayers and the Parliament?

11. Did DFRDB members agree at enlistment to CPI indexation, as the government claims?

No.

Leaving aside the fact that superannuation is further from the mind of any 17-18 year old ADF recruit than maybe anything else, and the fact that recruits have no say in their super pension conditions, the condition of service understood upon enlistment and later is that military superannuation pension *purchasing power* would be protected.

CPI indexation was never a condition of service. Purchasing power protection was.

12. So you are not looking for a new benefit, as some in the Government claim?

No.

We want the Government to restore a lost benefit, not to give us a new one.

CPI indexation once protected purchasing power. It no longer does. We want the restoration of an indexation regime that protects purchasing power.

Those in the Government who say we want a new benefit are either being poorly advised or are less than honest.

13. Aren't comparisons with the indexation method used for the pre-2004 Parliamentary Contributory Superannuation Scheme unfair because PCSS closed to new entrants in 2004?

No.

DFRDB closed to new entrants even earlier, in 1991. So what?

Closure dates have no bearing on the rights or wrongs of indexation regimes for any taxpayer-funded superannuation scheme.

Saying that a scheme's indexation regime is beyond criticism because the scheme is closed is at best disingenuous. Additionally, the confected linkage between scheme closure and indexation regime is a non sequitur. In other words, there is no linkage.

14. But aren't some pre-2004 PCSS MPs who are still serving in Parliament now seeing their super pension entitlements go backwards?

We don't know.

Even if that is happening, as some long-serving MPs may claim, it has no relevance to indexation regimes. Surely affected MPs do not see their indexation regime, as opposed to their generous length-of-service entitlements, as their only reward for further service?

ADSO members want to believe that no MP sees his/her super pension indexation regime as an additional reward that is exclusive to parliamentary service as opposed to military or any other Commonwealth service that imposes hardship on the individual and his/her family.

Anyway, which service imposes more hardship, parliamentary service or military service?

Linking an indexation regime to the entitlements that may or may not accrue to long serving MPs is fatuous. If diminishing termination entitlements are of overriding importance to an affected serving MP then would not s/he leave the Parliament immediately?

15. But pre-2004 MPs compulsorily contributed more to their PCSS than DFRDB contributors. Shouldn't MPs get better indexation than ADF people because of that?

No.

Pre-2004 MPs compulsorily contributed 11.5% of salary (reduced to 5.75% after 18 years) to PCSS compared with a compulsory contribution of 5.5% of salary to DFRDB by military people, a significant difference at least for the first 18 years. But the difference has nothing to do with indexation of the respective super pensions, or certainly should not.

The higher pre-2004 PCSS contribution rate means, inter alia, that:

- MPs can receive super pensions much earlier (with as little as eight years of service) than military people, who normally must give a minimum of 20 years of service to qualify for any DFRDB pension.
- MPs who leave the Parliament at an early age but with qualifying service do not suffer from DFRDB's "detriment" provisions, which severely reduce the DFRDB super pension paid to officers who leave the ADF before their notional retiring age.
- MP pensions are higher in terms of percentage of final salary (75% after 18 years MP service compared with 35% after 20 years military service under DFRDB).
- Reversionary pensions for the spouse of a deceased MP are 83.3% of the MP's pension compared with 62.5% for the spouse of a deceased DFRDB super pensioner.

ADSO does not necessarily begrudge either the higher dollar pensions paid to pre-2004 PCSS MPs or their very generous early payout provisions. They contributed at a higher rate than did ADF people, albeit very similarly after 18 years. Whether their higher contribution justifies their much higher payouts is not for ADSO to judge (although ADSO cannot understand why the spouse of a deceased MP is more highly valued than is the spouse of a deceased ADF member).

Regardless, it is clear that the higher percentage contributions paid by pre-2004 PCSS MPs are designed to help pay for PCSS' much more generous benefits and not for indexation that is tied to backbencher salaries.

The purpose of indexation, any indexation, is or should be solely to protect pension purchasing power, and not to confer an additional post-retirement benefit.

(ADSO has no criticism whatsoever of the federal judiciary's defined benefits pension scheme, but notes that a former deputy president of the Australian Law Reform Commission was recently reported ("The Australian" 3 June 2011) as saying that the judicial scheme needs reform. Judicial pension indexation is presently tied to judicial salaries, the same indexation principle used for pre-2004 PCSS MP pensions.)

16. Isn't the pre-2004 PCSS indexation regime locked in because the scheme is closed?

No.

The pre-2004 PCSS indexation regime can be changed at the stroke of a parliamentary pen. So can the indexation regimes applying to the (closed) DFRDB or the (open) MSBS or to any other taxpayer-funded super scheme. Closure is of itself irrelevant.

