Name & Topic

Laura Bielinko, Topic 1: Superannuation

In light of the FSI report and the maturing superannuation system in Australia,
a. What criteria should be used to judge the success of Australia's retirement system?
b. What changes should be made to meet these criteria over the next 20 years?

Abstract

This paper outlines my recommendation to provide more adequate retirement incomes to Australians by implementing a five percent increase in age pension for every year Australians continue working and contributing to their superannuation beyond the age pension age without accessing the age pension.

Executive Summary

The primary objective of Australia's retirement system should be to provide an adequate retirement income to Australians while balancing equity and fiscal sustainability to ensure our retirement system is sustainable for future generations. Success should be assessed using three criteria:

- Reducing **old-age poverty** should be considered to ensure Australians over 65 can meet their basic needs. Individuals who have less than 50-60% of the median income of $50,000 p.a. for the overall population are considered to be living in poverty (ACOSS, 2014). Australia currently has 36% of Australians over 65 living in poverty[i]. This is significantly higher than the OECD average of 13% (OECD, 2013) and should be reduced.
- Achieving a target **gross replacement rate** of 60% (ASFA Research Centre, 1999) to 70% (OECD, 2009) of pre-retirement income should be used to assess adequacy for the average earner. The current level for an average Australian is 52%, slightly below the OECD average of 54%.
- Maintaining **fiscal sustainability** should be assessed by looking at the impact to the budget and GDP. Australia's current and 2050 forecasted level of age pensions as a percentage of GDP are 2.9% and 3.6% respectively (Treasury, 2015). This is low compared to international standards (OECD, 2013). However, increases in this ratio need to be managed carefully in the context of the government's current level of debt and its longer term fiscal strategy to achieve budget surpluses.

Encouraging Australians to delay retirement is one of the most powerful levers we can focus on to improve both adequacy and fiscal sustainability. However, recommendations to increase the age pension age to 70 and change access to superannuation can undermine confidence in the system. Recent research from FSC-CBA Older Workers Report 2015 highlights that older Australians are willing to work for longer and barriers are reducing. We can capitalise on this by encouraging this behaviour and more equitably sharing the benefits of delayed retirement between individuals and the government.

My recommendation is to provide a five percent increase in age pension for every year Australians continue working and contributing to their superannuation beyond the age pension age without accessing the age pension. The factor of five percent is set to spread each forgone year of age pension over the average remaining life span of approximately 20 years. Similar global schemes range from 2% to 12% (OECD, 2013). My proposed scheme would appeal to those who will access the age pension at some point in their retirement, are willing and able to work past the age pension age, and would like to use income from wages as their primary source of income during this time. It is complementary to the existing work bonus. Previous challenges of the Pension Bonus scheme could be overcome by: providing a greater incentive for individuals[ii]; ensuring greater awareness; and leveraging existing mechanisms within our tax system and superannuation schemes to ensure it is integrated into the system without requiring pre-registration.

To assess this recommendation against old-age poverty, let's first consider a single Australian who is currently aged 56 with a wage of $40,000 and relies on the full age pension in retirement. We will assume a person in this situation has superannuation and other assets of $55,000. A level of $105,000 can be used to represent the case when the superannuation system is more mature. The table below shows how my recommendation would provide a way for these people to increase their retirement income to over 60% of the median wage, hence lifting them out of poverty.

Criteria 1: Old-age poverty[iii] Retirement income vs. median income **Target:** above poverty line of 60%	**Super and other assets** $55K	 $105K
Retire at 67	53%	57%
Delay retirement to 70	55%	61%
Delay retirement to 70, with proposed rules	63%	68%

To assess this recommendation against gross replacement rates, we will consider an average income earner who is currently aged 56 with a wage of $80,000 at the average superannuation balance today and in 2050. The table below shows how my recommendation would provide a mechanism for these people to increase their replacement rate to 60-70% of pre-retirement income.

Criteria 2: Gross replacement rate Retirement income vs. pre-retirement wage **Target:** 60-70%	**Super and other assets** $155K	 $300K
Retire at 67	51%	57%
Delay retirement to 70	55%	60%
Delay retirement to 70, with proposed rules	61%	65%

In terms of fiscal sustainability, my recommendation would deliver a 7 basis point reduction in spending as a percent of GDP assuming a 5% higher participation rate for people aged 70-79 once the system is mature. Up to 18 basis points is possible if we achieved a 10% increase in participation, in line with U.S. experience of 28% (IRI, 2015) of people expecting to work past 70 compared to 17% (ABS, 2013) in Australia.

