Retirement Saving in Australia

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Outline of Presentation

1. Introduction
2. Social Security in Australia
3. Voluntary private retirement saving
4. Mandated private retirement saving
5. Incomes of Current Retirees
6. Reform Proposals
I. Introduction

Introduction

- Retirement Incomes policy in Australia
- Institutional Features:
  - Tier 1. Public Age Pension (Means Tested)
  - Tier 2. Voluntary Private Retirement Saving
  - Tier 3. Mandated Private Retirement Saving
Introduction of the Age Pension in 1909

- primary objective was to alleviate poverty
- subject to a means test from its inception
  - initially highly targeted: 30% elderly received benefits
  - means test eased over time: 85% participation in 1980’s
- now resembles ‘general entitlement’
In 2004/05 the Age Pension accounted for:

- A$21b expenditures
- 1.95 million beneficiaries = 77% of the elderly population
- main source of income for the majority of beneficiaries
1. Eligibility

- Residency (10 years continuous residence)
- Age requirements:
  - Males ≥ 65 years of age
  - Females ≥ 63 years of age
    - Age Pension Age for women is increasing (will be 65 years in 2014 - applying to 1948+ birth cohort).
2. Benefit Levels

- Benefit = A$499 per fortnight for individuals
  or A$834 (combined) per couple.
- Benefit levels (and means test thresholds) adjusted every six months in line with inflation
- Recipients receive subsidies for health care, pharmaceuticals, public transport, utilities and rent assistance.
Structure of the Age Pension

3. Means Test

- **Income Test:**
  - Disregard of $128 ($228) per fortnight for singles (couples)
  - Benefits reduced by $0.40 ($0.20) for extra $1 income

- **Asset Test:**
  - Homeowners: Disregard of $161.5K ($229K) for S (C)
  - Non-homeowners: Disregard of $278.5K ($346K) for S (C)
  - Benefits withdrawn by $3 per fortnight for extra $1K assets

- 66% of recipients received the maximum pension amount
Structure of the Age Pension

4. Funding

- General tax revenues on as a Pay-As-You-Go basis.
- Benefits are not based on ‘contributions’ from earnings;
  (independent of prior earnings or taxed paid)
Voluntary “superannuation” has long been important for a minority of Australians

esp. public sector workers, high income earners

Received very generous tax concessions since 1914

e.g. prior to 1983, 5% tax on accumulation at withdrawal
⇒ especially valuable to high earners

Most workers did not have any super prior to 1986
Mandated Superannuation

- Forced Saving had its genesis in 1986 National Wage Case
- Govt and labour movement agree to split 6% CPI increase into 3% wage increase + 3% employer-contribution to super (known as ‘Productivity Award Superannuation’ PAS)

- 1991 attempt for further 3% PAS rejected by CAC
- Govt responded by legislating ‘Superannuation Guarantee’ (SG) in 1992
1. Contributions

- phased introduction, requiring 3% employer contributions in 1992
- reaching the full 9% of earnings in 2002 (earning cap at $122K in 2002).

2. Coverage

- All employees aged 18-65 years earning ≥ A$450 per month
  (threshold at 14% of average male earnings in 1991)
- Excludes the self-employed
Structure of the SG

3. Funding.

- Paid by employers into individual employee accounts
- Accounts held in private superannuation Funds
- No asset portfolio, or minimum rate of return, requirements for Funds

4. Benefits

- Typically paid on defined contribution basis
- Benefits are full vested, portable and are preserved until age 55
  (preservation age is increasing to age 60 by 2025)
Superannuation Coverage

- Super coverage substantially increased following SG (and PAS)