The then Government set a precedent in 1986 when it unilaterally and arbitrarily cut indexation for military and public service super pensions below the CPI percentage that then applied. CPI indexation was restored in 1989 but retired ADF people and others were never compensated for their losses over those three years.

Today's Government could, if it wished, cut pre-2004 PCSS indexation to CPI so that MP, military and other taxpayer-funded super schemes were all indexed identically.

Conversely, the Government can if it wishes introduce fair indexation that protects everybody's super pension purchasing power equally by aligning all taxpayer-funded super schemes to the fair indexation regime applying to the Age pension.

No indexation regime is "locked in".

17. If military super pension indexation is reformed, won't there be pressure to do the same for civilian super pensioners?

Maybe, but there is certainly no automatic flow-on.

This question warrants responses briefly addressing flow-on and cost, noting that ADSO is sympathetic with, but not the champion of, civilian super pensioners.

First, flow-on.

Military service is unique. It is recognised as unique through, inter alia, its unique legal system, the unique ADF structure (with *members*, not employees, all of whom are outside the industrial relations jurisdiction), its unique conditions of service (with long hours, no right to strike, frequent personal and family disruption, and many others that are unacceptable in the wider Australian community), and its unique Department of Veterans' Affairs.

But, most significantly, military service is unique because it is servicemen and women, and only servicemen and women, who are required, if lawfully directed by competent

authority and under severe penalty for disobedience, to surrender their human rights up to and including the sacrifice of their life. That's unique in anyone's language.

If civilian service was unique then Australia would have a Department of Civilian Affairs, an additional legal system and no trade unions, among other things. But it does not.

Military service is unique in the true sense of the word. Even the Parliament now (2 June 2011) formally recognises that military service is unique.

Military service bears no resemblance to the civilian public service or to any other walk of life, meaning that it should not be linked in the way that some may fear.

Recognition of the unique nature of military service does not lead automatically to a flow-on to the civilian public service, which is an important but not "unique" organisation.

Unique service can and does require unique solutions that do not flow-on elsewhere.

Second, cost.

It is outside ADSO's remit to comment on civilian super issues, cost or otherwise. But, clearly, the cost of indexation reform is less for military superannuants than for civilian superannuants.

It is less *universally* because there are fewer service people than civilians. It is less *individually* because mean and median military super pensions are less than mean and median civilian super pensions.

18. Aren't some military superannuation pensions high?

Yes.

46 (0.001%) military superannuation pensions are high (\$80,000 or more).

But the dollar size of any super pension, military or civilian, is irrelevant to the case for fair indexation. Some (all?) pre-2004 PCSS super pensions and some CSS/PSS super pensions are also "high". Are these high super pensions also relevant to indexation reform?

Regardless, if the tiny number of "high" military super pensions is an issue for some critics then the large number of "low" military super pensions must also be an issue for them.

19. So what is the truth about military superannuation pension dollars?

Let's use Matthews report numbers that are accepted by everybody, even if the numbers are a bit dated.

The *mean* (average) military DFRDB super pension (Matthews p62, as at Dec 2008) was \$21,286 (MSBS \$18,405).

Because any super pension usually supports a couple in their retirement, it is worth noting that at that time the couple rate for the Age pension was some \$23,000.

All numbers have risen since 2008 but the relativities are now worse because of the fair indexation regime applying to the Age pension and the unfair indexation regime still applying to military super pensions. The purchasing power of Age pensions post-Matthews has been protected; the purchasing power of military super pensions has not.

But *mean* pensions do not reveal the whole story. The *median* military super pension was well under \$20,000 (Matthews p7 Table 2.3), significantly lower than the mean. (A median is the number in the middle of a range of numbers. Half of all military super pensions are above the median and half are below.)

Sure, 46 people received the top tier of \$80,000 or more but a thumping 37,132 people (58%) received less than \$20,000. Of those, no fewer than 4,746 received less than \$10,000. And all contributors, from private to general, had compulsorily paid a fixed percentage of their pre-tax salary to their super while in uniform.

Note here that Matthews did not write about median military super pensions. The tables from which a dogged reader could extract mean and median super pension numbers were 55 pages apart in a 68 page report. Was that because the median numbers did not support his case? Is this another attempt to paint military super pensioners in the worst possible light by being economical with the facts presented to parliamentarians and to the taxpayer?

And it begs the question as to the conclusions one should draw regarding PSS/CSS/PCSS super pensions, which all have a very much greater percentage of “high” beneficiaries (i.e. above \$80k) than do the military schemes.

If indexation reform fails because 0.001% of military beneficiaries receive \$80k or more while 58% of military beneficiaries receive \$20k or less, with 7.4% receiving less than \$10k, then something is seriously wrong.

20. But don't military superannuation pensioners receive free rides with the RAAF and other exclusive benefits?

No.

The myth about free RAAF rides is just that, a myth. The US has some limited “indulgence” USAF flights for retired US military people but Australia does not.

