Defence Force Retirement and Death Benefits Amendment (Fair Indexation) Bill 2010

Leslie Nielson
Economics Section

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Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABS</td>
<td>Australian Bureau of Statistics</td>
</tr>
<tr>
<td>ADF</td>
<td>Australian Defence Force</td>
</tr>
<tr>
<td>Age Pension</td>
<td>Pension paid by Centrelink under the Social Security Act 1991 to a person who is at or over age pension age (65 to 67 depending on date of birth) and who otherwise qualifies for this payment</td>
</tr>
<tr>
<td>ARIA</td>
<td>Australian Reward Investment Alliance – Commonwealth civilian superannuation scheme trustee board. It is responsible for the PSS and CSS.</td>
</tr>
<tr>
<td>AWE</td>
<td>Average Weekly Earnings as calculated by the ABS</td>
</tr>
<tr>
<td>CPI</td>
<td>Consumer Price Index for 8 Australian capital cities as calculated by the ABS</td>
</tr>
<tr>
<td>Comsuper</td>
<td>Commissioner for Superannuation</td>
</tr>
<tr>
<td>CSS</td>
<td>Commonwealth Superannuation Scheme (Commonwealth civilian superannuation scheme between 1976 and 1990)</td>
</tr>
<tr>
<td>DFRB</td>
<td>Defence Force Retirement Benefits Scheme (military superannuation scheme between 1948 and 1972)</td>
</tr>
<tr>
<td>DFRB Act</td>
<td>The Defence Force Retirement Benefits Act 1948</td>
</tr>
<tr>
<td>DFRDB</td>
<td>Defence Force Retirement and Death Benefits Scheme (military superannuation scheme between 1972 and 1990)</td>
</tr>
<tr>
<td>DFRDB Act</td>
<td>The Defence Force Retirement and Death Benefits Act 1973</td>
</tr>
<tr>
<td>Indexation</td>
<td>The increase in the annual rate at which a pension is paid. Usually expressed as an increase of x per cent per annum</td>
</tr>
<tr>
<td>Indexation method</td>
<td>Method used to index a pension. Pensions can be increased annually or semi annually by increases in CPI, MTAWE or PBLCI—or a combination of these measures</td>
</tr>
<tr>
<td>Matthews Review</td>
<td>Review of Pension Indexation Arrangements in Australian Government Civilian and Military Superannuation Schemes chaired by Trevor Matthews</td>
</tr>
<tr>
<td>MSBS</td>
<td>Military Superannuation and Benefits Scheme (current military superannuation scheme).</td>
</tr>
<tr>
<td>MTAWE</td>
<td>Male Total Average Weekly Earnings as calculated by the ABS</td>
</tr>
<tr>
<td>PBLCI</td>
<td>Pensioner and Beneficiary Living Cost Index as calculate by the ABS</td>
</tr>
<tr>
<td>Podger Review</td>
<td>Review of Military Superannuation Arrangements chaired by Andrew Podger</td>
</tr>
<tr>
<td>PSS</td>
<td>Public Sector Superannuation Scheme (closed to new members in 2005)</td>
</tr>
<tr>
<td>Retirement pay</td>
<td>Formal name for DFRB and DFRDB pension</td>
</tr>
</tbody>
</table>

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<table>
<thead>
<tr>
<th><strong>Service Pension</strong></th>
<th>Pension paid by Department of Veterans Affairs under the VEA to retired ex-serviceman and woman who also otherwise qualify for this payment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SG</strong></td>
<td>Superannuation guarantee, which is the proportion of an employee’s ordinary time wages that their employer is required to contribute to a superannuation fund on that employee’s behalf. Current proportion is nine per cent</td>
</tr>
<tr>
<td><strong>Taxed benefit</strong></td>
<td>A superannuation benefit that has been subject to the normal tax arrangements applying superannuation funds. Such benefits are said to be paid from a ‘taxed-source’ about 93 per cent of all superannuation benefits come from a taxed-source</td>
</tr>
<tr>
<td><strong>Un-taxed benefit</strong></td>
<td>A superannuation benefit that has not been subject to the normal taxation arrangements applying to all superannuation funds. Such benefits are said to be paid from an un-taxed source. Such benefits are mainly paid from older public sector superannuation schemes</td>
</tr>
<tr>
<td><strong>VEA</strong></td>
<td><strong>Veterans Entitlement Act 1986</strong></td>
</tr>
</tbody>
</table>
Defence Force Retirement and Death Benefits Amendment (Fair Indexation) Bill 2010