### Table 1. Trends in Superannuation Coverage (% Covered)

<table>
<thead>
<tr>
<th>Year</th>
<th>Public</th>
<th>Private</th>
<th>Males</th>
<th>Females</th>
<th>All Employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>1974</td>
<td>57.5</td>
<td>23.9</td>
<td>40.8</td>
<td>16.5</td>
<td>32.2</td>
</tr>
<tr>
<td>1982</td>
<td>69.4</td>
<td>39.1</td>
<td>57.5</td>
<td>32.2</td>
<td>48.9</td>
</tr>
<tr>
<td>1988</td>
<td>71.9</td>
<td>47.7</td>
<td>65.7</td>
<td>39.0</td>
<td>54.5</td>
</tr>
<tr>
<td>1993</td>
<td>94.5</td>
<td>86.3</td>
<td>90.5</td>
<td>86.0</td>
<td>88.5</td>
</tr>
<tr>
<td>1997</td>
<td>95.4</td>
<td>86.2</td>
<td>89.3</td>
<td>86.8</td>
<td>88.2</td>
</tr>
<tr>
<td>2001</td>
<td>96.7</td>
<td>88.3</td>
<td>90.3</td>
<td>89.3</td>
<td>89.9</td>
</tr>
<tr>
<td>2004</td>
<td>97.2</td>
<td>88.5</td>
<td>90.4</td>
<td>89.6</td>
<td>90.1</td>
</tr>
</tbody>
</table>
### Superannuation Coverage

#### Table 2. Employees with Employer-Provided Super, 2004

<table>
<thead>
<tr>
<th>Weekly Earnings</th>
<th>Full-time</th>
<th>Part-time</th>
<th>Males</th>
<th>Females</th>
<th>All</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; $200</td>
<td>75.3</td>
<td>50.6</td>
<td>45.4</td>
<td>54.7</td>
<td>51.5</td>
</tr>
<tr>
<td>$200-$400</td>
<td>88.2</td>
<td>86.2</td>
<td>79.8</td>
<td>90.1</td>
<td>86.7</td>
</tr>
<tr>
<td>$400-$600</td>
<td>94.9</td>
<td>93.7</td>
<td>92.7</td>
<td>95.8</td>
<td>94.5</td>
</tr>
<tr>
<td>$600-$800</td>
<td>97.0</td>
<td>96.3</td>
<td>96.0</td>
<td>98.1</td>
<td>96.9</td>
</tr>
<tr>
<td>$800-$1000</td>
<td>97.8</td>
<td>94.8</td>
<td>96.9</td>
<td>98.5</td>
<td>97.5</td>
</tr>
<tr>
<td>$1000-$1200</td>
<td>97.9</td>
<td>98.3</td>
<td>97.3</td>
<td>99.3</td>
<td>98.0</td>
</tr>
<tr>
<td>$1200-$1400</td>
<td>98.8</td>
<td>86.7</td>
<td>97.9</td>
<td>99.5</td>
<td>98.4</td>
</tr>
<tr>
<td>$1400-$1600</td>
<td>96.5</td>
<td>100.0</td>
<td>96.7</td>
<td>96.3</td>
<td>96.6</td>
</tr>
<tr>
<td>$1600 +</td>
<td>95.4</td>
<td>86.6</td>
<td>94.8</td>
<td>96.8</td>
<td>95.2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>95.7</td>
<td>76.7</td>
<td>90.4</td>
<td>89.6</td>
<td>90.1</td>
</tr>
</tbody>
</table>
Impact of SG?

- Little known about the impact of the SG on household (or national) savings
- Connelly and Kohler (2004) first to evaluate the impact of the SG on private household saving
  - Model saving as a function of labour income, wealth, financial regulation, SG indicator
  - Find long run voluntary super reduced by 38c for every $1 of SG saving
  - SG crowd-out comparable to estimates of Attanasio and Brugiavini (2003), Attanasio and Rohwedder (2004) using Italian, UK social security reforms
4. Mandated Retirement Saving

Impact of SG?

- Limitations of Connelly and Kohler (2004):
  (i) only consider active savings
  (ii) focus on ‘average’ household saving behaviour
  (iii) not consider the distribution of responses
  (iv) counterfactual is pre-SG trend

- Much remains to be done!
The Incomes of Current Retirees

- Examine the role of the 3 tiers of retirement income policy for current retirees using the ABS Household Expenditure Survey for 2003/04
- Sample of single-family households where the reference person aged 65+ years
### Table 3. Households Where Head is Aged Over 65 Years

