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ASFA Research and Resource Centre

The Age Pension, superannuation and Australian retirement incomes

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Executive Summary

A major focus of this paper is on the role of both the Age Pension and the superannuation system in the provision of retirement income relative to the poverty line.

As noted in recent World Bank criteria for assessing the appropriateness of a nation's retirement income system, an adequate system should provide benefits to the full breadth of the population sufficient to prevent old age poverty.

The Age Pension currently provides the foundation for Australia's retirement income system and this is likely to continue for many years into the future. It forms a key part of the so-called 'three pillar' model for provision of retirement income.

POVERTY AMONGST THE AGED IN AUSTRALIA

While poverty is both an absolute and relative concept varying both over time and between countries, contemporary poverty for the aged in a developed country such as Australia usually has more to do with drabness of life and social isolation than homelessness or starvation.

Poverty can be measured using a variety of benchmarks. These include measuring the level of income or expenditure relative to benchmarks for general community living standards. This concept of poverty is one of relative socio-economic disadvantage, with the poverty threshold a function of the distribution of income in the community.

Usually the benchmark adopted is that poverty exists when income is below 50 per cent of the median income of the country concerned (median income is the income level at which half the population have an income above that level, and half below). In addition to this median income benchmark, Australia also makes use of what is known as the Henderson poverty line which had its genesis in academic research and which has been updated on a regular basis.

THE AGE PENSION RELATIVE TO THE POVERTY LINE

In setting the level of the Age Pension, governments in Australia have always taken into account the absolute needs of the aged, particularly in terms of what is needed to avoid the incidence of poverty.

In the June quarter 2008, the updated Henderson poverty measure provided a poverty line of $436.80 per week for a pensioner couple. This compared to Age Pension payments (including rent allowance of $50.50 per week) of $507.30. For a single Age Pensioner, the poverty line was $308.35 a week compared to the basic Age Pension of $273.40 a week plus rent allowance of $53.60 for those eligible.

Accordingly, the Henderson poverty line suggests a pensioner couple without other income is just above the poverty line, while for a single person the situation is more problematic depending on housing costs and receipt of rent assistance. Accordingly a retiree can move from just over the poverty line to being below it if their partner dies.

Comparisons of the Age Pension with the often used poverty benchmark of 50 per cent of median income present a similar picture. As the median income lies substantially below average male weekly earnings, an Age Pension based on 25 per cent of average male earnings just exceeds this poverty benchmark. Depending on the data source, date of the study and the methodology used, estimates of the incidence of poverty amongst those aged 65 and over range from 5 per cent upwards.

ADEQUACY OF THE AGE PENSION

Social justice and political reality require the Age Pension to be set at a level that alleviates poverty amongst the aged. Essentially it is a value judgment as to whether the current maximum rate for the Age Pension is set at the correct level. Questions of government budget affordability are also involved.

Although it prevents outright poverty for the vast bulk of retirees, the Age Pension provides a retirement lifestyle that is considerably more modest than that to which most Australians currently in employment would reasonably aspire.

However, increasing the base amount of the Age Pension and/or abolishing the means test for its receipt would involve considerable additional Commonwealth expenditures and would have flow-on effects for other social security payments. For instance, a 10 per cent increase in the Age Pension would cost at least $2.5 billion a year. Abolishing the means test would cost in excess of $6.5 billion a year.

QUALIFYING FOR THE AGE PENSION

Current research indicates a very substantial proportion of new retirees have very little in the way of assets outside their home. Although average retirement savings are increasing with the maturing of the compulsory superannuation system, the absolute level of assets remains very modest for many retirees.

Relatively few (less than 10 per cent) of the 2.9 million or so Australians currently aged 65 and over have a substantial private or taxable income. For instance, there were approximately 160,000 individuals in that age group with a taxable income of $50,000 and over in 2005-06, with a further 70,000 individuals with taxable income between $40,000 and $50,000.

DEVELOPMENTS IN THE MEANS TEST

The basic structure of the Age Pension as a means tested flat rate benefit has remained largely unchanged over its history, although numerous modifications have been made to the rules.

For much of the history of the Age Pension, the means test has provided significant disincentives for self provision. Over certain ranges of assessable assets, the asset test applying prior to 20 September 2007 effectively removed the benefit of increased private retirement savings, as any additional retirement income from higher private savings was totally offset by a decline in the amount of Age Pension received. As a result various strategies were developed to get around this.

However, the post 20 September 2007 rules, introduced as part of the Simplified Superannuation package, provide a more equitable approach.

Single homeowners as a result were able to have as much as $529,250 in assessable assets and still receive some Age Pension, while for a couple the figure was $839,500 (these amounts are subject to ongoing indexation).

While these changes have removed the need for retirees to take out non-commutable income streams in order to avoid the onerous impact of the assets test, they still disqualify relatively wealthy persons from receiving the Age Pension.

The changes have had the largest financial impact on single retirees with between $200,000 and $300,000 in assets and couples with $300,000 and $500,000 in assets. Couples have benefited by up to $11,000 per year, with around 220,000 individuals receiving some increase in Age Pension or qualifying for the first time. Most of the beneficiaries have been existing part rate pensioners.

SUSTAINABILITY OF THE AGE PENSION

Despite Australia's ageing population profile, the current Age Pension system will remain affordable well into the future. Accordingly, government policies relating to superannuation are more focused on improving retirement incomes than on restraining aggregate government expenditures on the Age Pension.

Authoritative projections of future Age Pension expenditures indicate public support for the aged can be maintained at current real levels without undue pressures on aggregate Commonwealth budget expenditures. The aggregate cost of income support payments to the aged in Australia was 2.5 per cent of GDP in 2006-07 and this figure is very modest by international standards. Even with the forecast rise in aggregate cost to 4.4 per cent of GDP by 2046-47, there will be no need to curtail the current level of availability of the Age Pension due to expenditure considerations.

In addition, there appears to be broad political and community support for a means tested Age Pension to continue indefinitely. Increasing the eligibility age for the Age Pension would lead to some decrease in government costs. It would also lead to higher living standards for at least a proportion of those aged 65 and over, albeit at the cost of some retirement leisure. That said, there are other options that could be effective in lifting retirement living standards and limiting government costs. These options could be pursued in addition to increasing the Age Pension eligibility age, or instead of doing that. Suggestions that that there is a potential case to increase to increase the eligibility age have not received significant community or political support in Australia.

RETIREMENT INCOME BUDGET FRAMEWORKS

While the Age Pension will remain the foundation of Australia's retirement income system into the future, it only provides basic income support at a level just slightly above the generally accepted benchmarks for measuring poverty. This is considerably less than the retirement aspirations of most Australians.

Alternative budgetary frameworks for retirement provide an insight into potential retirement living standards other than the Age Pension and which are further removed from the poverty line.

These benchmarks have been used to develop The Westpac ASFA Retirement Standard, which provides an indication of both a 'modest' and a 'comfortable' budget for retirees. The standard indicates that as at September 2008 a budget of around $50,560 per year is required to support a 'comfortable' lifestyle in retirement for a couple, while around $37,800 per year is required for a single person.

In this paper a 'low cost budget' for retirees is also prepared for the first time. The full Age Pension as at 20 September 2008 was $14,655 for a single person and $24,481 for a couple (combined). This falls somewhat short of the $19,617 for a single person and $27,454 for a couple needed at that time for a 'modest' lifestyle in retirement.

While providing an income sufficient for a 'low cost' retirement lifestyle for a couple, the Age Pension currently falls short by $460 per year from the $15,080 for a single homeowner for a 'low cost' standard of living in retirement. The adequacy of the current level of the Age Pension for both single persons and couples is currently the subject of a review initiated by the Government.

While the 'low cost' budget is just consistent with the avoidance of outright poverty, it falls short of what most individuals who are not yet retired would regard as adequate.

CURRENT AND PROSPECTIVE SUPERANNUATION BALANCES

While the Age Pension is consistent with only a 'low cost' standard of living in retirement, it can also contribute to the income needed to support either a 'modest' or 'comfortable' lifestyle in retirement. Most individuals retiring in the near future are likely to have some or considerable reliance on the Age Pension.

The increasing maturity of the compulsory superannuation system will lead to higher retirement incomes on average. However, a significant proportion (perhaps a majority) of retirees will not achieve 'modest' let alone 'comfortable' retirement lifestyles on the basis of their current superannuation contributions.

Additional retirement savings over and above the compulsory 9 per cent Superannuation Guarantee will reduce the proportion that falls short.

In 2007 the average accumulation balance for those aged 55 to 64 was $142,000 for those in accumulation schemes, and $181,000 for those in defined benefit schemes. However, the median figures were somewhat lower at $56,000 for accumulation schemes and $110,000 for defined benefit schemes. The average and median figures for members of accumulation schemes most likely have not generally increased since 2007, with falls being experienced by a substantial proportion of fund members. While further contributions would have been made by or on behalf of many fund members, investment returns in 2007-08 were on average a negative 6.5 per cent for a balanced investment option.

Between 1 July 2008 and mid December 2008 there were further negative returns, generally in the range 10-15 per cent for a balanced fund. For the hypothetical median person with superannuation in 2007 their account balance of $56,000 would have been bolstered by compulsory superannuation contributions after tax of around $4,000 on the median wage while at the same time being eroded by around $6,000 due negative investment returns. For those with higher account balances and/or inactive accounts the developments in investment returns would have been the dominant factor in regard to the overall account balance.

These negative investment returns have also impacted on those currently drawing down on their superannuation savings in retirement. Average balances will rise in the future as the compulsory superannuation system matures and from the eventual return to positive investment returns for balanced and growth investment options. In addition, cohorts of women with more paid labour force experience will move through the system.

Average gross income in the 2005-06 financial year (of people who were employed in 2001 and retired in 2006 who received no wage/salary income in 2005-06 financial year) was: $20,350. For those who were previously employees the figure was $17,800, while for the former self employed in the $24,430. Clearly most recent retirees have very modest retirement incomes.

IMPACT OF ADDITIONAL CONTRIBUTIONS ON EVENTUAL RETIREMENT INCOME

While current average superannuation balances at retirement remain low, they will rise in the future. This will have an important impact on the eventual level of retirement income future retirees enjoy. It will move future retirees further away from the current 'low cost' lifestyle provided by receipt of the Age Pension.

Although the Age Pension will continue to play a role in retirement income even for those with superannuation, encouraging additional superannuation contributions will be an important contributor to improved retirement lifestyles. It will allow some retirees to move closer to the 'comfortable' budget for a retirement lifestyle.

Contributions of 12 per cent or more of salary are required by a household with a single wage earner with an income of $100,000 a year to achieve a 'comfortable' lifestyle in retirement. For a dual wage household a similar level of contributions would be needed for both wage earners, assuming they both earn $50,000 per year.

While achieving a 'comfortable' lifestyle in retirement would be a major challenge for low income households, salary sacrifice contributions and/or personal contributions attracting the co-contribution can lead to the achievement of a 'modest' lifestyle or better in retirement.