Date introduced: 18 November 2010

House: Senate

Portfolio: Private Senator’s Bill (Senator Michael Ronaldson)

Commencement: Sections 1–4 on the day of Royal Assent; all other provisions on 1 July 2011

Links: The links to the Bill, its Explanatory Memorandum and second reading speech can be found on the Bills home page, or through http://www.aph.gov.au/bills/. When bills have been passed they can be found at the ComLaw website, which is at http://www.comlaw.gov.au/.

Purpose

The Defence Force Retirement and Death Benefits Amendment (Fair Indexation) Bill 2010 (the Bill) amends the Defence Force Retirement and Death Benefits Act 1973 (DFRDB Act) so that the pension paid under this Act to a retired defence force member over 55 years of age is increased bi-annually by the greater of the following percentage increases (as calculated by the Australian Bureau of Statistics (ABS)):

- the Consumer Price Index (CPI)
- the Pensioner and Beneficiary Living Cost Index (PBLCI), or
- Male Total Average Weekly Earnings (MTAWE).

The rate at which a pension increases is known as the ‘indexation rate’. Currently all Commonwealth military and civilian pensions are indexed by increases in the CPI.

Background

The Bill was introduced by Senator Ronaldson and has not, at the time of writing, been referred to any Committee. Senator Ronaldson presented the Bill in fulfilment of a Coalition pre-election promise to implement a more generous approach to the indexation of military superannuation.

Currently, superannuation pensions are paid to retired defence force members from three separate schemes:

- the Defence Force Retirement Benefits Scheme (DFRB), closed to new members in 1972
- the Defence Force Retirement and Death Benefit Scheme (DFRDB), closed to new members in 1990, and
- the Military Superannuation and Benefits Scheme (MSBS) which is open to new members.

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The proposed amendments in this Bill affect only current (and future) retired DFRDB members over the age of 55 who have commenced to receive their pension (also known as retirement pay). The following table shows the membership of each of the above schemes as at 30 June 2010:

Table 1: Military superannuation scheme members as at 30 June 2010

<table>
<thead>
<tr>
<th>Scheme</th>
<th>Contributing</th>
<th>Receiving pension</th>
</tr>
</thead>
<tbody>
<tr>
<td>DFRB</td>
<td>0</td>
<td>3978</td>
</tr>
<tr>
<td>DFRDB</td>
<td>4246</td>
<td>53 003</td>
</tr>
<tr>
<td>MSBS</td>
<td>54 525</td>
<td>7684</td>
</tr>
</tbody>
</table>

Source DFRDB and MSBS Annual Reports 2009–2010

Given that the DFRB scheme closed to new members in 1972, its existing members are well over 55 years of age. There are no remaining contributors to this scheme. The overwhelming majority of DFRDB members are over 39 years of age. The number of both contributors and pensioners in these schemes is declining. The second reading speech suggests that about 30 000 DFRDB and DFRB members would benefit from the proposed changes from 1 July 2011. In the following discussion the reference to DFRDB pensions will also include DFRB pensions.

History

The indexation of DFRDB pensions has been a contentious issue since the scheme commenced in 1972. The DFRDB was based on the work of Joint Select Committee on the Review of Defence Forces Retirement Benefits Legislation which reviewed the operation of the Defence Force Retirement Benefits Act 1948 (the DFRB’s enabling legislation), under the chairmanship of JD Jess, (Liberal member for the seat of La Trobe 1960–1972) (the Jess Review). The Jess Review recommended that military superannuation pensions ‘be expressed as a percentage of final pay and be adjusted annually so that relativity with average weekly earnings is maintained’.


