Chapter 3

Closing the Adequacy Gap

Introduction

3.1 The previous chapter noted evidence to the inquiry that there is a shortfall in the ability of the nine per cent superannuation guarantee (SG) contribution, together with the age pension, to deliver appropriate target retirement incomes for many representative groups of Australians.

3.2 This chapter considers whether more contributions are necessary and if so, from what source, including the role played by:

- additional compulsory contributions;
- voluntary contributions, including Government co-contributions; and
- increasing the access to superannuation as a long-term savings vehicle.

Additional compulsory contributions

3.3 The first pillar of the retirement income system, the compulsory employer SG, began from 1 July 1992. The level of compulsory employer contributions has grown from a minimum of three per cent of earnings to nine per cent by 1 July 2002.

3.4 A number of submissions to the inquiry called for additional compulsory contributions to close the adequacy or expectation gaps, that is the gap between what people desire in retirement and what the current systems will actually deliver. Some submitted that any additional contributions will help address the gap, and that the reduction of the contributions tax can have the same effect as an increase in contributions. Some also suggested that increasing the compulsory employer component would be necessary, while others favoured introducing compulsory employee contributions.

3.5 For example, the Australian Bankers' Association (ABA) submitted that it would be difficult to respond to the gap issue without increasing contribution levels, either voluntary or compulsory, and that the international experience suggests that compulsory contributions could come from the employee:

> In ABA's view, it is difficult to achieve a satisfactory response to the adequacy issue without increased contributions from individuals, whether voluntary or compulsory — or both.
>
> On the question of going further with compulsory contributions, it should be noted that virtually all of the major OECD countries have some system of mandatory contribution for retirement, in most cases through 'social

security' systems producing defined benefits.[1] Whether in North America or in Europe, all of these systems differ from Australia's Superannuation Guarantee in requiring a *sharing* of the burdens between employees and employers. The 9 per cent Superannuation Guarantee employer contribution in Australia is already a substantial employment on–cost. This suggests that any increment to the compulsory level should preferably be as an employee co–contribution, ideally with the impact on take–home pay softened by phasing (small steps over a period when most people's pay is likely to increase) and, say income tax cuts.

There is a public policy case that can be made out for further compulsory contributions, and it is worth noting that opinion surveys have found that compulsory superannuation is now widely accepted.[2] Many people appear to be grateful that someone has obliged them to put something away for their old age.

The precise means through which increased contributions are achieved are a matter for more detailed assessment, including by the Government's experts. However in ABA's view, the precise mix of means is less important than a firm commitment to set goals and identify measures which will effectively achieve them.[3]

3.6 In **Table 3.1** below, the ABA also demonstrated the need for additional contributions over varying working lives to achieve the target replacement rate of 75-80 per cent of pre-retirement income:

Table 3.1: Employer contributions (including 9 per cent SG) for person on AWE to achieve 75-80 per cent disposable income replacement[4]

	Years of work		
	40	**35**	**30**
Contribution Rate	12%	14%	17%

Source: *Submission* 51, ABA, p. 13.

3.7 **Table 3.1** suggests that additional contributions of about three per cent of salary, over and above the nine per cent SG contribution, are needed over an

1 See footnote in ABA submission: See *Retirement Income Systems: The Reform Process across OECD Countries*, Organisation for Economic Co-operation and Development (OECD) Working Paper AWP 3.4, 1998. *Submission* 51, ABA, p. 17.

2 See footnote in ABA submission: ASFA (based on an address by Philippa Smith to FPA Conference, November 2001) cites research indicting 95 per cent support. *Submission* 51, ABA, p. 17.

3 *Submission* 51, ABA, p. 17.

