Australia's super system stacks up well internationally

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OECD findings on the cost, adequacy and equity of government assistance for private pensions (superannuation)

This paper sets out a number of observations and findings from the fourth edition of the OECD Pension Outlook, published in December 2018, that are directly relevant to Australia.

The OECD Pensions Outlook publication[1] provides an analysis of different pension policy issues in OECD countries covering both public and private pension systems. The fourth edition of this publication provides a broad range of data for pension funds across the range of OECD countries. It also discusses policy options to help governments ensure that people will get the most out of the public and private pension (superannuation) systems. The charts and tables included in this paper are drawn directly from the OECD statistical database.

Findings relevant to Australia

While some less informed critics of the Australian system claim that government assistance for superannuation is not equitable or fiscally sustainable, the OECD analysis suggests otherwise. It indicates that tax assistance for superannuation in Australia is broadly equitable across a range of income levels and that the aggregate cost of such assistance is a relatively small and stable proportion of GDP.

The Australian system also meets the core design principles for a retirement income system suggested by the OECD, namely a robust safety net for pensioners, as well as a diversified and balanced pension system that incorporates a funded component.

Where Australia does not come out so well in terms of international comparisons is adequacy of retirement incomes. The OECD publication notes that to ensure higher retirement income, people need to increase:

- their retirement savings
- their pension contributions, and/or
- the length of their contribution period.

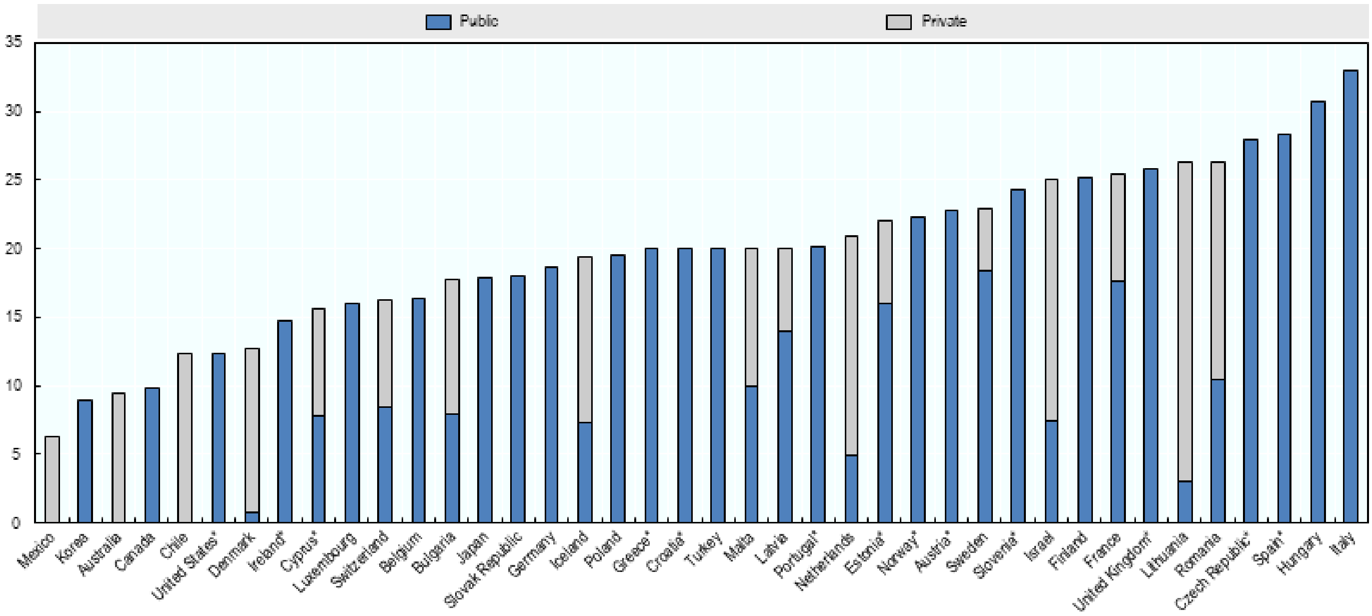
The OECD publication also supports tax rules being straightforward, stable and consistent.

[1] *OECD (2018), OECD Pensions Outlook 2018, OECD Publishing, Paris, https://doi.org/10.1787/pens_outlook-2018-en*

Contribution rates for retirement saving are relatively low in Australia

The Productivity Commission has suggested that there be a review before the currently legislated staged increase in compulsory superannuation contributions occurs.