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The enabling legislation for the DFRDB scheme, the DFRDB Act, as first passed by the Parliament, did not provide for the indexation of DFRDB pensions. Rather, DFRDB pension increases were authorised by separate annual Acts between 1 October 1972 and mid 1976. The indexation basis was the lesser of:

- 1.4 times the increase in the CPI, or
- increases in male average weekly earnings.

The sections requiring the DFRDB pension to be indexed to changes in the unadjusted CPI were added to the DFRDB Act by the Defence Forces (Retirement and Death Benefits Amendments) Act 1977. The rationale for these particular amendments to the DFRDB Act was set out in the second reading speech, as follows:

In essence, therefore, the pension updating arrangements encompassed by this Bill achieve the earlier stated aim of consistency with those currently applying to the comparable classes of pensioners under the Commonwealth Public Service superannuation schemes.

Thus the government of the day (the Fraser government) sought consistency in the manner in which all Commonwealth retirement income streams, whether pensions or retirement pay, were indexed.

**Subsequent enquires**

The question of whether, and by what method, the DFRDB pension should be indexed was subsequently considered by a number of inquiries and reviews:

- the Senate Select Committee on Superannuation and Financial Services, ‘A reasonable and secure retirement? – the benefit design of the Commonwealth public sector unfunded superannuation funds and schemes’ of April 2001 (A reasonable and secure retirement)
- the Senate Select Committee on Superannuation, ‘Superannuation and Standard of Living in Retirement’, December 2002 (Standard of Living)

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The following table summarises the main recommendations of these reviews in relation to the indexation of Commonwealth civilian and military pensions.

**Table 2: Summary of recommendations on Commonwealth Pension indexation**

<table>
<thead>
<tr>
<th>Report</th>
<th>Recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jess Review 1972</td>
<td>Pension adjusted annually so that relativity with average weekly earnings is maintained</td>
</tr>
<tr>
<td>A reasonable and secure retirement</td>
<td>Government to examine the feasibility of using an indexation method other than CPI to more adequately reflect actual costs of living increases</td>
</tr>
<tr>
<td>Standard of Living</td>
<td>The Government consider indexing Commonwealth superannuation benefits to either changes in CPI or MTAWE, whichever is greater</td>
</tr>
</tbody>
</table>


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Recent debate on military pension indexation has been framed by the recommendations of the two most recent reviews namely the Podger Review and the Matthews Review. Their recommendations in this area are worth noting in greater detail.

Podger Review

- The relevant recommendation of this review was:

  Recommendation 14 If the Government is willing to go beyond the envelope of current costs, it should consider indexing DFRDB/DFRB pensions for those over 55 on a similar basis to that applying to age pensions. Because of the costs involved, this option does not warrant the priority attached to the other recommendations. An alternative option the Government could consider is to limit this change to pensions paid from age 65.\(^{17}\)

As can be seen this recommendation is very close to the changes proposed by this Bill.

Matthews Review

The Matthews Review made the following recommendations in respect of the indexation of all Commonwealth pensions:

  Recommendation 1: That pensions from the Australian Government civilian and military superannuation schemes continue to be indexed against the effects of inflationary price increases.

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\(^{17}\) Podger Review, op. cit., p. xvi.

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**Recommendation 2:** That the same indexation methodology continue to apply to all civilian and military pensions.

**Recommendation 3:** That pensions from the Australian Government civilian and military superannuation schemes continue to be indexed by the CPI as the most suitable index to protect pensions against inflationary price increases available at this time.

**Recommendation 4:** That, if a robust index which reflects the price inflation experience of superannuants better than the CPI becomes available in the future, the Australian Government should consider its use for indexing Australian Government civilian and military superannuation pensions.

**DFRDB and other superannuation schemes**

Both the Podger Review and the Matthews Review observed that the retirement pay made to members of the DFRDB is quite generous compared to superannuation payments available to the workforce at large, particularly if a member accumulated 20 or more years of service. The first reason that it is comparatively generous is because the level of employer contribution is high. The following table shows the notional employer contribution to a Commonwealth employee’s superannuation benefits as a percentage of that person’s salary for superannuation purposes as at 30 June 2008.