ECONOMIC AND POLITICAL SUSTAINABILITY OF TAX CONCESSIONS FOR SUPERANNUATION

As with the Age Pension, Australia's ageing demographic has led to at least some commentators expressing concern about the sustainability of the current tax regime and concessions provided for superannuation. However, political support for the existing taxation regime for those making superannuation contributions remains strong.

In addition, the level of taxation support for retirement savings in Australia is relatively modest by international standards and will be affordable going forward. In fact, tax collections from superannuation contributions and fund investment earnings are substantial and have grown strongly in recent years. In 2006-07 over $8 billion in tax revenue was collected from superannuation funds, with additional superannuation related tax revenue paid by insurance companies.

Also, public opinion polling indicates high levels of public support for a system of mutual obligation where the government provides support to individuals making provision for their retirement through superannuation and for the abolition of taxation on most superannuation benefits received by those aged 60 and over.

CONCLUSIONS

The key findings and messages of the paper are:

- The Age Pension alone provides for only a very limited and low cost retirement lifestyle.
- Compulsory superannuation has made a substantial contribution to lifting many individuals towards a modest retirement lifestyle. However, the cup is still half full in that it leaves most workers well short of what they reasonably want and expect.
- More needs to be done, either through encouragement of voluntary contributions by way of an enhanced co-contribution or other government payment, or through the introduction of soft compulsion.
- Essentially the retirement income system in Australia has moved from one where the emphasis was on poverty alleviation amongst the aged to one where the emphasis is on achieving a modest or comfortable standard of living in retirement. In achieving this each of the three pillars has an important role to play.

1. Introduction

A major focus of this paper is on the role of both the Age Pension and the superannuation system in the provision of retirement income relative to the poverty line and adequacy of retirement living standards.

The Age Pension currently provides the foundation of Australia's retirement income system and this will continue for many years into the future. It forms a key part of the so-called 'three pillar' model for provision of retirement income.

In setting the level of the Age Pension, Australian Governments have always taken into account the absolute needs of the aged, at least in terms of what is needed to avoid the incidence of poverty. In addition to considerations of need, the level of the Age Pension has also been adjusted on both an irregular and a set basis to move in line with increases in general community living standards.

Given this approach, the Age Pension is relatively successful in preventing poverty for the vast bulk of retirees. However, the amount it provides is considerably less than what is needed to support the preferred retirement lifestyle of most Australians. Looking ahead, it will be how the Age Pension and superannuation combine and interact that will be important in achieving the retirement incomes that Australians both need and want.

1.1 Current system

For a number of years, Australia's retirement income system has been based on the 'three pillar' model as commonly described in international policy literature. This model consists of:

- Age Pension – Funded from government revenue (with income and asset tests applying).
- Compulsory superannuation for most employees – Funded by employer contributions of 9per cent of employee wages.
- Voluntary superannuation – Funded by contributions from some employers, employees and the self-employed.

1.2 Global trends

A three pillar system for the provision of retirement incomes is not unusual in terms of the practices followed in other countries. However, the composition of each pillar differs markedly between countries.

In practically all developed countries, some level (often very limited) of public assistance is provided to those without any other income or assets. In some countries the first pillar provides benefits to everyone above a set retirement age without any application of a means test. It is also not unusual for the first pillar to provide individual benefits related to the earnings (and social security contributions or the like) of the individual prior to retirement.

However, given the pressures placed on government expenditures by ageing populations and the relatively generous benefits provided (at least in some countries) of earnings related public retirement benefits, there is an increasing trend for flat rate or capped benefits to be provided by the first pillar. Earnings related, but privately funded, benefits increasingly are provided by the second pillar.

While the Australian system is not without its defects, it has become something of a role model for developing countries. It is being used as a model for establishing their first pillar, and in particular, second pillar systems. In the case of developed countries, the Australian system also has been the subject of interest from overseas policy advisers, given the challenge of delivering earnings related public retirement benefits for their ageing populations. A number of countries have found publicly funded earnings related retirement benefits soak up increasing amounts of taxation revenue, leading to doubts about the sustainability of such benefits.

1.3 Goals for a retirement income system

Recent World Bank research into old age support in the 21st century outlined a number of key criteria for assessing the appropriateness of a retirement income system. This research indicated the primary goals of this support should be to provide:

- An adequate system providing benefits to the full breadth of the population sufficient to prevent old age poverty on a country specific level. In addition, it should provide a reliable means of smoothing lifetime consumption for the vast majority of the population.
- An affordable system within the financing capacity of individuals and the society.
- A sustainable system that is financially sound and that can be maintained over a foreseeable horizon under a broad set of reasonable assumptions.
- A robust system with the capacity to withstand major shocks, including those from economic, demographic and political volatility.

As their starting point, ASFA's own Policy Principles show that there is broad political and community support in Australia for provision of an adequate safety net (the Age Pension) funded out of general revenue. This support also extends to compulsory payment of a set level of contributions into superannuation and encouragement of voluntary self-provision through superannuation and other savings.

In regard to adequacy targets for retirement incomes in Australia, polling conducted for ASFA in 2008 indicated that a substantial majority of respondents (60 per cent) wanted to be able to spend $40,000 or more a year in retirement, with around 40 per cent wanting to be able to spend $50,000 or more. A large majority of individuals specify a retirement income which is less than their current household income. However, up to 20 per cent of certain income groups indicated that they wanted a retirement income larger than their current household income. This may have been due to the household having a temporary downturn in income, or from the respondent being rather optimistic about the future.

2. The incidence of poverty amonst the aged

2.1 Ideological issues in measuring poverty

Determining the extent of poverty amongst any specified group, community or nation as a whole is fraught with both practical and ideological problems.

As one author has put it, poverty research and interpretation is often undertaken by combatants in the 'poor wars', with debate waged from entrenched bunkers, with open wounds rather than open minds.

Value judgments often intrude or even dominate public debate about levels of poverty. Questions about who are the 'deserving poor' can arise, together with questions about moral blame. However, the aged tend to generally be regarded as a more deserving class of the poor, as achieving old age usually does not involve any moral turpitude, usually the opposite.

Some enthusiasts for market processes argue it should be an individual responsibility to save for retirement rather than the state taking on the responsibility for retirement income provision. However, opinion polling shows little community support for such an approach.

It also needs to be kept in mind that poverty is both an absolute and relative concept varying both over time and between countries. Poverty in Australia seldom fits the skid-row image, with contemporary urban deprivation more likely to mean being unable to afford what others take for granted. Contemporary poverty for the aged usually has more to do with drabness of life and social isolation than homelessness or starvation.

However, while Medicare and government assistance for pharmaceuticals cover the bulk of health costs for retirees, chronic illness amongst the aged can also lead to poverty. In particular, certain care and support services may be either unaffordable or severely rationed.

The concept of poverty also changes over time. What was an acceptable standard of living in Australia in 1908 (the year the Commonwealth Age Pension was introduced) will generally not be an acceptable standard of living in 2008. Equally, a person who might be considered to be poor in Australia might be regarded to be very well off within the context of living standards in a rural area of a less developed country.

On top of these definitional issues there are practical problems around the quantitative measurement of poverty and in obtaining data about the characteristics of the population. However, the definitional, ideological and practical problems do not mean the challenges of poverty should be ignored. Most would regard the existence of poverty and lower than acceptable incomes in a rich country such as Australia as morally intolerable and dysfunctional for society as a whole.

2.2 Measuring levels of poverty amongst the aged

Poverty measures in Australia are generally based on a level of income or expenditure relative to some measure of general community living standards. This is a common approach taken in other countries and in international studies.

This concept of poverty is one of relative socio-economic disadvantage, with the poverty threshold a function of income distribution. The rationale for the relative concept of poverty is that absolute deprivation – the inability to sustain life – is not a significant feature of developed countries.

2.3 Median income poverty benchmark

Usually the benchmark adopted in poverty studies is that poverty exists when income is below half the median income of the country concerned. The median income is the income level at which half the community is above that income level and half below. The median income without exception lies below average (mean) income, given the average is affected by the relatively small number of high income earners.

The choice of the 50 per cent of median income benchmark is without doubt arbitrary, but it is one providing a benchmark for most economies that identifies those who are regarded by their fellow citizens as being poor or in poverty. That said, there are some commentators who see such a benchmark as overly generous, particularly because it is continually raising for both governments and individuals the bar for an escape from poverty as general community living standards improve.

However, in some overseas and international studies a benchmark of 60 per cent of median income is used, which increases the incidence of measured poverty somewhat.

There are also differences between studies in regard to the equivalence rates used. Equivalence rates are used to take into account that second and further additional members of a household do not lead to a strictly proportionate increase in expenditure needs. For instance, a second adult might lead to additional expenditure needs equivalent to 70 per cent of the costs of a single person given the sharing of housing and other costs. Different ratios usually are applied for infant or teenage children.

Equivalence rates are not just an abstract concept in the terms of public policy. Whether the single Age Pension is at the right level relative to the Age Pension paid to couples is an example of an equivalence rate in practice.

In theory it also would be desirable to take into account the different expenditure needs of individuals as they age after retirement. However, differences between individuals in how they age and hence their activities and expenditure needs would make such an approach quite problematic.

Measures of the number or percentage of a group that are in poverty are relatively sensitive to the benchmark and methodology used, as typically there are many individuals with incomes clustered around the 50-60 per cent of median income level. There is some circularity in this assessment of poverty, in that social security payments in many countries are around the 50-60 per cent of median income mark.

In addition to the 50 per cent of median income benchmark, Australia also has made use of what is known as the Henderson poverty line. This measure has both absolute and relative dimensions.

2.4 The Henderson poverty line

The Henderson poverty line has its genesis in research first undertaken in the mid-1960s, but it has been regularly updated since then. However, its current form has only a tenuous and convoluted link to its original formulation.

This evolution has resulted in the Henderson poverty line being the subject of criticism from both those who claim it is too generous and from academic researchers concerned about its theoretical rigour.

The Henderson poverty line had its basis in research originally conducted at the University of Melbourne by a team led by Professor Ronald Henderson. In its original formulation, the measure reflected the appropriateness of the then minimum (basic) wage (supplemented by family allowance benefits) as an approximation of the Australian low-income standard for a one-income family consisting of two adults and two children. Equivalence rates were used to apply this standard to other family and situation types.

The Henderson poverty line has been adjusted over time to reflect movements in household income per capita. While this has updated the measure as increases in general community living standards have occurred, the national accounts measure of household income includes imputed rent and employer superannuation contributions.

Accordingly, growth in superannuation contributions and in the average size and quality of housing leads to an increase in the measured poverty line, a not altogether intuitive outcome. As well, changes in the average number of household members influence the measure.

2.5 Comparison of the Age Pension with different poverty measures

In setting the level of the Age Pension, governments in Australia have always taken into account the absolute needs of the aged, at least in terms of what is required to avoid the incidence of poverty. On this criterion, the Age Pension prevents outright poverty for its recipients.

In the June quarter 2008, the updated Henderson poverty measure provided a poverty line of $436.80 per week for a pensioner couple. This compared to Age Pension payments (including rent allowance of $50.50 per week) of $507.30. For a single Age Pensioner, the poverty line was $308.35 a week compared to the basic Age Pension of $273.40 a week plus rent allowance of $53.60 for those eligible.Accordingly, the Henderson poverty line suggests a pensioner couple without other income is just above the poverty line, while for a single person the situation is more problematic depending on housing costs and receipt of rent assistance.

