1

Introduction

Background

1.1 The majority of Australians under age 40 have been subject to the framework of the compulsory Superannuation Guarantee (SG) contribution since the time they commenced paid work. The SG legislation commenced in 1992, when the eldest members of the group were aged 26. They are therefore the first generations of Australians to have the broadest access to superannuation contributions. Ironically, despite this level of coverage, surveys suggest that very few have a good understanding of superannuation and retirement savings.

1.2 Superannuation is a complex topic and as such appears to be shrouded in mystery to the average young Australian. While the simplification of the system proposed in the 2006–07 budget, *A Plan to Simplify and Streamline Superannuation*[1] (the superannuation plan), is welcome, there remain a number of widely held misconceptions about the current superannuation system.[2]

1.3 In 2002 the government tabled its Intergenerational Report[3] which indicated Australia will have a population imbalance by 2042, with more than half the population aged over 55 and with the high fiscal burden of an ageing population. The Investment and Financial Services Association

1 The Treasury, *A Plan to Simplify and Streamline Superannuation*, Canberra, May 2006.

2 The superannuation plan is discussed in detail throughout this report and is summarised in Appendix E.

3 The Treasury, *Intergenerational Report 2002-03,* Budget Paper No. 5, Canberra, 2002.

(IFSA) released a report in 2003 which claimed that a huge gap in retirement savings existed.[4] This was followed by the Productivity Commission's Ageing Report, released in 2005, which highlighted similar concerns to the Intergenerational Report, including the expected high cost of health care to this large old age demographic.[5] All of these reports discuss the projected situation for our current under 40s in retirement.

1.4 The inquiry into improving the superannuation savings for this particular demographic was therefore timely.

1.5 Owing to the broad nature of the topic the committee has received input on many issues and from a variety of sectors. Many submissions have focussed on the complexities of the system which make it difficult to provide clear and simple information to people and to raise the awareness of the importance and operation of superannuation.

1.6 It is important to note before beginning this report that all of the committee's evidence was received prior to the 2006–07 budget. Therefore, some of the issues raised will no longer be relevant if the government's budget proposals are implemented. The committee believes that this is a positive reflection on the quality of the evidence it received—many of the concerns raised have been directly addressed by the government in the budget.

1.7 The budget proposals will be subject to public consultation and then must pass through the parliament before they can be implemented. Therefore this report, while making reference to budget proposals, will still discuss issues as they stand under the current law. There are also, of course, many significant issues that are unaffected by the budget, and which remain of great importance. These are also discussed throughout this report.

Are the under 40s saving enough in superannuation?

Profile of the age group

1.8 The question of whether under 40s are saving enough in superannuation is an issue in itself. Superannuation saving during the pre-retirement years peaks when people have the most capacity to channel additional funds into this vehicle. This usually also coincides with maturing age and being

4 IFSA, *The Retirement Savings Gap*, Sydney, 2003.

5 Productivity Commission, *Economic Implications of an Ageing Australia*, Canberra, March 2005.

closer to retirement than the beginning of the working life. It is also not a coincidence that the awareness of retirement income increases as retirement looms in the near future rather than the distant.

1.9 The under 40s age group comprises two generations of people. One group born mid 1960s–late 1970s referred to by demographers as Generation X; the other from the late 1970s to the late 1980s, referred to as Generation Y. There has been much written about the unique general characteristics of individuals born in these two different eras and how their attitudes to life, relationships, authority and finances differ both between Generation X and Generation Y and between those of their parents and older age cohorts. However, all these generations will share one thing in common—they will all experience being at an age under 40, a time in their life when they are making the initial footprints of their life's goals including financial wellbeing.

1.10 The general life-cycle pattern of individuals means that the under 40s age group are more likely to be experiencing the high start-up costs of purchasing an owner-occupied dwelling and the high initial debt on infant mortgages, than any other age cohort. This group are also likely to forego household income whilst, simultaneously, household costs rise to have and rear children. Therefore, people under 40 are less likely to have the spare capacity to divert extra funds into this preserved savings vehicle.

1.11 Many submitters and witnesses have stated that the adequacy of retirement income is largely dependant upon whether the individual/couple own their own home. It may therefore be quite rational that the under 40s may prioritise buying and supporting the purchase of that asset over other asset classes and superannuation.

1.12 If a person has spare financial capacity to make additional superannuation contributions they have the market choice to decide where to rationally and practically place these funds. Surplus monies can be placed in alternative savings/investment strategies rather than formal superannuation contributions but which still feed into household wealth accumulation. The biggest difference is that funds in non-superannuation are not preserved and therefore can be accessed before retirement. This means these funds may be accessed when needed or desired and thus does not guarantee the monies will be available for retirement income.