Criteria 3: Fiscal sustainability[iv] Budget impact as a % of GDP in 2051 **Target:** Neutral or positive position	**Additional people 70-79 who delay retirement** 2%	 3.5%	 5%	 10%
Tax contributions ($BN)	1.2	2.1	3.0	6.1
Additional age pension paid ($BN)	2.0	2.0	2.0	2.0
GDP increase (from higher participation)	0.5%	0.9%	1.3%	2.6%
Net budget impact as a % of GDP	3.60%	3.57%	3.53%	3.42%

My recommendation can enhance the three criteria for a successful retirement system:

- It provides a way for low income earners to lift themselves out of old-age poverty
- It can improve gross replacement ratios for the average Australian
- It balances these against fiscal sustainability and delivers benefits for the budget

References

ACOSS, 2014, *Poverty in Australia*, accessed via acoss.org.au

OECD, 2013, *Pensions at a Glance 2013: OECD and G20 Indicators*, accessed via oecd-ilibrary.org or compareyourcountry.org/pensions

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OECD (2009), *OECD Private Pensions Outlook 2008*, accessed via oecd.org/daf/pensions/outlook

Department of the Treasury (Australia), March 2015, *2015 Intergenerational Report Australia in 2055*, accessed via treasury.gov.au

FSC and CBA, 2015, *Older Workers Report: Results of the National Survey on Attitudes to Older Workers*, accessed via fsc.org.au

Australian Bureau of Statistics, 2013, *Retirement and Retirement Intensions Australia July 2012 to June 2013*, accessed via ausstats.abs.gov.au

Insured Retirement Institute (IRI), 2015, *Boomer Expectations for Retirement 2015*, accessed via myirionline.org

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[i] 36% is in line with the proportion of people in poverty quoted by OECD based on 50% of the median income but is in line with the 60% of median income benchmark from ACOSS. According to the Australian Council of Social Service (ACOSS, 2014), 50% of median income is used by the OECD and equates to a very austere living standard: a disposable income of less than $400 per week for a single adult. The poverty line set at 60% of median income is widely used in Britain, Ireland and the European Union. Given the significant proportion of retirees who are sitting around the line of 50-60% of median income, I recommend considering both a 50% and 60% poverty line.

[ii] Comparison of the PV of age pension bonus available at retirement from the former Pension Bonus Scheme and my proposed scheme for a single male, assuming the maximum rate of age pension is payable when claiming the age pension:

Number of years	Former Pension Bonus Scheme	Proposed Scheme
1 year	$1,966	$20,280
2 years	$7,865	$38,326
3 years	$17,696	$54,158
4 years	$31,459	$67,803
5 years	$49,155	$79,745

Note: The proposed scheme has higher payments for the average female due to longer life expectancy

[iii] Calculation assumptions for old-age poverty and replacement rates

- Real asset returns 4%, sourced by comparing the average 10 year superannuation fund return for large funds of 6% from APRA compared to CPI from ABS
- Real wage and pension increase 0.9%, sourced by comparing CPI and wage indexes over the last 3 years from ABS
- Age pension payments and eligibility requirements were sourced from www.humanservices.gov.au
- Marginal tax rates were sourced from www.ato.gov.au
- Superannuation balances from ABS and http://www.pc.gov.au/research/completed/superannuation-post-retirement/super-post-retirement-volume1.pdf

