File No: P570

04 December 2002

Mr Adam Cunningham
Secretary to the House of Representatives Committee on Ageing
Parliament House
CANBERRA ACT 2600

Dear Mr Cunningham

The Association of Superannuation Funds of Australia Ltd. (ASFA) welcomes the opportunity to make this submission to the House Committee on Ageing's ***Inquiry into Long term strategies to address the ageing of the Australian population over the next 40 years***

ASFA is a non-profit, non-political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. Our members, which include corporate, public sector, industry and public offer (retail) superannuation funds, account for more than 5.7 million superannuation accounts and over 80% of superannuation savings.

ASFA's submission addresses primarily the issue of future adequacy of retirement incomes. It does not address in any detail workplace participation, aged care, education, housing and health. The issue of adequacy of income in retirement has also been raised with the Senate Select Committee on Superannuation in its *Inquiry into superannuation and standards of living in retirement.*

If you have any questions or comments on the items raised in this submission, please feel free to contact me on 02 9264 9300.

Yours sincerely,

Dr Michaela Anderson
A/Chief Executive Officer

Submission to

House of Representatives Committee on Ageing

Inquiry into

Long term strategies to address the ageing of the Australian population over the next 40 years

by

The Association of Superannuation Funds of Australia Ltd

November 2002

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Executive summary

This submission addresses primarily the issue of future adequacy of retirement incomes. It does not address in any detail workplace participation, aged care, education, housing and health. The adequacy issue has been raised with the Senate Select Committee on Superannuation in its *Inquiry into Inquiry into Superannuation and standards of living in retirement.*

ASFA takes as its starting point that there is broad political and community support in Australia for a retirement income system which involves:

- provision of an adequate public safety net (the Age Pension) funded out of general revenue;
- compulsion of self-provision based on a set level of contributions for those in the labour force at the very least; and
- encouragement of self-provision (by way of superannuation or other savings preserved until retirement) for those in the labour force and others.

Australia has in place the fundamentals of a good retirement income system, but there is both a capacity and a need to do better. Confidence in the system and adequacy in retirement incomes need to be improved by increasing the net contributions received on behalf of individuals and by reducing the complexity of both superannuation and social security arrangements.

While the recent Intergenerational Report does a good job in identifying developing pressures on Commonwealth expenditures and revenues, it does not audit the increasing gap between the current level of the Age Pension and expectations of those who will retire in the decades ahead. Removing the tax on contributions and fund earnings could be a substantial investment by the government in future retirement incomes and future government balances. For instance, if taxes raised had instead been kept in the superannuation system, aggregate superannuation assets would now be some $75 billion higher, a 14% increase on current superannuation balances. This would have helped to provide more adequate retirement incomes, would have reduced pressures on government expenditures, and through the taxation of end benefits would have strengthened the future revenue base of governments.

An adequate retirement income

Assessment of adequacy necessarily requires some value judgements to be made. However, both opinion polling and objective assessment of income requirements in retirement indicate that the current Superannuation Guarantee arrangements will not generate adequate retirement incomes for most individuals even when supplemented by the Age Pension.

Opinion polling indicates that around 70% of respondents believe they would require at least $30,000 per year in retirement, with 30% wanting at least $50,000. A variety of research studies examining expenditure by those of retirement age indicate that a budget of at least $25,000 and preferably $30,000 per year is needed for a relatively modest but comfortable lifestyle in retirement. For those on relatively high incomes prior to retirement, needs and expectations will be somewhat higher than these amounts.

ASFA recommends that the target for a minimum retirement income for a person on around average weekly earnings be initially set at $25,000 per year in today's dollars, with this target rising to $30,000 for those retiring in 2030. In terms of replacement rates, the target might be a replacement rate of 100% for a person on social security prior to reaching retirement age, to 60% for a person on average earnings to 50% or less for a person on $60,000 or more a year. Options for reaching those targets should be based on the assumption of an average of 30 years in paid employment – earlier policy assumptions as to an unbroken work career of 40 years are no longer valid.

Reducing the gap between expectations and outcomes

Action is needed as soon as possible to boost retirement savings, as current and forecast retirement savings will fall well short of needs and expectations. Only a relatively small minority now have adequate or large superannuation entitlements. The average account balance currently is only $54,000, with current average age retirement lump sums only slightly higher at $62,000. While official projections indicate the average retirement lump sum will rise to $135,000 in 2020, this is well short of needs and expectations. Even when the Superannuation Guarantee system is fully mature in thirty or more years time, lump sums will only be of the order of $180,000 to $200,000, rather than the $250,000 or $350,000 needed and expected by retirees.

Analysis by ASFA also indicates that any actions which allowed withdrawal of a lump sum early in the accumulation period, or which puts a proportion of the retirement savings to one side to cover catastrophic health care costs, aged care (or other needs), would seriously compromise retirement incomes, and would not be an effective solution for dealing with these other social needs.

Strategies to move forward

ASFA's priorities remain:

- ensuring adequacy of retirement incomes;
- providing incentives for greater self reliance, with assistance particularly directed to lower and middle income groups;
- broader coverage of superannuation, especially the self employed, casual employees, and those with a limited or no link to the paid labour force;
- simplification, particularly of taxation arrangements;
- better integration between social security entitlements and private provision, and greater flexibility in work and retirement income arrangements after normal retirement age; and
- promoting confidence and security for retirement/superannuation strategies.

Removing contributions tax and boosting contributions

Action by both individuals and government will be necessary. ASFA considers that important steps in improving adequacy of retirement incomes and equity will be to remove the contributions tax and to increase contributions. For a 35 year old individual on $40,000 per year (around AWE), removing contributions tax and increasing contributions to 12% of wages would increase the retirement savings, in today's dollars, from $207,000 to $292,000. This is a very substantial increase which would go a long way to meeting retirement expectations of such an individual.

If budget pressures do not allow the immediate removal of contributions tax, ASFA suggests that it be phased out over a period of up to 10 years.

Assisting middle income earners

ASFA proposes that contributions be increased by measures either mandating or supporting member contributions. For equity reasons middle income earners with a salary in the range $30,000 to $60,000 might be a particular target of government assistance.

This group receives no assistance from the government's proposed co-contribution, although it should be noted that ASFA recommended in its pre-Budget submission that the upper limit for the co-contribution be increased in the next financial year to $40,000.

A particular reason for focussing on individuals on $30,000 to $60,000 per year is that those on lower incomes already are benefiting from the Age Pension, and some of them at least will benefit from the soon to be introduced co-contribution. At the other end of the scale, upper income earners have greater capacity to make contributions without the need of a co-contribution.

Extending coverage

Changing work patterns highlight the importance of revising (downwards) assumptions as to the likely "average" years in full time work and the need for better coverage and greater self-reliance for those in casual, part-time, and contract employment or who are self-employed.

The submission suggests that a number of recent initiatives be enhanced:

- the tax deductibility of contributions by the self employed should be made equivalent to that for employees, with consideration given to similarly mandating contributions;
- the earnings threshold for the SG be maintained at $450 a month to help ensure that casual workers do not miss out on contributions; and
- there be greater flexibility in work and retirement arrangements after age 65.

While a link with employment has traditionally been part of superannuation policy this requirement is increasingly confusing, difficult and less relevant from a public policy context. ASFA recommends that, subject to age limits and appropriate Reasonable Benefit Limit arrangements, an individual in receipt of taxable income be permitted to contribute to superannuation.

Promoting confidence in the security of superannuation

There is evidence from public opinion polling and other material that the public has lost some confidence in the “security” of saving for retirement through superannuation. This is due in large part to the complexity of the current system and the danger of future rule changes, and a perception that governments treat superannuation as a cash cow to the detriment of eventual retirement savings.

Adoption of ASFA recommendations in regard to the use of transitional arrangements that cash out or crystallise past entitlements would assist in achieving simplicity. Accordingly, ASFA recommends that Treasury and the Australian Taxation Office set up a working group, including industry representatives, to consider options for simplifying taxation of superannuation which involve the replacement of “grandfathering” with more efficient and equitable provisions.

Integration with social security

The objective of super savings is to improve the adequacy of retirement savings and reduce the reliance by individuals on the age pension (and hence contain future budgetary costs and taxation requirements). For many people it will be the combination of a full or part pension and their superannuation savings that determines their retirement income and lifestyle.

The actuarial value of the age pension (over 20 years of retirement) is valued at $200,000 or more and is an important feature of ensuring equity and redistribution in the current arrangements. The operation of the incomes and assets test is critical to the sustainability of and confidence in the public support arrangements.

However, the means test is not easy to understand, and it has punitive withdrawal rates of benefits for individuals who have assets subject to the test which fall within the range $140,000 to $280,000. Limiting the availability of lump sum arrangements and ensuring effective complying pension or growth pension arrangements will also become of increasing importance as the system (and likely savings) mature.

ASFA considers that the best approach would be for those with detailed knowledge of the means test and of private retirement income arrangements to sit down and consider options for reforming the means test in a way that is simple, equitable and supportive of self provision. The submission also makes a number of specific suggestions regarding the broad direction of such a review, including the introduction of an integrated means test that treats assets and income in a consistent way, revised taper rates for the means test which provide greater incentives for self provision and the desirable characteristics of a growth pension paying a private retirement income stream.

Recommendations

R1 ASFA recommends that the target for the <u>minimum</u> level of retirement income in 2020 for an individual on average weekly earnings who has been employed for 30 years be accepted as $25,000 per year. The longer term target, to be achieved by 2030, should be set at $30,000 per year, reflecting both rising expectations and the greater number of possible years of additional savings.

R2 ASFA recommends that target replacement rates for retirement income be set with regard to pre-retirement income. For a person on social security benefits the required replacement rate might be 100% or even more. For a person on average earnings, it will be around 60% of gross earnings, while for a person on $60,000 a year it might be 50% or less of gross earnings.

R3 ASFA recommends that projections of future retirement savings and levels of retirement income be based on the assumption of the equivalent of 30 years full-time in the paid labour force. This is consistent with current labour force experience of most women, and is becoming increasingly more common for men.

R4 ASFA recommends that consideration be given to mechanisms for lifting current retirement savings, with a view to achieving as soon as possible average retirement savings approaching $250,000 or more in today's dollars, based on 30 years in the paid labour force. In the longer term retirement savings of $350,000 or more would be appropriate. This would be consistent with a retirement income target of around $25,000 per year by 2020 and $30,000 by 2030 (see Recommendation 1).

R5 ASFA recommends that consideration be given to increasing the superannuation coverage of the self employed by mandating contributions and/or increasing the tax incentives for contributions.

R6 ASFA recommends that incentives be increased for contributions on behalf of spouses and others not in the paid work force.

R7 ASFA recommends that the monthly earnings threshold of $450 be maintained for determining Superannuation Guarantee obligations.

R8 ASFA recommends that retirement savings continue to be used primarily for the provision of private income. While better retirement incomes will assist in addressing increasing health and aged care costs, diversion of retirement savings to additional health or aged care insurance and/or catastrophic health care costs will not be an effective solution.

R9 ASFA recommends that the structure of the means test for social security be reviewed by a joint government and superannuation sector working group, rather than just focussing on marginal changes or the treatment of specific financial assets or income streams.

R10 ASFA does not support abolition of the age pension means test because of the cost to revenue and the doubtful equity implications of such a change.

R11 ASFA recommends that there be better integration of work and retirement by introducing an income bank for Age Pensioners for income derived from employment.

R12 ASFA recommends that the amount and conditions for the Pension Bonus Scheme be reviewed so as to make it more attractive to potential users and fairer.

R13 ASFA recommends that the current asset and income test be replaced by an integrated means test in which a deemed earnings rate is applied to all assets which are included in the test.

R14 ASFA recommends that the taper rates for income and particularly for assets be reduced so as to provide both greater integration and increased incentives for self provision.

R15 ASFA recommends that the definition of complying pensions be expanded to include pensions which have exposure to growth assets while at the same time requiring the likely exhaustion of capital over the life or the life expectancy of the pensioner.

R16 ASFA recommends that in the future retirement benefits be required to be taken in the form of an income stream along the lines of a complying pension or a growth pension as currently being considered by government.

R17 ASFA recommends that a cap of, say, $50,000 be placed on the availability of a lump sum paid from concessionally taxed retirement savings.

R18 ASFA recommends that consideration be given to mechanisms that would reduce the amount of "grandfathering" in the superannuation system while at the same time preserving equity between fund members.

R19 ASFA recommends that any individual in receipt of taxable income be permitted to contribute to superannuation.

R20 ASFA recommends that in order to better meet retirement income needs and expectations that contributions be increased from 9% to 12% of wages and salaries, and by the government removing the tax on contributions (value approximately 3% of wages). The combined effect would be similar to a 15% contribution under current superannuation tax arrangements.

R21 ASFA recommends that the contributions tax be steadily reduced over no more than a ten year period commencing in, say, 2003-04.

R22 ASFA recommends that contributions be fully deductible for the self employed up to the limits that apply to employees.

R23 ASFA recommends that the co-contribution proposal for low income earners be available in 2002-03 for individuals with a personal taxable income of up to $40,000 per year and a family income of less than $80,000.

R24 ASFA recommends that a higher level of contributions be encouraged by a targeted co-contribution directed at middle income earners (those with earnings in the $30,000 to $60,000 range).

R25 ASFA strongly supports the move to at least quarterly payment of the Superannuation Guarantee, but does not support an earnings threshold for the SG of $1,350 in a quarter.

R26 ASFA recommends that the work test applying to members aged over 65 who wish to continue contributing should be simplified through relying on information about their work experience in the previous financial year.

R27 ASFA recommends that Treasury and the Australian Taxation Office set up a working group including industry representatives to consider options for simplifying taxation of superannuation which involve the replacement of "grandfathering" with more efficient and equitable provisions.

R28 ASFA recommends that the Department of Family and Community Services and Treasury set up a working group including industry representatives to consider options for simplifying the means test applying to the Age Pension and for improving the incentives for part self provision in retirement.

1. Introduction

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide a submission to the Committee concerning superannuation and standards of living in retirement. ASFA is the peak industry body for superannuation. ASFA's 547 constituent members are estimated to be responsible for around $420 billion of assets, or about 80% of total superannuation funds under management. ASFA's coverage by percentage of assets and members varies between categories, ranging from around 70% for corporate funds to around 90% for industry, public sector and retail funds.

Given this wide coverage of both funds and fund members ASFA is uniquely placed to present both industry and community views on the issues of adequacy of both retirement savings and retirement income. In doing so it is able to draw on the experience of member funds, and a considerable body of research. Most ASFA member funds have considerable experience in the design of retirement benefit arrangements and/or have had considerable exposure to fund member expectations in regard to retirement living standards. The research undertaken by ASFA includes both modelling of projected retirement incomes and needs in retirement, and public opinion polling in regard to community perceptions of adequacy.

1.1 The broad parameters of the Australian retirement income system

ASFA takes as its starting point for this submission that there is broad political and community support in Australia for a three pillar system for retirement income along the following lines:

- provision of an adequate public safety net (the Age Pension) funded out of general revenue;
- compulsion of self-provision based on a set level of contributions for those in the labour force at the very least; and
- encouragement of self-provision (by way of superannuation or other savings preserved until retirement) for those in the labour force and others.

These principles have achieved support amongst the public, major political parties and stakeholders in the superannuation sector.

At the outset, it also needs to be clearly acknowledged that Australia has a world class retirement income system which is the envy of many other countries. While in retrospect the notion of compulsory employer contributions for the vast bulk of employees seems entirely sensible, it was a courageous decision at the time for the parties involved. Equally, the Age Pension in Australia has been remarkably successful in providing for poverty alleviation amongst the aged, while at the same time remaining affordable in an aggregate sense. A commitment to Australia's three pillar system is now accepted as bi-partisan policy and the structure is regarded as world best practice.

Policymakers in other countries have looked long and hard at the Australian retirement system in the hope that they can replicate our institutional arrangements at least in part in their own countries. However, some aspects of the Australian system are hard to replicate in other countries and at a different time. There also are aspects of the

Australian system which other countries may not want to replicate. Indeed, in retrospect there are elements of the Australian system that Australian policy makers might have regrets about!

It also needs to be emphasised that Australia has a three pillar system for retirement income, not a system for provision of additional social and private expenditures as is the case in, say, Singapore. One of the reasons our retirement income system has achieved what it has is that its focus is on retirement income. Compulsory savings arrangements which can be used for purposes as diverse as housing, aged care, unemployment benefits, health costs etc run the risk of spreading themselves too thin (see section 3.6.2 below for further discussion of this point).

If retirement income financing arrangements in Australia were to be used for any such additional purposes this would have to be on the basis that additional contributions were made to cover such expenses, and such contributions would need to be on top of what is decided as the appropriate amount of saving for retirement. Superannuation is not a magic pudding from which additional slices can be taken without compromising the core goals of retirement savings.