Other myths say that military superannuation pensioners receive free medical and dental care, free or subsidised housing, and subsidised groceries. Not true.

And military super pensions are not tax free. Unlike the vast majority of Australians who are, or will be, accumulation fund beneficiaries, military super pensions are subject to income tax (with a small 10% offset).

Military super pensioners receive no special universal benefit that is unavailable to other Australians.

21. What about compensation payments? Aren't they linked to military superannuation pensions?

Yes

Incapacity payments are reduced by the Commonwealth contribution from a Commonwealth Superannuation Scheme. This amount is deemed to be 80% in the case of DFRDB benefits and 100% in the case of MSBS benefits.

There is no reduction for Special Rate Disability Pension (SRDP) for DFRDB payments.

Special Rate Disability Pension (SRDP) for MSBS payments is offset at the rate of 60 cents for each \$1 of any Commonwealth funded component of superannuation a person receives.

22. Did DFWA, the RSL and others pursue fair indexation in 1998 when welfare pension indexation was first reformed?

Yes, but it is fair to say we were all more naïve in 1998.

Service people expected, and most still expect, the government of the day to do the right thing by serving and former ADF people without our having to jump up and down to be noticed, as others in the community must do.

Serving and former military people are collectively apolitical, and want to be seen as collectively apolitical. That is why they did not demonstrate outside Parliament House in 1998 when the Coalition government did the wrong thing with military super pension indexation. That is also why they did not demonstrate outside Parliament House in 2009 when the Labor government did the wrong thing with military super pension indexation by accepting the demonstrably flawed Matthews report after sitting on it for eight months.

Further, ex-service people then took some time to wake up to what was happening, because the difference between CPI indexation (military super pensions) and CPI/(PBLCI)/ MTAWWE indexation (Age etc. pensions) is incrementally small. But in the same way that compound interest acts incrementally to build savings wealth over the long term, so these small incremental discrepancies compound to destroy military super pension purchasing power over the same long term.

Unfortunately, the days of pursuing fair indexation apolitically in concert with the government and opposition of the day are now gone. Governments neither listen nor act.

23. Are you saying that serving and former service people should now be party-political?

No. Certainly not.

ADSO is saying that we must become involved in the political *process* if we are to achieve fair indexation, which is an entirely different thing from becoming party-political.

24. But aren't you just splitting hairs?

No. This issue is of fundamental importance.

Serving ADF members must always obey lawful directions given to them through the CDF by the Government of the day, regardless of each ADF member's personal political opinions. And serving sailors, soldiers and airmen & women cannot march through the streets with anti-government banners or overtly support any political party. Nor should they.

Former ADF members do not have the same party-political restrictions as serving members. That's why we see and hear some ex-service individuals loudly denouncing the ALP while others, equally loudly, denounce the Coalition. That's their right. That's democracy. They are no longer in the ADF.

But it is important to distinguish between *individual* party-political opinions and the *collective* political – but not party-political – opinions of ex-service organisations such as ADSO.

ADSO represents individuals of all party-political opinions. ADSO addresses the rights and wrongs of political *issues*, not the rights and wrongs of political *parties*.

Put another way, individuals may well be “capital P” Political but ADSO is always “lower case p” political. ADSO is solely concerned with issues and process.

25. Does this mean a change of direction in the way ADSO pursues fair indexation?

Yes.

Indexation inaction by all Governments since 1998 made ADSO realise fairly recently that if ex-service organisations do not adopt more active practices then we and our loved ones and those we leave behind are condemned to a lifelong erosion of our standard of living. Traditional “behind the scenes” practices have failed us.

We can be accused of being slow on the uptake but not of greed or of being unreasonable.

Remembering that all we want is an indexation regime that again protects our military super pension purchasing power, and that the present Age pension indexation regime does no more and no less than just that, we want the Age pension indexation regime.

We do not seek the very generous indexation that applies to certain taxpayer-funded super pensions, even though a strong case can be made for doing so.

That's fair to us and, importantly, fair to the taxpayer. But achieving fair indexation means that we must now actively involve ourselves in the political process – submitting papers to parliamentary inquiries, lobbying parliamentarians, making public statements on indexation issues, engaging the media and the public, and engaging those affected by unfair indexation.

This means we must engage in more public activities than has traditionally been the case.

Glossary:

ADF – Australian Defence Force

CPI – Consumer Price Index

CSS - Commonwealth Superannuation Scheme

DFRDB – Defence Force Retirement and Death Benefits Scheme

MSBS – Military Superannuation and Benefits Scheme

MTAWE – Male Total Average Weekly Earnings

PBLCI – Pensioner and Beneficiary Living Cost Index (introduced for welfare pensions in 2009)

PCSS – Parliamentary Contributory Superannuation Scheme

PSS - Public Sector Superannuation scheme

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