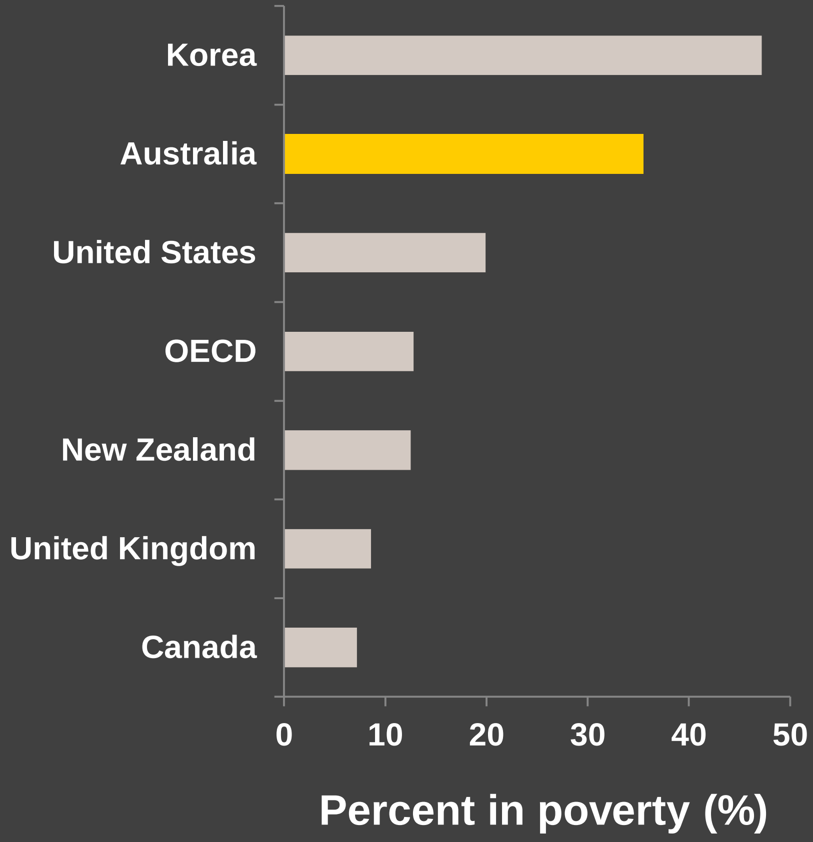
- Average and median salaries were sourced from ABS
- Survival probabilities were used from the Australian Government Actuary Life Tables, averaging the PV results for a male and female
- Each individual aims to match a steady post-retirement income

[iv] Calculation assumptions for fiscal sustainability:

- Assume that initiative is implemented in the next 2-5 years so it is mature by 2051
- Tax contributions calculated as 3.5mil people aged 70-79 in 2051 (Treasury, 2015) multiplied by proportion of people who delay retirement, average salary and 20% tax rate
- Additional age pension paid is calculated assuming that people on the age pension are currently half as likely as the average to delay retirement past 70, multiplied by average pension rate, assumed to be increased by an average of 15%
- GDP increase scaled from Treasury 2015 calculations that a 0.8% increase in participation rate results in a 1.5% increase in GDP
- Net budget impact as a % of GDP is calculated as age pension spending plus additional age pension payments minus tax contributions divided by GDP

Rewarding older workers

Old-age poverty



Criteria for success

1. **Reduce old-age poverty**
2. **Target gross replacement rate of 60-70%**
3. **Fiscal sustainability**