In this regard the two main goals of the Superannuation Guarantee are to:
- improve the adequacy of retirement income
- reduce reliance by individuals on the Age Pension and hence contain future budgetary costs and taxation requirements.

For most people it will be the combination of a full or part-pension and their superannuation savings that determines their retirement income and lifestyle.

It is important that the agreement and consensus across political parties, and indeed in the community as a whole, in regard to the underlying soundness of the three pillars of Australia's retirement income system be built upon. Analysis and recommendations in this submission should not be regarded as a criticism of actions by past or current governments. Rather, it is saying that we have in place the fundamentals of good retirement income system that can be made even better.

In particular, there appears to be scope both to improve the adequacy of incomes and living standards in retirement, and to reduce or at least contain the burden on future taxpayers of the costs of retirement income provision. Accordingly, the major focus of this submission will be on these two objectives. The joint pursuit of these two objectives also requires careful consideration to be given to how social security and private provision of retirement income interact.

In this submission ASFA will emphasise that particular attention needs to be given to the middle income groups ($30,000 to $60,000 per year income). Those on higher incomes generally have a capacity to save more for retirement, while those on lower incomes typically will achieve relatively high replacement incomes in retirement through the operation of the social security system. For these low income earners the Age Pension can be equivalent to a life annuity with purchase price of $200,000 or more. This is a considerable wealth and income transfer.

It is the middle income groupings who are given relatively little support in their efforts to achieve greater self reliance and improved adequacy in their retirement incomes. The Age Pension asset test contains a range of anomalies which if not remedied have the potential to erode the efforts of current and future generations to save for retirement.

1.2 The case for further changes

The considerable progress made to date does not mean that there is no room for further improvements. Given the complicated and not always understandable history of the development of retirement income arrangements in Australia, it would be remarkable if we had by good luck achieved current and prospective outcomes that are exactly right and which entirely meet the retirement income and related needs of Australians.

For the conclusion to be drawn that arrangements are exactly right and should be left untouched it would have to be accepted that successive governments have:

- selected the right level of compulsory contributions,
- provided the exactly correct incentives for voluntary contributions,
- applied the right levels of tax at the appropriate points,
- designed a means test for public benefits that is both fair and encourages self provision, and
- put in place an absolute amount for the Age Pension that is appropriate, together with a viable ongoing adjustment mechanism for public benefits.

There have been ongoing changes in the system both small (superannuation accounts for children using modest contributions from their parents) and large (taxation of superannuation funds and the surcharge) which indicate that even in the relatively recent past governments have not considered that arrangements are quite right. Whether they are exactly right now is seriously open to doubt, given both the nature of some of the changes made, and the level of complexity that has arisen from “grandfathering” and other design features.

As well, much of the debate to date about adequacy of the system has been about the level of compulsory employer contributions, rather than the level of retirement incomes that the community desires or is likely to achieve. In the absence of clearly defined goals for eventual retirement incomes it is not possible to come to the conclusion that the Superannuation Guarantee (SG) at 9% of applicable employee earnings is exactly right.

As well, assuming that there is community consensus that a higher level of retirement income is required than is likely to be generated by the current SG arrangements, there is a need for consideration and debate to be given to how Australia might achieve a higher level of compulsory and voluntary savings. Who pays and/or bears the incidence of the costs of such higher contributions is also an important consideration for the community and hence for the Committee.

Following sections of this submission will examine these various issues, starting with the issue of adequacy.

2. Adequacy – how much is enough?

A key word in the terms of reference for the inquiry is "adequacy". The dictionary definition of adequacy is along the lines "proportionate to requirements, sufficient, satisfactory". There is no simple way of quantifying what resources are required in retirement, or what is sufficient to meet expectations or what will generate satisfactory outcomes. Value judgements are required. As well, assessments have to be made of likely outcomes based on existing or proposed arrangements. On top of this judgements also have to be made about the relative priority of improving retirement income compared to, say, spending more public or private money on health or education.

Needless to say, this is a complicated task. However, ASFA has conducted a range of research and analysis which assists considerably. A number of other agencies or organisations, such as the National Centre for Social and Economic Modelling (NATSEM) of the University of Canberra, and the Retirement Income Modelling Unit of the Commonwealth Treasury have also undertaken relevant work.

2.1 Defining adequacy

What is adequate has to be considered in the context of both community living standards and individual needs and expectations. What is adequate in rural China might be inadequate in urban China, and totally inadequate anywhere in Australia.

How then can an evaluation be made of what is adequate in Australia, and what is likely to be adequate in the future? ASFA has researched this question through various approaches:

- review of adequacy goals implicit in Australian and overseas superannuation schemes;
- modelling of prospective outcomes of the Superannuation Guarantee;
- review and analysis of modelling and research by other organisations;
- examination of minimum expenditure required to sustain basic standards of living in retirement;
- case studies of lifestyles and regrets of current retirees;
- focus group exploration of adequacy issues; and
- quantitative research into the views of the Australian population as to needs and expectations.

2.2 Targets for retirement income adequacy

Table 2.1 below (updated from ASFA, 1999a for changes in the Age Pension and other relevant parameters such as tax rates and supplemented by subsequent research) provides a summary of benchmarks or targets that are commonly applied in assessing adequacy. Some of these benchmarks have been explicitly set, while others are derived from the design parameters of specific contribution or benefit arrangements.

Table 2.1: Targets set or implied for adequacy of retirement income(a)

Source of target	% pre-retirement gross	% pre-retirement net (disposable)(d)	Minimum annual income needed in 2002 dollars
Poverty line			$10,700
Age Pension			$10,997
"Low cost" budget standard(b)			$12,560
"Modest but adequate" budget standard(b)			$16,400
"Comfortable" budget standard(b)			$24,500
Conventional wisdom, commonly used in retirement planning literature	60%		$24,000 for person on AWE
Quantitative research into community expectations			90% of all groups seeking more than $20,000. Over 70% of Generation X and babyboomers seeking $30,000, and 30% at least $50,000.
Compulsory systems in major OECD countries		70% to 80%	
Financial planners	75%		
Department of Treasury Retirement Income Modelling (RIM) Unit		60%	$11,000 (Age Pension)
Defined benefit schemes(c)	50-79%	70-94%	
Superannuation guarantee after 30 years at 9% plus part Age Pension(c)	37-74%	49-83%	$19,000 (48% of gross earnings) for person on AWE
Superannuation guarantee after 40 years at 9% plus part Age Pension(c)	48-85%	65-96%	$23,000 (58% of gross earnings) for person on AWE

(a) These targets are for a single person who is a homeowner. The required amount for a couple is generally regarded as being around 1.7 times that for a single person. Additional income of between $5,000 and $8,000 a year is required if a person is in private rental accommodation.
(b) As estimated by the Social Policy Research Centre of the University of New South Wales, adjusted for changes in the cost of living.
(c) Higher replacement rates are achieved at lower incomes due to the flat rate nature of the Age Pension and the progressive nature of the tax system. The lower value given is for a person earning $60,000 a year before retirement, while the upper replacement rate is for a person on $20,000. Replacement rates for those on incomes in excess of $60,000 a year are also potentially affected by the superannuation surcharge and by Reasonable Benefit Limits.
(d) Net replacement rates take into account income tax paid both pre- and post-retirement. The income tax rates applied are those current in 2001-02.

Details of the research supporting these summary findings are set out in the following sections of the submission.

2.3 Minimum income needs in retirement

In regard to the bare minimum of income needed for life in Australia by retired persons, the Age Pension provides a reasonable benchmark. It reflects both community standards and political perceptions of the minimum required income for those who have retired from the workforce on the basis of age. This comes from the Age Pension being adjusted regularly in line with movements in the Consumer Price Index and irregularly in order to be at least 25% of male total average weekly earnings. As a result, the level of the Age Pension has been kept just above what is generally regarded as the poverty line in Australia.

As well, the majority of persons currently of retirement age live on the Age Pension with nothing or very little more in the way of private income. However, to have an income of just a few hundred dollars a year more than what is a quite austere poverty line does not achieve adequacy of retirement income. It is a demonstration of the inadequacy of current arrangements for many, rather than their adequacy.

While poverty alleviation, typically through safety net arrangements, is a necessary condition for the success of retirement income arrangements, it certainly is not sufficient to demonstrate success. The prospect of several decades in near poverty is also not very attractive for babyboomers who have considerably higher expectations in regard to acceptable living standards in retirement.

2.3.1 Assessment of budget standards by the Social Policy Research Centre

Evidence on the adequacy of the Age Pension and other social security payments in the context of contemporary community standards is provided in a 1998 report of the Social Policy Research Centre ("Development of Indicative Budget Standards for Australia"). That report, as its authors readily admit, is long and complex. However, the report produced summary measures of the level of income as at March 1997 that would be sufficient to support different standards of living for various household types.

Table 2.2 below updates certain relevant estimates in the report for movements in the Consumer Price Index since 1997, and then compares them to levels of income, including the Age Pension, that might be achieved for various income groups through the operation of Superannuation Guarantee over thirty years with contributions at the rate of 9% of wages. The wage growth assumed is 3.75%, with fund earnings after payment of fees and tax of 7%. The replacement ratios in this Table are slightly higher than those published in the 1999 ASFA report on adequacy, reflecting increases in the Age Pension since that time and changes to tax rates and provisions, including the tax offset now available for certain persons of Age Pension age.

The way the percentages in the Table should be interpreted is that a figure above 100% shows that the budget needs of the individual exceed their income, while a figure of less than 100% indicates that they have enough income to cover the low cost or modest budget with some income left over for discretionary expenses.

It should be emphasised that the low cost budget is <u>very low cost</u>, and the modest budget has a lot to be modest about. As discussed below, neither budget would

meet the minimum expectations of most of the community, particularly those who have not yet retired.

Table 2.2: Projected retirement incomes relative to low cost and modest budgets

	Low cost annual budget for single home-owner	Low cost annual budget for single renter	Modest but adequate annual budget for single home-owner	Modest but adequate annual budget for single renter
	$12,563	$16,061	$16,364	$21,634
Final Salary	Budget as a % of retirement income	Budget as a % of retirement income	Budget as a % of retirement income	Budget as a % of retirement income
$20,000	85%	109%	111%	147%
$40,000	68%	87%	89%	117%
$60,000	54%	72%	74%	98%

The projections in the table indicate that for a single person who does not achieve home ownership the Superannuation Guarantee for a low income worker even when supplemented by the Age Pension will be not enough to achieve a low cost annual budget. The SG will be insufficient or at best barely sufficient for a modest but adequate budget for a renter at any income level. Home ownership helps considerably in achieving a level of income which is sufficient to meet a low cost or modest budget in retirement.

However, there are no grounds for complacency in this finding. There is not much margin between the retirement income projected for the majority of the categories considered and the required budget expenditures at even these relatively low standards of living. For those without home ownership, in particular those who rely on private rental, it is very tight indeed.

The severe constraints on the standard of living imposed by an income of less than $20,000 a year are clearly demonstrated in another study commissioned and published by ASFA.

2.3.2 Looking Forward to Retirement……..Is this as good as it gets?

In a December 2000 ASFA publication “Looking Forward to Retirement……..Is this as good as it gets?” the case studies presented of the situation of current retirees indicated that instead of being a golden time of long-anticipated freedom, retirement for many can be a life of virtual imprisonment due to a lack of income to sustain leisure, travel and cultural pursuits.

The accounts of real individuals reveal that retirement can be a daily compromise where individuals keep a close track of spending and watch every cent as they preside over a shrinking horizon of reduced opportunities. Conversely, for those with a higher retirement income it can be a period of liberation and expanding horizons as the retiree is freed of the bonds of work and in possession of the means of meeting their retirement expectations. In this regard, it is superannuation and other private retirement savings which does the liberating. The Age Pension prevents poverty, but even its strongest supporters would struggle to claim it is liberating.

2.4 A "comfortable" standard of living in retirement

Australians typically would aspire to at least a comfortable standard of living in retirement, or one that bears at least some relationship to their standard of living prior to retirement. Table 2.3 sets out estimates of the minimum level of income needed to support a comfortable standard of living in retirement based on a budget 1.5 times the level of a modest but adequate budget. This is a level that is suggested by the Social Policy Research Centre (SPRC) as an appropriate, but admittedly arbitrary, benchmark for a "comfortable" budget in the community.

The Table indicates that at each of the income levels considered the SG at 9% over 30 years **will not** be enough to generate a retirement income sufficient to support a comfortable standard of living as defined for home owners, and will fall well short for a person renting.

Table 2.3: Projected retirement incomes relative to a "comfortable" budget

Super Guarantee 30 years		Comfortable annual budget, single home-owner	Comfortable annual budget, single renter
		$24,546	$32,451
	Final Salary	Budget as a % of retirement income	Budget as a % of retirement income
9%	$20,000	167%	220%
	$40,000	133%	176%
	$60,000	111%	146%

In order to bring these various amounts into perspective, Table 2.4 provides some indicative budgets based on various annual expenditure levels. When the annual amounts are translated into actual budgets for individuals, it becomes clear that an income of less than $25,000 a year, and particularly one significantly less than $20,000, can only support a severely limited lifestyle. These illustrative expenditure patterns make use of data on actual households from the ABS Household Expenditure Surveys, and from the SPRC budget standards research.

Table 2.4: Illustrative expenditure patterns at different retirement income levels(a)

Budget area	Age Pension - $10,000 per annum	Age Pension and super totalling $19,000	Age Pension .and super totalling $22,000	Age Pension and super totalling $24,400
Housing	$2,300 If renting, only gov't rental with rent assistance. Home owners cover basic costs, no allowance for maintenance.	$4,400 Can afford strata levies but can only undertake some basic maintenance	$4,500 Can afford strata levies for more expensive unit or some more maintenance	$4,600
Energy	$300 Limited use of energy, one bar	$500 Can use two bar radiator, take baths,	$700 Able to use clothes dryer.	$1,200 Able to use central heating/air

	radiator.	higher wattage lightbulbs.		conditioner for limited periods.
Food	$1,500 $29 per week Very basic diet, limited meat and fruit, no frills.	$3,000 $58 per week Greater range of meat and fruits. Able to feed dog or cat.	$3,500 $67 per week More seafood and more fruits.	$4,000 $77 per week Good quality cuts of meat, seafood and deli items.
Clothing and Footwear	$200 Can only replace basic clothing.	$500 Purchase of a new outfit each year, shoe repairs.	$800 Two new outfits from a chain store.	$1,000 Two new outfits and new shoes.
Household goods	$500 Emergency repairs and replacement only.	$1,000 Able to update one major appliance a year.	$1,200 Some purchases of minor appliances.	$1,400 Regular updating of small and some major appliances.
Health	$800 Cannot afford health insurance, not all scripts filled, dental work not done.	$1,700 Basic health insurance. All scripts filled, and basic dental.	$2,000 Extras health insurance, possibility of specialist dental or gap payments.	$2,200 Extras health insurance, can have specialist dental, fashion frames for spectacles.
Transport	$1,900 Struggling to maintain car.	$2,500 More able to maintain car.	$3,000 Able to cover more kilometres.	$3,500 Able to travel interstate, keep vehicle in good order.
Leisure	$2000 $3 meals at local club, no alcohol, some raffle tickets. No holidays.	$4,000 Able to attend clubs more regularly, some meals out elsewhere. Possibly able to have holiday in own state in low cost destination.	$4,500 Eat out more regularly, some cinema attending and magazine purchase. More up-market holiday accommodation.	$5,500 Able to eat out in restaurants, able to buy some books and attend cultural events. Occasional interstate holiday.
Personal care	$100 A few haircuts, limited makeup and grooming aids.	$400 Able to have hair coloured (female) or more regular trips to hairdresser.	$600	$1,000 Regular trips to hairdresser, podiatrist etc. Some makeup and perfume puchases.
Gifts and donations	$400 Only coins for collection at church, small gifts for family members	$1,000 Able to make regular donations, modest presents for relatives	$1,200 Able to give more presents and donations	$2,000
Total income and expenditure	$10,000	$19,000	$22,000	$26,400

2.5 Community views on the level of income needed in-retirement

ASFA has commissioned research into community views on the required level of income in retirement making use of both focus groups and quantitative research into the opinions of those aged between 30 and 69.

Research conducted for ASFA in 2000 by Wirthlin Worldwide Australasia indicated that only 4% of respondents believed that less than $20,000 per year would be adequate. Nearly 50% indicated that $20,000 to $40,000 would be required, with around 35% nominating $40,000 to $60,000 per year.

Further and more detailed quantitative research conducted by ANOP Research Services in August 2001 indicated that only 3% of non-retired respondents considered that an income of $20,000 or less would be sufficient in retirement. Around 70% of respondents indicated that an income of at least $30,000 per year would be necessary in retirement, with 30% wanting at least $50,000 per year (Tables 2.5 and 2.6). In contrast official projections of retirement savings suggest that only around 20% of workers will achieve an income of more than $30,000 per year.