Comparisons of the Age Pension with the traditional poverty benchmark based on 50 per cent of median income present a similar picture. Given median income in the community lies substantially below average male weekly earnings, an Age Pension based on 25 per cent of average male earnings generally just exceeds a poverty benchmark based on 50 per cent of median income.

However, official household income and expenditure surveys typically report significant numbers of individuals with incomes apparently below social security payment levels. A number of possible reasons for this include:

- misreporting by individuals;
- failure to claim entitlements due to ignorance or the lack of physical or mental capacity to do so; and
- lack of eligibility due to failure to meet the residence and other tests for the receipt of benefits.

Depending on the data source, date of the study and the methodology used, estimates of the incidence of poverty amongst those aged 65 and over, based on a poverty benchmark based on 50 per cent of median income, range from 5per cent upwards. Self reported rates of financial stress, such as not being able to pay electricity or other utility accounts on time or going without a meal, are also around the 5 per cent level.

3. Financial support provided by the Age Pension

Public provision of retirement income in Australia consists of regular income payments through the Age Pension and access to a variety of concessions and discounts which reduce the spending requirements of Age Pensioners.

3.1 Income benchmark for the Age Pension

The public provision of retirement income has a long history in Australia and Appendix A provides more detail on the major developments.

New South Wales was the first Australian jurisdiction to introduce a publicly funded age pension in 1900. This was a means tested benefit set at a rate of £26 a year. When the relevant federal legislation, The Invalid and Old Age Pensions Act, was passed in 1908, it was set at the same rate as the New South Wales pension.

The Age Pension started off at 21.5 per cent of average earnings, and remained at around that level for several decades until it peaked in the 1970s, reaching around 27 per cent of average earnings. Since the 1970s, the benchmark for the Age Pension has been at least 25 per cent of average male weekly earnings and this was enshrined in legislation in 1997. Payments of this order of magnitude (at least in terms of a percentage of average earnings) are not dissimilar to the minimum payments made to the aged in a number of other developed countries.

The legislation provides that the full rate Age Pension for a single adult will be maintained at a minimum rate equal to or greater than 25 per cent of male total average weekly earnings, with the partnered rate set at 83 per cent of the single rate of the pension.

Certain additional payments made on an irregular basis for one reason or another have led to the Age Pension being around 26 per cent of male total average weekly earnings in recent years.

Over the last decade the Age Pension has increased by around 19 per cent over and above what it would have increased if adjusted only in line with movements in the Consumer Price Index.

As at September 2008, the single rate for the Age Pension was $14,655 a year, while the annual rate for a couple was $24,481. Assorted additional supplementary allowances, including for pharmaceutical costs and utilities are also payable.

One-off, lump sum bonuses in addition have becoming relatively routine and can be of significant amounts. Bonuses, however described and of varying amount, were paid to Age Pensioners in 2001, 2006 and 2007. In 2008 lump sum Economic Security Strategy Payments have been provided to a variety of social security recipients.

Age Pensioners received in December 2008 a lump sum payment of $1,400 for single Age Pensioners and $1,050 each for couples receiving the Age Pension.

3.2 Additional concessions and discounts to Age Pensioners

Recipients of the Age Pension also receive certain core concessions such as discounts on council, water, sewerage and electricity charges, together with concessions on motor vehicle registration and public transport.

In 1993 the Australian Government extended the Pensioner Concession Card to all part rate pensioners and certain older long-term allowance recipients. In response to concerns from the States and territories that an increase in the number of eligible card holders would have an impact on their State concession programs, the Australian Government agreed to provide an annual payment as compensation for the increased costs of core concessions-utilities, municipal and water rates, public transport and motor vehicle registration.

The agreement does not specify the level of concession that must be offered and the various State and territory governments determine these matters individually. This results in the concession benefits differing significantly between States and territories. For example, the annual average value of motor vehicle registration concessions in Tasmania is $33, while in the ACT it can be over $200.

The value of a PCC to different individuals is determined by their circumstances. For example, they may not be eligible for rates concessions if they do not own their home and they are ineligible for vehicle registration concessions if they do not own a car, which in turn impacts on the value of public transport concessions.

In addition to the core concessions noted above, there is a wide variety of secondary concessions available to PCC holders, including dog registration, dental concessions, various education allowances or concessions, ambulance services, certain eye care programs and spectacles. In addition, companies such as Telstra and Australia Post have offered concessions or rebates to cardholders at various times.

Estimates of the overall annual value of concessions received through holding a PCC vary from $300 to $1,000 a year, depending on the State or territory of residence and the person's circumstances. According to the Australian Institute of Health and Welfare, the overall cost of these concessions was around $1.75 billion in 2005-06, with this mostly funded by the States and Territories but with a contribution of around $200 million from the Commonwealth Government. Not all beneficiaries of these concessions are the aged; Disability Support Pensioners also qualify for the concessions.

Nearly everyone who has reached eligibility age for the Age Pension receives further concessions for items under the Pharmaceutical Benefits Scheme (PBS) by holding either a PCC or a Commonwealth Seniors Health Card (SHC). The SHC is available to most self-funded retirees, who by definition do not receive any Age Pension.

The SHC is not subject to an assets test, but an annual income test of $50,000 for a single person and $80,000 for a couple applies. Around 280,000 individuals held the SHC in 2007-08. This is down on the 320,000 in 2006-07 who held a SHC, perhaps due to the easing of the means test for the Age Pension leading to more individuals qualifying for an Age Pension. Around 85per cent of people over pension age hold an Australian government concession card.

Since January 1999 when the income test was introduced for the SHC, the main reason for largely self-funded retirees to seek to obtain at least some Age Pension has been to gain access to the benefits associated with the PCC.

3.3 Income replacement provided by the Age Pension and related concessions

The replacement rates for income in retirement generated by Age Pension payments and related concessions in Australia are not significantly out of line with the minimum payments for the retired in many other developed countries. That said, in a significant number of other countries the maximum rate of government financed retirement income is higher than in Australia. In these other countries benefits and contributions are linked to pre-retirement earnings.

Australia's flat rate benefit structure and the income and asset testing regime for receipt of the Age Pension is in contrast to the approach in these countries. In Australia, retirees with higher incomes during their working life and who have consequently accumulated higher levels of superannuation and other forms of saving, receive less than the maximum Age Pension or no Age Pension at all in retirement.

3.4 Maximum rate for the Age Pension

Social justice and political reality require the Age Pension to be set at a level that alleviates poverty amongst the aged and also forms a base for the total retirement income received by those who have compulsory and/or voluntary superannuation and other retirement savings.

Essentially it is a value judgment formed as part of the overall political process as to whether the current maximum rate for the Age Pension is set at the correct level. However, generally there appears to be broad political support for the Age Pension being at least at the current level and for the Age Pension to continue indefinitely into the future.

The appropriate method for adjusting the rate of the Age Pension is also essentially a matter for political judgment.

The current method, which makes use of both six-monthly indexation for movements in the Consumer Price Index (CPI) and more irregular adjustments to keep the Age Pension at no less than 25 per cent of male average weekly earnings, means recipients do not miss out on general improvements in community living standards. From time to time governments have also made additional one-off supplementary payments to the aged.

Any further increases in the level of the Age Pension would involve substantial ongoing costs to the public purse. For example, an increase of 10 per cent would cost around $2.5 billion annually, with potentially much higher costs from a flow-on to other pensions and allowances. The cost would also grow over time.

Abolishing the means test for the Age Pension would involve a net cost well in excess of $6.5 billion a year. Such a change would by definition benefit most those retirees with the greatest assets and private incomes. However, the operation of income tax provisions would claw back a proportion of such additional payments.

It would also avoid having to apply what are necessarily intrusive and complicated means tests. The Australian Institute of Actuaries has published several documents explaining how a universal Age Pension would operate in practice. To date, there has been little political traction in regard to such a proposal.

4. Qualifying for the Age Pension

4.1 Population groups qualifying for the Age Pension

In aggregate, the amount of government expenditure on the Age Pension is considerable reflecting that most of the aged receive some Age Pension. In 2005-06 expenditure was $20.6 billion, with expenditure of $24.6 billion in 2007-08. There is also additional expenditure on pensions paid to war veterans and war widows who are over the qualifying age for the Age Pension.

Between 1980 and 2008 the number of Age Pensioners increased from 1.3 million to 2.05 million largely due to population growth and demographic trends. The number of service pensioners and war widow pensioners was relatively stable at around 300,000 for most of that period, but this number is now starting to decline due to the length of time elapsing since the end of World War II.

The Australian population over the qualifying age for the Age Pension was around 2.95 million in June 2007. At that time, 66 per cent or 1.95 million people, received the Age Pension. A further 9 per cent (253,000 people), received a similar income tested benefit from the Department of Veterans' Affairs, bringing the total take-up rate to 75 per cent, down from 79 per cent a decade earlier. Some Australians also receive the Age Pension while resident overseas.

In June 2008 around 67 per cent of those over the qualifying age for the Age Pension received some Age Pension, with the modest increase in coverage compared to the year before due to the easing of the means test in September 2007.

The number of older Australians receiving the Age Pension increased over the decade due to the ageing population structure, but this increase was moderated by the gradual rise in the eligibility age for women.

In terms of coverage, 70.6 per cent of income units (that is, individuals within a household who share financial resources) headed by a person aged 65 years or over relied on a government pension as their principal source of income in 2007-08.

In 2007-08 around 42 per cent of female Age Pensioners and 45.5 per cent of male Age Pensioners were on only a partial Age Pension due to the means test. This percentage is up about eight percentage points over the last decade, largely due to growth in private income and assessable assets amongst the retired but also due to the easing of the means test. The Superannuation Guarantee has already had a discernable impact on retiree incomes and assets of younger retirees. For new entrants to the Age Pension, around 57per cent receive a part Age Pension.

4.2 The Age Pension, employment and other income

Around 96 per cent of pensioners have assessed private income. For many pensioners this is relatively small in amount and comes under the means test thresholds, or it results in only a relatively small reduction in the level of Age Pension received. For instance, 40 per cent of single Age Pensioners and around 25 per cent of those with partnered Age Pensions have a private income of less than $500 a year. For those receiving less than the maximum rate Age Pension in 2007-08, the average private income was around $10,000 a year.

Age Pensioners are not much involved in the paid labour force. In 2007-08, only 3 per cent of Age Pensioners reported employment earnings, although younger pensioners who had just become eligible for the Age Pension had an employment rate of around 7 per cent.

While the participation rate in the labour force for those aged 65 and over is not high and declines with age, those employed on a full-time basis and/or in a professional occupation will have earnings over the maximum allowed for receipt of the Age Pension.

Participation rate figures indicate around 16 per cent of those aged 65 to 69 are in the paid labour force, suggesting about 10 per cent of that age group are income tested out of the Age Pension due to employment income. The remaining 15 per cent or so of that age cohort are excluded due to investment income and/or assets they or their partner hold, or due to the employment income of their partner.