<table>
<thead>
<tr>
<th>Scheme</th>
<th>Notional percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>DFRDB</td>
<td>33.4</td>
</tr>
<tr>
<td>MSBS</td>
<td>27</td>
</tr>
<tr>
<td>CSS</td>
<td>21.4</td>
</tr>
<tr>
<td>PSS</td>
<td>16.3</td>
</tr>
<tr>
<td>SG (actual required contribution)</td>
<td>9</td>
</tr>
</tbody>
</table>

Sources: Aust Gov. Actuary, Finance and Deregulation

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20. Salary for superannuation purposes is not the same as salary that a person receives at the time of exit in all cases. For example for the MSBS and PSS the superannuation salary is the average of the salary received over the three years preceding resignation or retirement. For the CSS the superannuation salary is that received on the person’s birthday preceding retirement.
21. The government support of the Parliamentary Contributory Superannuation Scheme (now closed to new members) and the Judge’s Pension scheme is higher again than these figures.

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In this table the term ‘SG’ stands for Superannuation Guarantee regime. Under this regime an employer is required to contribute the specified percentage of their employee’s ordinary time earnings (currently nine per cent) to a superannuation fund on the employee’s behalf. It is the level of employer superannuation contribution generally enjoyed by the wider community.

As can be seen the DFRDB receives the highest level of employer support of all current general Commonwealth superannuation schemes.

The second reason that it is comparatively generous is because of the amounts paid to members. All other things being equal a higher rate of contribution leads to a higher benefit payout. One way of gauging the level of benefit payout is to compare the average annual pension paid by Commonwealth government schemes, as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>2006-07</th>
<th>2007-08</th>
<th>2008-09</th>
<th>2009-10</th>
</tr>
</thead>
<tbody>
<tr>
<td>CSS</td>
<td>24 703</td>
<td>26 292</td>
<td>26 058</td>
<td>26 963</td>
</tr>
<tr>
<td>DFRDB</td>
<td>20 478</td>
<td>21 486</td>
<td>22 092</td>
<td>23 549</td>
</tr>
<tr>
<td>MSBS</td>
<td>18 000</td>
<td>19 196</td>
<td>19 690</td>
<td>21 967</td>
</tr>
<tr>
<td>PSS</td>
<td>17 598</td>
<td>18 879</td>
<td>18 616</td>
<td>19 631</td>
</tr>
</tbody>
</table>

Sources: DFRDB, MSBS and ARIA Annual reports to Parliament - various years

The average DFRDB pension is generally higher than two other average pensions paid by other Commonwealth civilian and military superannuation schemes. However it is important to understand that the amount of DFRDB paid is dependent on years of service as illustrated below:

<table>
<thead>
<tr>
<th>Completed years</th>
<th>Amount of annual salary</th>
</tr>
</thead>
<tbody>
<tr>
<td>15</td>
<td>30.00</td>
</tr>
<tr>
<td>16</td>
<td>31.00</td>
</tr>
<tr>
<td>17</td>
<td>32.00</td>
</tr>
<tr>
<td>18</td>
<td>33.00</td>
</tr>
<tr>
<td>19</td>
<td>34.00</td>
</tr>
</tbody>
</table>

References:

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By way of example: a 42-year-old Squadron Leader with 22 years of effective service has decided to retire from the Defence Force. He has a salary for superannuation purposes of $78,916. Using the Table above, the percentage to apply to his final salary is 38. His annual retirement pay is $78,916 x 38% = $29,988.08 per year

The third reason that it is comparatively generous is because of the age at which benefits can be paid. Generally, all other superannuation benefits are paid when:

- the person has retired, and
- the person has passed their ‘preservation’ age for superannuation purposes. This age is at least 55 for those born before 1960 and gradually rises to age 60, according to date of birth.

The DFRDB pension is generally paid upon a person’s retirement from the Australian Defence Force (ADF) after 20 years service. Most DFRDB members have left the ADF by age 55, often well before that age.\(^{25}\) That being the case, DFRDB pensions are often paid for a longer period of time than those that are paid to members of the wider community.