Table 2.5: Estimated Minimum Required Retirement Income

Non Retireds	Unsure	Under $20k	$20-29k	$20-39k	$40-49k	$50k plus
30-39 yo	7%	3%	17%	21%	20%	32%
40-54 yo	8%	3%	17%	21%	19%	32%
55-69 yo	15%	7%	27%	27%	13%	11%
Total	8%	4%	18%	22%	19%	29%

Source: ANOP National Survey of Population, August 2001

Table 2.6: Estimated Minimum Required Retirement Income by Household income

	Estimated Retirement Income		
	Under $30k	$30-$49k	$50k plus
Non Retireds	22%	41%	29%
Household Income:			
Under $20k	52%	22%	7%
$30-$39k	51%	33%	7%
$40-$59k	18%	56%	19%
$60-$79k	14%	45%	36%
$80-$99k	9%	40%	50%
$100k plus	2%	39%	52%

Source: ANOP National Survey of Population, August 2001

ANOP concluded in part from these and the other survey results that:
most respondents were reasonably confident about their own plans……but that this personal confidence was not soundly based;

the SG and home ownership are the most common ways that people are preparing for retirement;
on the basis of current settings and retirement savings, the large majority will find their retirement income inadequate or less than expected;
babyboomers and Generation X have significantly higher expectations than those currently aged over 55; and
most of the not yet retired expected to retire before age 65, with mean age of planned retirement being 58 years. However, earlier retirement would put additional strains on private savings, due to the longer period of retirement and lack of an Age Pension for part of the retirement period.

2.6 Modelling of adequacy undertaken by the National Centre for Social and Economic Modelling (NATSEM)

The broad thrust of the research and modelling of outcomes conducted by ASFA has been confirmed by other independent researchers. NATSEM in a paper "Superannuation – The Right Balance" released in early 2002 published a range of research that had been commissioned by CPA Australia. The research modelled for a number of family types the outcomes that would be achieved by compulsory 9% employer contributions with what would be achieved by increasing employer contributions on a voluntary basis or by way of an increase in the SG, or by removing taxation on contributions and fund earnings. All of the options examined had a dramatic impact on projected living standards in retirement.

The research used a concept of adequacy based on the "modest but adequate" budget standards developed by the SPRC and referred to earlier in this submission. Consistent with the approach generally used by ASFA, these standards when applied to future expenditures by the retired were adjusted in line with assumed movements in average weekly earnings. However, different patterns of expenditure for the retired and pre-retired are assumed, with assumed lower housing costs of those who have retired in particular boosting their disposable income. NATSEM focuses on discretionary spending by individuals, not their total gross or net income.

The NATSEM research presents a number of measures of adequacy. The first is to compare projected discretionary spending with the discretionary spending implied by the SPRC budget standards. The second approach is to compare discretionary spending during the years in the work force with discretionary spending in the years in retirement.

The NATSEM researchers came to a number of relatively strong conclusions::

- Compulsory superannuation at the rate of 9% will raise retirement incomes well above pension levels but many are projected to experience lower living standards in retirement than before retirement.
- Early retirement makes a huge difference in projected adequacy of retirement incomes generated by superannuation.
- A 3% employee contribution increases retirement living standards by about 15%, while a 6% contribution roughly doubles the impact.
- The impact of a 3% employer contribution has a smaller impact than a 3% employee contribution because of the tax on employer contributions.
- The abolition of the tax on employer contributions would have a similar impact on living standards as a 3% employee contribution.

- Considerably higher contributions are needed to achieve a given standard of living if there is a delay in making additional contributions.

In summary, the NATSEM researchers used absolute and relative measures of adequacy which have a common heritage with others that have been used in Australia. They also produce results generally consistent with projections published by ASFA and others. However, they make some refinements which while having some theoretical justification are difficult to tie back to community views or standards. Their approach also requires a fairly sophisticated model peculiar to NATSEM to be used.

Notwithstanding the different methodology employed by NATSEM, and the relatively conservative approach to assessing adequacy that they adopt, the NATSEM findings are strongly supportive of the conclusions drawn by ASFA in regard to adequacy.

2.7 Differences between ASFA and the Commonwealth Treasury Retirement Income Modelling Unit regarding adequacy measures

ASFA and the Treasury both make use of microsimulation models to project future retirement incomes. These models differ in their technical structure, but use similar parameters and can deliver remarkably similar projections. ASFA can largely replicate significant parts of the Treasury work on projections for individual scenarios, and Treasury has replicated ASFA projections almost to the decimal point stage.

The main unresolved differences relate to differing judgements about some important assumptions, and in regard to some technical/policy considerations in assessing adequacy. Some of these differences are relatively easy to comprehend, while others involve important but quite complex technical issues in the Treasury models.

First, the more comprehensible difference between ASFA and Treasury. The assumption underlying most Treasury projections of adequacy of retirement incomes is that individuals will be in the paid labour force for 40 years. This assumption is becoming less relevant for men, and has never been relevant for women. **OECD projections suggest the years in employment for men have dropped to around 38 years by the year 2000, and can be expected to fall to 35 years by 2030. For women the full-time equivalent years is only 21 years on average in the year 2000, and will reach only around 22 years in the decades to 2030.**

These averages certainly do not support the adoption of 40 years in paid employment as the benchmark for projections. As well, such averages conceal the diversity in individual employment experiences. Many individuals will have voluntary and/or involuntary absences from the paid labour force that will result in them having fewer years in employment than these averages for men and women.

As will be indicated in the next section of this submission, breaks in employment and contributions and/or any drawing down of benefits prior to retirement will generally significantly reduce these replacement ratios.

Another important difference between Treasury and most other researchers is the measure of adequacy that they use. This is the more technical area, which it would be fair to say is only properly understood by a few researchers and which will be near incomprehensible for most lay people. However, the assumptions and methodology have important implications for the validity of the Treasury assessment of adequacy.

In this regard, Treasury uses, amongst other measures, the ratio of real average annual net potential expenditure in retirement to real average working life net salary. This measure is well documented by Treasury researchers in their various publications (for example, Tinnion and Rothman, 1999) but it is not a concept that immediately springs to the mind of ordinary workers, or anyone else for that matter. However, a more fundamental flaw in the Treasury work is that a benchmark of 60% is applied to the measure on the basis that this is a rate commonly used by actuaries. While at least some actuaries might use this rate, they rarely if ever have calculated real average annual net expenditure in retirement, and will have seldom calculated average working life net salary. To put it simply, the Treasury approach applies a percentage used for other purposes to a completely different calculation.

This is not just a matter of researchers splitting hairs over the best methodology. While, the arithmetic is a little complicated, **the effect of the Treasury methodology is to apply a lower goal than 60% of pre-retirement gross income**. It applies a percentage normally applied to gross salary (before tax) to after tax measures. The calculation also inflates expenditure in retirement by building in future increases in the Age Pension in excess of movements in the Consumer Price Index. Most commentators (and individuals) would regard this, if they ever turned their mind to this effect, as keeping up with community living standards rather than being a boost to measured adequacy. In this regard, there really is nobody outside the Treasury who knows or applies this particular adequacy measure, so applying a 60% target to it has only a very tenuous link to community standards.

There also are differences between ASFA and Treasury in how to translate projected retirement incomes into the terms meaningful to current workers and citizens. In effect when ASFA calculates retirement income projections in absolute dollar terms, such as $19,000 per year, it uses a deflator for future benefits based on projected movements in average earnings. The rationale for this is that individuals will judge their living standards and the adequacy of retirement incomes at the time they retire based on community standards at that time, rather than at the time they started contributing to superannuation.

In contrast, the Treasury methodology estimates future retirement incomes in terms of today's price levels and living standards, adjusting by movements in the CPI rather than average earnings. While both positions are arguable, ASFA considers that its methodology provides estimates that are the most relevant for considering current policy settings for retirement income savings. To adopt the Treasury approach would be akin to evaluating a retirement income in the year 2000 to what living standards were in the 1960s. Recent retirees are not caught in such a time warp in regard to how they perceive living standards, so ASFA argues that its measure is more meaningful. In this context, it should be noted that it is official government policy to adjust the Age Pension so it increases more than the CPI and keeps a link with average weekly earnings. If this is good enough for the Age Pension, it is good enough for private retirement income.

2.8 Conclusions from adequacy research

The research summarised in Table 2.1 and above allows a number of relatively strong conclusions to be drawn. These conclusions are:

- The Age Pension at 25% of male total average weekly earnings is only just above the poverty line.
- The Age Pension needs to be supplemented by private income if even a low cost budget standard is to be met, and certainly would have to be supplemented to meet the minimum expectations of the those currently below retirement age.
- By international standards the Australian system is effective at poverty alleviation for the great bulk of the aged, but it currently provides only modest retirement incomes at best, and a very compressed range of incomes in retirement.
- One estimate based on analysis of the budgets of retired persons indicates that currently a “modest but adequate” lifestyle can be achieved with an income in excess of $25,000 a year. The analysis, however, demonstrates just how modest that lifestyle would be.
- Over 70% of those currently in the labour force consider that they will require at least $30,000 per year, and 30% want at least $50,000 a year
- Expectations are increasing, with the expectations of baby boomers (and generations following) much higher than their parents or grandparents.
- Required replacement rates of income decrease with increasing income, but at around the level of average weekly earnings a replacement rate of 60% or more of gross income is expected. Those on higher incomes might require a low replacement rate, but the absolute amount of income required in dollar terms will be higher.
- The required replacement rate varies with the concept of income or expenditure that is used. For instance, a 60% replacement of gross income equates to a higher percentage when net income is considered, and an even higher percentage when expenditure or discretionary expenditure is considered. `
- The Superannuation Guarantee over plausible periods of paid work will deliver retirement incomes significantly greater than the Age Pension, but at the current capped SG rate retirement incomes will be significantly lower than the needs and expectations of the those currently employed.

2.9 ASFA recommendations concerning adequacy targets

R1 ASFA recommends that the target for the <u>minimum</u> level of retirement income in 2020 for an individual on average weekly earnings who has been employed for 30 years be accepted as $25,000 per year. The longer term target, to be achieved by 2030, should be set at $30,000 per year, reflecting both rising expectations and the greater number of possible years of additional savings.

R2 ASFA recommends that target replacement rates for retirement income be set with regard to pre-retirement income. For a person on social security benefits the required replacement rate might be 100% or even more. For a person on

average earnings, it will be around 60% of gross earnings, while for a person on $60,000 a year it might be 50% or so of gross earnings.

R3 ASFA recommends that projections of future retirement savings and levels of retirement income be based on the assumption of the equivalent of 30 years full-time in the paid labour force. This is consistent with current labour force experience of most women, and is becoming increasingly more common for men.

3. Reducing the gap between expectations and outcomes

As indicated by the previous chapter of this submission, outcomes projected for voluntary and compulsory superannuation will in many cases fall short of expectations. This will have consequences for millions of Australians and for aggregate demands on government given the ageing of the Australian population structure.

3.1 Babyboomers rampant and ageing

In Australia, like most developed and many developing countries, the population structure is ageing. Official projections by the Australian Bureau of Statistics indicate that the Australian population aged 65 years and over will rise rapidly over the next 40 to 50 years both in absolute numbers and as a percentage of the total population. The age group rises in number from 2.3 million in 1999 to about 4.2 million in 2021 to reach a massive 6.5 million by 2051. As a proportion of the population this represents an increase from 12% in 1999 to 19% in 2021 to 25% in 2051.

The growth of this group increases rapidly over the next decade or two, reflecting the impact of the ageing of the "babyboomers". In 2012 the archetypical babyboomers, born in 1947 just after World War II, turn 65.

There is also significant growth projected in the number of very old. In 1999 the population aged 85 years and over was relatively small in number at 240,000, but annual growth in the number of this group will peak in 2032 when those born in 1947 will reach the age of 85.

In terms of absolute numbers the number of those aged over 85 is expected to double within 20 years, reaching 480,000 in 2021. By 2051 the groups is projected to reach 1.3 million, around 5% of the population compared to only 1.3% now.

In 1999 there were about 2,500 Australians aged 100 years more. This is projected to increase to 38,000 in 2051.

With the ageing of the population there will be significant increases in the both public and private costs associated with retirement income and health care.

3.2 Implications for government expenditure from an ageing population structure

The Intergenerational Report 2002-03, published as Budget Paper No. 5 of the 2002-03 Budget Papers, updates earlier work undertaken by government agencies such as EPAC and the Retirement Income Modelling Group.

While providing considerably more detail and more robust modelling assumptions for the projections, the broad thrust of the projections and the scale of projected impacts on expenditure and revenue have remained similar. As the Report notes, over half of Commonwealth government spending is directed to health and aged care, the social safety net of payments to individuals, and education. All this spending is sensitive to demographic changes, particularly health and aged care and Age and Service Pensions.

As indicated by Table 3.1, over the 40 years to 2041-42, the proportion of GDP devoted to Commonwealth spending on health and aged care is projected to more than double, from 4.7% of GDP to 9.9%. To put these figures into context, 1% of GDP in 2001-02 is about $7.1 billion, and 1% of GDP in 2041-42 might be of the order of $17.5 billion in today's dollars.

The increase in expenditures on Age and Service Pensions is an increase of around 50%, but from a relatively low base. Expenditure on government income support to the aged of 2.9% of GDP (the current rate) is quite low by international standards, and the projected level of 4.7% of GDP will also be relatively modest by international standards. The Report notes that age pension spending is contained because the Australian Age Pension is means tested and targets poverty alleviation, compared to other countries which typically pay pension according to previous individual earnings.

Table 3.1: Projections of Commonwealth spending affected by ageing population structure (per cent of GDP)

	2001-02	2006-07	2011-12	2021-22	2031-32	2041-42
Health and aged care	4.7	4.8	5.1	6.2	7.9	9.9
Age and Service Pension	2.9	2.8	2.9	3.6	4.3	4.6
Other payments to individuals	3.9	3.5	3.3	3.2	2.9	2.8
Education	1.8	1.8	1.7	1.6	1.6	1.6
Undunded gov't superannuation	0.6	0.5	0.5	0.5	0.4	0.3
Total	**13.9**	**13.3**	**13.6**	**15.1**	**17.1**	**19.2**

Source: Intergenerational Report, 2002-03

However, what is fiscal rectitude on the part of the Commonwealth government, is not so benign at the individual level. Low, flat rate social security payments mean that additional private retirement income is needed if even minimum expectations and needs are to be met. **The Intergenerational Report does not audit the increasing gap between the current level of the Age Pension and expectations as to lifestyle of those who will retire in the period covered by the Report.**

Compulsory and voluntary superannuation arrangements therefore have an important role to play in making the Australian system sustainable, both in the sense of containing Commonwealth government expenditures and meeting minimum expectations of retirees. Somewhat surprisingly, the Intergenerational Report makes scant reference to superannuation arrangements, nor to the cost savings to government that will be delivered by compulsory and voluntary superannuation.

Previously published research by the Treasury RIM Unit (Rothman, 1998) indicates that without the SG government expenditure on the Age and Veterans Pensions would be around 4.75% of GDP rather than 4.5% of GDP in 2040-41, a saving of around $4.4 billion in terms of today's dollars. However, this is only part of the tale. The same research indicates that a universal Age Pension would cost around 6.4% of GDP, around $28 billion extra, while a move to the pension being 30% of male average earnings would involve expenditure of 5.3% of GDP, or $10.5 billion.

The SG both leads to direct savings in government expenditures, and reduces pressures that would otherwise arise for making government payments available to more of the retired and/or at a higher rate. It is a question of what is a sustainable policy in terms of adequacy at the individual level, as well as the sustainability of government expenditures in a macroeconomic sense.

More adequate retirement incomes also have the potential to assist in dealing with costs of health and aged care, particularly those that are not covered by Commonwealth or State Governments. Maintenance of private health insurance, payment of gap payments for pharmaceuticals, additional home care and assistance, and a range of other expenditures are only possible with an adequate private retirement income. On the Age Pension alone such expenses may not be sustainable, or might only be possible if other essential expenditures are sacrificed.

3.3 Current superannuation savings at time of retirement

Currently, on average superannuation is the second largest financial asset held by Australian families after the family home. However, only a small proportion of retirees, mostly those who had been employed for more than 35 years in the public sector or by a corporation with a generous defined benefit scheme, receive a superannuation related retirement income that is significant in both absolute terms and relative to their pre-retirement income. A relatively small proportion of that age group have significant investment income as the result of asset accumulation during a business career, or inheritance. This latter proportion is not easily influenced by any policy measure, nor is the amount of assets accumulated or inherited. That said, there have been some changes to the tax law so as to provide greater tax relief for capital gains within small businesses which are used to provide for retirement.