A very small proportion is excluded because they do not meet the residence test, or although eligible have not applied for the Age Pension. Some individuals delay applying for the Age Pension because they have registered under the Age Pension Bonus Scheme (see section 4.4 following).

4.3 Changes in the profile of Age Pensioners

While Age Pensioners tend to be viewed as a single group, there are differences between the "young aged" and the "older aged". More specifically, there is a greater incidence of involvement in the paid labour force and higher wealth and income for those aged 65 to 69. This group has a lower take-up rate of the Age Pension and a greater incidence of part Age Pensions than those aged 70 and over.

Previously unpublished data from the Household, Income and Labour Dynamics in Australia (HILDA) Survey provides information on individuals of Age Pension Eligibility age in 2001 who were either employed or self employed five years earlier. The data indicates that for employees, 75 per cent of this group were receiving some Age Pension, with 44 per cent receiving the full Age Pension. For the previously self employed, 51 per cent of this group were receiving some Age Pension, with 30 per cent receiving the full Age Pension.

Average gross income in the 2005-06 financial year (of people who were employed in 2001 and retired in 2006 who received no wage/salary income in 2005-06 financial year) was: $20,350. For those who were previously employees the figure was $17,800, while for the former self employed in the $24,430. Clearly most recent retirees have very modest retirement incomes.

Officers of the then Department of Family and Community Services also have undertaken research into the characteristics of these “New Age Pensioners”, that is, those who have recently become entitled to the Age Pension. This research shows that for those newly qualifying for the Age Pension in 2003-04, average (mean) assessable assets were only $57,000.

Some part-rate pensioners have substantially more in assessable assets than this figure and the significant minority with substantial assets or private income do not qualify for an Age Pension at all. However, this research indicates a very substantial proportion of new retirees have very little in the way of assets outside their home. Although the average is increasing with the maturing of the compulsory superannuation system, the absolute level of level of assets remains very modest for many retirees.

Relatively few (less than 10 per cent) of the 2.9 million or so Australians aged 65 and over have a substantial private or taxable income. For instance, there were approximately 160,000 individuals in that age group with a taxable income of $50,000 and over in 2005-06, with a further 70,000 individuals with taxable income between $40,000 and $50,000.

4.4 The pension bonus scheme

The Pension Bonus Scheme is intended to encourage older Australians to defer Age Pension and continue working beyond age pension age rather than retiring from the workforce and claiming Age Pension. It provides a one-off tax-free lump sum to eligible people and is paid when a person registered in the scheme finally claims and receives Age Pension.

At June 2008, among the 11 per cent of those over age pension age who were working, 27 per cent received Age Pension while they worked (includes those with earnings and/or business income) and another 21 per cent were registered in the Pension Bonus Scheme. As at 30 June 2008, 152,300 people had registered in the scheme since it commenced on 1 July 1998. In 2006-07 a total of $104,655,372 was paid in bonuses to 8,514 people.

Compared to the overall number of people receiving or first qualifying for the Age Pension, these are relatively low numbers. The scheme is not very well known in the community. As well the trade-off between delaying receipt of the Age Pension and the amount of the bonus apparently is not that attractive to the bulk of those who might qualify.

The scheme does not suit people who work less than 20 hours per week over a year, so is not necessarily suitable for those with intermittent or casual work, or even those in full time low paid employment. The scheme also cannot be accessed by people re-entering the workforce after receiving Age Pension or other income support after age pension eligibility age.

The Pension Bonus Scheme has the potential to significantly improve retirement living standards for those who qualify while at the same time helping to contain public expenditure on the Age Pension. However, redesign of the scheme to make it more attractive to potential users of it appears necessary for this potential to be realised.

As currently cast, the scheme rules are complex and difficult for customers to understand. Potential recipients of the bonus can be excluded because they inadvertently failed to meet one or more of the conditions applying.

5. Developments in the Age Pension means test

The basic structure of the Age Pension as a flat rate benefit subject to a means test has remained largely unchanged over its history, with the exception of a period in the 1970s when the asset test was removed. While various forms of means testing have been used for determining eligibility for the Age Pension, numerous changes have been made to the rules over the years.

5.1 Means test changes introduced in 2007

One of the most significant changes to the means test rules for the Age Pension occurred in the package of measures relating to retirement income announced in the May 2006 Budget and subsequently legislated as the Simplified Superannuation regime. These new rules saw the Age Pension assets test taper rate halved with effect from 20 September 2007.

This resulted in pension recipients losing only $1.50 per fortnight (rather than $3.00) for every $1,000 of assets above the relevant threshold. This resulted in new upper limits applying for the level of assets consistent with receiving at least some Age Pension (Table 1). Under these new limits, a single homeowner could own as much as $529,250 in assessable assets and still receive some Age Pension, while for a couple the combined asset holding can be as much as $839,500.

Subsequent indexation of amounts have increased them to $550,500 and $873,500 respectively in September 2008. Current asset test limits are available from www.centrelink.gov.au.

Table 1: Limits applying to the assets test, September 2007

Single	Homeowner	$529,250 (up from $343,750)
	Non-homeowner	$650,250 (up from $464,750)
Couple (combined)	Homeowner	$839,500 (up from $531,000)
	Non-Homeowner	$960,500 (up from $652,000)

Important note: The value of primary residence is not included in the assets test.

5.2 Financial impact of the new asset test rules

Over certain ranges of assessable assets, the asset test applying prior to 20 September 2007 effectively removed the benefit to an individual of an increase in private retirement savings. This is because over those asset ranges any additional retirement income achieved from higher private savings was totally offset by a decline in the amount of Age Pension received. This offset affected only a minority of retirees, as most retired individuals have assets below the assets test threshold, or have assets and income such that they could never plausibly become eligible for the Age Pension. Around about 8 per cent of all pensioners are affected by the asset test, with around 17 per cent of new entrants (who generally are financially better off) affected by the test.

Well advised retirees also made use of complying pension products that were either 100 per cent or 50 per cent exempt from the asset test to avoid or ameliorate the impact of the test. In 2006-07 31,000 recipients of the Age Pension purchased income streams, with an average purchase price of $123,000. Generally, retirees at most only placed part of their financial assets in complying pensions because of the asset test thresholds and caps available. Most retirees wish to have access to some capital for themselves or their heirs. The implicit low rate of return in complying pensions given their capital guaranteed nature also tended to make them not very popular.

The post 20 September 2007 rules provide a simpler and more equitable solution to the problem of disincentives for private saving due to the operation of the assets test. More fundamentally the new rules are fairer in that withdrawal rates of benefits of the order of 100 per cent or more are now avoided. This is illustrated in the following tables.

Table 2 sets out the total level of retirement income and its components for various levels of retirement savings in superannuation both before and after the 20 September 2007 changes for a single person. Table 3 relates to a retiree couple. While the impact of these changes will depend on the individual circumstances of each retiree, the scenarios in the tables assume the single or couple retiree is a homeowner, has $10,000 in the bank and $10,000 in personal assets. It is also assumed that the retirement income stream product achieves a 7 per cent annual nominal return after fees. (This is not inconsistent with the assumption made by the Australian Securities and Investments Commission on its consumer website of an 8 per cent return before fees and any tax for a balanced fund).

While personal assets are assessed by Centrelink as part of the asset test, generally a low value is attached to them. As can be seen from Table 2, prior to the 20 September 2007 changes there was little point for a single person in having increased superannuation assets (or at least superannuation subject to the assets test) in the range of $200,000 to $300,000. From 20 September 2007 onwards this disincentive has been removed, with additional superannuation assets unequivocally leading to higher retirement incomes without the need to take out a complying pension or the like.

Another result is that the impact of compulsory and voluntary superannuation contributions is to unequivocally improve the adequacy of retirement incomes. The previous asset and income test arrangements were unfair for a growing proportion of the workforce accruing significant private retirement savings through superannuation. Accordingly the easing of the means test could be seen as a necessary step for appropriate integration between superannuation and the Age Pension.

Table 3 sets out the equivalent retirement income figures for a couple. The pattern is similar, except the flat spot in income pre-20 September 2007 occurred in the $300,000 to $500,000 asset range, reflecting the higher asset test threshold and

TABLE 2: Levels of retirement income for a single homeowner pre- and post-20 September 2007

Level of Superannuation Assets	Pre 20 September Age Pension Entitlement	Total income pre 20 September 2007	Post 20 September Age Pension Entitlement	Total income post 20 September 2007
$100,000	$13,071	$20,071	$13,071	$20,071
$200,000	$9,649	$23,649	$10,871	$24,871
$300,000	$1,849	$22,849	$7,826	$28,826
$400,000	0	$28,000	$3,926	$31,926
$500,000	0	$35,000	$26	$35,026

Source: Author's calculations

TABLE 3: Levels of retirement income for a couple who are homeowners pre- and post-20 September 2007

Level of Superannuation Assets	Pre 20 September Age Pension Entitlement	Total income pre 20 September 2007	Post 20 September Age Pension Entitlement	Total income post 20 September 2007
$100,000	$22,952	$29,952	$22,952	$29,952
$200,000	$21,268	$35,268	$21,268	$35,268
$300,000	$16,439	$37,439	$19,615	$40,615
$400,000	$8,639	$36,639	$16,343	$44,343
$500,000	$839	$35,839	$12,443	$47,443
$600,000	0	$42,000	$8,543	$50,543
$700,000	0	$49,000	$5,543	$54,543
$800,000	0	$56,000	$743	$56,743

Source: Author's calculations

upper limit applying to couples. Again, the 20 September changes removed the disincentive for saving and delivered higher returns for those with superannuation assets over the asset test threshold.Single pensioners benefited from an increase in the Age Pension of up to $6,000 per year, while couples benefited by up to $11,500 (combined), depending on how their assets were held.

5.3 Cost of the new asset test changes

ASFA Research Centre analysis of Centrelink data suggests around 170,000 current Age Pensioners benefited from the easing of the assets test through an increase in their pension. Based on the coverage of the Age Pension increasing from 65% to 67% of the applicable population age group following the changes, this suggests around 50,000 newly qualifying Age Pensioners because of the easing in the means test.

The changes to the means test for Age Pension eligibility make up a large proportion of the claimed costs of the Simplified Superannuation package of measures. The relevant Budget Papers estimate the cost in 2007-08 as being $593 million, rising to $966 million in 2009-10. This is a total of over $2.4 billion over the three years. Just prior to implementation of the new rules, the then Minister for Families, Community Services and Indigenous Affairs, Mal Brough, indicated the government expected an estimated 300,000 older Australians would be able to access the Age Pension for the first time or get a higher rate of pension under the new regime because of changes to the asset test. Another 600,000 or so Age Pensioners also received an increase in income due to the easing of the income test. Around 60% of the budget cost of the means test changes is attributable to the change in the income test taper rate. These estimates suggest an average annual benefit for each part rate Age Pensioner of about $1,000 a year in the form of additional Age Pension, with a very small minority receiving substantially more than this (in some cases up to $6,000). However, the actual number benefiting from the easing of the asset test seems likely to be more around the 220,000 mark (rather than 300,000) with aggregate costs similarly lower than forecast prior to the changes being made.