As shown in Chart 1 below, the OECD analysis indicates that Australia has one of the lowest mandatory contribution rates for pensions in the world, although in some other countries social security contributions also fund other types of benefits.



Source: OECD Pensions Outlook 2018, page 20, http://dx.doi.org/10.1787/888933850070

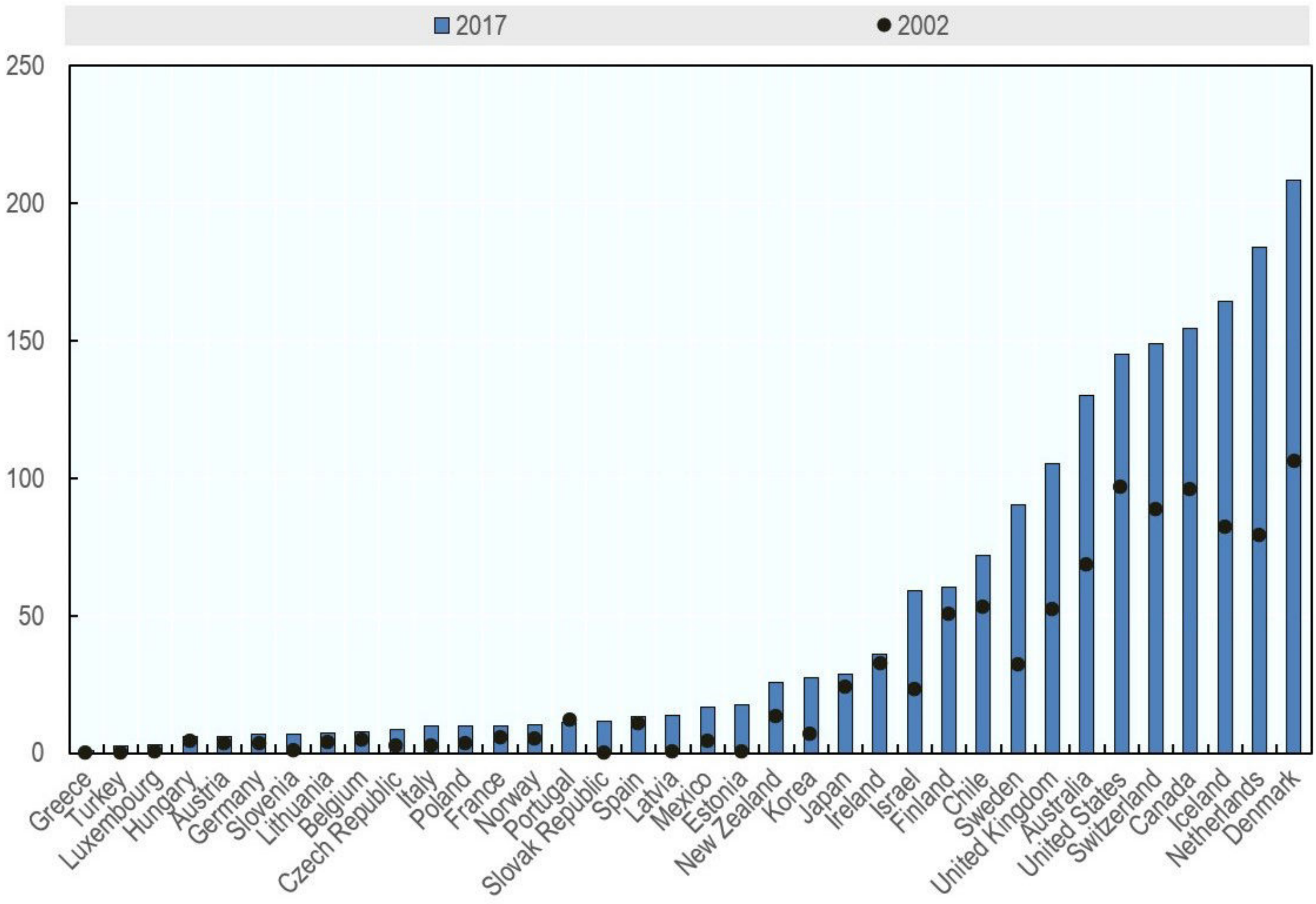
Private pension (superannuation) assets are large in Australia relative to GDP and growing strongly

Chart 2 shows that contribution rates are relatively modest compared to other countries.