The proportion of the population with superannuation has been more susceptible to changes in policy. Prior to the introduction of award superannuation in the late 1980s and the Superannuation Guarantee in 1992, only around 40% of employees had superannuation. Only a minority of this 40% achieved the maximum benefits available due to the requirement in most such schemes to be in continuous employment with the specific employer for 35 or more years. Those who changed their employment generally achieved lower retirement savings or income.

Superannuation coverage for employees in Australia has more than doubled since 1992, growing to around 87% (91% of males and 85% of females) by December 2001. Superannuation coverage for all workers (including the self-employed) is around 87%. While coverage for full-time permanent employees is near universal, for other groups it is much lower. For instance, coverage of self identified casual employees is around 70%. For employers it was 51% and for own account workers (the self employed who employ nobody else) it was 36% in 1995. For these latter groups the lack of any compulsion to have superannuation, together with only partial deductibility of superannuation contributions (only 75% deductible for contributions over a relatively modest cap), have led to the relatively low levels of coverage.

Superannuation coverage for those who have never been in the labour force is negligible given that, in the past, contributions have only been allowed for individuals with a link to the paid labour force. However, legislation was enacted with effect from 1 July 1997 which allows for contributions to be made on behalf of a spouse. In 1998-99 26,000 spouses received a tax rebate for making such contributions to a low income spouse, and other spouse contributions would have been made as well. The coverage of superannuation will also be extended by recent government measures to allow superannuation contributions to be made on behalf of a child, and for the baby bonus to be used to contribute to a superannuation account. The family law provisions which will allow the splitting of superannuation entitlements following separation or divorce also have the potential to spread the coverage of superannuation, albeit at the expense of the party whose superannuation interest is split.

Currently most superannuation benefits received in lump sum form, which is the case for the vast bulk of persons in the private sector, are of modest size. As shown in Table 3.2, in 1995 around 85% of lump sums received were less than $100,000, with over 70% of lump sums less than $60,000. With the maturity of the compulsory superannuation system these averages will increase, but it will be a number of decades before a significant proportion of benefits will exceed $100,000 in terms of today’s dollars (see Section 3.4 below).

As a result, the major problem with the current payouts in terms of numbers affected is their relative paucity, rather than tax and social security provisions being too harsh on large benefits. As the Superannuation Guarantee system matures, these payouts will gradually increase.

At the other end of the scale, certainly some individuals currently have problems with Reasonable Benefit Limits applying to their superannuation benefit and other employer termination payments, but ATO and industry figures suggest that this group is unlikely to be more than 1,500 in number every year. Around about 650 people a year pay tax on excess benefits, but others are likely to have put in place strategies to deal with their potential excess benefits. This compares to the one million or so taxpayers in the age group where superannuation benefits are customarily or required to be taken.

Table 3.2: Value and incidence of superannuation lump sums received in the previous two years by persons aged 45-74 who had ceased work, 1995

Range value of lump sum	Males (%)	Females (%)	All persons (%)
Under $5,000	19	47	30
$5,000-$20,000	19	22	20
$20,000-$60,000	23	19	21
$60,000-$100,000	16	6	12
$100,000-$200,000	15	5	11
Over $200,000	8	1	5
Total	100	100	100

Source: ABS, *Superannuation Australia, November 1995*, Cat No 6319.0

Australian Taxation Office statistics (ATO, 2000) indicate that in 1997-98 around 410,000 individuals received an eligible termination payment (ETP). Around two-thirds of these recipients were aged less than 55, and were not retired or permanently disabled.

Around $2.5 billion was received by around 130,000 individuals who retired or became disabled.

Along with these numbers from the ABS and the ATO, researchers in the Treasury and elsewhere have used partial data sources and microsimulation techniques to estimate average and total superannuation assets by gender and by age for the population as a whole both now and in the future. For instance, Treasury has estimated that as at June 1994 the average superannuation entitlement for women was around $17,000 compared to $42,000 for men (Rothman, 1996).

Separately derived estimates prepared by the National Centre for Social and Economic Modelling (NATSEM, 1999) suggest that in 1993 for persons then aged 35 to 49 years, the average superannuation balance for males was $46,300 and for females it was $15,600. **More recent work (Harding, King and Kelly, 2002) suggests average balances in 1993 for those aged 65 and over of $75,400 for men and $26,000 for women**.

3.4 Projected individual savings and expectations

The Treasury RIM Unit has released projections of average balance per person, both for the population as a whole and for those retiring These indicate a current balance per person of around $54,000 with a wide variation around this average. By 2005 this is projected to increase to $67,000 in today's dollars, to $80,000 by 2010 and $106,000 in 2020 (Kemp 2000). These overall averages are consistent with, but just a little higher, than 1996 RIM projections.

Average age retirement payouts are projected by RIM to increase from $62,000 currently to $77,000 in June 2005, to $97,000 in 2010, and to $135,000 in June 2020. These projections are more or less consistent with the ASFA projections of Superannuation Guarantee outcomes for various individual cases.

In the future there will be a mix of those in traditional schemes which have always equalled or exceeded SG entitlements, and an increasing proportion of the remaining employees with SG contributions over a significant number of years. It will be some 30 years or more before all employees will have had the opportunity of a long string of superannuation contributions of 9% or more. Even then, there will be many, particularly women, who will have had voluntary or involuntary career breaks which will reduce their eventual retirement savings.

For many women an assumption that they will be in the paid labour force for the equivalent of 30 full time years will be a significant overestimate, as it will be for an increasing number of men as well. For this reason any assessment of adequacy should be based on the policy assumption of 30 years in the paid labour force, rather than the 40 or more years that underlies much of the Treasury modelling of adequacy.

In this context, **when fully mature the Superannuation Guarantee will generate individual retirement saving outcomes with a capital value in the order of $180,000 to $200,000 on average in the terms of today's dollars**. This is in line with modelling of individual outcomes for those on average weekly earnings with 30 or more years of paid full-time employment. A minority will have higher retirement savings, which helps balance out the impact on the average of those with lower incomes and/or disrupted patterns of paid employment. **However, at the individual level those with disrupted work patterns obviously will achieve lower retirement incomes**.

As indicated by Table 3.3, even over a 35 year period of accumulating superannuation, the combined effects of a lower income at the start of the accumulation period, and a break from the paid labour force for 7 or so years in the first half of the period, leads to relatively modest lump sums and associated retirement incomes. For those women who manage to achieve a high income towards the end of their working life, the combined effect of the delay in achieving a significant income, the years out of the workforce, and the surcharge is considerable. **The table highlights the inequity of the contributions surcharge for a person who does not fit the supposed conventional pattern of a steady income over their entire career.**

Table 3.3: Impact of breaks from paid labour force

Scenarios (based on SG contributions)	Lump Sum	Annual Gross Income inc Age Pension
Starting at $20,000 for 10 years. A break for 7 years then $45,000 for 17 years	$115 365	$16 770
Starting at $40,000 for 10 years. A break for 7 years then $40,000 for 17 years	$140 090	$18 006
Starting at $40,000 for 10 years. A break for 7 years then $80,000 for 17 years	$212 601	$21 632
Starting at $60,000 for 10 years. A break for 7 years then $100,000 for 17 years inc 10.5% surcharge for $100k	$260 254	$24 015

The Government's proposal to move from the $450 a month earnings threshold for the SG to a $1,350 a quarter threshold also has the potential to disadvantage thousands of part-time and casual employees, many of whom are women. If someone earns, say, $1,000 in any one job during a quarter, they would miss out on their $90 superannuation entitlement. Some casuals might miss out on hundreds of dollars in a quarter if they work in a number of jobs, each with earnings more than $450 in a month but less than $1,350 in a quarter.

Spouse contributions, the splitting of superannuation contributions by a spouse, and the splitting of superannuation balances at the time of divorce or separation have the capacity to boost outcomes for women. However, while splitting superannuation will benefit a spouse, this benefit comes at the cost of reduced benefits for their partner. That said, there will be circumstances where the combined retirement income of a couple is greater because of the use of two tax free thresholds for benefits, and reduced Reasonable Benefit Limit problems.

In regard to spouse contributions, to date have been used by only a relatively small number of couples. It would appear that a higher level of rebate would be required for more spouses to make such contributions.

Accordingly, in order to generate retirement incomes and living standards which are closer to the expectations of a replacement income of 60% and/or a minimum

of $25,000 to $30,000 or more in retirement, higher retirement savings will be needed. This will particularly be the case for those with broken work patterns.

An average retirement payout of between $250,000 and $300,000 in today's dollars would be more in line with community expectations regarding retirement incomes once allowance is made for receipt of partial Age Pension for many retirees. However, for those on relatively high salaries prior to retirement even this would not be sufficient.

Both modelling of individual situations and the microsimulation modelling of the community as a whole suggest that higher effective retirement savings will be required for persons across the entire income range. The options available are higher compulsory employer contributions, higher voluntary contributions by employees, lower taxation of superannuation, or a combination of these options. However, even with a combination of such approaches it may take some decades for the majority of those in the paid labour force to achieve these retirement income targets.

3.5 Conclusions regarding prospective adequacy of retirement income

The preceding sections of this chapter of the Submission provide clear evidence of the prospective shortfall between retirement income needs and expectations and likely outcomes. A growing proportion of the population will be affected by this, leading to impacts at both the individual and macroeconomic level.

In terms of the proportion of the population who will be aged over 65, over the next 40 years this proportion will rise from 12% to nearly 25%. Both the higher absolute numbers of such individuals together with expectations in excess of those of earlier generations will place considerable demands on both government and private retirement income arrangements.

While the main effect of demographic change on Commonwealth government expenditures will be on aged care and health services, there also will be a significant impact on social security expenditures. Without the Superannuation Guarantee and superannuation more generally, expenditure on Age and Veterans Pensions would be higher. This is both because of the operation of the means test for these pensions, and because it will enable governments to resist pressures for moving to substantially higher pension payments and/or provision of a universal Age Pension. Higher retirement incomes will also allow certain aged and health care services to be paid for privately.

However, while the Superannuation Guarantee will lead to a substantial increase in retirement incomes once the system is fully mature, outcomes will fall short of expectations and needs in many cases. This will be particularly the case when an individual has breaks in their time in the paid labour force, or they are unable to achieve 30 or more years of SG contributions because of their age. In addition, SG contributions over the last 10 years have been less than 9%, starting for some individuals at only 3% in 1992. Higher contributions and/or lower taxes or other government assistance is needed to boost retirement incomes.

In this context the following recommendations are made:

R4 ASFA recommends that consideration be given to mechanisms for lifting current retirement savings, with a view to achieving as soon as possible average retirement savings approaching $250,000 or more in today's dollars, based on 30 years in the paid labour force. In the longer term retirement savings of $350,000 or more would be appropriate. This would be consistent with a retirement income target of around $25,000 per year by 2020 and $30,000 by 2030 (see Recommendation 1).

R5 ASFA recommends that consideration be given to increasing the superannuation coverage of the self employed by mandating contributions and/or increasing the tax incentives for contributions.

R6 ASFA recommends that incentives be increased for contributions on behalf of spouses and others not in the paid work force.

R7 ASFA recommends that the monthly earnings threshold of $450 be maintained for determining Superannuation Guarantee obligations.

A number of other specific strategies for improving adequacy are set out in Section 6 of this Submission, which deals with strategies for moving forward.

3.6 Actions which would erode adequacy of retirement income and which therefore should be avoided

The analysis above indicates that contributions at the maximum rate of the Superannuation Guarantee (9% from 1 July 2002) will not be sufficient to generate retirement incomes that will meet retirement income needs. Any erosion of retirement income savings through diversion of savings during the accumulation period, or through assigning some amount of the final benefit to a fixed purpose such as medical expenses or aged care, would lead to a greater shortfall in retirement incomes.

A very few countries, most notably Singapore, have central provident funds which are available for a range of purposes, including funding a deposit for home purchase and providing for medical expenses, but they have much higher contribution rates. These contribution rates can be up to 40% of wages and salary, and often replace a significant part of the income tax or other taxation of the country concerned.

Even with contributions as high as 40% of wages, the Singapore arrangements are showing signs of strain in that they are unable to fund the diverse activities that are supported by the fund. This is particularly the case if significant withdrawals are made early in the accumulation period.

In the context of the Australian Superannuation Guarantee arrangements, there clearly is much less scope for any withdrawals. A contribution rate of 9% is nowhere near the 40% contribution rate in Singapore.

3.6.1 Withdrawing a lump sum early in the accumulation period

Drawing down part of retirement savings early in an accumulation period means that the benefits of compound interest are lost, with a significant erosion of retirement benefits.

Calculations by ASFA indicate that drawing down $10,000 10 years into a 30 year saving period will lead to a reduction, in today's dollars, of $18,500 (Table 3.4). Over a 40 year saving period the equivalent impact of a withdrawal after 10 years is $25,200. For a person on $20,000 a year salary, this amounts to an erosion of their retirement benefit of 25% for a 30 year period and around 21% for a 40 year saving period. For a person on $40,000 a year the reduction is the same in absolute terms, but as a proportion of retirement savings is between 12% and 10%. In other words, early withdrawal has the greatest impact on those with least income in retirement.

Table 3.4: Impact on final lump sum of withdrawal of $10,000 after first ten years of contributions(a)

Income level	$20,000	$40,000	$60,000	$80,000
Lump sum after 30 years without withdrawal	$74,373	$148,747	$223,120	$297,494
Lump sum after 30 years if withdrawal made	$55,842	$130,215	$204,589	$278,962
Lump sum after 40 years without withdrawal	$118,892	$237,785	$356,677	$475,570
Lump sum after 40 years if withdrawal made	$93,665	$212,558	$331,450	$450,343

Source: ASFA Research Centre projections
(a) In constant dollars, assuming 7% fund earnings and 3.75% growth in average weekly earnings.

3.6.2 Using retirement savings for aged care and health costs

At current rates of contributions superannuation does not have the capacity to meet the increase in aged care and health costs. Commonwealth expenditures on health and aged care are projected in the Intergenerational Report to increase by 5.2 percentage points of GDP over the 40 years to 2042. In contrast, the flow of retirement income from a fully mature Superannuation Guarantee system is likely to be much less than this, perhaps around the 3% of GDP mark. Even if all retirement savings were diverted to health and aged care there would not be enough to offset the increased costs that are projected.

In any event, self insurance through access to savings type accumulation accounts would not be an effective mechanism at an individual level. Personal savings generally will be either too much or too little to deal with health and aged costs. Most individuals do not have the capacity to deal with the large or catastrophic costs of health care and aged care that are faced by just a minority of the aged population. Money set aside for such costs will either be wasted and form part of the estate of the person, or will be nowhere sufficient to meet the costs that might be involved.

Governments will and should have ongoing roles in providing what is in effect community based insurance against health and aged care costs which would be catastrophic at the individual level.

However, enhanced retirement incomes do have the capacity, amongst other things, to facilitate the maintenance by individuals of membership of private health insurance in the post-retirement period, and to pay for ancillary services and a better quality of lifestyle. The primary goal should be to generate significant retirement incomes, which can then be used for a range of purposes according to the needs and interests of specific individuals.

R8 ASFA recommends that retirement savings continue to be used primarily for the provision of private income. While better retirement incomes will assist in addressing increasing health and aged care costs, diversion of retirement savings to additional health or aged care insurance and/or catastrophic health care costs will not be an effective solution.

4. Integration of superannuation with social security and tax provisions

Australia faces a number of challenges in regard to the integration of occupational provisions for retirement income and the more general social security system. Unlike social security payments to the retired in a number of other countries, the Australian Age Pension is a flat rate, means tested benefit which is not related to previous occupational earnings. Australia is also unlike most other countries in that it permits the payment of substantial lump sum retirement benefits from occupational schemes. In fact the payment of lump sum benefits is by far the most common method for superannuation funds. A significant proportion of superannuation benefits are also paid out as lump sums prior to retirement age, although progressively tightening compulsory preservation arrangements will diminish this leakage from the system in the future.

However, the Australian arrangements have had advantages compared to other countries. In some countries the very strong links between occupational retirement income arrangements and social security provisions have led to substantial integration of the two systems, but at the cost of large and growing social security obligations as the population ages. Clearly, the experience of these countries shows that any benefits of improved integration through having earnings related, publicly provided social security provisions are outweighed by the costs. Social security arrangements are effective and affordable when they target poverty alleviation, and private arrangements are best for providing retirement income above that level. Accordingly the sensible and realistic option for Australia is to continue to have social security and occupational superannuation arrangements that are separate.

The challenge is to have them both separate and better integrated. Better integration will have both efficiency and equity benefits. However, it should be acknowledged that **poverty alleviation and, to a lesser extent, equity goals are already delivered to a considerable extent by the provision of Age and Veterans Pensions**.