What happens when the youngest of the age group turn 50?

1.13 The current under 40s age group is financially unique in that, provided they have been fully employed in positions that exceed the SG threshold, most of them will enjoy superannuation savings accruing from a compulsory scheme from the very early years of their working life.

1.14 Treasury, in its submission to the inquiry[6], estimates that a person aged 25 on median earnings, saving only the SG of nine per cent will, after 40 years of continuous working, amass enough retirement savings to provide, coupled with the receipt of a small part-Age Pension, an 83 per cent spending replacement rate.[7] This projection will be affected by the government's proposed changes to superannuation taxation (discussed in Chapter 2). The government has projected that should the budget changes proceed a person on average wages taking superannuation as a lump sum will be nine per cent better off than they are now; the same person taking a superannuation pension will be 17 per cent better off than they are now.[8]

1.15 In 2002 the Senate Select Committee on Superannuation noted the high level of consensus that a 60–65 per cent gross pre-retirement income replacement rate or a 70–80 per cent pre-retirement expenditure rate should be the savings target. When SG was implemented in 1992 a replacement rate of 40 per cent of pre-retirement income was calculated. Given this age group will have been exposed to the compulsory superannuation savings scheme most of their working life, the Treasury estimation on compulsory contributions alone, even prior to the government's proposed changes to superannuation taxation, looks positive.

1.16 However, the Treasury replacement rate assumes many things, the most obvious being the fiscal ability of the government at the time of retirement to bring the replacement rate up to 83 per cent. It also assumes a full-time continuous work pattern which is not enjoyed by all people, particularly women. In addition, self-employed persons are not covered by the SG requirements.

1.17 The Intergenerational Report[9] detailed estimates of how many Australians will be retired in 2042 and how many people will be in the workforce earning income and paying tax for government revenue. The report indicated that assuming the level of taxation remains a constant proportion of national output, in 2042 the federal budget deficit will blow out to $87 billion in 2002 dollar terms.

6 The Treasury, *Submission no. 47*, p. 14.

7 Spending replacement rate is the ratio of an individual's income or spending power after retirement to that before retirement.

8 The Treasury, *A Plan to Simplify and Streamline Superannuation*, Canberra, May 2006, p. 55.

9 The Treasury, *Intergenerational Report 2002-03,* Budget Paper No. 5, Canberra, 2002.

1.18 The report claims there will be 10 million retirees in 2042 and 55 per cent of them will be dependent on the Age Pension. Given the oldest of Generation X will be aged 75+ in 2042 and the youngest of Generation Y will be in their mid 50s, the bulk of retirees in 2042 will comprise the current under 40 age group. The projections in the Intergenerational Report and the estimate in Treasury's submission[10] indicate that the current level of superannuation savings by the under 40 age group will still leave a heavy reliance on the government provision of the Age Pension in their retirement.

1.19 Treasury has stated that there has been no suggestion that the government will withdraw the Age Pension (as a safety net). Currently the Age Pension remains an essential pillar of retirement income policy. However, given the statistics presented in the Intergenerational Report and the Productivity Commission's Ageing Report[11] stating that government expenditure is likely to rise more rapidly than taxation revenue growth by 2044–45, it is clearly desirable for accumulated superannuation savings to be robust by the time this age group starts to retire. The debate is whether it is necessary or practical to increase the level of superannuation savings in this group, given the compulsory system will provide a large proportion of their retirement income needs.

1.20 Any additional saving for retirement income would be beneficial for the public purse. However, what may be more pertinent is the desirability of being able to meet the retirement lifestyle expectations of people in the current under 40 age bracket or more closely align their expectations with reality. Evidence provided to the committee, including from a specific research study commissioned by the Institute of Securities, Banking and Finance[12], indicates that under 40s are expecting a more comfortable lifestyle than could be met by their current average level of retirement savings.

1.21 The committee will consider a number of areas in the superannuation regulatory framework, in order to provide equity in superannuation coverage and to encourage additional savings by those who can afford it and are willing to save via superannuation.

1.22 Ultimately, without imposing additional compulsory superannuation requirements the choice as to whether to contribute more to superannuation lies with the individual.

---

10 The Treasury, *Submission no. 47*, p. 14.

11 Productivity Commission, *Economic Implications of an Ageing Australia*, Canberra, March 2005.

12 Institute of Securities, Banking and Finance (now the Financial Services Institute of Australasia), *Submission no. 49*.