The wealth distribution for retirees tends to get quite thin at asset levels above the cut out point for the Age Pension. Liberalisation of the means test as a result does not bring about massive numbers of current retirees becoming eligible for the Age Pension.

Individuals becoming eligible for the Age Pension as a result of the changes also receive a Pensioner Concession Card and its attendant concessions, which as noted earlier, are valued between $300 and $1,000 a year. Generally such individuals would already have qualified for a Seniors Health Card.

6. Political and economic sustainability of Age Pension expenditures

Despite Australia's ageing population profile, the current Age Pension system will remain affordable well into the future. As a result government policies relating to superannuation are more focused on improving incomes in retirement than on restraining aggregate government expenditures on the Age Pension.

6.1 Modelling future Age Pension expenditure

Community surveys regularly point to a level of concern amongst respondents about the future availability of the Age Pension given the ageing of Australia's population profile. However, authoritative projections of future Age Pension expenditures indicate that public support for the aged can be maintained at current real levels without undue pressures on aggregate Commonwealth budget expenditures. This finding is not dependent on any unduly optimistic assumptions about the future. For instance, Treasury's modeling has mapped the maturing of the Superannuation Guarantee (SG) arrangements and other government policies such as the Simplified Superannuation package and the co-contribution. The results of this modeling project the well-established trend of higher private incomes and wealth interacting with means testing as a tool for constraining future government expenditure on Age Pensions.

Chart 1, which is extracted from the Intergenerational Report 2007, shows superannuation assets are projected to rise from 100per cent of GDP to around 180 per cent by 2046-47. The impact of higher wealth is shown by the projected decline in the number of full-rate pensioners and the projected rise in part-rate pensioners and non-pensioners. This forecast decline is also partially driven by assumption that means test thresholds are adjusted by no more than movements in the CPI. In 2006-07, payments to the aged in aggregate amounted to around 2.5 per cent of GDP, a relatively modest proportion by the standards of most developed countries. Given that in other developed countries payments to the aged are often earnings related, it is not uncommon for aggregate government payments to reach a percentage of GDP in high single figures, or even well into the teens.

In Australia, the prospective increase in Age Pension expenditure outlined in Treasury modeling is also very moderate by international standards. The Intergenerational Report 2007 projects expenditure on income assistance for the aged to rise to only 4.4 per cent of GDP by 2046-47.

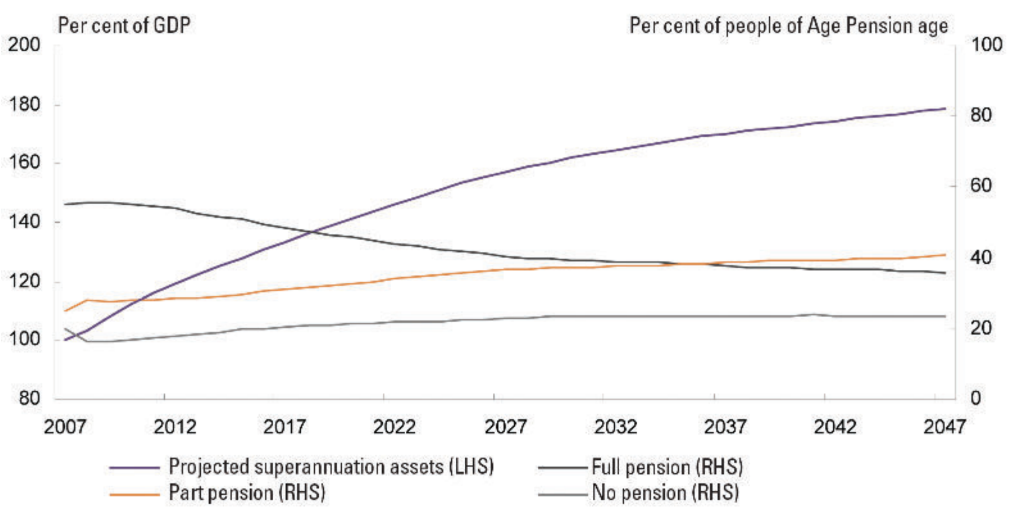
6.2 Sustainability of the Age Pension

Given this level of future spending, expenditure on the Age Pension is very affordable going forward and there will not be a need to curtail its availability or its amount due to budgetary pressures. In addition, there is strong support for the basic structure of the current Age Pension across the political spectrum. Moreover, there is strong community acceptance of a flat rate Age Pension financed by a progressive income tax paid by current income earners. Equally, there is strong community acceptance of the Age Pension being more or less a universal entitlement (subject to means testing) rather than a measure of last resort. This is consistently shown by social attitudes surveys in Australia.

Government policies relating to superannuation as a result tend to be more focused on improving incomes in retirement than on restraining aggregate government expenditures on the Age Pension. Given the targeted and fiscally affordable nature of the Age Pension, Australia has not experienced the economic and political pressures that have built up in a number of other developed countries. Those countries with generous employment earnings related systems of retirement income financed out of general revenue are seeing massive increases in costs as their populations' age.

In Australia, the pressures have been more around the adequacy (or inadequacy) of the Age Pension. The complexity of benefits administration and the disincentives for private retirement savings due to the means test have also been issues. In regard to the World Bank criteria for a sustainable system, the Australian Age Pension is financially sound and can be maintained over a foreseeable horizon under a broad set of reasonable assumptions.

CHART 1: Superannuation assets and Age Pension coverage projections



6.3 Should the eligibility age for receiving the Age Pension be increased?

In a paper prepared for the Committee for Economic Development of Australia (CEDA), David Knox has suggested that the eligibility age for receiving the Age Pension be gradually increased in line with the increase that has occurred in life expectancy. He points to such adjustments being made or proposed in a number of developed countries.

Governments in many developed countries are struggling between the rock of cutting back benefits, and the hard place of increasing taxation to cover retirement income payments. Earnings related retirement benefits are very expensive for governments (or other plan sponsors) to provide. However, the impact of prospective cost increases in Australia need to be kept in perspective. As noted above, in Australia payments to the aged in aggregate amounted to 2.5per cent of GDP in 2006-07. This is a relatively modest proportion by the standards of most developed countries.

In the overseas countries with emerging affordability concerns, changing the eligibility age for a full benefit tends to be a more politically palatable option than reducing benefit levels. The existence of earnings related benefits for disability and unemployment also tends to soften the impact for older workers, protecting those unable to work. In fact the main impact of such a change can be in regard to a corresponding increase in the age when a partial social security benefit can be taken. Rather than early retirement in such countries being at age 55 it leads to early retirement being no earlier than, say, age 57.

Australia has actually made a number of the hard decisions that other developed countries are just starting to struggle with, and did so over a century ago. Our flat rate and means tested Age Pension is good at alleviating poverty, while at the same time strictly limiting the amount that governments need to spend. There is not really any scope to cut benefits, as to do so would make them fall below the poverty line.

However, a flat rate Age Pension is not very good at ensuring adequacy of retirement income. More years in the paid labour force increases retirement incomes, especially if the onset of retirement is delayed. The arithmetic of compound interest and the operation of the Superannuation Guarantee is clear on this. Providing a supportive, indeed encouraging, environment for individuals to work past age 65 makes a lot of sense. This applies in both an individual and collective sense. Paid work provides a sense of purpose for many individuals. It also contributes to overall productivity and community living standards. Even the worst paid full-time job pays a lot more than the $14,700 or so a single person gets from the Age Pension.

However, today many males are anticipated to participate in the formal, paid labour force for less than half of their roughly 80 year life expectancies. For females the proportion is even lower, given longer life expectancies and more time (on average) out of the paid labour force because of family responsibilities. The average retirement age is around 62.5 years for men, and around 60 for women, with quite a bit of variance about these ages. Given that life expectancies continue to increase on the face of it there appears to be a case for increasing the eligibility age for the Age Pension. If 65 were the right eligibility age for men 50 years ago, then shouldn't it logically be higher now? However, the logic of this argument breaks down if an increase in the eligibility age for the Age Pension does not have much impact on when people leave the paid labour force.

Currently just over 50 per cent of those reaching Age Pension age actually get some Age Pension due to the operation of the means test. This compares to somewhere between 30 and 40 per cent of those aged 64 being entitled to income support from the government that is not activity tested (such as by having to look for work). Given that disability rates increase quite sharply for people aged in their late 60s with even relatively high levels of takeup of the disability support benefits for those aged in their early 60s, increasing the Age Pension age might not have a big impact on individuals or government expenditures. Social security benefits paid might have a different label, but still would be paid in most instances.There would also be a shift in the burden of costs, with workers compensation payments presumably still payable until individuals reached the higher Age Pension eligibility age. There would be other insurance cost implications as well, including in regard to the premium rates for various personal liability and salary continuance products.

Increasing the eligibility age for the Age Pension would certainly lead to some decrease in government costs. It would also lead to higher living standards for at least a proportion of those aged 65 and over, albeit at the cost of some retirement leisure. Although there currently is no compulsory retirement age in most jobs in Australia, changing the eligibility age for the Age Pension could change the mindsets of both individuals and employers. This would open up some opportunities for individuals who want to work past age 65 but currently are encouraged or pressured not to do so.That said, there are other options that could be effective in lifting retirement living standards and limiting government costs. These options could be pursued in addition to increasing the Age Pension eligibility age, or instead of doing that. Making the Pension Bonus Scheme more attractive to individuals and promoting the Scheme more effectively might be one such option. Another might be to provide additional support and training for older workers.

Clearly both individuals and the government are concerned with the affordability of the Age Pension going forward and the adequacy of retirement incomes. Given that any policy changes will take some decades to have their full impact, it is important that action be taken soon. While increasing the Age Pension eligibility age is one such possible action, there are others that might be more effective in both containing costs for government and improving the adequacy of retirement incomes.

7. Retirement income budgetary frameworks

While the Age Pension will remain the foundation of Australia's retirement income system into the future, as noted earlier it only provides a basic form of support which is just slightly above the accepted benchmarks for measuring poverty. The amount it provides is considerably less than what is needed to support the reasonable retirement aspirations of most Australians.

To establish outcomes further removed from the benchmarks for poverty than those provided by the Age Pension, it is necessary to consider additional budgetary frameworks for retirement living standards. These can then be used as a guide for the provision of more appropriate levels of retirement income than that provided by the Age Pension.

7.1 Indicative budget standards for retirement

Additional benchmarks for assessing the adequacy of retirement incomes can be derived from indicative budget standards for various groups, including those that are already retired. Such budget standards have been constructed in a number of developed countries.

In Australia the primary source for indicative budget standards is derived from, or inspired by, research published in 1998 by the Social Policy Research Centre (SPRC) of the University of New South Wales. This research was originally commissioned by the then Department of Social Security.

A budget standards framework provides a method for identifying and costing the consumption needs associated with a specific standard of living. Budget standards can be used to inform judgments about the adequacy of income levels (and associated expenditure levels) since they incorporate expert assessments of the level of consumption of goods and services that can be supported by a given level of income.

In particular, the SPRC research developed detailed budgets at both the 'low cost' and 'modest' levels for a variety of groups, including single and couple retiree households.