The Australian social security provisions are effective in providing poverty alleviation, essentially through providing a means tested minimum benefit. An annuity with similar characteristics that was purchased privately would have a capital value of over $200,000 for persons of Age Pension age. In effect, the existence of the Age Pension means that persons of Age Pension age who do not have private savings receive a significant wealth transfer from the government, albeit one that can be accessed only in income form.

Where the social security system has been less successful is in its treatment of those with modest private income or assets, particularly in the asset range $140,000 to $280,000 where a relatively severe means test taper applies to receipt of the Age Pension. As the Superannuation Guarantee system matures and hopefully is enhanced, a growing proportion of retirees if not a majority will have superannuation and other financial assets within that range. Improvements to the integration between social security and private retirement income are both possible and desirable.

In the absence of a properly funded and integrated system of superannuation, Australia would only be able to achieve a very limited and unfortunate kind of equity in the sense that the great bulk of retirees would be on a similar income. While that may not sound alarming in itself, it is when that similar income is just above the poverty line.

This focus on poverty alleviation in past retirement arrangements in Australia shows up in international comparisons of where pensioners end up in the overall income distribution in the community. As shown by Table 4.1, in Australia retirement incomes are very compressed compared to our international peers, and this compression has put most retirees at the bottom of the income distribution.

Table 4.1: Proportion of pensioners in three parts of the overall income distribution of the community

	% in poorest 30%	% in middle 40%	% in richest 30%
Australia	48	44	7
Canada	49	37	15
France	28	43	30
Germany	36	44	20
Italy	28	46	27
Netherlands	32	51	18
UK	38	46	15
US	41	40	18

Source: Johnson, 1999.

4.1 Recent provisions impacting on integration of superannuation with social security and tax

Specific recent provisions relating to interaction have also been the subject of ASFA submissions. One example is the inclusion of superannuation assets in the means test for receipt of social security benefits by the long term unemployed aged over 55. ASFA, among other groups, had serious reservations in regard to that change in the means test. ASFA was appreciative of the Government’s decision in the 2001 Budget to remove those assets from the means test for that group, thereby restoring the preservation of superannuation for retirement and improving the integration between social security and retirement income provision through superannuation.

The Government has also undertaken a number of other measures to improve the interaction of social security with both superannuation and other private income provision in retirement. Measures which have helped improve interaction with private income generally have included an easing of the income test through a reduction in the rate at which the Age Pension is reduced with an increase in income, and changes to the deeming rate for income assumed to be received from financial investments.

While not strictly measures which relate to integration of private retirement incomes with social security, the introduction of the Senior Australia Tax Offset has assisted self funded retirees, as has the availability of the Seniors Health Card. However, the Senior Australia Tax Offset has contributed to the complexity of the tax system, and has also led persons with similar taxable income being dealt with quite differently by the tax system once they reach Age Pension age. While some commentators have welcomed this, others have been critical.

Significant changes also have been made to the means test treatment of certain long term, non-commutable income streams. These changes, which came into effect in September 1998, provide an exemption from the asset test component of the means test for complying pensions and annuities. As well, given the way income is calculated for such products and given their low underlying investment rate of return, recipients of such income streams often are not affected to a great degree by the income test.

The Coalition parties also indicated in their 2001 election commitments on superannuation that "consistent with providing an effective and sustainable retirement income system, the Coalition believes that there should be a range of income options for Australians to consider". They also indicated that "a re-elected Coalition will examine whether certain market lined income streams (know as growth pensions and sometimes referred to as account-based income streams) should receive concessional tax and social security treatment with a particular view to the revenue and social welfare impacts of such a proposal". No announcement had been made at the time of writing concerning the method or timing for this review.

While ASFA does not necessarily disagree with the thrust of a number of these measures, these changes have tended to address the symptoms of poor integration, rather than the fundamental underlying causes, and, arguably, have created new anomalies and inequities. A more fundamental review has the potential to deliver considerable benefits in terms of equity and efficiency, and to lay the foundations for an integrated retirement income system for the future.

In this overall context the submission will look first at the current interaction between superannuation and social security and then at possible ways of improving this interaction.

4.2 Social security and superannuation recipients

Retirement income provision in Australia is currently characterised by what can be considered as a disjunction between the social security and superannuation systems. This is both a function of how the means test for social security works, and the fact that to date only a minority of retirees have substantial private income derived from occupational superannuation.

Most current retirees receive the Age Pension and little or no superannuation income (or any other private income to speak of), a minority are self funded retirees relying on superannuation income streams or assets that have been derived from the superannuation system and/or from private savings outside superannuation, and a growing proportion receive both social security and superannuation payments.

According to Australian Bureau of Statistics (ABS) data there were some 2.678 million people over Age Pension age as at June 2001. The 2001 Annual Report of the Department of Family and Community Services provides information about the receipt of benefits and income by this group. It indicates that 1.793 million people received the Age Pension, while a further 341,000 in the same age group received similar means tested benefits from the Department of Veterans' Affairs. This results in a total takeup rate of around 80 per cent for the age group. There also would be some retirees below Age Pension age who would be in receipt of social security benefits and/or income derived from superannuation.

The takeup rate has been reasonably steady over the last five years, but is up from around 75 per cent at the start of the 1990s. Easing of the means test, together with the popularisation by financial planners and advisers of strategies designed to achieve access to at least a part Age Pension, would appear responsible for this increase.

The incidence of receipt of a part Age Pensions is reasonably high. As at June 2001 some 36 per cent of people on the Age Pension received a part pension. This percentage is up by about 4 percentage points from two years earlier. The increase in the percentage receiving a part pension is due in part to cohort effects. Those receiving the pension for the first time tend to have greater than average income and assets. This reflects both rising personal wealth in the form of superannuation assets and other financial assets, and the financial planning strategies aimed at achieving a part pension.

For those receiving a part pension the average reduction is around $95 a fortnight, compared to the single Age Pension of around $410 as at February 2002. For around 75% of Age Pensioners the Pension accounts for over 50 per cent of the income of their household. Significant private income tends to be concentrated in a small minority.

Around 20 per cent of households with the head aged 65 and over have the Age Pension contributing less than 20 per cent of the household income. A surprising 15 per cent of the total number of such households have the Age Pension contributing 1 per cent or less of the household income. This would again appear to be an outcome of strategies designed to achieve receipt of at least a minimal Age Pension in order to receive other concessions, and the inclusion in the household data of children of workforce age still living with their parents. In regard to the former factor, while the Commonwealth has extended a number of concessions to self funded retirees with modest incomes, State governments have yet to extend rates and other concessions to self funded retirees.

Projections of Age Pension recipients and rates of payment that have been undertaken by the Treasury indicate that the proportion of those aged over 65 receiving the Age Pension is likely to remain more or less constant. However, the proportion of those receiving a part Age Pension due to the operation of the means test is likely to nearly double from the current level of 36%.

In summary, only a minority of the retired population currently have sufficient private retirement savings to be subject to the Age Pension means test. In the decades ahead most individuals who retire will be affected to a significant degree by the means test if it is maintained in its current form.

4.3 Operation of the means test for the Age Pension and other social security benefits

Commonwealth income support payments, including the Age Pension, have been subject to means testing ever since they were first paid in 1909.

The means test has a long history, but its rationale and design features are shakier than this long history might suggest. Over that period there have been significant changes to structure, incidence and relative generosity of those arrangements. As well, integration between social security and superannuation has, at least until relatively recently, been only a relatively minor consideration in the design and operation of the means test.

While a number of recent changes by both the current and previous government have improved integration, further enhancements to integration appear both possible and desirable. It could be argued that while tax concessions encourage additional retirement savings through superannuation, the means test discourages such savings. This is a rather mixed message to be giving to the population.

R9 ASFA recommends that the structure of the means test for social security be reviewed by a joint government and superannuation sector working group, rather than just focussing on marginal changes or the treatment of specific financial assets or income streams.

4.3.1 The cost to revenue of removing the means test

An obvious way of removing the disincentive for private savings that flows from the operation of the means test would be abolish the means test. This has been suggested by some groups from time to time, including by the Institute of Actuaries Australia a few years ago. However, in the current political climate abolition would be challenging, as the gross cost would be some $4 billion a year, with a net cost of around $2.8 billion once the offset from increased tax on incomes was taken into account (Ingles, 2001). This costing could be on the conservative side given recent changes to income tax arrangements applying to those of Age Pension age which reduce or eliminate income tax liabilities for individuals with a modest income.

These costs would grow over time. The Retirement Income Modelling Unit of the Treasury has projected that a universal pension would cost an additional 2% of GDP by 2050, equivalent to around $12 billion gross in current dollars, $8 billion or more net once income tax receipts were taken into account. However, these costings may be on the high side because they were prepared prior to the taper rate for the income test for the Age Pension being reduced from 50 cents in the dollar to 40 cents. That said, a very large reduction from $8 billion a year would be needed to make this affordable to the Commonwealth budget, particularly as there would be other pressures on the budget from the ageing of the population.

Apart from the cost, the equity implications of a universal Age Pension would be less than desirable. While part of the Age Pension paid to upper income earners would be clawed back through the income tax system, paying the Age Pension to multi-millionaires or billionaires is not really supportable on equity grounds. The expenditure required for a universal Age Pension would be better spent on more tightly focussed assistance for the retirement income needs of low to middle income earners. A number of recommendations in this submission pursue this latter objective.

R10 ASFA does not support abolition of the age pension means test because of the cost to revenue and the doubtful equity implications of such a change.

4.3.2 The need for changes to the means test

Clearly the means test plays, and will continue to play, an important role in both containing the overall budget costs for government. It also is important for equity purposes. The electorate sees more pressing needs than giving multimillionaires the Age Pension, even if they would pay back at least part of the Age Pension as income tax.

That said, the current means test has a number of undesirable consequences for retirement saving through superannuation or other self provision, particularly for those on average weekly earnings or just above who accumulate modest retirement savings. These include:

- confusion and uncertainty about the way the system works;
- a significant role in the creation of a planning and advisory industry because of the complexity of rules and the frequency of changes;
- perceived, even if not very common in practice, opportunities for double dipping;
- high effective tax and withdrawal rates of benefits over some ranges of assets and income of the retired; and
- efficiency costs of massaging income and assets to better meet the means test.

4.4 Design parameters for the means test

The design parameters for the means test play an important role in the integration, or relative lack thereof, between the social security system and superannuation.

The important parameters of the means test are:

- **Income**. For the purposes of the means test income includes earned income such as wages and also income from investments. For some investments, such as most financial investments, the amount of income is deemed by way of set percentages applied to the aggregate amount of the financial investments. For other investments it is usually the actual amount of income derived or received. In the case of some income payments such as pensions or annuities there is an adjustment made to the gross amount received in order to reflect any return of capital. As at 20 March 2002, once income reaches $30,790 for a single person no Age Pension is payable.
- **Assets**. The pensions asset test was introduced in 1985 and operates alongside the income test. The test which produces the lower rate of pension is the one that is applied. Certain assets, principally the recipient's home and certain long term income streams which meet strict criteria, currently are excluded. The asset test tends to predominate over the income test once a significant level of assets are held. For a single homeowner, no Age Pension is available once assets exceed $283,500. At a 7% annual return, such a lump sum would generate an income substantially less than the maximum income allowed under the income test. As the compulsory superannuation system matures with more individuals with substantial lump sums, the asset test will have an increasing impact on those who have retired. For ASFA comments and recommendations on this, see Section 4.5.2.
- **The free area**. Both the income and assets tests allow for income and assets up to certain amounts (a relatively low amount for the income test) to be ignored in calculating Age Pension entitlement. These amounts are known as the free area. The current free areas for a single homeowner are $141,000 for the assets test and

$2,920 per year for the income test. At current rates of return, the free area is more generous for assets than income.

- **Taper rates**. Income and assets above the free areas result in a reduction of the Age Pension. Taper rates can apply to successive parts of the income or asset range, or to the entire range. As noted above, in the current Australian system and with current earnings rates for investments, the taper rates for assets tend to dominate over the income taper, at least for higher levels of assets. Over a significant range of asset holdings subject to the asset test, an increase in assets and private investment income can lead to no net increase in total retirement income. For persons in this situation, this amounts to a powerful incentive to use at least past of the assets held to purchase a complying income stream which is exempt from the asset test.
- **Cut out points**. The net effect of the taper rates and free areas is that with higher income and assets the pension payment progressively decreases until none remains.
- **Joint testing of couples**. The benefit paid to a couple is less than twice the payment to a single, and the assets and income of a couple are considered jointly in the operation of the means test.
- **Home owners and renters.** An additional rental allowance is paid to renters that qualify, and they also receive the benefit of a higher free area under the assets test.

On top of these characteristics of the means test is the treatment for income tax purposes of income received by those of Age Pension age. While in the past income tax rates and arrangements were largely independent of the age of the taxpayer, in recent years a number of changes have been made which provide preferential tax treatment for older Australians, but again subject to a means test based on taxable income.

4.5 Improving integration between superannuation and social security

Just writing down the parameters is bad enough, let alone considering their detail or application in specific circumstances. This in itself demonstrates problems with integration given the current complexity of the arrangements and the lack of understanding of their detail by most retirees. However, it should be acknowledged that changes to the parameters made in recent years have simplified the system for most Age Pension recipients, that is, those with little private investment or superannuation income. Equally, those with substantial assets outside the family home and/or who have a significant pension from a previous employer normally receive clear and simple treatment – they are not eligible for any payment.

Currently the means test system works reasonably simply and fairly for the bulk of current retirees. Unfortunately, for the current minority of retirees with significant superannuation derived savings in the order of $140,000 to $280,000 the system is neither simple nor fair. In the future as the proportion of retirees with assets and income in excess of the free areas increases, this problem of lack of appropriate integration will increase. Superannuation and other financial assets of the order of $140,000 to $280,000 is fair and square in the range of outcomes that the Superannuation Guarantee is projected to deliver over 30 to 40 years for a person on average earnings. The means test is already a problem for middle Australia, and will become an even greater problem in the future if it is not reformed.

The next sub-sections of this submission make suggestions for improving integration and fairness in regard to the various parameters of the means test. A number of these suggestions also have the potential to improve the simplicity of the system through adoption of clearer and more uniform rules. It should be noted that in some cases the suggestions made are in regard to the broad direction of reform, with further detailed work required to make them operational.

4.5.1 Better integrating private income and the Age Pension

Currently different types of income are treated differently even though in essence they are similar or identical. This relates both to the quantum and timing for inclusion in the income test.

Fortnightly wages but annual reckoning for other income

Personal earnings (earnings for work performed, including salaries and wages) is included in the income test on the basis of income received in the applicable two weeks. In contrast, most other forms of income are in effect averaged over the entire year even though such earnings are attributed to specific fortnights.

The current arrangements discourage intermittent and casual work because the combined effect of withdrawal of the Age Pension with any income tax liability leads to very high effective marginal tax rates (EMTRs) for employment by persons primarily reliant on the Age Pension. This is inconsistent with the thrust of government policies which aim to increase labour force participation by those past normal retirement age and to support flexibility of arrangements past Age Pension age. For a few social security benefits the concept of an income bank is applied, where any unused portion of the free area for income in a given fortnight can be applied in later periods.

R11 ASFA recommends that there be better integration of work and retirement by introducing an income bank for Age Pensioners for income derived from employment.

In addition, while it is not strictly relevant to the integration of superannuation and social security, the Pension Bonus Scheme, introduced on 1 July 1998, has not been an outstanding success in encouraging individuals to work past Age Pension age and delay receiving the pension. As at 30 June 2001, 23,703 people had registered with the scheme with $7.2 million being paid in bonuses to around 3,000 people. The Department of Family and Community Services has been conducting a review of the scheme since 2000-01 and is expected to complete the review soon. It is likely that the review will consider both how the scheme has been promoted, and whether the level of the bonus is sufficient to induce changes in retirement behaviour.

The scheme perhaps has not received as much publicity as it might have, but the deal offered is not a great one. There is a need to register, and to work in paid employment at least 960 hours a year. Currently the labour force participation rate for persons of Age Pension age is very low, and is mostly made up of professionals and the self employed who are less likely to be eligible for the Age Pension. The bonus payable is also a relatively small proportion of the value of the pension foregone. If this is a tool to encourage higher labour force participation post normal retirement age then it needs to be sharpened somewhat.

R12 ASFA recommends that the amount and conditions for the Pension Bonus Scheme be reviewed so as to make it more attractive to potential users and more actuarially fair.

Differences in treatment of various financial and pension income streams

There are significant differences at present in regard to how various forms of non-wage income are included in the income test for the Age Pension.