My recommendation

5% increase in age pension for every year retirement is delayed

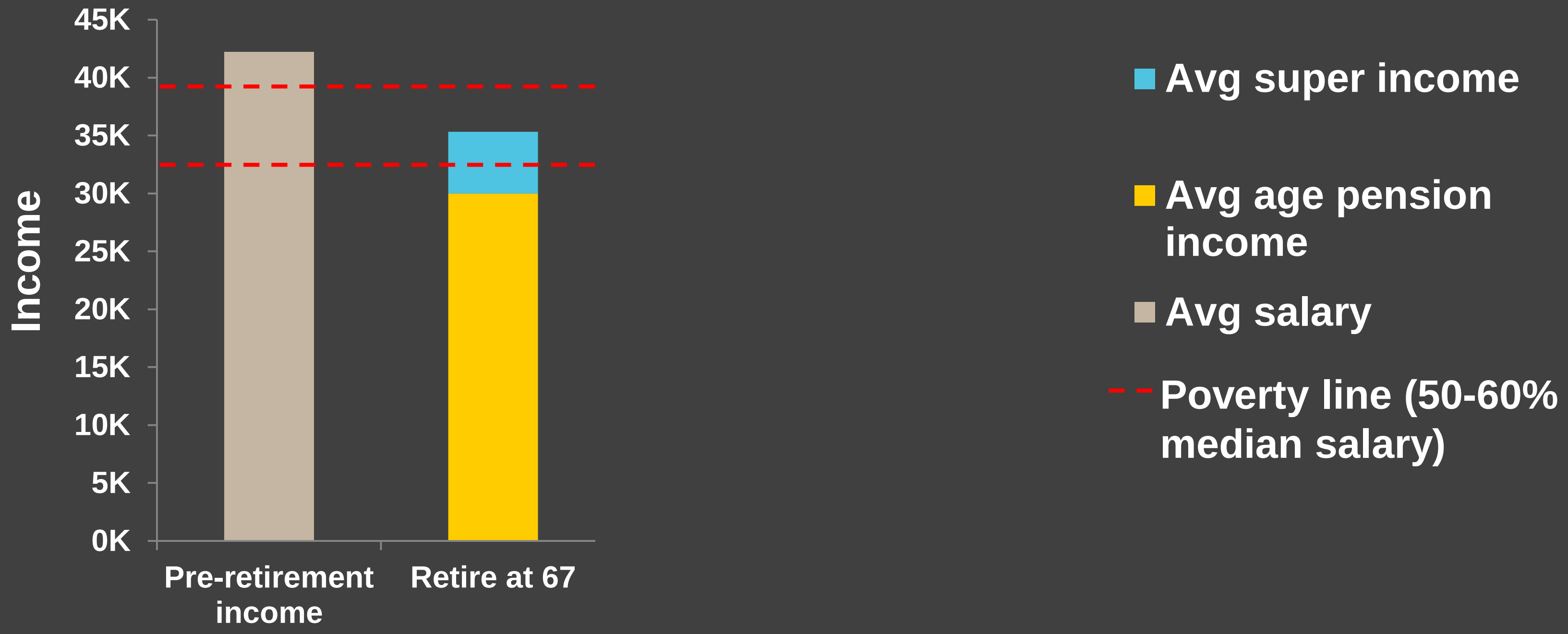
Requirement

1. Continue working and contributing to superannuation beyond the age pension age

2. Do not access the age pension

Criteria 1: Reduce old-age poverty

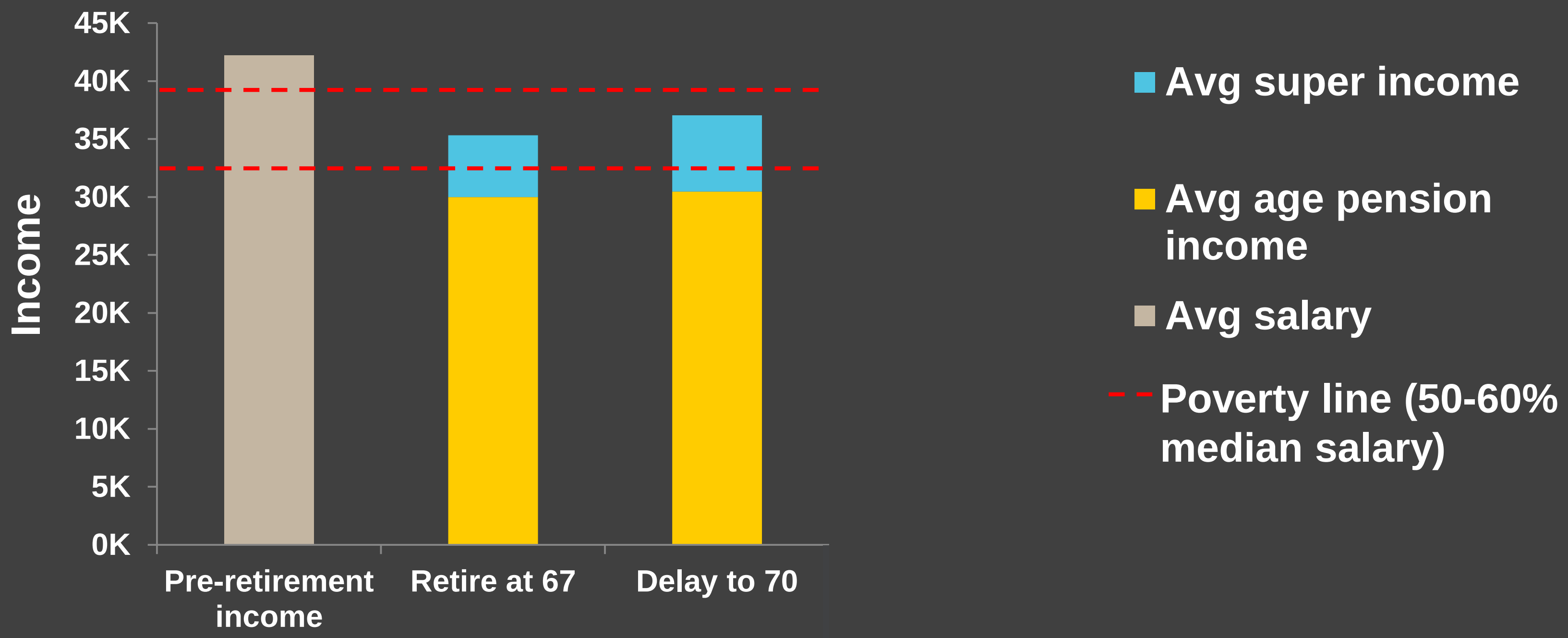
Assumptions: Age 56, $40K salary, $55K super/assets