\(^{25}\) Until 1 July 2007 the maximum age for service in the ADF was 55. This has been increased to 60 since that date. This change was implemented by the Defence (Personal) Amendment Regulations 2007 (No. 1).

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The generally earlier age at which DFRDB pensioners receive their benefits allows time for those individuals to accumulate an additional significant superannuation benefit before retirement age.

The fourth reason that these pensions are generous is their tax treatment after age 60. The DFRDB (and the DFRB and CSS) pension is paid from an ‘un-taxed’ source. That is, a source that has not been subject to the normal taxation arrangements applying to superannuation funds. Before the recipient reaches age 60 these pensions are taxed as ordinary earned income. After age 60 they qualify for a special tax rebate (often called a tax offset). Briefly, this rebate is equal to 10 per cent of the gross value of the pension. When combined with the low income tax offset DFRDB pensions equal to or below about $38,125 per annum are tax free.

While pensions paid from a ‘taxed-source’ (being a superannuation fund that has been subject to the ordinary superannuation tax arrangements) are also tax free after age 60, they are rarely paid at the above rates and never with the same degree of security as government pensions like that paid by the DFRDB (and other government schemes mentioned above).

Military pensions indexation: overseas comparisons

Generally, the military pension schemes of the United States, United Kingdom, Canada and New Zealand and South Africa are all indexed to movements in prices – not wages. The following table summarises the indexation methods applying to military superannuation schemes in selected countries:

<table>
<thead>
<tr>
<th>Country</th>
<th>Indexation method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canada</td>
<td>CPI adjustment</td>
</tr>
<tr>
<td>NZ</td>
<td>No pension paid, lump sum benefits only</td>
</tr>
<tr>
<td>UK</td>
<td>Retail price index adjustment</td>
</tr>
<tr>
<td>USA</td>
<td>Cost of living adjustment</td>
</tr>
</tbody>
</table>

Source: Podger Review

DFRDB and Social Security and Veterans’ Affairs pensions

The relationship between military superannuation on the one hand and Social Security/Veterans Affairs payments on the other is complex.

While all retired full time service persons are eligible to claim a military superannuation pension, not all such pensioners are able to claim a Veteran’s Affairs service pension. These latter payments are

27. Calculation by Parliamentary Library taking into account the pension tax offset and the low income tax offset only.
29. Podger Review, op. cit., Appendix F.
made to those retired service men and woman that have also served in a theatre of war, conflict zone or other highly dangerous situations (that is ‘qualifying service’). Not all military superannuation pensioners have so served. Conversely, there are some who do not qualify for a military superannuation pension (such as short term members of the defence forces, members of the merchant marine during world war two and other world war two veterans) who can qualify for a Veteran’s Affairs service pension, by virtue of their qualifying service.

However, all military superannuation pensioners are eligible to claim a social security age pension if they otherwise qualify.

A major source of disquiet within the retired defence force community is the method used to index both the Social Security age pension and the Veterans Affairs’ service pension. Indeed, the second reading speech to this Bill emphasised that the purpose of the proposed changes was to bring the method of indexation of the DFRDB pension into line with the method used for the age pension and service pension. Indexation of the Social Security age pension and the Veterans’ Affairs service pension is determined under the Social Security Act 1991 and the Veterans’ Affairs Act 1986 respectively.

Under changes contained in the Social Security and Other Legislation Amendment (Pension Reform and Other 2009 Budget Measures) Bill 2009, from 20 September 2009 the single Social Security age pension and Veterans’ Affairs service pension are indexed to 27.7 per cent of Male Total Average Weekly Earnings (MTAWE). The couple’s pension rate is indexed to 41.76 per cent of MTAWE.

As a cross check, rates of pension are also indexed having regard to changes in CPI or PBLCI. If increases in these statistical series produce a greater rate of pension than the above mentioned MTAWE benchmarks, those payment rates apply.