Income from financial investments is treated in a simple and consistent way through the operation of the deeming provisions. As at March 2002, if you are single and receiving the Age Pension, the first $33,400 of financial investments is deemed to earn income at 2.5% per annum, with any amount over that deemed to earn income at 4% per annum. For a couple the same deeming rates apply, but the lower rate applies to combined financial investments of $55,800 or less.

In contrast, other financial investments such as allocated pensions and annuities and complying pensions and annuities include in the amount subject to the income test the gross amount received by the recipient less an adjustment for any return of capital. This adjustment has to make use of factors relating to life expectancy or the term of the pension or annuity, and identification of an initial capital purchase price. These adjustments can be particularly problematic when the income stream is not straightline, for example, when payments increase over time with movements in the Consumer Price Index or other specified indicator.

Extending the deeming provisions to cover all assets, including the capital value of allocated and other pensions, would lead to both greater simplicity and greater integration between superannuation and the Age Pension. It would also provide incentives for individuals to achieve greater returns from allocated and other pensions, because the excess of the actual return over the deemed return would not form part of the income test. This incentive currently only applies to a limited range of financial investments. There appears to be no good reason why deeming is appropriate for a balanced managed investment fund but not appropriate for income received from an allocated pension backed by an identical investment.

Extending the deeming provisions to cover all assets and hence integrate the income and assets tests actually has precedents in the Australian social security system. For the first fifty years of the Age Pension both assets and income were taken into account in a merged test, albeit in a fairly punitive way. The current structure dates back only to 1985 when the Hawke government reintroduced the assets test following its earlier removal from older recipients of the Age Pension. The rationale for applying both an assets and income test, with the test being used the one that gave a lower pension level, and a relatively punitive test on assets, was not clear at the time of its introduction, and has not become any clearer since then. In the absence of any such rationale the case for a simpler and integrated means test becomes all the stronger.

R13 ASFA recommends that the current asset and income test be replaced by an integrated means test in which a deemed earnings rate is applied to all assets which are included in the test.

4.5.2 Changes to the taper rates and hence to the cut off levels of income and assets

The degree of integration between superannuation and other private income and the Age Pension has been progressively increased over the years with changes to the taper arrangements. However, the taper rates can still provide considerable disincentives for private provision of retirement income, at least over some income ranges.

The most recent significant change to the taper rate for the pension income test was in June 2000 when the taper rate for income above the free area was reduced from 50% to 40%. This change formed part of the ANTS changes, and was estimated to involve additional pension expenses of around $400 million a year.

However, even after this change Effective Marginal Tax Rates (EMTRs) on additional private income are still quite high, particularly over income ranges where a particular benefit is phased out, or income tax is phased in. Ingles, 2001 has indicated that EMTRs can be nearly 70% for a single Age Pensioner over significant income ranges.

As well, the ANTS changes did nothing to the taper rates on the capital component of the means test. Where an asset value can be attached to private income, which currently is the case for most financial investments with the exception of complying pensions, the taper rate applicable to assets is even more severe than that applying to income. For a homeowner, when assets for a single person exceed $141,000 and for a married person joint assets exceed $200,500 then the Age Pension is reduced by $3 per fortnight for every $1,000 above the limit. On an annual basis this is equivalent to each $1,000 reducing the Age Pension by around $78 a year.

Given that at current interest rates and yields from financial investments $1,000 is likely to generate at best around $70 a year, this taper rate is in effect confiscatory, with an EMTR in excess of 100%. When income tax on the income received is taken into account, the EMTR figure is even higher. Greater self provision actually leads to a reduction in income over the range of assets to which the taper applies. It is only when a single person has more than $283,750 in assets that the taper rate ceases to have an effect (no pension is payable). The taper rate and the effective marginal tax rates involved also can lead to use of low yielding but asset test exempt complying pensions.

The rationale for a higher effective taper rate applying to assets once a minimum asset level is exceeded is not entirely clear. However, it may have something to do with the notion that a person with access to a significant sum of money should be forced to draw down on that amount even if the income it generates is still with the range permitted by the income test. This arguably may have made some sense at the time the taper was designed when superannuation lump sums were generally either higher or lower than asset range over which the taper applies. However, as the Superannuation Guarantee system matures and an increasing number of retirees have financial assets in this range, the taper rates make no sense at all. A redesign of the means test is needed to bring about integration of private retirement income provision and social security.

R14 ASFA recommends that the taper rates for income and particularly for assets be reduced so as to provide both greater integration and increased incentives for self provision.

4.6 Complying pensions and proposals for growth pensions

Complying pensions, while similar to retirement income streams offered in a number of countries, are another peculiar construct of the Australian tax and social security systems. The concept was invented so as to support a different and higher Reasonable Benefit Limit applying to the capital value of a pension. Without a definition of complying pension it would not be possible to determine whether a pension attracts the higher RBL. A further and even more peculiarly Australian twist is the exemption from the asset test for social security of the capital value of a complying pension.

This is not something that is generally an issue in other countries, as the social security entitlement on retirement in most other countries is related to previous contribution history and/or final salary rather than assets or income during the retirement period. As well, in most other countries the availability of lump sums generally has been very limited. In those countries defined benefit pensions rather than account based income streams have been the dominate form of benefit, and in any event their social security provisions are not means tested in the Australian manner. Complying pensions therefore are not an issue in most other countries.

In Australia complying pensions are increasingly becoming an issue, as more individuals approach or exceed their lump sum Reasonable Benefit Limit and/or get asset tested excluded from receipt of the Age Pension. For those fortunate enough to receive a public sector indexed pension, the generosity of most such pensions means that there are few concerns at the consumer level about the form of the benefit, or the investment returns, if any, sitting behind the pension. However, for individuals purchasing an income stream from a capital sum accumulated within the superannuation system, the characteristics of and the rate of the imbedded investment return in their income stream is a much more crucial issue.

Current rules for complying pensions and annuities require, amongst other things, for the annual payment to be fixed, with the only variation permitted being a CPI or like adjustment. There also are strict limits on the ability to commute or pass on the capital value of the pension. Given these product characteristics, life companies that offer such products generally hold fixed interest or CPI linked debt securities to back them. The more innovative providers boost implicit returns, or at least provider profit, by holding some property assets as well. Return of capital tends to increase the annual payment made from such products, but the underlying rate of investment return is low and in line with fixed interest securities such as government bonds or term deposits.

Actuarial analysis (Knox, 1999) indicates that complying pensions and annuities offered in the Australian market by commercial providers generally offer fair value in actuarial terms in that they reasonably reflect life expectancies and current fixed interest returns, and do not appear to have excessive fees or profit margins for providers. However, whether they offer good value, or value relative to other managed investments, is another matter. The basic problem is that they have to offer fixed payments to individuals and capital security. The inevitable consequence of this is low investment returns.

As a result, complying pensions generally are not popular with consumers other than as a mechanism for avoiding the asset test and achieving a part Age Pension. Complying pensions tend to be part of a package of products and advice provided by financial planners rather than a product sought to be purchased. It is the implicit subsidy that flows from access to the Age Pension rather than their underlying characteristics which has led to some consumers taking them up. In contrast, retirement income products such as allocated pensions are better understood and more popular in the market, even though they are tested against the lump sum RBL and are subject to the asset test component of the means test.

The Government has indicated that it will examine the tax and social security treatment of certain market linked income streams including growth pensions. In that context ASFA will be providing detailed comments and suggestions, as will other organisations. For the moment ASFA suggests a number of principles that should be taken into account. In summary, these are that:

- The pension should be simple for the pensioner to understand and use.
- The pension should be simple and inexpensive for the provider to administer.
- The pension should allow the pensioner to gain the benefit of market based investment returns, and bear the consequences of any market downturns, while ensuring that the income stream can be paid for at least life expectancy and preferably life.
- The rules for the growth pension should be designed to ensure that the majority or all of the capital should be distributed as income rather than being a mechanism of estate planning used to shift tax advantaged assets to the next generation. In this regard, some Self Managed Superannuation Funds providing a complying pension to a member appear to be driven more by estate planning than retirement income concerns.

R15 ASFA recommends that the definition of complying pensions be expanded to include pensions which have exposure to growth assets while at the same time requiring the likely exhaustion of capital over the life or the life expectancy of the pensioner.

4.7 Should superannuation benefits be required to be taken as an income stream?

The evidence available indicates that estate planning tends to be more of an issue than individuals "double dipping" by taking a superannuation benefit and then dissipating the money on an overseas trip or the like before taking up the Age Pension. Surveys undertaken for the Department of Family and Community Services and its predecessor, and by the ABS, indicate that lump sums generally are reinvested in income producing financial assets, used to pay debts and/or are used to purchase essential consumer items or to carry out repairs.

A long standing policy of ASFA has been that a number of characteristics should be attached to retirement benefits which receive the benefit of concessional tax treatment or other assistance from government. These include:

- being in the form of an income stream rather than a lump sum (apart from a modest sum to meet immediate or urgent expenses);
- providing reasonable protection against the financial consequences of longevity through being available for a period not dissimilar to life expectancy;
- providing protection for dependants through appropriate reversionary benefits; and
- requiring a drawing down of capital rather than being a form of estate planning.

ASFA acknowledges that it would not be sensible to require relatively small lump sums to be converted into an income stream or pension given the administrative costs that are involved. However, the minimum purchase price for a viable income stream product should decrease if the rules for a complying pension are made simpler.

There also is a case for having a modest amount available at the time of retirement to meet debts and to undertake repairs or replace consumer items in the home. While the specification of an amount is somewhat arbitrary, a cap of $50,000 on the availability of a lump sum sourced from retirement savings that have received concessional tax treatment might be appropriate. A matter for further consideration would be whether there should be an absolute prohibition on lump sums above such a cap, or whether payment should be allowed subject to a rate of tax that offsets any tax advantages that were received.

R16 ASFA recommends that in the future retirement benefits be required to be taken in the form of an income stream along the lines of a complying pension or a growth pension as currently being considered by government.

R17 ASFA recommends that a cap of, say, $50,000 be placed on the availability of a lump sum paid from concessionally taxed retirement savings.

5. Enhancing confidence in superannuation and simplifying arrangements

ASFA's research into the views of Australians indicates that the complexity of superannuation and the uncertainty that has flowed from constant changes has caused many consumers to tune off from additional voluntary superannuation savings. There also is evidence of a level of complacency in that it is often assumed that "the Superannuation Guarantee must be enough" since that is what the government requires. However, once it is explained to consumers just what the Superannuation Guarantee will deliver relative to their expectations, and what the government currently taxes in the way of taxes on superannuation, that complacency is disturbed. The introduction of taxes at every stage of superannuation has led to both increased complexity and the unfortunate perception that the government does not support superannuation or the efforts of individuals for greater self reliance.

In essence, confidence and simplification go hand in hand. Increased confidence in superannuation also comes with any evidence that the government is providing support for individuals for their greater self provision in retirement.

In the next section of this submission a number of strategies are suggested for increasing both consumer confidence in superannuation and adequacy in retirement incomes by enhancing the support government provides for superannuation. The remainder of this section looks at ways of addressing the complexity of the system.

5.1 The real and perceived complexity of superannuation

It is widely accepted that superannuation and retirement income arrangements need simplification. In particular, simplification of tax arrangements relating to superannuation is an objective which receives widespread support in the community, in the sector and even by government. There is also community unease when most individuals with significant or even relatively modest assets or private retirement income find it necessary to consult a professional adviser.

Over the last decade arrangements at the fund level have tended to become more complex rather than less. Each year there have been scores if not hundreds of changes in tax and prudential provisions relating to superannuation. Some of these changes have been relatively minor or technical, but many have been substantive and have been perceived as such by superannuation funds and, when they have been aware of the changes, by the members of funds. Some of these changes were intended to deliver benefits to fund members through greater options being available or by providing enhanced member protection in some form or another. Other changes had the aim of addressing actual or perceived abuses of the concessions available to superannuation and/or to generate additional tax revenue for the Commonwealth government. These have contributed to the level of complexity and increased administration costs of funds.

The constant legislative and regulatory changes have not been helpful in terms of the way superannuation is perceived by fund members. For some fund members, particularly longstanding members with pre-1983 and pre-1988 contributions, the changes are a genuine source of complexity. While transitional arrangements are to the financial benefit of fund members, they do lead to greater complexity as different tax and preservation arrangements apply to different components of the member's accrued superannuation entitlement. For example, whatever the underlying merits, the calculation and application of transitional reasonable benefit limits does not contribute to a perception of simplicity.

Other recent provisions adding to complexity have been put in place because of the impact of equity and prudential measures on the entitlements or expectations of superannuation fund members. Examples include changes to the preservation arrangements governing the age at which benefits can be accessed, and the type of investments a self managed fund can make.

For relatively recent entrants to superannuation, complexity can be more perceived than real, at least for members of accumulation schemes. Such members have in effect a financial product which is not much more complicated than a bank account, at least during the accumulation phase. However, complexities still remain in regard to the circumstances in which withdrawals can be made, and in regard to tax and social security consequences of either cashing out, rolling over or purchasing a retirement income product with the benefit.

The layering of superannuation taxes, with two levels of taxation at the contributions level, taxes on fund earnings, and multiple rates applying to benefits depending on the age and other circumstances of the member, is a major source of complexity and confusion. Most superannuation fund members and even superannuation practitioners can have difficulty in understanding the interaction of these taxes. This is particularly so given that even though the ultimate incidence of the taxes is on the fund member, the taxes are paid at different times, by both the individual and the fund, with the rate of tax on benefits conditional on uncertain factors and circumstances.

The lack of clarity is so extreme that many fund members blame their superannuation fund for the deduction of contributions tax from their contributions rather than seeing it as part of the overall taxation of superannuation.

However, change in the sector is much easier to achieve than simplicity. This is particularly the case given that superannuation now accounts for over 20% of household wealth, 8% of employee total remuneration and around 4.5% of Commonwealth tax revenue. For change to be acceptable it must not unduly disturb accrued rights or reasonable expectations.

5.2 Grandfathering rather than transition

Major changes made to the taxation of superannuation over the last two decades have tended to be made late in the budget cycle with little or no public or industry input, or indeed any comprehensive analysis by government advisers. Such major changes have the potential to disturb the well established and mostly legitimate expectations of the soon to be retired and even those some years away from retirement. If not addressed, this would be a major political problem for any government, given that voters do not appreciate large and seemingly arbitrary downwards adjustments being made to a major component of their wealth. Those close to retirement have no or little opportunity to address such adverse changes.

With sufficient time available it would be possible to devise a variety of transition strategies that might permit an orderly changeover to a new taxation regime for superannuation or income taxation more generally. This might involve allowing a defined period for benefits to be taken under the old arrangements, the value of past entitlements to be paid out in some form or some cap to be put on the value of the concession that accrued in the past.

5.3 Doing away with grandfathering

A significant source of complexity is the different tax and other treatment of superannuation entitlements according to the time period for which the entitlement is attributable. For instance, under current arrangements benefits attributable to pre-1983 service will need to be separately identified by superannuation funds and employers until the last person with pre-1983 employment has retired or otherwise taken all their superannuation benefit. This may not occur until the year 2030 or even later. Similarly, superannuation funds need to identify for preservation purposes entitlements prior to certain dates so as to draw a distinction between preserved and non-preserved benefits. Again, while Treasury has estimated that the proportion of non-preserved benefits will fall to around 10% of total superannuation assets by 2007 compared to around 65% in 1995 (Rothman, 1997) it will be some decades before funds will be able to do away with this distinction.

A number of alternatives to grandfathering are available which are much more conducive to simplicity in that they make a cleaner break with the past. Such methods can include:

- Use of a sunset clause
- Transition based on age or years until retirement
- Transition value of accrued benefits at a given date
- Payment of any accrued tax liability at a given date making use of applicable concessional tax rates
- Sorting out equity concerns by paying a bonus or providing a tax benefit for certain affected individuals at the time of retirement.

A **sunset clause** provides a time limit for the further operation of a concession. This can allow orderly planning and fair treatment of persons close to retirement. The downside for individuals is that if they retire outside the time limit allowed then no concession at all is available. For instance, if a period of 5 or 10 years starting in 2003 were set for access to superannuation benefits under the 5% assessable arrangements, then those near retirement would not have their retirement arrangements unduly disturbed. Those losing the benefit of the concession would have little objective cause for concern given that it related to employment some 25 or more years earlier. Arguably, the current treatment of superannuation and other benefits even vaguely linked to pre-1983 employment goes beyond what equity strictly requires. Similarly, a sunset clause could apply to non-preserved superannuation benefits, with all benefits becoming preserved in, say, five year’s time.

Transition based on age or years until retirement could work in a similar way. For those aged under 45 or 50, retirement is sufficiently far off that loss of the ability to access previously unpreserved benefits could not be seen as being an undue imposition. Similarly, for such individuals the loss of any pre-1983 employment related concessions in most cases will not involve any substantial amount. If the amount is more substantial then the overall superannuation benefit being received almost certainly will be substantial, with the individual having the capacity to pay a larger amount in benefit tax.