% of median salary **53%**

Criteria 1: Reduce old-age poverty

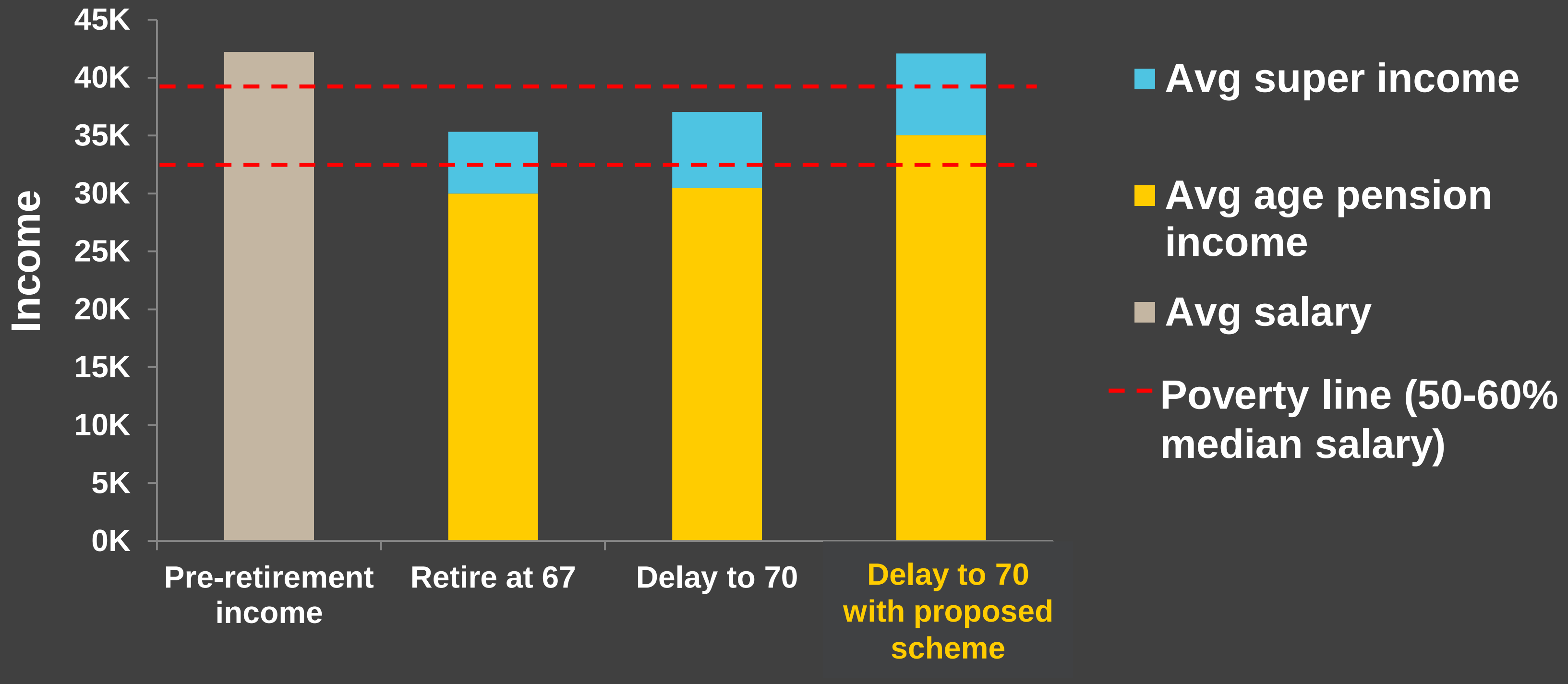
Assumptions: Age 56, $40K salary, $55K super/assets