In 2017, Australia ranked number 7 amongst OECD members in terms of private pension assets as a proportion of GDP. In absolute dollar terms Australia ranks higher than that given our economy is larger than those of Switzerland, Iceland, Denmark and the Netherlands.

This reflects that contributions are invested rather than used to help with pay as you go funding requirements, and investment earnings have been strong.

Chart 2: Total assets in funded and private pension arrangements as a percentage of GDP, in 2002 and 2017



Source: OECD Pensions Outlook 2018, page 21, http://dx.doi.org/10.1787/888933850089

Tax treatment of superannuation is broadly equitable across a range of income levels

The OECD publication also provides an estimate of the tax advantage provided to individuals by tax arrangements applying to private pensions. They calculate this by estimating the present value of taxes saved over a lifetime due to the tax treatment of private pensions expressed as a percentage of the present value of contributions. This calculation allows comparisons to be made across countries with differing personal income tax rates.

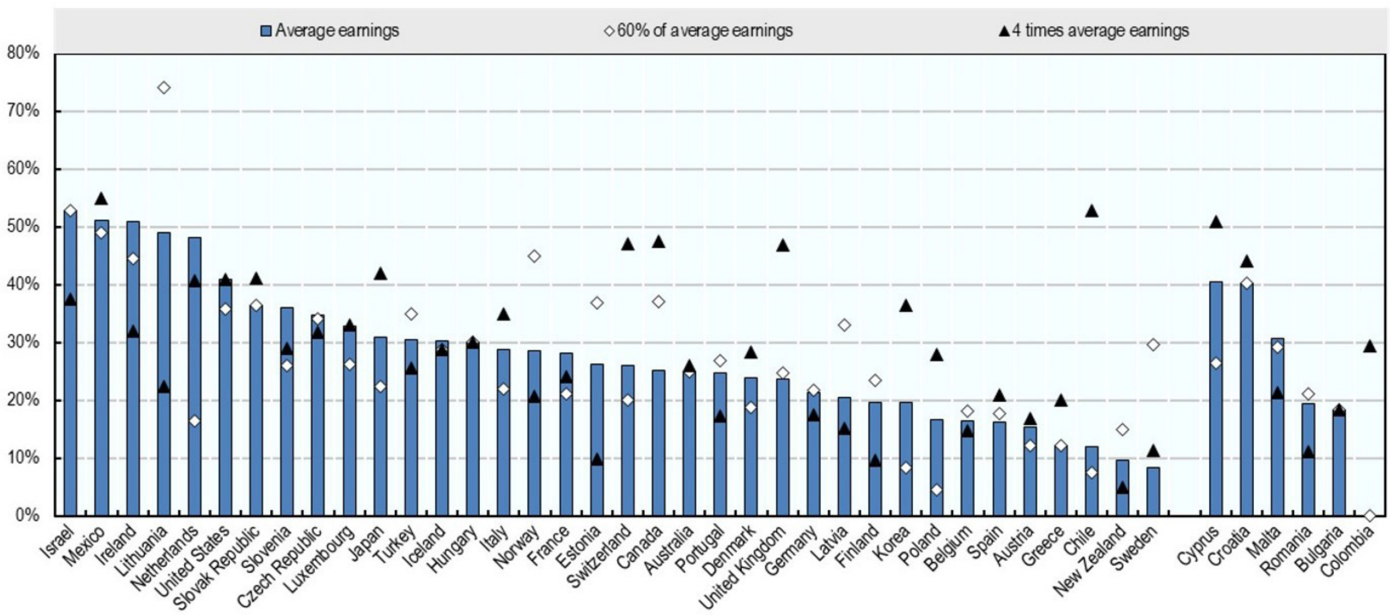
Chart 3 below shows that, in some countries, high-income earners (earning four times average earnings) benefit from a higher overall tax advantage than average earners and low-income earners (earning 60 per cent of average earnings). This is the case in Canada, Chile, Denmark, Italy, Japan, Poland, Switzerland and the United Kingdom (black triangles are on top). Low-income earners receive higher financial incentives in Estonia, Ireland, Latvia, Lithuania, New Zealand, Norway and Turkey (white diamonds are on top). These countries offer fixed nominal subsidies (e.g. Lithuania, Turkey) or matching contributions with a low maximum entitlement (e.g. New Zealand). This type of incentive is found to be more valuable to low-income earners because the payment represents a larger share of their income. Other countries provide the largest tax advantage to average earners. These include France, Iceland, the Netherlands and Slovenia (blue bars are higher than the other symbols).