The formal provisions linking the Social Security age pension and Veterans’ Affairs service pension to increases in MTAWE commenced in September 1997. However, it had been a matter of informal government policy that the basic age pension rate not fall below 25 per cent of Average Weekly Earnings (AWE) since about 1975. The provisions enacted in 2009 formalised what had previously been general government policy since the mid 1970s.

32. Senator Ronaldson, op. cit.
33. These changes were accompanied by an increase in the pension income test taper rate, for income in excess of the income test free area, from 40 cents in the dollar to 50 cents in the dollar. That is, the income test applying to the payment of the social security and veteran’s affairs pensions became more severe.
34. Policy of indexing the Age Pension to increases in average earnings was first implemented in 1975, see Social Services Act No. 3 1975.
The question of whether it is appropriate to apply the indexation method used for age and service pensions to DFRDB retirement pay should take into account the significant differences between these payments. The following table summarises some of these differences:

**Table 7: Differences between DFRDB and Age/Service Pensions**

<table>
<thead>
<tr>
<th>Issue</th>
<th>DFRDB</th>
<th>Age/Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purpose</td>
<td>Provide retirement pay for ex-service personnel. Part of remuneration for services rendered(^{35})</td>
<td>Reduce poverty in retirement/recognition of qualifying service</td>
</tr>
<tr>
<td>Access</td>
<td>After 20 years service (can be below the age of 55)</td>
<td>Service pension at age 60, Age pension at ages 65–67, depending on date of birth</td>
</tr>
<tr>
<td>Rate</td>
<td>Average rate currently $23 549 p.a. (single only)</td>
<td>Maximum rate currently $17 118 p.a. (single) or $25 807 p.a. (couple) if both income or assets below set levels(^{36})</td>
</tr>
<tr>
<td>Payments reduced according to either income or assets?</td>
<td>No</td>
<td>Yes (if either are above set levels)</td>
</tr>
<tr>
<td>Indexation</td>
<td>CPI</td>
<td>CPI, PBLCI or MTAWE as appropriate.</td>
</tr>
<tr>
<td>Reversionary upon death of primary recipient?</td>
<td>Yes</td>
<td>No (surviving partner must qualify in their own right)</td>
</tr>
</tbody>
</table>

Source: Parliamentary Library

It is clear that DFRDB retirement pay and the age/service pensions have different purposes and are paid under different conditions.

As noted above, a person in receipt of DFRDB retirement pay may also access the age or service pension, if they otherwise meet the relevant eligibility requirements and pass the relevant income or assets tests. For example, a person receiving the average DFRDB pension of $23 549 as at 20 September 2010 may also be eligible for the following amounts of age/service pension:

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\(^{35}\) Matthews Review, op. cit., p. 4.


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Table 8: Possible total retirement income, as at 20 September 2010

<table>
<thead>
<tr>
<th>Pension category</th>
<th>Average DFRDB pension $p.a.</th>
<th>Pension amount paid taking into account average DFRDB pension $p.a.</th>
<th>Total retirement income $p.a.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single age/service pension entitlement</td>
<td>23 549</td>
<td>8742</td>
<td>32 291</td>
</tr>
<tr>
<td>Couple age/service pension entitlement</td>
<td>23 549</td>
<td>19 642</td>
<td>43 191</td>
</tr>
</tbody>
</table>

Source: Parliamentary Library

This table assumes that the DFRDB pensioner receives no other retirement income and does not have assets which would affect the rate of pension payable. As noted above, military retirees often have additional superannuation based income in retirement. In addition, the DFRDB pension increases according to increases in the CPI. However, the income test thresholds for the age and service pensions increase according to the indexation method applied, either by increases in the CPI, MTAWE or PBLCI, whichever is the greatest. If increases in MTAWE or PBLCI continue to be greater than increases in CPI, this will currently lead to a situation where the proportion of a DFRDB pensioner’s total retirement income made up of either age or service pension will increase over time. This is due to the faster rate of increasing in the age/service pension income test thresholds compared to the rate of increase in the DFRDB pension.