Characteristics by Income Quintile

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Weekly Income ($)</strong></td>
<td>200</td>
<td>305</td>
<td>411</td>
<td>551</td>
<td>1260</td>
<td>541</td>
</tr>
<tr>
<td>- with Govt Ben</td>
<td>0.902</td>
<td>0.964</td>
<td>0.929</td>
<td>0.862</td>
<td>0.609</td>
<td>0.855</td>
</tr>
<tr>
<td>- Ben / Income</td>
<td>0.868</td>
<td>0.846</td>
<td>0.803</td>
<td>0.603</td>
<td>0.188</td>
<td>0.665</td>
</tr>
<tr>
<td>- with Super</td>
<td>0.022</td>
<td>0.132</td>
<td>0.166</td>
<td>0.438</td>
<td>0.505</td>
<td>0.251</td>
</tr>
<tr>
<td>- Super / Income</td>
<td>0.032</td>
<td>0.040</td>
<td>0.084</td>
<td>0.210</td>
<td>0.297</td>
<td>0.131</td>
</tr>
<tr>
<td><strong>Average Expend ($)</strong></td>
<td>281</td>
<td>303</td>
<td>322</td>
<td>382</td>
<td>508</td>
<td>358</td>
</tr>
<tr>
<td><strong>Average Wealth ($1K)</strong></td>
<td>34</td>
<td>295</td>
<td>413</td>
<td>556</td>
<td>1295</td>
<td>575</td>
</tr>
<tr>
<td><strong>Own home Outright</strong></td>
<td>0.704</td>
<td>0.656</td>
<td>0.854</td>
<td>0.859</td>
<td>0.880</td>
<td>0.789</td>
</tr>
<tr>
<td><strong>Average Family Size</strong></td>
<td>1.06</td>
<td>1.18</td>
<td>1.82</td>
<td>1.87</td>
<td>2.15</td>
<td>1.61</td>
</tr>
</tbody>
</table>
## The Incomes of Future Retirees

### Table 4. Households Where Head is Aged 55-64 Years

Characteristics by Income Quintile

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Weekly Income ($)</strong></td>
<td>214</td>
<td>462</td>
<td>772</td>
<td>1175</td>
<td>2398</td>
<td>1004</td>
</tr>
<tr>
<td>- with Govt Ben</td>
<td>0.701</td>
<td>0.730</td>
<td>0.350</td>
<td>0.345</td>
<td>0.211</td>
<td>0.468</td>
</tr>
<tr>
<td>- Ben / Income</td>
<td>0.647</td>
<td>0.564</td>
<td>0.168</td>
<td>0.082</td>
<td>0.021</td>
<td>0.296</td>
</tr>
<tr>
<td>- with Super</td>
<td>0.027</td>
<td>0.205</td>
<td>0.247</td>
<td>0.166</td>
<td>0.121</td>
<td>0.153</td>
</tr>
<tr>
<td>- Super / Income</td>
<td>0.018</td>
<td>0.107</td>
<td>0.150</td>
<td>0.080</td>
<td>0.043</td>
<td>0.080</td>
</tr>
<tr>
<td><strong>Average Expend ($)</strong></td>
<td>327</td>
<td>369</td>
<td>431</td>
<td>514</td>
<td>592</td>
<td>447</td>
</tr>
<tr>
<td><strong>Average Wealth ($1K)</strong></td>
<td>379</td>
<td>581</td>
<td>594</td>
<td>773</td>
<td>1492</td>
<td>763</td>
</tr>
<tr>
<td><strong>Own home Outright</strong></td>
<td>0.621</td>
<td>0.709</td>
<td>0.534</td>
<td>0.546</td>
<td>0.529</td>
<td>0.588</td>
</tr>
<tr>
<td><strong>Average Family Size</strong></td>
<td>1.28</td>
<td>2.07</td>
<td>2.03</td>
<td>2.25</td>
<td>2.85</td>
<td>2.10</td>
</tr>
</tbody>
</table>
Simulated Incomes of Future Retirees

Figure 1. Composition of Future Retirement Income

Source: Bateman and Piggott (1997: 27)
Current Reform Proposals

- Treasury *Intergenerational Report* (2002),
  - PC *The Economic Implications of An Ageing Australia* (2005)
    - current policy settings $\implies$ fiscal gap of 5% GDP by 2040
- Continuing pressure for reform
- Selective Review of reform proposal
1. Integration of Tiers

- Superannuation preservation age: Increase to Age Pension Age
- Promote Lifetime Income Streams
2. Age Pension Policy

- Age Pension Assets Test - Include Housing
- Link Age Pension Age to Mortality
3. Superannuation Policy

- Improve Adequacy: Increase Mandatory Contributions?
- Governance and Regulation of Funds