Let Pensioners Work (LPW): Options and costings

National Seniors Australia is calling for changes to the pension system that will increase workforce participation among pensioners (Aged and DVA Service Pension) to help address workforce shortages. Our research shows 20% of pensioners are considering re-entering paid work. A majority cite money as the main motivation (see attached infographic).

We have explored four options and commissioned Deloitte to undertake cost/benefit modelling for the first two options listed below.

> ***Option 1****: An opt-in scheme giving an exemption from the income test for income from personal exertion.* ***Option 1a****: An exemption targeted at workers in the Health Care and Social Assistance (child care, aged care, disability care and health care).*
>
> ***Option 2****: An end-of-year tax rebate / reimbursement (via the ATO) for pension lost from income earned from personal exertion.*
>
> ***Option 3****: A hybrid model offering a tax rebate / reimbursement to all pensioners and a targeted income test exemption for those in the Health and Social Assistance sector.*

Given the scale of current labour force shortages (480,100 vacancies), our preference is an economy wide exemption from the pension income test (Option 1). This will mobilise the greatest number of pensioners in the shortest time. It could be trialled for two years and dropped if economic conditions change. It is the simplest and most effective option because it removes interaction with Centrelink and the fear of losing pension payments. Centrelink rules and bureaucracy stop people from working and from working more and encourages participation in the "cash in hand" black economy, reducing government tax revenue.

According to the modelling from Deloitte our policy is **"estimated to be [cost] neutral if 8.3% of pensioners take up the opportunity to go back to work (174,000) or work more (5,000)."**

An exemption targeted at the Health Care and Social Assistance sector (Option 1a) "**is estimated to be [cost] neutral if 8.3% of pensioners take up the opportunity to go back to work (21,000) or work more (600)."**

Beyond this, the policy is revenue positive.

As the Deloitte report concludes, "Our modelling shows that while there are fiscal risks for the government in implementing the NSA proposal, these risks over a potential two-year trial are modest and the potential increase in employment would be material."

Option 1: Opt-in exemption from the income test

- Pensioners could opt in and receive an exemption from the income test for income from personal exertion.
- Income from personal exertion <u>would not</u> be subject to the income test so they can work as much as they want <u>without</u> losing 50c in the dollar from their pension.
- Other income (e.g., income from assets, either real or deemed) would continue to be subject to the income test for the purpose of pension eligibility and entitlement.
- Participants would **<u>not</u>** be required to report earnings to Centrelink, significantly reducing administrative costs and the bureaucratic burden on working pensioners.
- Centrelink would withhold tax from pension payments (at the 32.5c tax rate) to avoid any compliance burden on employers and end-of-year tax bill for participants (a single pensioner would receive $666.30 per fortnight, which is 67.5% of the full pension rate.)
- They would have their tax return adjusted to account for the LITO and SAPTO at the end of the financial year based on their net income (full pension and work income).
- Pensioners who **<u>do not</u>** opt-in continue under the current income test taper rate of 50c in the dollar and the Work Bonus of $7,800 per year. They declare earnings as usual. If they get to a point where they are better off under an exemption, Centrelink could send a notice asking if they wanted to opt-in to the scheme.
- Participants would be able to opt-out if circumstances changed and the exemption was no longer in their interest (e.g., they retired, quit, or lost their job unexpectedly).
- ***Option 1a**: Restrict eligibility to pensioners working in the Health Care and Social Assistance sector (child care, aged care, disability care and health care) as part of the initial trial before extending to other areas of the economy.*

Benefits of an "opt-in" exemption

- **Easy to communicate.**
    - Unlike incremental changes to the Work Bonus, offering pensioners a full exemption (the choice to work and pay tax) which is easy to communicate. This will result in a rapid and sustained take-up to meet the critical jobs and skills shortage.