Potential effect of new indexation method

There is little doubt that the application of the proposed indexation method to DFRDB retirement pay will increase the level of these payments. The following graph illustrates the rate of change in the CPI, PBLCI and MTAWE in recent years.
The reason for choosing June 2007 as the base is that data only exists for PBLCI from June 2007. Therefore, June 2007 has been set to equal 100 and each subsequent quarter indicates the percentage difference between that quarter and the base year. The graph demonstrates that if DFRDB retirement pay had been indexed to MTAWE it would be far higher than it currently is.

In the next twenty years, wages growth is likely to be quite strong. This is due to the demographic ageing of the population and the consequent relative labour shortage. In these circumstances wages growth may well continue at a higher rate than either the CPI or PBLCI increases as employers pay higher wages to compete for scarce labour resources. That being the case, if the Bill is enacted, the rate of DFRDB retirement pay is likely to increase significantly, along with increased MTAWE.

Veterans’ other benefits

Retired servicemen and woman are eligible for a range of other benefits administered by the Department of Veterans’ Affairs which are not available to the general community. These benefits include subsidised housing loans, continuing health care, special disability pensions and other benefits. These benefits are provided as compensation for the continuing affects of military service. The availability of these benefits should be taken into account when deciding whether to further increase the indexation rate of DFRDB retirement payments.

Policy position of non-government parties/independents

The former Rudd government accepted the recommendations of the Matthews Review and did not support the proposed changes to the indexation of any Commonwealth civilian or military pension. The current Gillard government has not, to date, commented on this particular matter.

During the 2010 election campaign the Coalition undertook to introduce legislation to index DFRB and DFRDB retirement payments received by those over the age of 55 by the greatest of changes in:

- CPI
- PBLCI, or
- MTAWE.\(^{39}\)

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The Bill satisfies this undertaking. Notably, this Private Member’s Bill adopts a position which is dramatically different to the one taken by the previous Coalition government, which declined on several occasions to implement similar changes.  

Senator Fielding appears to support the proposal as he is sponsoring a petition in support of the proposed changes.

**Position of major interest groups**

The retired ADF community strongly supports the proposed changes.

**Financial implications**

The second reading speech notes that the estimated budget cost will be $98 million over the forward estimates (generally next four years). Over the longer term the proposed changes would cost some $4.2 billion over the next 45 years, which is the estimated remaining life of the DFRDB. The Matthews Review noted that if DFRDB pensions were indexed to the higher of CPI or MTAWE then the notional employer contribution would rise from 33.5 to 46.3 per cent of wages.

**Main issue**

The issue is whether it is appropriate for the indexation of DFRDB retirement pay to be increased.

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43. Senator Ronaldson, op. cit.
44. Ibid.

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Arguments in favour of increase

The possible arguments for the increase proposed by this Bill are:

- the original DFRDB scheme contained a wage-based indexation element which was removed in the mid-1970s when the Government decided to apply the CPI to a wide range of social security and superannuation pensions (see above for details)
- in recent years the Government has changed indexation arrangements for social security pensions to include a wage-based component
- while CPI indexation does maintain the purchasing power of pensions, it does not maintain relativity with community incomes, and
- DFRDB recipients have limited choice between pensions and lump sums, which is confined to the once-only commutation election at the point of separation from the Australian Defence Force. Commutation is the conversion of a part of the DFRDB pension to a lump sum.46

The argument based on the existence of wage-based indexation when the DFRDB was first established is somewhat misleading. Its validity in the current debate depends on changes to the CPI (multiplied by 1.4) being less than changes in wages for the period in question (1973 to 1976).

Initially, DFRDB retirement pay was indexed to movements in wages, because they were less than the movements in the CPI (multiplied by 1.4) during that period. In 1977 the change to CPI indexation was a change to a more consistent indexation method. It is also noted that, while there is a limited commutation option for the DFRDB (maximum lump sum is five times the annual pension amount), a once only option for commutation also applies to the MSBS, CSS and PSS.