7.2 Different household budgetary standards

Given the focus of the SPRC's initial research was on households that were recipients of social security payments, it focused on two distinct budgets at the less affluent end of the scale. More specifically, one of the two standards used was 'modest but adequate', which was intended to reflect a standard that provides an opportunity to participate in the basic options available in contemporary society.

There was also preparation of a more down-market standard, the 'low cost' standard. This standard represents a lifestyle that may require frugal and careful management of resources.

The authors of the study indicated that while the 'low cost' standard was not necessarily to be seen as a minimum standard, it was intended to describe a level below which it is increasingly difficult to maintain an acceptable living standard and there exists an increased risk of deprivation and disadvantage for those at that level.

A household budget at the 'low cost' level implies a very austere lifestyle for a retiree, even when allowance is made for no longer having work related expenses or a requirement to make mortgage repayments.

7.3 Westpac-ASFA retirement standard

This research into 'low cost' and 'modest' budget standards as at February 1997 was subsequently updated and extended for retiree households to provide budget standards at both a 'modest' and a 'comfortable' level as at September 2003.

This research was commissioned by Westpac and ASFA. It has been published on a quarterly basis since February 2004 under the title The Westpac ASFA Retirement Standard. Regular adjustments have been made in line with price changes in relevant components of the Consumer Price Index (CPI).

The Westpac ASFA Retirement Standard has become the definitive indicator of required expenditure levels in retirement consistent with specified levels of living standards. It is commonly cited by both financial planners and government agencies.

Table 4 (opposite, top) sets out the retirement budgets for couples and singles at both the 'low cost' and 'modest' budget standards as at September 2008. The 'low cost' budgets were derived by the author through making use of the historical relationships between the components of the 'low cost' and 'modest' budgets and applying current price levels. These low cost budget estimates for aged singles and couples are the first to be produced in a decade.

7.4 Living standards at the low cost level

While it could be argued the 'low cost' budget is consistent with the avoidance of outright poverty, it clearly falls short of what most individuals who are not yet retired would regard as adequate.

In terms of the living standards implied by expenditure at this level, the food and calorie intake supported by this budget is no more than the minimum required for sustenance. Only basic, generic brands of groceries are provided for in the budget. There is no allowance for eating out, or for alcohol or tobacco.

A household with a cat or dog would also struggle at this budget level, given that no allowance is made for food or maintenance of a companion animal, despite the fact 30 per cent of retiree households have a companion animal.

On a 'low cost' retirement budget, infrequent purchases of clothing from a chain store such as Big W or Kmart are only possible making use of the lowest priced items.

TABLE 4: Budgets for various households and living standards (a)

	Modest, single	Modest, couple	Low cost, single	Low cost, couple
Housing – ongoing only	$69.51	$71.89	$69.51	$71.89
Energy	$12.77	$15.21	$12.06	$13.70
Food	$68.00	$143.11	$53.70	114.50$
Clothing	$14.62	$25.21	$13.35	$22.40
Household goods and services	$49.02	$51.91	$40.40	$40.00
Health	$12.65	$23.83	$10.60	$19.30
Transport	$78.04	$78.91	$54.20	$55.50
Leisure	$45.12	$74.71	$26.00	$47.90
Personal care	$26.48	$41.73	$9.40	$16.10
Total per week	$376.21	$526.51	$289.22	$401.29
Total per year	$19,617	$27,454	$15,080	$20,925

(a) Budgets for a modest lifestyle in retirement taken from the Westpac-ASFA Retirement Standard for September 2008. The budgets for the low cost lifestyle have been derived by the author for the purposes of this paper using methodologies and relationships between expenditure levels as set out in SPRC,1998.

Very limited purchases of personal care items and services are allowed in the budget. This includes infrequent hairdressing services utilising discount offers on so-called 'pensioner days' with no hair colouring services. Recreational outings are limited to seniors' excursion tickets on public transport, with trips to the cinema unaffordable.

The 'low cost' budget also assumes that these households, while they are able to afford a vehicle, only have older cars that are driven less and the household will be required to shop around for the cheapest petrol.

The budget only extends to a holiday costing the equivalent of an off-season trip to a nearby coastal resort for one week with accommodation in a modest one-bedroom flat. Such a holiday would only be affordable once in three years.

The low cost budget also leaves little or no buffer for any unexpected costs, such as costs associated with health care or large increases in petrol or food costs.

While it is clear that the low cost lifestyle is of a very austere nature, price increases faced by those living such a lifestyle have been not dissimilar to movements in the CPI generally.

Low cost households have certainly faced increases in food and petrol prices, but they have largely escaped larger than average price increases in the prices of goods and services such as health, education and housing. As a result, over the four years to the September quarter 2007 the cost of the low cost basket of goods and services increased by 11.7 per cent, which is not significantly different from the increase of 11.6 per cent in the All Groups CPI. However, over shorter periods it is likely that there will be differences in movements in the prices of the items in the low cost retirement budget and the All Groups CPI basket of goods and services.

Differences over longer periods are also possible if there are sustained increases in the relative prices of basic items such as food and petrol but it is difficult to say that increases in the living costs of Age Pensioners are systematically underestimated by the All Groups CPI. In 2007 and much of 2008 increases in the prices of food and petrol placed pressure on the budgets of Age Pensioners and other low income households. In forthcoming quarters the fall in the price of petrol and the easing of inflationary pressures will reduce these pressures to a degree.

7.5 Comparison of the alternative budget benchmarks with the Age Pension

The figures in Table 4 allow informative comparisons to be made between the various budget benchmarks and the lifestyle provided by reliance solely on the Age Pension.

For instance, the full Age Pension as at 20 September 2008 was $14,655 for a single person and $24,481 for a couple (combined). This falls somewhat short of the $19,617 for a single person and $27,454 for a couple needed at that time for a 'modest' lifestyle in retirement.

The Age Pension also falls short by $460 per year from the $15,080 for a single homeowner for a 'low cost' standard of living in retirement. Accordingly, without additional private (or other) income or access to resources, such an individual is at risk of deprivation and disadvantage.

This would appear to be one of the reasons that various bonus or one-off payments have been made to Age Pension recipients in recent years.

The establishment of the Harmer Review of Age and Carers Pensions as part of the overall Henry Review of Tax and Transfers also clearly had its genesis in the community and political perception that the base level of the Age Pension requires review and amendment.

The current (as at November 2008) risk of deprivation is even greater if the Age Pension recipient is in private rental accommodation, as any rental allowance available is unlikely to cover the additional housing costs associated with private rental. For Age Pensioners in public housing, the situation in terms of retirement income adequacy may not be dissimilar to that applying to homeowners.

For a couple, the full Age Pension generates just over $3,500 a year more than the $20,925 required for a 'low cost' lifestyle in retirement.

The reason for this disparity between the 'low cost' standard for singles and couples relative to the Age Pension is that the Age Pension provides an income for the second member of a couple that is higher than the assessed additional expenditure needs of a couple. However, the lifestyle of a couple on no more than the full Age Pension could not be regarded as being anything more than marginally above a 'low cost' benchmark.

It should also be noted that the Westpac-ASFA Retirement Standard has been adjusted only for changes in prices since 2003 and not for general increases in living standards since that date. The next major update, in line with the schedule for updates recommended by the SPRC in its report, is currently set for 2009 when the composition and level of the budget standards for retirees will be reviewed.

Adjustment for the general improvement in community standards would lead to a greater assessed shortfall in regard to the single Age Pensioner and substantially reduces the excess of income over expenditure at the 'low cost' standard for a couple on the Age Pension.

It should also be noted that the budgets are prepared on the basis the retirees are in relatively good health without the need for any extensive expenditure on health needs or assistance with personal care. Retiree households facing such costs, particularly if there are only limited government subsidies available, would require higher expenditures in retirement than those in the table. As well, health and personal care costs tend to rise more quickly than other prices in the economy.

The budgets also assume the retirees own their own suitable housing. For those in private rental or needing to move to more suitable owner-occupied housing, higher costs will generally be involved.

8. Current and prospective superannuation balances

These alternative budget frameworks indicate the importance of encouraging private retirement savings to supplement the Age Pension for those wishing anything more than a lifestyle slightly above the accepted poverty benchmarks. However, current statistics on savings balances indicate the Age Pension will remain the foundation for retirement income for many years into the future. It is too late for those who have already retired to increase their retirement savings, but for those still in the paid labour force, future compulsory and voluntary superannuation contributions will increase their retirement savings and future retirement income above the levels currently experienced by most Australian retirees.

8.1 Indicative superannuation balances

Data on current superannuation balances at the time of retirement has become available with the release of unit record data from the ABS Surveys of Income and Housing held in 2003-04 and 2005-06. The ABS also released in November 2008 its 2007 Survey of Employment Arrangements, Retirement and Superannuation (Cat No 6361.0).

Table 5 below sets out summary data extracted by NATSEM from those unit records specifically for use by ASFA. The data clearly indicate the majority of current retirees have very modest superannuation balances. This is consistent with the take-up rates of the full and part Age Pension for those aged 65 to 69 described earlier in the paper.

It is possible the figures in the table may have underestimated superannuation balances as they are based on information from households with some individuals not aware of or underestimating their current superannuation balance.

There also has been further contributions and a period of positive investment returns followed by negative investment returns since 2006.

The average balanced fund return in 2006-07 was around 14 per cent followed by an average investment return in 2007-08 of around negative 7 per cent.

The figures in Table 5 are averages and distributions for all persons in the various age groups. Medians are considerably below the average figures given that a significant proportion of each age group has nil or little superannuation. For instance, the median balance for all males is $24,000 compared to an average (mean) of $69,050.

The calculation of average balances for only those with superannuation would result in somewhat higher figures due to the exclusion of the substantial proportion with nil superannuation. The percentage with no superannuation varied between males and females, with around 14.5 per cent of males reporting nil superannuation, and 24.5 per cent of women with no superannuation. Around 55 per cent of females

TABLE 5: Average Superannuation Balance, 2005-06, Persons aged 25-64 years

Superannuation Group		Nil	Low	Middle	High	Overall
Male	25-34	$0	$14,070	$54,190	$139,180	$19,780
	35-44	$0	$17,060	$61,400	$194,600	$46,890
	45-54	$0	$16,900	$66,800	$278,160	$93,920
	55-59	$0	$17,010	$64,970	$338,120	$126,090
	60-64	$0	$16,320	$70,870	$373,980	$135,810
	All	$0	$15,750	$63,090	$288,070	$69,050
Female	25-34	$0	$11,980	$55,260		$14,060
	35-44	$0	$13,440	$61,020	$188,470	$25,580
	45-54	$0	$14,300	$62,760	$252,780	$48,250
	55-59	$0	$14,130	$64,450	$280,550	$58,760
	60-64	$0	$15,980	$67,110	$281,840	$62,600
	All	$0	$13,220	$61,800	$253,600	$35,520
Persons	25-34	$0	$13,010	$54,560	$161,970	$16,920
	35-44	$0	$15,090	$61,270	$192,750	$36,150
	45-54	$0	$15,380	$65,100	$270,000	$70,820
	55-59	$0	$15,430	$64,730	$319,350	$92,460
	60-64	$0	$16,160	$69,560	$340,000	$99,430
	All	$0	$14,400	$62,590	$276,860	$52,200

Notes: Low balance is defined as less than $40,000, High balance is over $100,000, while Middle balance lies between High and Low.
Source: Unit record file of the ABS Survey of Income and Housing, 2005-06.

in their 60s reported having no superannuation. This would be a result of some in the age group never having had super, while others would have had some superannuation but had taken their benefit from the superannuation system. This figure is down significantly from the 65 per cent figure applying in 2004.This would be the result of some in the age group never having had superannuation, while others would have had some superannuation but have removed their benefit from the superannuation system.