Another approach is to **calculate a value of tax benefits at the transition date** and for this to be carried forward in the personal records of the taxpayer, or perhaps recorded in the database used for assessing compliance with the Reasonable Benefits Limits. While maintaining the value of the concession in nominal terms (or indexed to inflation or average earnings if preferred), this would negate the need for funds to maintain separate records of pre-1983 service and would provide a more transparent valuation of the concession for the individuals concerned. It also would stop the concession flowing to benefits attributable to employment after the transition date, as is often the case to some extent at the moment.

Payment of the accrued tax liability associated with any previously grandfathered concession as at the transition date also would simplify future record keeping while capping the value of the concession provided. It also would have the advantage, at least from the point of the view of the government, of bringing forward the collection of tax revenues. This might be particularly important if other changes made by the government led to lower tax collections in the immediate future.

Paying a bonus or providing a tax benefit is an option that may need to be considered if there were a shift from the current system where there is tax on contributions and fund earnings to one where tax was paid only when benefits were received. If grandfathering were to be avoided, allowance would need to be made when benefits were paid under the new arrangements for tax paid on contributions and fund earnings in the period 1988 to the date of implementation of the new arrangements.

R18 ASFA recommends that consideration be given to mechanisms that would reduce the amount of "grandfathering" in the superannuation system while at the same time preserving equity between fund members.

5.4 Rationalising restrictions on those who can contribute

Currently superannuation contributions and accounts are restricted to:

- those who are in the paid labour force;
- those who were in the paid labour force in the last two years;
- those who have been on maternity leave but were employed in the last 7 years;
- those with a spouse of the opposite sex who can make contributions on their behalf or whose superannuation entitlement is transferred in part at the time of divorce or separation; and
- some individuals who have reached aged 65 but are still in employment and wish to have contributions made, with proposals before the Parliament seeking to extend this to individuals aged over 70.

The government is also proposing to extend the ability to establish a superannuation account and make contributions to:

- relatives and friends of children making contributions into accounts established by a parent of guardian for a child; and
- single mothers and those in same sex relationships (presumably recipients of artificial insemination or IVF) who do not have a link to the paid labour force but have received the Baby Bonus in the previous twelve months (spouse contributions would be available if there were an opposite sex spouse present).

While a link with employment has traditionally been part of superannuation, the introduction of spouse contributions and the more recent provisions relating to children and recipients of the Baby Bonus have placed greater emphasis on retirement income provision rather than employment. As well, the introduction of compulsory splitting in certain circumstances of superannuation account balances or benefits as proposed by recently introduced amendments to the Family Law Act and the Superannuation Industry Supervision (SIS) Act further breaks the link between employment and the ability to have contributions made.

It could be argued that the occupational link for superannuation is in such disarray that the pretence of maintaining it should be abandoned. Allowing any individual who is in receipt of taxable income to participate in the accumulation phase of superannuation, subject to the age limits and appropriate reasonable benefit limits that apply to other contributors, would both reduce the complexity of current arrangements and improve adequacy. The revenue costs would be very minor because only a relative few with the capacity to contribute now fall outside the current convoluted criteria. Requirements related to involvement in the labour force are confusing and difficult for both members and funds, and increasingly are becoming less relevant in a public policy context.

R19 ASFA recommends that any individual in receipt of taxable income be permitted to contribute to superannuation.

6. Strategies to move forward

The preceding sections of this submission have clearly confirmed that Australia has the basis of a world class retirement system. Equally, it has been demonstrated that there is scope for considerable further improvements.

ASFA's priorities for the long term reform and further development of Australia's retirement income system remain:

- ensuring adequacy of retirement incomes;
- providing incentives for greater self reliance, with assistance particularly directed to lower and middle income groups;
- broader coverage of superannuation, especially the self employed, casual employees, and those with a limited or no link to the paid labour force;
- simplification, particularly of taxation arrangements;
- better integration between social security entitlements and private provision, and greater flexibility in work and retirement income arrangements after normal retirement age; and
- promoting confidence and security for retirement/superannuation strategies.

6.1 Options for achieving better adequacy

The level of income replacement in retirement is sensitive to a number of factors. These include the pattern of paid employment of an individual and the number of years over which the contributions are made; the level and pattern of contributions, the level of contributions and earnings taxes and the rate of investment returns within the fund that is used. Some of these factors are susceptible to changes in policy, while others basically are history and/or are driven by social and economic factors that are difficult to influence.

That said, modelling of individual outcomes clearly confirms what is technically described by researchers as "the bleeding obvious". Higher contributions for more years, lower or no contribution taxes, and higher fund earning rates all contribute to greater adequacy of retirement income.

Accordingly, ASFA has focussed on options involving additional contributions and/or removal of contributions tax as ways of improving adequacy. This submission first examines what the impact would be of removing the contributions tax together with a 3% additional contribution. Given the substantial costs to tax revenue of such a proposal along with a number of other practical considerations, the submission examines options which involve phasing of the reduction in the contributions tax and/or alternative ways of boosting contributions. A number of these latter options build on recent initiatives proposed or being implemented by the Government and the Opposition.

6.1.1 Impact of additional contributions on retirement incomes

Table 6.1 shows the impact of additional contributions over the 9% Superannuation Guarantee and additional years of contribution. Over a 30 year period additional contributions of between 5% and 12% of salary on top of the SG at 9% of salary are required to achieve a retirement income equal to 60% of pre-retirement gross income. Working and contributing for 35 years spreads the burden more, with the additional contributions needed falling several percentage points to the range 2% to 8%.

Table 6.1: Percentage of income over and above the 9% Superannuation Guarantee required to be saved to achieve 60% of pre-retirement income(a)

	Final Income (Retirement income sought)		
Years to retirement	**\$35000 (\$21000)**	**\$50000 (\$30000)**	**\$75000(b) (\$45000)**
5	94%	127%	153%
10	43%	60%	74%
15	24%	35%	44%
20	15%	22%	28%
25	9%	14%	19%
30	5%	9%	12%
35	2%	5%	8%
40		3%	5%

(a) Projections based on fund net (after tax and fees) earning rate of 7% nominal and growth in average earnings of 3.75% with contributions being made by the employer and subject to 15% tax.
(b) Individual on \$75,000 a year is not subject to the superannuation contributions surcharge if receiving contributions at the SG rate of 9%. Additional contributions quantified in this table are assumed to be salary sacrifice, with total salary and superannuation contributions remaining under the surcharge threshold.

6.1.2 Impact of removing contributions tax on retirement incomes

The retirement savings task of individuals would be considerably assisted if the tax on contributions were removed. As indicated by Table 6.2, **removing the contributions tax would reduce the extra amount of contributions needed to achieve 60% of pre-retirement income by two to three percentage points. This is more or less equivalent to the impact of an additional 3% employer contribution or a slightly smaller percentage member contribution out of after-tax income.**

Table 6.2: Percentage of income to be saved for 60% of pre-retirement income assuming no contributions tax

	Final Income (Retirement income sought)		
Years to retirement	**\$35000 (\$21000)**	**\$50000 (\$30000)**	**\$75000 (\$45000)**
5	81%	110%	133%
10	36%	51%	62%
15	20%	29%	36%
20	11%	18%	23%
25	6%	11%	15%
30	3%	6%	9%
35	0%	3%	5%
40		1%	3%

In brief, the scenarios show that:

- Shortening the period of contributions and savings by even 5 years generally lifts the required saving task by 3% or more of salary a year. Delay is costly.

- Getting rid of the current contributions tax would be equivalent to a 2 or 3 percentage point increase in the SG.

- Achieving a gross income in retirement of 60% of pre-retirement income requires 9% SG contributions for at least 40 years, with contributions above the SG needed for higher income earners for even this long period, or where full time employment amounts to less than 40 years for those on lower incomes.

Essential elements in this increase in the effective rate of contributions are likely to be a reduction or abolition of contribution taxes, and the introduction of a government co-contribution for low to middle income earners. With the introduction of such measures there will be an enhanced perception of joint responsibility between individuals and government for retirement income provision, with a subsequent increase in contributions by individuals.

In this context, while the increased spread of coverage in recent years is very important, it will be some decades before a clear majority of those who are employed will have significant retirement savings. The reason for this is that the Superannuation Guarantee only started at 3% of wages in 1992, and it will be 2032 before the first person will have had the benefit of 30 years' contributions at the full SG rate of 9% of salary. In the meantime, for those receiving the SG only, superannuation benefits will be a little or a lot less than will be delivered by a mature SG system.

Table 6.3 provides detailed projections for various salary levels and current age of members based on current SG and tax arrangements. This provides a benchmark for assessing the impact of changes to parameters such as contributions tax and contribution rates.

Table 6.3: Projections of lump sum superannuation benefits based on current age and past receipt of the Superannuation Guarantee(a)

Wage		**$30,000**	**$40,000**	**$60,000**	**$80,000**	**$90,000(c)**	**$100,000(c)**
Starting balance		*$18,000*	*$24,000*	*$36,000*	*$48,000*	*$54,000*	*$60,000*
Age	**Retiring at**						
20(b)	**55**	142 000	190 000	285 000	380 000	374 000	416 000
	65	220 000	294 000	441 000	587 000	579 000	644 000
25(b)	**55**	112 000	149 000	223 000	297 000	293 000	326 000
	65	178 000	238 000	357 000	476 000	469 000	521 000
30	**55**	123 000	164 000	246 000	328 000	337 000	375 000
	65	194 000	258 000	388 000	517 000	528 000	587 000
35	**55**	95 000	126 000	190 000	253 000	261 000	290 000
	65	156 000	207 000	311 000	415 000	425 000	473 000
40	**55**	71 000	94 000	142 000	189 000	196 000	218 000
	65	123 000	164 000	246 000	328 000	337 000	375 000
45	**55**	50 000	67 000	100 000	134 000	141 000	157 000
	65	95 000	126 000	190 000	253 000	261 000	290 000
50	**55**	33 000	43 000	65 000	87 000	93 000	104 000
	65	71 000	94 000	142 000	189 000	196 000	218 000
55	**55**	18 000	24 000	36 000	48 000	54 000	60 000
	65	50 000	67 000	100 000	134 000	141 000	157 000

Source: ASFA Research Centre projections.

(a) The projections are in current dollar terms using a 3.75% AWE deflator, and assumed nominal fund earnings of 7% after taxes and fees per year, with SG at 9% from 2002.

(b) No prior superannuation savings are assumed for those aged 20 or 25. For ages above these, the start balance assumed takes into account the phased introduction of the Superannuation Guarantee. While examples of salary levels in excess of $80,000 a year are given for ages 20 and 25 on the grounds of completeness, it is unlikely that there would be many if any such cases.

(c) Surcharge at 10.5% assumed for the entire contribution period for those on $90,000 and $100,000 a year. If the surcharge rate is not reduced then the lump sums for these cases would be lower.

As illustrated by Table 6.4, removing contributions tax and increasing contributions would have a marked impact on retirement savings through superannuation, including for individuals who have less than 30 years to retirement. For instance, for a 35 year old individual on $40,000 per year (around AWE) removing contributions tax and increasing contributions to 12% of wages would increase the retirement savings, in today's dollars, from $207,000 to $292,000. This is a very substantial increase which would go a long way to meeting retirement expectations of such an individual.

Table 6.4 also shows that even with higher contributions and no contribution tax, all the cases modelled would come within the pension RBL, with most projected benefits also falling within the lump sum RBL.

Table 6.4: Projections of lump sum superannuation benefits assuming no contributions tax and contributions of 12% of wages

Wage		**$30,000**	**$40,000**	**$60,000**	**$80,000**	**$90,000**	**$100,000**
Starting balance		*$18,000*	*$24,000*	*$36,000*	*$48,000*	*$54,000*	*$60,000*
Age	**Retiring at**						
20	**55**	223 000	298 000	447 000	596 000	600 000	666 000
	65	346 000	461 000	691 000	921 000	928 000	1 031 000
25	**55**	175 000	233 000	350 000	467 000	470 000	522 000
	65	280 000	373 000	559 000	746 000	751 000	835 000
30	**55**	171 000	228 000	343 000	457 000	472 000	524 000
	65	275 000	366 000	549 000	733 000	754 000	838 000
35	**55**	130 000	174 000	261 000	348 000	360 000	400 000
	65	219 000	292 000	438 000	584 000	602 000	669 000
40	**55**	95 000	127 000	191 000	254 000	265 000	294 000
	65	171 000	228 000	343 000	457 000	472 000	524 000
45	**55**	65 000	87 000	131 000	174 000	183 000	203 000
	65	130 000	174 000	261 000	348 000	360 000	400 000
50	**55**	40 000	53 000	79 000	105 000	113 000	125 000
	65	95 000	127 000	191 000	254 000	265 000	294 000
55	**55**	18 000	24 000	36 000	48 000	54 000	60 000
	65	65 000	87 000	131 000	174 000	183 000	203 000

Source: ASFA Research Centre projections.
Footnotes: See Table 6.3

The preceding analysis clearly shows that an increase in contributions together with removal of the contributions tax would largely achieve the appropriate level of adequacy of retirement income for persons with 30 to 40 years prospective time in the labour force. It would also substantially improve the situation of individuals who expect to retire in less that number of years.

R20 ASFA recommends that in order to better meet retirement income needs and expectations that contributions be increased from 9% to 12% of wages and salaries, and by the government removing the tax on contributions (value approximately 3% of wages). The combined effect would be similar to a 15% contribution under current superannuation tax arrangements.

6.1.3 Reducing contributions tax in part

The cost to Commonwealth revenues could be an important constraint on the ability of a government to remove the contributions tax in its entirety in one year. However, no official figures currently exist on the total tax on superannuation contributions paid to superannuation funds and to life insurance companies. This is because superannuation funds pay a combined tax bill on both contributions and investment earnings, and a substantial proportion of contributions and earnings tax is paid as part of the company tax of life insurance companies.

In part due to this lack of hard data, there is some dispute between the Government and the Opposition on the costing of these measures, the timing of the budgetary impact, and the source of potential offsetting savings. ASFA does not wish to enter into this debate, other than to note that the more information available about the total taxation raised from superannuation, and the split of this revenue between funds and life companies and between investment income and contributions, the more informed policy development and public consideration will be. Accurate costing of reform proposals is essential given the significant taxation revenue currently raised from superannuation. Any major change to fund taxation will only be able to occur in the context of costed proposals and a supportive budget environment.

On the basis of figures that have been published by the Government and the Opposition, together with research undertaken by the ASFA Research Centre, in 2002-03 the lower boundary for tax revenue from superannuation contributions to both funds proper and to life companies is around $2.6 billion, with the upper bound around $3.6 billion. Clearly, whatever the figure is, it is a very substantial number. However, it needs to be stressed that this revenue flow and subsequent spending by the government now is both detrimental to the adequacy of individuals' retirement income and to the government's future revenue from taxes on end-benefits.

The cumulative effect of these taxes is considerable. Over the period 1989-90 to 2001-02 the taxation revenue collected from superannuation funds has been some $36.7 billion. When the tax collected in regard to the superannuation business of life companies is taken into account, this figure increases to some $46 billion. If these taxes had been left to grow in member accounts the aggregate assets in superannuation funds alone would have been some $74 billion higher as at June 2002. If accounts held through life companies were taken into account the figure would be higher still. However, around $75 billion might be a reasonable estimate for the system as a whole given that there was some withdrawal of benefits over the period.

An additional $75 billion in the system would have helped to provide more adequate retirement incomes, would have reduced pressures on government expenditures and through the taxation of end benefits would have strengthened the future government revenue base.

In effect, governments have spent this money in advance of when it is really needed to meet the multi-billion dollar "blackhole" of income support and health and aged care costs identified in the Intergenerational Report.

In the financial year ahead it would be fair to assume that only a cut in the rate rather than a complete abolition of contributions tax would be possible. Beyond the 2002-03 financial year and into the medium term a substantial cut in the tax rate on contributions or complete abolition might be possible, depending on developments in revenue and in the Budget surplus. Opinion polling commissioned by ASFA indicates strong community support for a cut in the contributions tax to allow savings to grow rather than a cut in personal income tax rates.

One possible way forward would be to gradually reduce contributions tax over, say, a ten year period starting, say, in 2003-04. The continuing reductions in the rate of the tax could be built into the forward estimates on an ongoing basis.

In this context, it should be noted that both the Government and the Labor Party have put forward proposals to cut tax on contributions to some degree. The Government is proposing to progressively cut the rate of the surcharge from 15% to 10.5% over the next three years. The Labor Party in its response to the 2002-03 Budget has put forward proposals to either cut the superannuation contributions tax for all fund members from 15% to 13%, or, as an alternative to cut the tax to 11.5% for people aged over 40. While not being overly explicit on this point, Labor also appears to be proposing a phasing in over three years or so of the cuts that it is proposing.