% of median salary 53% 55%

Criteria 1: Reduce old-age poverty

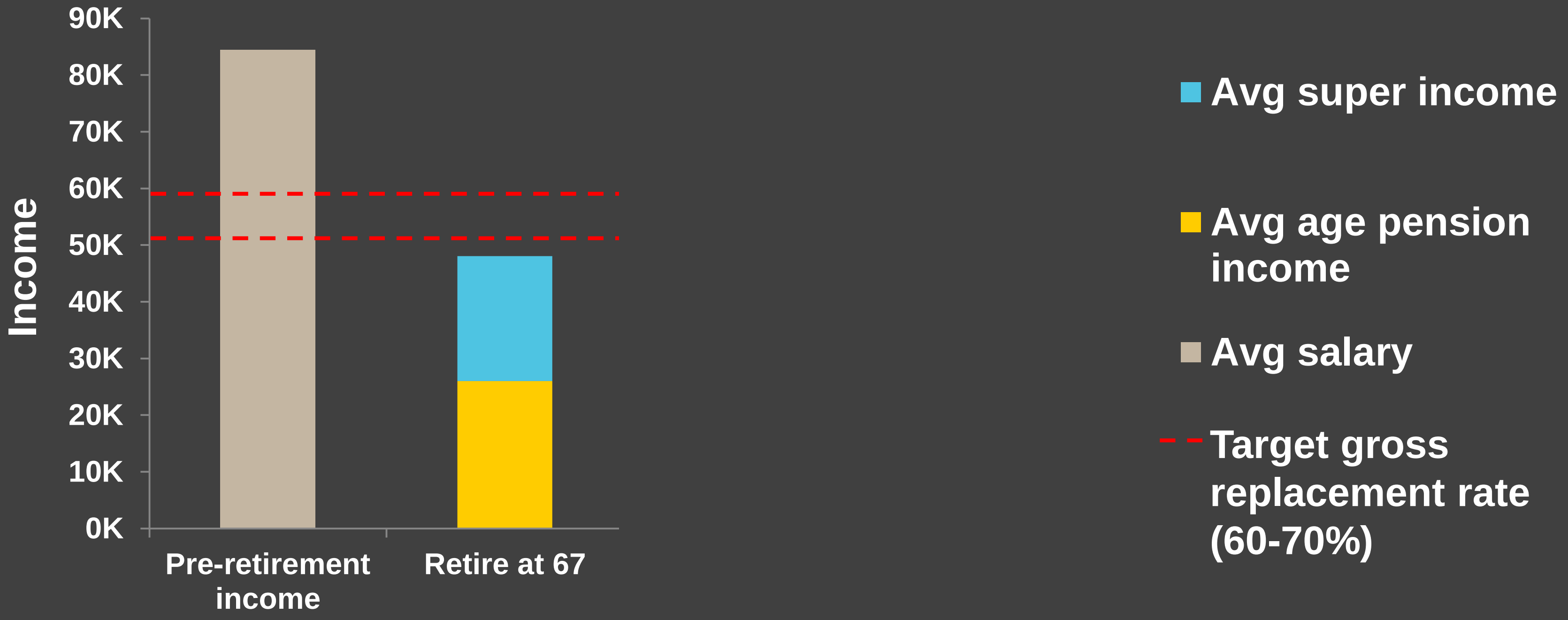
Assumptions: Age 56, $40K salary, $55K super/assets