The ABS data for 2007 shows a similar pattern. However, the 2007 ABS figures are for the entire population with superannuation, including those aged 15 to 24 and 70 plus. The median balance in 2007 for all males with superannuation in the accumulation phase was only $23,000 and for females it was an even lower $13,700. For those with defined benefit accounts the median figures are higher at $75,000 for males and $41,000 for females.

The mean (average) balances are somewhat higher given the impact of the minority with relatively high balances. In 2007 the mean balance for males was $72,200 for males and $47,200 for females for accumulation account holders. The respective figures for those with defined benefit accounts were $120,700 and $80,200.

8.2 Superannuation balances at retirement

The figures for an average balance for those aged 60 to 64 form a reasonable proxy for average retirement payouts, given that most individuals retire at or around their early 60s.

On this basis, average retirement payouts in 2005-06 were of the order of $136,000 for men and only $63,000 for women.

In 2007 the average figures were somewhat higher with average accumulation balances for those aged 55 to 64 of $142,000 for those in accumulation schemes, and $181,000 for those in defined benefit schemes. However, the median figures were somewhat lower at $56,000 for accumulation schemes and $110,000 for defined benefit schemes.

The average and median figures for members of accumulation schemes most likely have not generally increased since 2007. While further contributions would have been made by or on behalf of many fund members, investment returns in 2007-08 were on average a negative 6.5 per cent for a balanced investment option.

Between 1 July 2008 and mid December 2008 there were further negative returns, generally in the range 10 -15 per cent for a balanced fund. For the hypothetical median person aged between 55 and 64 with superannuation in 2007, their account balance of $56,000 would have been bolstered by compulsory superannuation contributions after tax of around $4,000 on the median wage while at the same time being eroded by around $6,000 due to negative investment returns.

These negative investment returns have also impacted on those currently drawing down on their superannuation savings in retirement.

It is clear that most recent retirees will need to substantially rely on the Age Pension in their retirement and this will continue to be the case for many years to come.

ABS figures from the Income and Housing survey indicate that currently around 70 per cent of income units headed by a person aged 65 and over rely on the government pension as the principal source of income. Only 21 per cent of that age group rely principally on superannuation or investment income.

Average balances will rise in the future as the compulsory superannuation system matures. In addition, groups of women with more paid labour force experience will move through the system. However, even for these younger women early retirement, retrenchment and withdrawal from the paid labour force for family and other reasons will have an impact.

9. Impact of additional superannuation contributions on eventual retirement income

While current average superannuation balances on retirement remain low, they will rise in the future.This will have an important impact on the eventual level of retirement income future retirees enjoy. It will move more future retirees further away from the current 'low cost' lifestyle provided by receipt of the Age Pension, which is only slightly above accepted poverty benchmarks. Although the Age Pension will continue to play a base role in providing retirement income even for those with superannuation, encouraging additional superannuation contributions by those currently in the labour force will be an important contributor to improved retirement lifestyles. It will also alleviate the potential for poverty amongst retirees.

9.1 Impact of additional contributions

Calculations by the ASFA Research Centre illustrate the greater and the earlier additional superannuation contributions are made, the more likely an adequate retirement income, which may include the Age Pension, will be achieved. In brief, the calculations show:

- Shortening the period of contributions and savings by even five years generally lifts the required saving task by 3per cent or more of salary a year. Delay is costly.
- Achieving a gross income in retirement of $21,000 (or 60per cent of pre-retirement income of $35,000) requires contributions at 9per cent of wages for at least 35 years.
- Contributions above the 9per cent Superannuation Guarantee level are needed for most income earners and retirement targets, or where full-time employment amounts to less than 40 years.
- Putting off an increase in contributions from 9 per cent to 15 per cent for, say, five years means the increase then needs to be to 18 per cent. Compound interest and additional years of higher contributions are powerful forces.

Table 6 outlines the amount that needs to be saved above the current 9per cent SG level to achieve certain retirement income targets. The estimates in the table take into account the abolition of the tax on superannuation benefits received at age 60 and older, as well as the easing of the assets test for receipt of the Age Pension.

9.2 Improving lifestyle outcomes through additional contributions

Another way of looking at the impact of additional employer (whether through salary sacrifice or soft compulsion) and/or member contributions, is to compare the lump sums generated by various levels of contribution with the lump sums needed to support a retirement lifestyle matching either the 'modest' or 'comfortable' benchmarks outlined earlier.

As noted, a 'low cost' lifestyle in retirement can be supported with little more than receipt of the Age Pension.
Most retirees from age 65 onwards will rely at least in part on the Age Pension. Accordingly, receipt of a part-rate Age Pension is assumed in the calculations of the lump sums needed set out in Table 7.

TABLE 6: Extra percentage of income to be saved for 60 per cent of pre-retirement income

	Final Income (Retirement Income Sought)		
Years to retirement	$35000 ($21000)	$50000 ($30000)	$75000 ($45000)
10	37%	51%	59%
15	19%	29%	35%
20	10%	17%	22%
25	5%	10%	14%
30	2%	6%	10%
35	0%	3%	6%
40	-	1%	3%

Assumptions: 9 per cent SG already paid by employer, includes value of age pension, nominal fund earnings of 7 per cent after fees and taxes, and 15 per cent contributions tax and 15 per cent earnings tax are payable, no superannuation at the start of the period to retirement.

For both a single person and a couple, a lump sum of only around $100,000 is required to support expenditure in retirement consistent with a 'modest' lifestyle, namely $25,786 a year for a couple and $18,375 for a single person. The reason for this is that the Age Pension provides most of the necessary income.

For a 'comfortable' lifestyle, larger retirement savings are needed. For a single person the amount required is around $500,000 (assuming nominal investment returns of 7 per cent per annum), while for a couple the amount is just over $500,000. Receipt of the Age Pension at the couple rate means the amount to be saved by a couple is not double the amount needed by a single person.

As shown in Table 7 (above right), even a person on a salary of $100,000 a year would need to make contributions at the rate of 12 per cent or more to achieve a 'comfortable' standard of living in retirement, assuming he or she was single or the only person with superannuation within a couple household.

For a person on $50,000 a year, contributions in the order of 20 per cent per year over 30 years would be needed to support a 'comfortable' lifestyle in retirement.

Alternatively, if both members of a couple had incomes of $50,000 a year and each made total contributions (including the SG) of between 11 and 12 per cent per year, they would be able to achieve a 'comfortable' lifestyle.

Of course, some single persons and couples might be assisted in achieving their retirement savings from receipt of an inheritance or from savings outside the superannuation regime.

TABLE 7: Lump sum retirement benefits after 30 years in a taxed fund for a person aged 60 or over (a)

Tax treatment and contribution level	Wage of $30,000	Wage of $50,000	Wage of $100,000
9 per cent contributions and investment earnings taxed at current rates	$110,000	$183,000	$366,000
Pre 1 July 2007 net amount after benefits tax on lump sum	$110,000	$174,214	$327,018
Improvement after 1 July 2007 with no benefits tax	Nil	$8,786 (5.0%)	$38,982 (11.9%)
Lump sum if contributions made at the rate of 12 per cent of salary	$146,000	$244,000	$487,000
Lump sum needed to support comfortable lifestyle (assumes receipt of part Age Pension).	$500,000	$500,000	$500,000

All figures in today's dollars (using 3.75 per cent AWE as a deflator), investment earning rate of 7 per cent assumed.

Any additional contributions will assist individuals and couples achieve a higher standard of living in retirement, even if a 'comfortable' standard of living is not achieved. This is illustrated in Table 8, which shows the impact in two typical cases (using applicable average figures for men and women) of making personal non-concessional contributions of $1,000 a year and receiving the applicable co-contribution amount.

The co-contribution is available for both wage and salary earners and the self-employed with taxable income plus reportable fringe benefits of less than $58,980 in 2007-08, with the maximum co-contribution available to those with incomes of $28,980 or less. Given the current parameters of the co-contribution, it provides only very modest assistance to males on average incomes.

The great bulk of the increase in superannuation balance for the man aged 35-44 shown in the table comes from the assumed making of a $1,000 a year personal contribution.

TABLE 8: Impact of the co-contribution

	Average salary	Average Super balance	Super benefit without co-contribution (SG only)	Super benefit with co-contribution
woman aged 35-44	$31,730	$25,580	$117,000	$175,000
man aged 35-44	$56,920	$46,900	$214,000	$244,000

Assumptions: Average superannuation balances and incomes as at 2005-6, assumed 20 years of further contributions, investment return of 8% gross with fees of 0.55% and $52 a year, $1,000 a year personal contribution made to gain the co-contribution.

10. Sustainability of tax concessions for superannuation

As with the Age Pension, community concern remains about the sustainability of the current tax regime and the concessions provided for superannuation. However, political support for the existing taxation assistance for those making superannuation contributions remains strong and the current Commonwealth budget position is such that these concessions are not fiscally irresponsible.

In addition, public opinion polling indicates high levels of public support for a system of mutual obligation where the government provides assistance to individuals who make provision for their retirement through superannuation.

10.1 Tax concessions for contributions and investment returns

From time to time some commentators and lobby groups have criticised the level of assistance provided to superannuation through tax concessions. However, no major political party in Australia is advocating reducing the assistance to those making superannuation contributions.

Importantly, public opinion polling indicates high levels of public support for a system of mutual obligation where the government provides support to individuals making provision for their retirement income through superannuation.

Treasury regularly publishes estimates of the annual cost of tax concessions for superannuation in terms of its impact on tax collections relative to contributions, investment earnings and benefits being taxed under a comprehensive income tax base.

These estimates of tax expenditures on superannuation have grown from $10.6 billion in 2002-03 to $17.3 billion in 2006-07 to $26 billion in 2007-08. However, the methodology used by Treasury in making these estimates arguably goes against international best practice.

In most OECD countries the practice is to tax private pensions (superannuation) at the stage benefits are received, rather than at the contributions or fund investment earnings stages. A number of major OECD countries such as Belgium, France, Germany, Netherlands and Portugal consider the appropriate point for taxation is when benefits are received. Accordingly, they do not claim private pensions in those countries receive substantial tax concessions.

Another concern with the Treasury's tax expenditure estimates for superannuation is that they should not be interpreted as a time series of the ongoing amount of revenue that could be obtained if superannuation concessions were eliminated. This is because the application of higher taxes would lead to lower contributions and lower account balances. It would also reduce the tax from investment earnings.

If anything, Australia is an outlier in terms of international practice in regard to the taxation of private pensions (superannuation). A 2004 OECD study into the taxation of private pensions showed Australia had the third highest effective rate of taxation on superannuation, with only New Zealand and Denmark having higher rates of taxation.