As the chart shows, Australia sits in the middle of the pack with tax assistance of around 25 per cent of the value of contributions made.

Unlike most other countries, the percentage of tax assistance is the same for those on four times average earnings as it is for those on 60 per cent of average earnings. The various measures that limit the tax advantage accruing to upper income earners (contribution caps, Division 293 taxation on contributions of upper income earners) together with the Low Income Superannuation Tax Offset have been very effective in bringing about, what is in effect, flat taxation rates for superannuation. **The analysis indicates that the taxation of superannuation in Australia does not unduly favour upper income earners.** There are many other OECD countries which provide greater relative assistance to upper income earners.

Redistribution and more general vertical equity goals in Australia are pursued effectively through a personal tax system with progressive tax rates, and also through a flat rate and means tested Age Pension system.

Chart 3: Overall tax advantage provided to individuals in OECD and selected non-OECD countries, by income level (a)

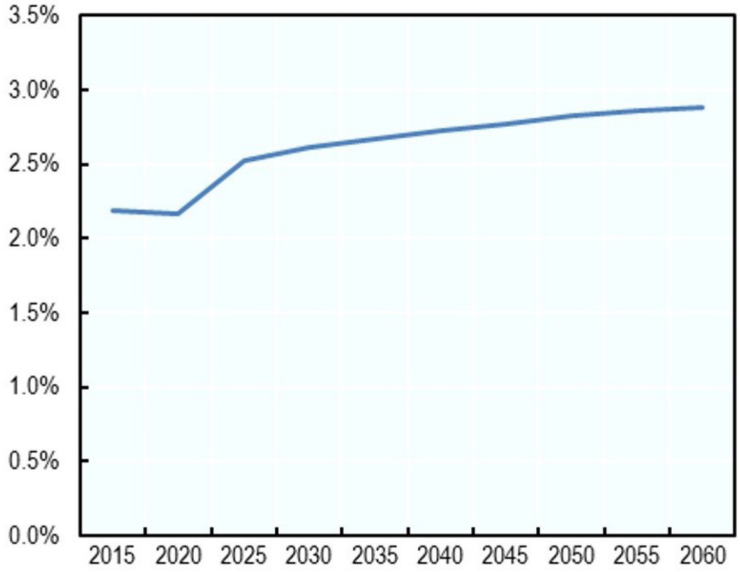


Source: OECD Pensions Outlook 2018, page 51, http://dx.doi.org/10.1787/888933850146
(a) Present value of taxes saved over a lifetime, as a percentage of the present value of contributions. Calculations based on the 2018 tax treatment of the main pension plan in each country

The budget cost of taxation incentives for superannuation and direct payments to retirees

The OECD publication also projects the cost to the government budget of financial incentives to promote retirement savings. Australia has a large and growing pool of retirement savings relative to GDP. Nevertheless, the cost to the budget of these tax concessions is projected to grow relatively slowly and to stay below 3 per cent of GDP. The increase after 2020 reflects the scheduled increase in the rate of the Superannuation Guarantee.

Chart 4: Projected fiscal cost of financial incentives to promote retirement savings as percentage of GDP, Australia



Source: OECD Pensions Outlook 2018, page 58

The overall cost to the budget of government assistance to retirement incomes is relatively low in Australia. This is due to the fact that the Age Pension is flat rate and means tested. Rising superannuation balances will also help contain future Age Pension expenditures. Without superannuation, Age Pension expenditures could be one percentage point of GDP or even higher.

As shown by Table 1, the cost of the Age Pension is projected to remain well below 4 per cent of GDP. Even if the cost of tax assistance for superannuation is added to this the overall cost to the budget for assistance for retirement incomes at less than 6 per cent of GDP (based on updated figures for the cost of the Age Pension) is well below government expenditure on direct payments to retirees in other countries.

For instance, by 2060 direct payments to retirees are projected to be more than 12 per cent of GDP in France and Germany and more than 8 per cent of GDP in the United Kingdom. The overall average figure for OECD countries is 10.9 per cent of GDP.

Government assistance in Australia for retirement incomes is both equitable and fiscally sustainable, unlike a substantial number of other OECD countries.