% of median salary	53%	55%	63%

Criteria 2: Target gross replacement rate

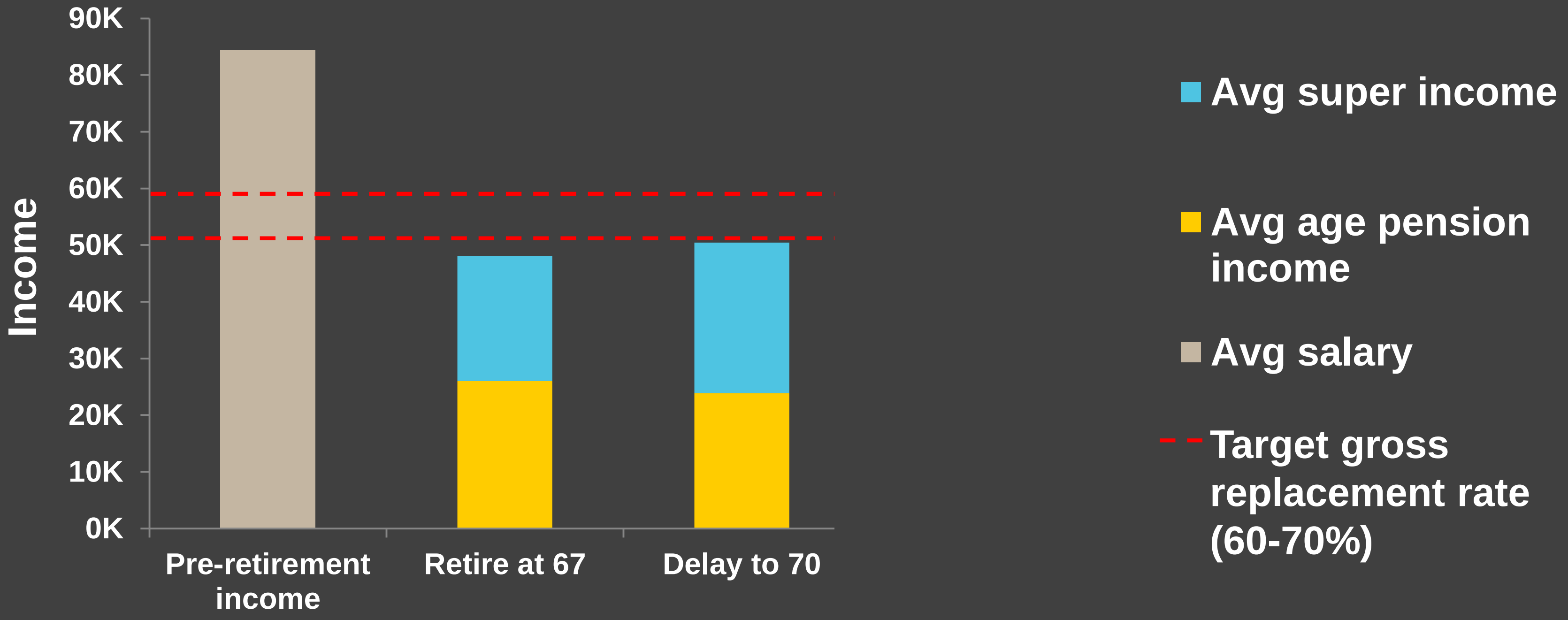
Assumptions: Age 56, $80K salary, $155K super/assets



Replacement rate 57%

Criteria 2: Target gross replacement rate

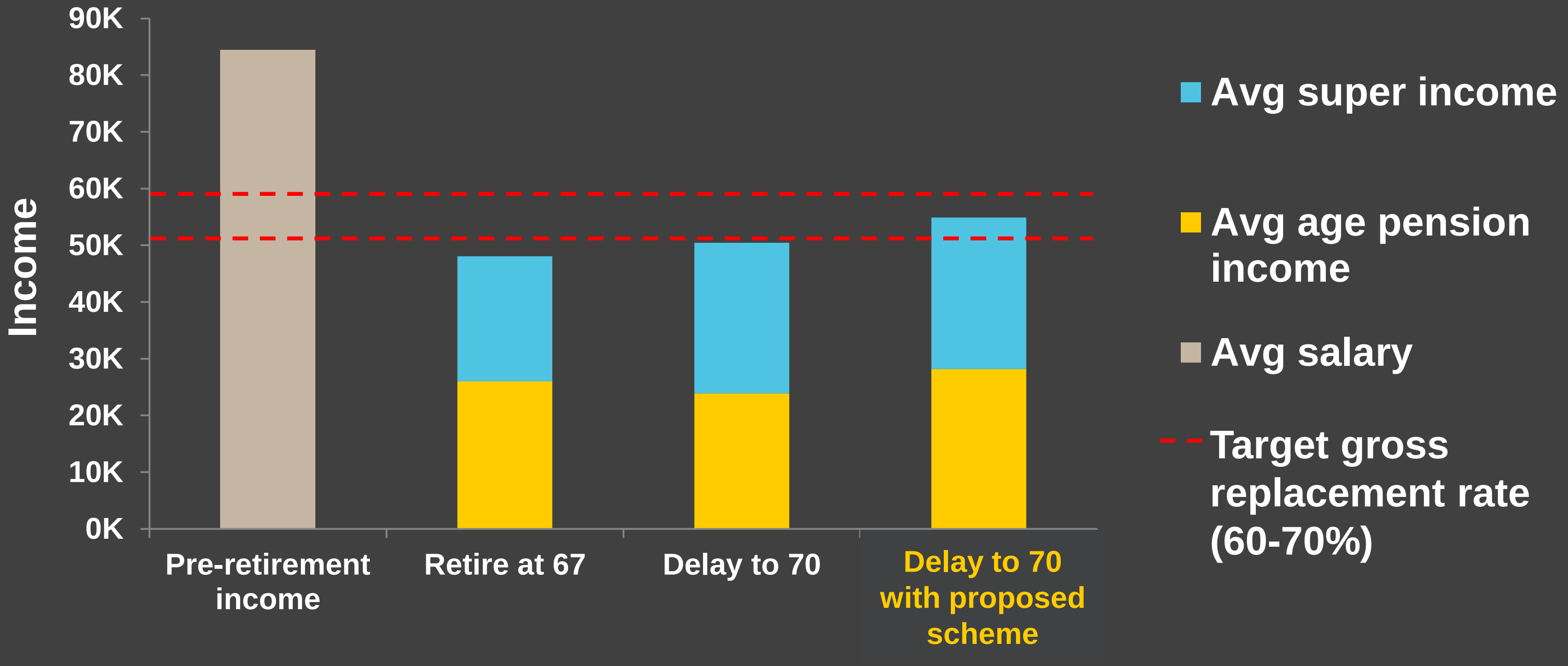
Assumptions: Age 56, $80K salary, $155K super/assets