- **Rewards people who work.**
  - Participants will see a significant increase in income compared with the existing rules. A worker with limited savings would be better off financially from working more compared to the current complicated Work Bonus rules.
- **Would be more effective in inducing behaviour change.**
  - It removes Centrelink reporting (which we are told is a key reason pensioners choose not to work). It increase the likelihood they will work and work more.
  - An opt-in removes worry around under or over reporting income. This fear of losing part of all the pension stops people working. (Cf. Robodebt)
- **Reduces government administrative costs**
  - An opt-in cuts down Centrelink administration, reducing government costs. The Work Bonus requires burdensome reporting and is expensive to administer.
- **Can be time-limited**
  - By applying the rebate as a temporary measure, government can assess the impacts and remove the rebate if conditions change, or results are sub-optimal.

Costs of an "opt-in" exemption

- **The policy could result in additional budgetary costs, <u>however</u> at higher participation rates the policy becomes revenue positive.**
  - As a full exemption is open ended, there could be costs from extending a full pension to those who have lost some <u>or</u> all their pension reduced by current the income test rules.
  - However, these costs are offset by gains in additional income tax from increased work force participation.
  - Workforce participation in Australia among 65 and over is low compared to other OECD countries indicating opportunity for greater participation within this cohort[i]:
    - Australia = 14.2%
    - OECD average = 15.3%
    - Sweden = 19.0%
    - United States = 19.4%
    - Israel = 21.5%

    - New Zealand = 24.8%
    - Japan 25.5%
    - Korea 35.3%

- There are additional tax benefits from pensioners moving out of the cash economy (as there will be less of an incentive to be paid in cash).
- There are also secondary tax benefits. (GST, superannuation tax, payroll tax.)
- Deloitte has estimated the cost and benefits of implementing an income test exemption for all pensioners and pensioners working in the Health Care and Social Assistance sector.
    - Deloitte modelled changes to Age Pension outlays and income tax revenue only and did not take into account other government tax or revenue benefits (GST, superannuation tax, payroll tax).
    - They found that only **8.3% of all pensioners (174,000)** and **8.3% of pensioners in the Health and Social Assistance sector (21,000)** need to join the workforce or work a modest number of additional hours **for the policy to be cost neutral for government. Beyond this, the policy is revenue positive.** Full details are included in the attached letter**.**

Table 1: Cost / benefit to government by take up rate of pensioners going back to work or increasing hours of work – assumes 10% of people of pensionable age (who are currently working) opt in and receive a pension.

Take up rate of pensioners going back to work and working pensioners moving up an income band	Cost to the government ($ million)	Number of additional working Age Pensioners
0% take up rate	622.2	0
2% take up rate	472.6	41,697
5% take up rate	248.0	104,280
10% take up rate	-126.4	208,571

Table 2: Cost / benefit to government by take up rate of pensioners in Health and Social Assistance workforce only going back to work or modestly increasing their hours of work - assumes 10% of people of pensionable age (who are currently working) opt in and receive a pension.

Take up rate of pensioners going back to work and working pensioners moving up an income band	Cost to the government ($ million)	Number of additional working Age Pensioners
0% take up rate	74.7	0
2% take up rate	56.7	5,004
5% take up rate	29.8	12,514
10% take up rate	-15.2	25,029

Option 2: End-of-year tax rebate / reimbursement

- Pensioners are given an end-of-financial-year rebate - an age-based earned income tax credit (EITC) – as an incentive. This reimburses them for some of the pension lost via the income test.
- The Work Bonus of $7,800 continues
- The ATO applies a rebate from $7,800 up to a maximum threshold (tbc) at which point the rebate cuts out.
    - As an example - the rebate could be provided on a sliding scale from $7,800 up to $30,000 and then reduce on a sliding scale to a $75,000 cut-out threshold (e.g. $7,800 = $0 rebate; $20,000 income = $2470.5 rebate; $30,000 income = $4,500 rebate; 45,000 = $3,000 rebate ; $60,000 = $1,000 rebate; $75,000 = $0 rebate) The rebate increases from 7,800 by $0.2025 per dollar of income earned to the maximum of $4,500 at $30,000 and reduces by $0.10 for every dollar of earned by which your rebate income exceeds the $30,000.
- Participants would submit a standard tax return, which would be adjusted to account for the rebate, LITO and SAPTO.
- Because the rebate is offered as a reimbursement for pension income lost via the income test, fortnightly pension payments would still have to be adjusted. This could be adjusted using one of two options depending on circumstance.
    - ***Option A** – Fortnightly reporting of income.*

      This option involves no change to current pension income reporting

      Option A would suit those working irregular or seasonal work throughout the year who are not able to easily estimate their annual income.