Since then New Zealand has introduced a system of government subsidies and tax concessions for superannuation. The introduction of what is called KiwiSaver was a direct result of the previous system which provided no concessions at all for superannuation resulting in practically no contributions being made.

International experience shows individuals require some level of tax concessions before committing to long-term and inaccessible retirement savings vehicles such as superannuation.

As Australia has been able to deliver a string of substantial budget surpluses in recent years, the existing superannuation tax concessions clearly have not led to fiscally irresponsible outcomes. In fact, tax collections from superannuation contributions and fund investment earnings are substantial and have grown strongly in this period.

In 2006-07 over $8 billion in tax revenue was collected from superannuation funds, with additional superannuation related tax revenue paid by insurance companies.

10.2 Sustainability of taxation concessions for those aged 60 and over

Treasury has estimated that implementation of the 2007 Simplified Superannuation package abolishing taxation on most superannuation benefits received after age 60 and the easing of the Age Pension assets test will cost around $2.2 billion in 2007-08. This will rise to around $2.6 billion in 2009-10. (As noted earlier, a significant portion of this cost relates to the easing of the assets test rather than removal of the taxation of benefits.)

Some commentators have questioned whether removing taxation on benefits received from a taxed fund for persons aged 60 and over is sustainable.

While there are no detailed long-term projections of the tax foregone as a result of this measure, the reality is most retirees never paid much benefits tax. In addition, a number of other investments where money now in superannuation was previously invested, such as negatively geared investment properties, have actually drained tax collections.

For the foreseeable future, most lump sums received by retirees will still be below what was the tax-free threshold for lump sum superannuation benefits.

For those with larger sums, the usual practice was and will continue to be to take an income stream. Prior to 1 July 2007, the vast bulk of income stream recipients paid little tax. This was due to the typically modest levels of taxable income derived from income streams after allowance was made for return of capital and the benefit of the 15 per cent tax rebate. As well, individuals who achieve Age Pension eligibility age were, and continue to be, eligible for the Senior Australians Tax Offset.

As noted earlier in Table 5, current average superannuation balances are modest.

While average balances and retirement payouts will continue to grow, it will be many decades before average balances will be at a level that would have attracted significant amounts of benefit tax.

In addition, the new contribution limits applying to both concessional and non-concessional contributions will limit the ability of individuals with substantial assets to minimise taxation through the accumulation of superannuation balances. This will particularly be the case when current transitional arrangements relating to concessional contributions come to an end in five years.

Preservation of superannuation benefits for most individuals to their preservation age also means the very rich who want access to all or part of their savings will only put part of their wealth into superannuation.

In summary, the really rich cannot and do not want to put a large part of their wealth into superannuation, while the relatively poor will not have that much in superannuation and never were going to pay much tax on benefits.

10.3 Constraints on reintroducing benefit taxes

In addition to there being little future revenue need to reinstate benefit taxation, there would be both practical and political constraints on such a move.

At a political level, public opinion polling indicates there is a high level of community support for the abolition of taxation benefits because individuals regard the new arrangements as both simplifying the taxation of superannuation and offering potential benefits to them (ANOP, 2006).

While this may be surprising given the relatively small proportion of current and prospective retirees likely to benefit from the taxation changes, polling results on the point are quite clear. In addition, there has been little, if any, adverse media coverage of the changes.

Given this community view, it is unsurprising no major political party is in favour of reintroducing benefit taxes.

The abolition of Reasonable Benefit Limits, ending the collection of information about the level of benefits paid, and shifting from benefit limits to contribution limits means in practical terms it would be very difficult to reintroduce benefit taxation.

11. Findings and conclusions

- Australia's current retirement income system is relatively successful in preventing poverty for the vast bulk of retirees, but currently only provides a lifestyle slightly above customary poverty benchmarks.

- Increasing the base amount of the Age Pension and/or abolishing the means test would involve considerable additional Commonwealth expenditures.

- The cost of the Age Pension is affordable and sustainable in political and fiscal terms both now and in future decades.

- The current thrust of retirement income policies is for individuals to boost their retirement incomes through greater savings for retirement while they are in paid employment rather than through increasing government payments to the aged.

- Most of the age cohort retiring in the near future are likely to have some or considerable reliance on the Age Pension.

- The level of the maximum Age Pension is consistent with only a 'low cost' standard of living in retirement, but it can also contribute to supporting either a 'modest' or 'comfortable' lifestyle in retirement.

- The increasing maturity of the compulsory superannuation system will lead to higher retirement incomes, but a significant proportion of retirees will not achieve 'modest' let alone 'comfortable' lifestyles on the basis of their current superannuation contributions.

- While achieving a 'comfortable' lifestyle in retirement would be a major challenge for low income households, salary sacrifice contributions and/or personal contributions attracting the co-contribution can lead to the achievement of a 'modest' or better lifestyle in retirement.

- Retirement savings can also be boosted by government action to direct part of the Budget surplus into superannuation by way of enhancement of the co-contribution or similar method.

- The cost of the current tax concessions for superannuation is affordable and sustainable both now and into the future.

Appendix A - the history of the Age Pension in Australia

Early developments

In 1900, New South Wales became the first Australian jurisdiction to introduce a publicly funded pension for the aged in the form of a non-contributory flat rate payment financed out of general revenue. A compulsory contributory insurance scheme was considered but rejected.

The pension was set at £26 per year, which is equivalent to $52 per year in currency terms but not current purchasing power. It was means tested against both property held and income. Victoria and Queensland also introduced age pensions, but both were more basic than the New South Wales scheme.

Federation in 1901 gave the Commonwealth power to legislate for the provision of age pensions and to displace State provisions, but this power was not exercised until the Commonwealth had in place arrangements to provide the supporting revenue needed.

The *Invalid and Old Age Pensions Act* was passed in 1908 with the amount set at the same rate applying in New South Wales, namely £26 per year or 10 shillings per week. This was equivalent to 21.6per cent of then average earnings.

The 1908 legislation limited eligibility for the Age Pension according to character and race, age, residency and means. This denied the pension to persons who were not of "good character" and to non-residents, non-Australian born Asians, Australian Aborigines, Africans, Pacific Islanders and New Zealand Maoris. These provisions were progressively removed over the next 60 years.

The residency test started off requiring 20 years of residence in Australia, but this was reduced to 10 years in 1962, largely in recognition of the needs of many post-war migrants who did not have 20 years residence prior to reaching Age Pension age. In 1973 the legislation was amended to allow an Age Pension granted in Australia to be paid in whatever country the pensioner later chose to live. These arrangements have been supplemented by an extensive range of bilateral social security agreements between Australia and other countries.

Eligibility age

Under the 1908 legislation, a pension was paid to both men and women at age 65. However, in 1910 the pension age for women was reduced to 60 on the claimed grounds women generally became "incapacitated for regular work at an earlier age than men".

Some of this incapacity for work occurred at quite early ages through the imposition of marriage bars on the permanent employment of women in public service jobs and other discrimination against the employment of women.

The age threshold remained unchanged until 1993, when provision was made to progressively increase entitlement age for women to age 65 over a 20 year period. The eligibility age for women currently stands at 63.5 years.

Means testing

The means test applying to the Age Pension initially partially excluded owner-occupied housing and by 1912 it totally excluded its value, which has been the case ever since.

The means tests that did apply in the early years of the Age Pension were relatively severe in their impact with regard to the assets and income they took into account, with a dollar for dollar (or pound for pound) reduction in the benefit paid.

It was not until 1969 that a tapered means test was applied, under which only half the amount of a pensioner's assessed means was deducted from the pension they received. Introduction of this measure significantly increased the incidence of part-rate Age Pensioners.

The means test was repeatedly modified in the 1970s, first being removed (in 1973) for people aged 75, with this being extended to those aged 70 and over in 1975. Age Pension coverage hit a peak at around 83per cent of the relevant age group in the 1970s, but the percentage then fell as the result of a number of policy measures. For instance, the means test was tightened in 1978 when the income test was partially restored for people aged 70 and over.

In 1985 the assets test was reintroduced, with either the income or assets test applied depending on which test gave a lower pension level.

By 1989, the coverage level for the Age Pension amongst the relevant age group was down to 64 per cent, where the level has hovered ever since. An additional significant minority of the age group receive either a veterans or war widow pension.

The period since 1985 has seen the basic structure of the means test remain in place, but numerous tweaks have been introduced. For instance, in 1990 income test deeming rules were introduced to cover cash and money in accounts.

In 1992 allocated pensions became subject to both the asset and income tests, while in 1998 certain non-commutable annuities that met required minimum standards became 100 per cent exempt from the assets test in a measure designed to encourage the taking out of income streams.

This 100 per cent exemption was reduced to a 50 per cent exemption for income streams taken out after 20 September 2004, but the range of qualifying income streams was broadened to include non-commutable market linked income streams.

Appendix B - technical issues realting to projections of future retirement incomes

Some caution is required in projecting forward levels of retirement income. Any projections over 30, 40 or even more years are subject to numerous uncertainties. As well, use of appropriate deflators (price adjustments) is required for converting future dollars into figures that are meaningful in today's terms.

Projecting forward requires assumptions to be made about how various thresholds, limits and rates will be indexed in both the taxation and social security systems. While some thresholds, limits and rates are subject to regular and legislated indexation to movements in the Consumer Price Index (and sometimes to movements in average earnings), many are not, particularly in regard to income tax rates and thresholds. Periodic adjustments tend to be made from time to time on an ad hoc basis, generally reflecting movements in community living standards rather than just prices.

Some of the challenges of such projections are illustrated by Treasury projections set out in the government May 2006 publication, A Plan to Simplify and Streamline Superannuation.
These projections show a person on a current weekly income of $400 a week would have a projected retirement income of $736 a week in retirement after 40 years of standard Superannuation Guarantee contributions. This suggests that retirement would be a welcome prospect for such an individual.

However, the calculations, while arithmetically correct, are based on the assumption that future retirees will judge their living standards in retirement on the basis of community standards 40 years earlier, rather than on the basis of community standards at the time of their retirement.

More specifically, the implied projected income replacement rate in retirement of 185 per cent is largely the product of projecting an Age Pension of over $22,500 in today's dollars, even though the Age Pension would remain at 25 per cent of male average earnings.

These numbers appear to come about through deflating future outcomes by assumed growth in the CPI rather than projected growth in average earnings.

Today's Age Pensioners do not feel relatively well off in either relative or absolute terms because the Age Pension is 65 per cent higher than it was 40 years ago based on the comparative movement in the amount of the Age Pension relative to the increase in prices over that 40 year period.

Accordingly, in projecting future retirement incomes it is appropriate to use the projected annual increase in community living standards (with movements in average wages the usual proxy for this) rather than movements in prices.

As well, projections should be based on tax and social security parameters being adjusted over time with movements in community living standards rather than prices.

These preferred approaches have been used in past ASFA Research Centre projections of retirement income. The Australian Institute of Actuaries also has supported the use of the increase in average earnings rather than the increase in prices as the basis for bringing projections of retirement income back into today's dollars.