ASFA welcomes any measures that would cut the taxation imposed on contributions. Both the standard contributions tax and the surcharge are inefficient and inequitable taxes. However, it suggests that these proposals be extended by moving to complete abolition over a period of time, say, ten years. Depending on the budget surplus in years ahead, and the availability of additional tax revenue from measures such as crystallising the tax on pre-1983 entitlements, it may be possible to remove contributions tax over a shorter period than 10 years.

It also should be noted that removing contributions tax would lead to additional taxation receipts at the benefit stage as a consequence of the increase that would occur in the net contributions being credited to individual accounts. There would also be increased revenue from tax on fund earnings as a consequence of higher account balances. While the impact of these factors is difficult to precisely quantify, after 10 or more years the impact would be significant.

However, taxation revenue neutrality should not be the only or even the main criterion on which changes to the contribution tax should be judged. Removal of the contributions tax would have a number of significant benefits for both government and individuals. It would:

- Increase adequacy of retirement incomes.
- Reduce reliance on the Age Pension.
- Reduce the extent of the future “blackhole” between Commonwealth government revenues and expenditures.

It also would facilitate greater equity in the taxation of superannuation, in that benefits could be taxed a the time of payment in line with the total amount accumulated and the circumstances of the individual when they receive the benefit. Taxing contributions is at best only a very rough if not rugged approach to achieving equity between individuals.

In regard to options for partial removal, ASFA prefers a uniform cut for all fund members. ASFA acknowledges that applying different rates of tax to contributions according to the age of the member on whose behalf contributions were made would have the potential to boost the retirement savings of the age groups targeted. However, such a measure would involve considerable complexity in administration on the part of funds. Funds do not always hold information on the date of birth of a member, or have inaccurate information. This is especially the case when a member is enrolled by an employer.

R21 ASFA recommends that the contributions tax be steadily reduced over no more than a ten year period commencing in, say, 2003-04.

6.2 Other options for improving adequacy

While substantial changes along these lines outlined above would be preferable, ASFA is not adverse to other more limited changes favourable to retirement incomes being made. In this context, adequacy of current superannuation arrangements is squarely on the political agenda with both the Government and Opposition announcing policies aimed at, amongst other things, improved retirement benefits for part or all of the Australian population.

ASFA commends both the Government and the Opposition for their renewed attention to adequacy issues and on how to improve adequacy. The political debate has moved on from whether any action is required, to what measures would be most effective, and what is affordable in the immediate future.

ASFA considers that there are elements in the policies of each of the major political parties which should be adopted and/or developed further. These proposals relate both to spreading the coverage of superannuation, and decreasing the tax raised from various aspects of superannuation.

6.2.1 Tax treatment of superannuation contributions by the self employed

Currently contributions made by the self employed to superannuation receive less favourable tax treatment than contributions made by an employer on behalf of an employee. Employer contributions are in effect fully tax deductible (up to age based annual limits) while only the first $3,000 of deductible contributions made by the self employed are fully deductible, with only 75% of any amount over $3,000 deductible.

The rationale for this discrimination between the employed and the self employed is not apparent, but may have had something to do with what was affordable when changes to the tax treatment of superannuation were made in the early 1990s. As well, as time has passed the benefit of the $3,000 cap on full deductibility has been eroded by the effects of inflation.

ASFA has welcomed the Government's decision to increase the cap on full deductibility from $3,000 to $5,000. This decision reduces the degree of discrimination between the self employed and the employed. However, $5,000 is still a very modest cap. This amount is equivalent to only a 9% Superannuation Guarantee payment on a salary of $55,000 or so. While 75% of any contribution in excess of $5,000 will be deductible, ASFA suggests that the self employed receive tax concessions for superannuation no better or worse than those applying to employees.

There also are grounds for improving the tax treatment of contributions made by the self employed apart from removing discrimination between different components of the labour force. These relate to increasing the superannuation coverage of the self employed. In the absence of any compulsion flowing from the Superannuation Guarantee arrangements and of an appropriate level of taxation concessions, superannuation coverage of the self employed is relatively low. Nearly 65% of owner managers of unincorporated enterprises have either no superannuation or are not currently making contributions. An appropriate response to this is to provide tax treatment for contributions by the self employed that is at least equivalent to that provided for employer contributions.

In the longer term it would be appropriate for consideration to be given to possible mechanisms for compelling superannuation by the self employed or providing greater incentives than mere tax deductibility for voluntary contributions (see Recommendation 5 of this submission).

R22 ASFA recommends that contributions be fully deductible for the self employed up to the limits that apply to employees.

Budget cost: Around $25 million a year

6.2.2 Co-contribution for low income earners

ASFA has also welcomed the Government's proposal to replace, with effect from 1 July 2002, the current very modest tax rebate for personal superannuation contributions by low income earners with a more generous co-contribution.

Receipt of the proposed co-contribution is dependent on a personal contribution being made, and the low income earner also having contributions being made by an employer. Not all low income earners will be able to afford to make such a payment, and the self employed and those not in the paid labour force will miss out. As a result, only a relatively small proportion of low to middle income earners can be expected to make use of it. Treasury costing of the proposal appears to assume that fewer than 75,000 individuals will be eligible to claim the maximum co-contribution with up to 170,000 claiming less. Of this latter group, it is assumed that 100,000 or so will only be able to claim a maximum co-contribution of $500 or less.

However, having in place a mechanism for delivering a targeted co-contribution is nearly as important as the characteristics of the co-contribution itself. In ASFA's view, there are grounds for expanding the number of potential recipients of the co-contribution, while at the same time focussing more closely on low to middle income family units.

ASFA suggests that the co-contribution could be refined by focussing on singles and couples where the family income is modest. It also would be more effective in achieving retirement income objectives if the payment were made available to a wider range of low to middle income earners so as to encourage their efforts at saving and greater self reliance.

For instance, including individuals with taxable income of up to $40,000 would double the number of potential recipients to a little less than 600,000 individuals. ASFA appreciates that such a dollar for dollar co-contribution would have a cost of up to $300 million a year. If the cost in the current Budget context were a significant concern then consideration could be given to a co-contribution rate which was less than dollar for dollar.

R23 ASFA recommends that the co-contribution proposal for low income earners be available in 2002-03 for individuals with a personal taxable income of up to $40,000 per year and a family income of less than $80,000.

Budget cost: Potentially less than $50 million a year in addition to the costing of the election commitment, depending on detailed eligibility criteria applied and the rate of the co-contribution. Cost would be higher if a full dollar for dollar co-contribution were applied.

6.2.3 Increasing contributions by way of new measures

Beyond the year 2002-03, it would be desirable to have a rate of co-contribution which encouraged and supported significant additional member contributions further up the income range of low to middle income individuals and families, and which provided dollar for dollar assistance.

Research commissioned by ASFA indicates that there is very high support in the community for greater self reliance in retirement, with this greater self reliance supported by more government incentives to save for retirement. In this regard, a national survey of the population conducted in August 2001 by ANOP indicated that 83% of those surveyed agreed that there should be more government incentives to save for retirement, with 73% indicating support for more individual self reliance.

ASFA suggests that this widely based support for mutual obligation in which individuals save more for their retirement in return for greater support from government be built upon in strategies for increasing contributions to superannuation. A reduction or elimination of tax on contributions together with a targeted co-contribution by government in excess of that already announced by the Government for 2002-03 would be likely to form a key part of such an approach and provide greater incentives to save.

It should be made clear that ASFA in putting forward this strategy is not suggesting that there be an increase in the rate of the Superannuation Guarantee. The opportunity to phase in increasing employer contributions comes rarely, and it is unlikely that in the current environment of wage bargaining and relatively low inflation that the consensus needed to increase the rate of the SG could be achieved. That said, ASFA research indicates a preparedness and awareness in the community that Superannuation Guarantee payments may need to be increased. However, the responses generally indicate that next steps should be shared by government and individuals.

Accordingly, ASFA's proposal is that additional contributions be encouraged and supported as part of a process of mutual obligation, rather than being mandated. A possible way of doing this would be by way of personal contributions matched by a government contribution. For equity reasons middle income earners with a salary in the range $30,000 to $60,000 might be a particular target of government assistance. This group receives no assistance from the government's co-contribution, although the Committee will note that in the previous section ASFA was recommending that the upper limit for the co-contribution be increased in the next financial year to $40,000.

Another reason for focussing on individuals on $30,000 or $40,000 to $60,000 per year is that those on lower incomes already are benefiting from the Age Pension, and some of them at least will benefit from the soon to be introduced co-contribution. At the other end of the scale, upper income earners have greater capacity to make contributions without the need of a co-contribution.

R24 ASFA recommends that a higher level of contributions be encouraged by a targeted co-contribution directed at middle income earners (those with earnings in the $30,000 to $60,000 range).

6.2.4 Splitting of superannuation contributions between couples

An important initiative which forms part of the Government's election commitments is the proposal to allow spouses to split the employer contributions made in regard to an employee between superannuation accounts of that employee and their spouse. The intention is to remove discrimination against single income families in the taxation system by allowing access to two Reasonable Benefit Limits (RBLs) and two tax free thresholds for benefits in the same way as for dual income families.

It is in this context of the Government's desire to avoid any burden on employers and to maximise the retirement benefits of single income families that ASFA made a number of recommendations in the context of the 2002 Budget. These suggestions sought to achieve the aims of the measure while at the same time minimising the costs for employers, funds and the families who wish to make use of the option.

In essence, ASFA recommended that consideration be given to allowing the splitting of benefits rather than contributions. Members generally also would gain from the reduction in costs. The option proposed by ASFA would achieve the objectives underlying the government's proposals, but would do this at lower cost for both members and superannuation funds, and would not require any burden at all for employers. This would assist in maximising the superannuation benefits available to couples.

The legislation supporting the splitting of contributions is yet to be introduced into the parliament. ASFA seeks the support of the Committee for its proposal, details of which are in the ASFA 2002 Pre-Budget Submission, copies of which have previously been forwarded to Committee members.

6.2.5 The earnings threshold for the Superannuation Guarantee

Currently the Superannuation Guarantee applies to eligible employees receiving pay of $450 or more in a calendar month, with the quantum assessed on a monthly basis. The Government has introduced legislation proposing that the minimum frequency of SG payments be increased from annually to at least quarterly. Currently over 80% of employees have contributions made at least quarterly, and the proposed legislation would make this universal.

However, as part of this legislative package, the Government is proposing to raise the minimum earnings threshold to $1,350 in a quarter. This would mean that an individual who earned say $600 in one month, and $800 in the following month and nothing in the third month would not be entitled to any SG payment. There are many thousands of casual and part-time employees, many of whom are women, who would be affected by this change.

ASFA does not consider that low income earners should be disadvantaged by the proposed move to quarterly SG payments. ASFA strongly supports the move to at least quarterly payment, but is strongly opposed to changing the threshold to $1,350 in a quarter. If there was a true desire to simplify administration without disadvantaging low income earners then a threshold of $450 in a quarter could be applied.

R25 ASFA strongly supports the move to at least quarterly payment of the Superannuation Guarantee, but does not support an earnings threshold for the SG of $1,350 in a quarter.

6.2.7 Greater flexibility in work and retirement income arrangements after age 65

The Government has recognised that some people choose to work past the usual age for retirement while still looking forward to and making provision for their retirement years. One of the Government's election commitments is, from 1 July 2002, to increase from 70 to 75 the age up to which working members of superannuation funds can make personal superannuation contributions. The issue of greater flexibility in superannuation arrangements for older workers was also canvassed in the report of the Standing Committee on Employment, Education and Workplace Relations which was tabled on 14 August 2000.

Currently the participation rate in the paid labour force of individuals aged over 65 is not high, and the rate for those aged over 70 is even lower. Further the takeup rate for personal contributions for those aged over 65 is low, in part because of the difficulties in complying with the work test that has to be met to make contributions. APRA has indicated to funds that where a member is aged 65 and over the trustee must be satisfied that the member is gainfully employed for a minimum of 10 hours each week in respect of which the trustee accepts non mandated employer contributions. The trustee must have in place arrangements such as monthly monitoring to determine whether a member satisfies the gainful employment test in respect of each week. Individuals with intermittent work patterns face the risk of having contributions returned, unaccepted by a fund. Even worse, they may face having their entire balance paid out without it being requested.

A change that could be made without any significant adverse impact on tax revenue or individual entitlements would be to simplify the work test for those aged over 65. The current requirement for funds to be satisfied that a contributor is still in employment when each contribution is made is resource intensive and unsatisfactory for both funds and members. This compliance burden will increase following the implementation of the government's decision to allow workers to continue to make personal contributions from 70 to 75 years of age.

The Government in a number of contexts has indicated its support for continued involvement (on a voluntary basis) by individuals in the paid labour force at ages in excess of the customary retirement age. It has also indicated support for phased withdrawal from the labour force in appropriate circumstances. These goals would be supported by simpler and more supportive work tests for continued contributions into superannuation by those aged over 65.

A simple method for funds to determine whether an individual still has an attachment to the labour force would be to require members aged over 65 to provide to their fund at the beginning of the financial year a copy of a group certificate or a letter from an accountant indicating that the member earned more than, say, $5,000 from personal exertion in the previous financial year. This advice could then be relied on for the remainder of the financial year.

Any cost to tax revenue would be minor given that the rate of labour force participation of those aged over 65 is low, and for those aged over 70 it is very low. The number of contributions that would be made under the ASFA proposed test where the member was not in continuing employment would be very low. As well, the extent of the concessional tax treatment of the earnings on such members' balances within the superannuation system is very modest given the typical income of such members, and the rebates that apply to individuals of Age Pension age.

R26 ASFA recommends that the work test applying to members aged over 65 who wish to continue contributing should be simplified through relying on information about their work experience in the previous financial year.

6.3 Promoting confidence in the security of superannuation

There is evidence from public opinion polling and other material that the public has lost some confidence in the "security" of saving for retirement through superannuation due to the complexity of the current system and the danger of future rule changes, and a perception that governments treat superannuation as a cash cow to the detriment of eventual retirement savings.

To be fair to the public, they have objective grounds for such concerns. The system is too complex, and the taxation take from superannuation is too high.

However, it also needs to be acknowledged that there is overwhelming support for the compulsory superannuation system. This has been shown in opinion polling commissioned by ASFA and in separate research commissioned at various times by the government and others. The challenge is to build on this support for superannuation. Some care will be needed in making any further changes. In particular, any suggestion that there will be increased complexity and/or less support by government would have to be avoided.

In this regard, simplification of taxation arrangements for superannuation is not a simple task given the rather complex history of the system. However, adoption of recommendations earlier in this Section would be a significant start in this direction. Removal of restrictions on who can contribute would eliminate complex and at times bizarre restrictions, at little cost to the revenue.

Other ASFA proposals in regard to current government proposals, such as the splitting of superannuation contributions by a couple, would also avoid increasing complexity and increased administration costs in the future.

However, "grandfathering" of past entitlements or expectations is one of the major causes of complexity. Unwinding such provisions has its challenges given the expectations that have been raised on the part of at least some fund members. However, with some care and the use of transitional arrangements that cash out or crystallise past entitlements it should be possible to bring about change.

R27 ASFA recommends that Treasury and the Australian Taxation Office set up a working group including industry representatives to consider options for simplifying taxation of superannuation which involve the replacement of "grandfathering" with more efficient and equitable provisions.

Another area where the public has lost some confidence in superannuation is the perception that superannuation savings will replace rather than supplement access to the Age Pension. Part of this belief is more perception than reality, but there again there are objective grounds for holding such views. The means test is not easy to understand, and there are more than 20,000 financial planners in Australia who spend quite a bit of their time explaining means test provisions to clients and suggesting strategies for maximising entitlements.

As well, as detailed in Chapter 5 of this submission, the current means test has punitive withdrawal rates of benefits for individuals who have assets subject to the test which fall within the range $140,000 to $280,000. Lump sum amounts of this order will be needed and achieved by middle Australia on or about average weekly earnings as the compulsory superannuation system matures with a substantial number of years of contributions at the 9% rate.

While there are options available for getting around this problem with the asset test, albeit at the cost of lower investment returns and onerous restrictions on the investment products that can be used, there can be genuine concerns about whether saving more for retirement will actually generate a higher retirement income. Individuals can understand the accumulation phase of superannuation. They need also to be comfortable with and have faith in how the social security system will treat them.

ASFA considers that the best approach would be for those with detailed knowledge of the means test and of private retirement income arrangements to sit down and consider options for reforming the means test which are simple, equitable and supportive of self provision.

R28 ASFA recommends that the Department of Family and Community Services and Treasury set up a working group including industry representatives to consider options for simplifying the means test applying to the Age Pension and for improving the incentives for part self provision in retirement.

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