Table 1: Projections of public expenditure on pensions, 2013-60

	2013-2015	2020	2025	2030	2035	2040	2045	2050	2055	2060
OECD members										
Australia	4.0								3.7	
Austria	13.9	13.9	14.1	14.4	14.7	14.7	14.7	14.6	14.6	14.4
Belgium	11.8	11.8		12.3		13.0		12.9		13.0
Canada	5.5							6.9		
Chile	5.1							4.2		
Czech Republic	9.0	9.0	9.1	9.0	8.8	9.0	9.3	9.6	9.8	9.7
Denmark	10.3	8.7	8.4	8.3	8.2	8.0	7.7	7.5	7.3	7.2
Estonia	7.6	7.6	7.3	7.1	7.0	6.9	6.8	6.7	6.6	6.3
Finland	12.9	14.2	14.9	15.0	14.4	13.6	13.0	12.8	12.8	12.9
France	14.9	14.6	14.9	14.7	14.2	13.8	13.3	12.8	12.3	12.1
Germany	10.0	10.3	10.9	11.6	12.1	12.2	12.3	12.5	12.6	12.7
Greece	16.2	15.5	15.0	14.4	14.1	14.1	14.1	14.4	14.2	14.3
Hungary	11.5	9.8	9.3	8.9	9.1	9.6	10.4	10.7	11.0	11.4
Iceland	3.3							3.5		
Ireland	7.4	8.0	8.7	9.1	9.6	10.0	10.2	10.0	9.3	8.4
Israel	5.3							6.2		
Italy	15.7	15.3	15.5	15.7	15.8	15.8	15.5	14.8	14.2	13.8
Japan	10.2							9.5		
Korea	2.6							6.3		
Latvia	7.7	5.9	5.5	5.5	5.5	5.4	5.3	5.2	5.0	4.6
Luxembourg	9.4	10.6	11.2	11.9	12.4	12.7	12.7	12.5	12.4	13.4
Mexico	1.8							3.0		
Netherlands	6.9	7.1	7.4	7.7	8.1	8.3	8.3	8.1	7.9	7.8
New Zealand	4.7							7.2		
Norway	9.9	10.7	11.1	11.3	11.4	11.4	11.4	11.6	11.9	12.4
Poland	11.3	10.6	10.5	10.4	10.1	10.0	10.1	10.4	10.7	10.7
Portugal	13.8	14.6	14.9	15.0	15.0	14.8	14.6	14.4	13.8	13.1
Slovak Republic	8.1	8.0	7.9	7.6	7.7	8.1	8.6	9.1	9.7	10.2
Slovenia	11.8	11.1	11.4	12.3	13.3	14.3	15.1	15.6	15.6	15.3
Spain	11.8	11.8	11.4	11.2	11.5	11.9	12.5	12.3	11.4	11.0
Sweden	8.9	8.3	8.1	7.9	7.8	7.5	7.3	7.2	7.4	7.5
Switzerland	9.8							10.7		
Turkey	7.2							5.6		
United Kingdom	7.7	7.4	7.8	7.9	8.2	8.4	8.1	8.1	8.3	8.4
United States	4.9							5.9		
OECD	**8.9**							**9.5**		**10.9**

Source: OECD Pensions at a Glance, 2017, page 147, http://dx.doi.org/10.1787/888933634610

The Australian retirement income system meets a number of objectives set by the OECD

The OECD publication summarises the various objectives of pension systems, how different pension designs can help to achieve them, and the risks to which these designs are vulnerable. It notes that there are trade-offs involved in determining priorities and allocating responsibilities for pension provision, giving rise to a number of policy implications.

The design of the Australian system is consistent, as are foreshadowed changes, with the following findings on what is good design for retirement income systems, as outlined on page 37 of the OECD publication.

- Non-contributory public pensions are the most efficient vehicle for achieving the objective of poverty relief; they also contribute to goals of equity and redistribution with only a limited negative effect on labour market participation.
- Introducing a funded pension arrangement is intended to make pension systems more sustainable and to improve consumption smoothing.
- Higher retirement income may require higher savings, contributions, and longer contribution periods, especially in a context of low returns, low growth and improvements in mortality and life expectancy.
- A pension system that includes both PAYG and funded arrangements is better able to achieve its various objectives and more resilient to the multiple risks to old-age financial security.
- Defined contribution (DC) pension arrangements are more sustainable than defined benefit pension arrangements because DC pensions adjust automatically to any changes in the parameters (e.g. contributions, returns, longevity).