Replacement rate	57%	60%

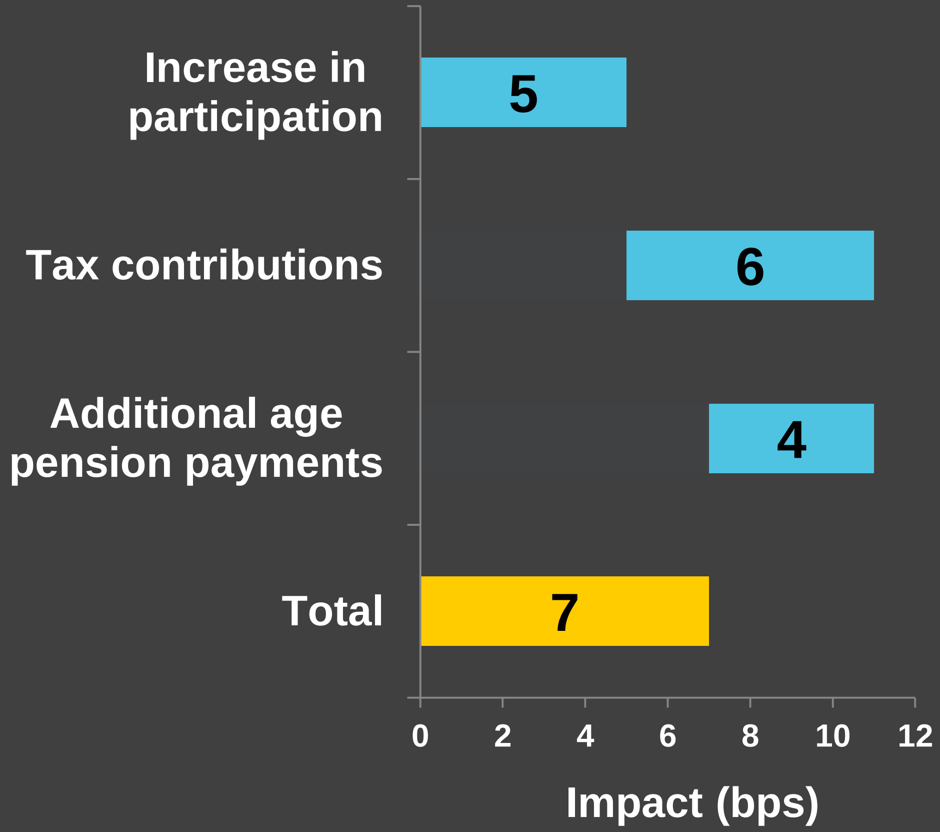
Criteria 2: Target gross replacement rate

Assumptions: Age 56, $80K salary, $155K super/assets



Replacement rate **57%** **60%** **65%**

Criteria 3: Fiscal sustainability



Sensitivity analysis

Additional people 70-79 who delay retirement	Impact (bps)
2%	0
3.5%	3
5%	7
10%	18

Evaluation

1

Reduce old-age poverty

✓

2

Target gross replacement rate of 60-70%

✓

3

Fiscal sustainability

✓