Arguments against increase

The possible arguments against a new indexation method for DFRDB retirement pay are:

- employers, including the Australian Government, provide superannuation for their employees as part of their reward for service. Where that superannuation includes a defined benefit pension (as it does in this particular case), it is usual for it to be indexed against erosion by inflation. Any enhancement of such indexation arrangements would constitute an additional reward for no additional service. This is especially so in the context of the reversionary quality of retirement payment. That is, the entitlement reverts to the spouse of a former ADF member in the event of their death.
- any change in current indexation arrangements would increase the real value of a pension post-retirement and provide an additional financial benefit that would not be available to those military personnel who did not receive a pension, for example, those who took all their superannuation benefit as a lump sum

46. Podger Review, op. cit., p. 60

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• a failure to increase military pensions in line with the age and service pensions is not inequitable. The latter are different benefits provided for different purposes and are not comparable with military superannuation pensions in general and the DFRDB pension in particular. If they were to be compared, it is notable that although the age and service pensions may be increased to achieve a minimum benchmark, the proposed changes place no such restrictions on DFRDB retirement pay. Further, civilian and military pensions have advantages that do not apply to the age and service pensions (see above discussion).

• the Matthews Review did not find any evidence that the CPI understates inflation as it affects Australian households in general—although it did acknowledge that the CPI may not represent the average experience of a particular sub-group, such as self funded retirees.\(^47\)

• CPI indexation is generous when compared to most contemporary civilian superannuation schemes that may only provide account-based pensions at the members’ risk.\(^48\)

• changing the DFRDB indexation method would be expensive and would require significant additional funding over an extended period of time, well beyond the forward estimates period.

• the proposed changes would also add pressure for a similar change to the CSS, PSS and MSBS pension indexation provisions, at considerably higher long-term cost, and\(^49\)

• military superannuation pensions are occupational pensions. They are not compensation for stress and injury experienced in this occupation. Such compensation is provided to retired ADF members by the Department of Veterans’ Affairs, under the VEA. Therefore, any claim to enhance the DFRDB retirement pay on the grounds that warlike ADF service is especially dangerous (which it undoubtedly is), may be construed as an attempt to ‘double dip’.

Significant technical flaws

The second reading speech claims that the proposed amendments will alter the pension indexation arrangements for both the DFRB and DFRDB pensions.\(^50\) However, the proposed amendments are only made to the DFRDB Act and only affect pensions paid under this particular Act. The proposed amendments do not apply to pensions paid under the DFRB Act.

Key provisions

Item 6 of Schedule 1 inserts three new sections into Part XA of the DFRDB which relates to the manner in which certain pension increases are calculated.

\(^{47}\) Matthews Review, op. cit., pp. x, xi.

\(^{48}\) An account based pension is one where a superannuation fund retains a lump sum in a separate account. A pension is paid from that account according to specified percentages of the capital. When the capital is exhausted the pension stops. The member bares all the investment risk.

\(^{49}\) Podger Review, op. cit., p. 60.

\(^{50}\) Senator Ronaldson, op. cit.
New section 98BA requires that the pension paid to DFRDB pension recipients over the age of 55 be increased by the higher of increase in CPI, PBCLI or MTAWE, as appropriate.

New section 98BB allows for the DFRDB pension rate increase to be the same as that worked out in item 1A of the table in section 59 of the Veteran Entitlements Act 1986 (VEA). This particular provision ties the increases in the DFRDB pension to increases in the maximum single service pension or income support supplement for a person increased by bi-annual changes in MTAWE.

New section 98BC allows for the DFRDB pension to be increased by changes in the PBLCI on a bi-annual basis.

Concluding comments

It has been argued that the unique nature of military service should be recognised in military superannuation arrangements. No one would argue that military service is not unique, compared to the employment experience of the general population. However, it can also be argued that the DFRDB scheme already recognises this, as do the other benefits available to the retired ADF community.

Notions of fairness are subjective. What may seem fair to one group could be seen as unfair to another. The pension indexation arrangements applying to age and service pensions apply to payments designed to alleviate poverty in retirement. The application of similar indexation arrangements to a payment that was never designed to alleviate poverty in retirement could be seen in this light.

Alternatively it may be thought that maximising retirement benefits for military personnel should take precedence over other considerations such as comparative equity and relative need.