

Retirement Saving in Australia

Garry Barrett
UNSW

Yi-Ping Tseng
University of Melbourne

November 2006

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

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

Social Security in Australia

- 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'

Social Security in Australia

- 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

Structure of the Age Pension

1. Eligibility

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

Structure of the Age Pension

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 - Benefits withdrawn by \$3 per fortnight for extra \$1K assets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

- 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

Structure of SG

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 \geq 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)

	Public	Private	Males	Females	All Employees
1974	57.5	23.9	40.8	16.5	32.2
1982	69.4	39.1	57.5	32.2	48.9
1988	71.9	47.7	65.7	39.0	54.5
1993	94.5	86.3	90.5	86.0	88.5
1997	95.4	86.2	89.3	86.8	88.2
2001	96.7	88.3	90.3	89.3	89.9
2004	97.2	88.5	90.4	89.6	90.1

Superannuation Coverage

Table 2. Employees with Employer-Provided Super, 2004

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

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
 - Aggregate, annual time series data for 1966/67 - 2001/2002
 - 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

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

The Incomes of Current Retirees

Table 3. Households Where Head is Aged Over 65 Years
Characteristics by Income Quintile

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

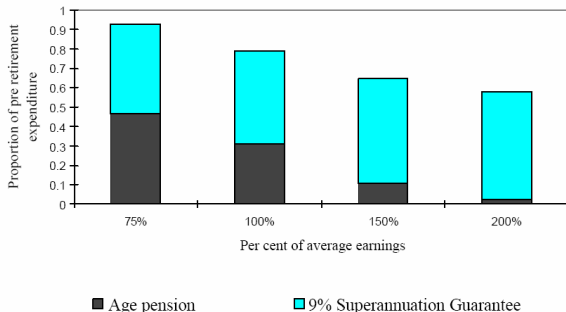
The Incomes of Future Retirees

Table 4. Households Where Head is Aged 55-64 Years
Characteristics by Income Quintile

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

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 \Rightarrow 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