- *Option B* – *Declare projected annual income with no ongoing Centrelink reporting.*

  Participants would declare their expected annual income to Centrelink – the same as for the Child Care Subsidy – which would be used to estimate and adjust their fortnightly pension payment.

  Participants can then work without reporting to Centrelink unless their work income changes, reducing fortnightly administrative costs and interactions with Centrelink.

  Option B would suit those with regular income who can readily project their annual income.

Benefits of a tax rebate / pension reimbursement

- **It's targeted.**
  - A sliding scale rebate would reduce budget costs. The incentive would not be open ended as with a full exemption under Option 1.
  - As such, eligibility would not have to be limited by either a stricter asset test or sector specific eligibility test.
- **The rebate is only paid if income is earned.**
  - Government only pays a benefit to those who work, which occurs at the end of the financial year, limiting up-front costs.
- **Rewards people who work.**
  - Participants will see a significant increase in their income from working compared with existing rules.
- **Can be time-limited**
  - Applying the rebate as a temporary measure, allows government to assess the impacts and remove it if conditions change, or results are sub-optimal.

Costs of a tax rebate / pension reimbursement

- **Complicated to communicate**.
  - A rebate would be more complicated to explain than a simple opt-in exemption, which could undermine capacity to induce behavioural change.

  - By introducing a sliding scale to reduce open ended costs, government would find it more difficult to easily explain the benefits of the scheme. Analysis of a similar scheme operating between 2004 – 2014 showed limited evidence the rebate induced higher workforce participation.[1] However, it should be noted the previous scheme offered a very limited benefit (maximum of $500). In contrast, this proposal is to have a maximum rebate of up to $4,500, which would be a much stronger inducement to work.

- **Does not remove reporting requirements**.
  - Because participants may still be required to report earnings to Centrelink on a fortnightly basis this would act as a disincentive.
  - However**,** the addition of an option to report annual income for those with regular income would offset this somewhat.
- **Could result in additional budgetary costs**
  - There could be budgetary costs from offering a rebate.
  - However, these will be offset by gains in income tax (and other tax) receipts when pensioners engage in additional work. There would also be additional income tax benefits from pensioners moving out of the cash economy (as there won't be an incentive to be paid in cash or a disincentive to declare earnings).
  - There will also be other secondary tax benefits to GST, superannuation tax, payroll tax etc.
  - Due to resourcing constraints, we were not able to commission Deloitte to estimate the cost and benefits of implementing this policy, but we expect the targeted nature of the rebate will make this cost effective (albeit at the expense of higher participation).

Option 3: Hybrid model

- Apply a rebate for all workers (Option 2) or double the Work Bonus limit for all pensioners (Option 3) and apply the opt-in income test exemption (Option 1) to pensioners working specifically in the areas of Health and Social assistance (primary health care settings such as hospitals, disability care, aged care and child care).

Benefits of a hybrid model

- **Targeted.**

[1] https://esacentral.org.au/images/BreunigRobertCarterAndrew.pdf

- A hybrid model gives government the ability to provide a higher incentive to those in key sectors where need is greatest, while also offering a modest bonus to induce pensioners to work more in other sectors, reducing budget costs.

- **Can be time-limited**
  - By applying the rebate as a temporary measure, government can assess the impacts and remove the rebate if conditions change, or results are sub-optimal.

Costs of a hybrid model

- **Complicated to communicate**.
  - A hybrid scheme would be more complicated to explain, which would undermine capacity to induce behavioural change.
- **Complicated to administer**
  - A hybrid scheme would create greater administrative costs
  - Additional Centrelink resources would be required to promote and explain the scheme and ensure only those in targeted sectors were granted an exemption.

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[i] https://data.oecd.org/emp/labour-force-participation-rate.htm#indicator-chart