4 See footnote in ABA submission: 'Based on modelling presented in a statement published by a group of experts, the 'Retirement Futures Forum' early last year. The statement was released by D. Chessell, V FitzGerald, B. Fraser, S. Grant, D. Knox, M. Robertson, S. Ryan, I. Silk, P. Smith and G. Weaven, 19 March 2001 (via the office of Industry Fund Services).' See *Submission* 51, ABA, p. 13.

uninterrupted 40 year career to achieve the desired outcome of 75-80 per cent of pre-retirement income for a person on average earnings. For a more realistic 35 years of work about 5 per cent additional contributions are needed.[5]

3.8 Like the ABA, IFSA also considered that there is scope to increase employee contributions while ensuring that real take home pay does not fall through some future tax cut being directed to retirement savings.

3.9 Mr Willis from the Australian Industry Group also called for an additional three per cent in compulsory contributions to close the adequacy gap, but from employees and not employers:

> we are very cognisant that that is not widely supported, at least publicly, at this time. It is nonetheless a position we have advocated for at least 12 years. We believe the merits of the proposition on equity considerations are unarguable. We believe that people should be required to contribute to their own retirement income. We accept that there are significant political and economic difficulties associated with the implementation of such a policy. We do not come to this committee with a specific strategy or a time line over which that should be introduced but we do strongly support the principle and commend it to the committee and to the parliament.[6]

3.10 By contrast, the Industry Funds Forum (IFF) and the Australian Council of Trade Unions (ACTU) considered that the compulsory SG should be increased to 15 per cent.[7] In addition to supporting an increase in compulsory contributions from nine to 15 per cent, the ACTU also envisaged that the additional contributions could be shared:

> The ACTU recommends that the Committee consider options for this to occur, including through the taxation system, direct employer contributions, member co-contributions or a combination of some or all of these.[8]

3.11 In addition to recommending an increase in the SG to 12 per cent, ASFA also focused on options involving the removal of the contributions tax as ways of improving adequacy.[9] ASFA submitted that:

> 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 per

---

5 *Submission* 51, ABA, p. 13.

6 *Committee Hansard*, 17 July 2002, p. 329.

7 *Submission* 28, IFF, p.2. *Submission* 57, ACTU, p. 1.

8 *Submission* No.57, ACTU, p. 2.

9 Suggestions to increase adequacy through a reduction or removal of superannuation taxes are addressed later in this report in Part III – Equity.

> cent 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.[10]

Voluntary contributions

3.12 Further to the suggestions for additional compulsory contributions, from either the employer or the employee, many submissions also called for improving incentives for voluntary contributions, either independently or in conjunction with a Government co-contribution, to address the shortfall in reaching desirable retirement incomes.

3.13 In its written submission to the Committee, the National Institute of Accountants (NIA) advised that: 'Individuals must be educated on the importance of making greater personal contributions and should be given greater incentive to do so'.[11]

3.14 In its written submission to the Committee, the AMP submitted that Australians are willing to make voluntary contributions to boost their retirement incomes:

> Recent figures indicate that Australians are voluntarily contributing to their retirement savings. It is estimated that in 2000-01, 44% of total contributions to superannuation were voluntary employee contributions, up from 23% in 1995-96 (APRA 2002). Data also suggests that the proportion of employees making voluntary superannuation contributions rises with income.[12]

3.15 The following table provided by the AMP demonstrates the level of voluntary contributions by various income groups.

Table 3.2: Voluntary contributions to super by income - 2000[13]

	Annual income	**$1 - $19,999**	**$20,000 - $39,999**	**$40,000 - $59,999**	**$60,000 - $79,000**	**$80,000 - $99,999**	**$100,000 +**
% making contributions		8.6%	23.7%	43.9%	48.5%	44.0%	39.5%
Of this group, the level of weekly contributions	Under $20	35.7%	28.3%	13.2%	7.6%	8.4%	6.5%
	$20 - $39	21.7%	35.1%	25.9%	12.4%	10.1%	10.0%
	$40 to $59	10.0%	12.7%	26.8%	23.6%	16.8%	9.6%
	+ $60	11.5%	8.4%	21.3%	43.4%	51.3%	61.1%

Source: ABS 6360.0, cited in *Submission* 64, AMP, p.18.

3.16 The AMP also submitted that:

10 *Submission* 73, ASFA, p. 5.

11 *Submission* 59, NIA, p. 3.

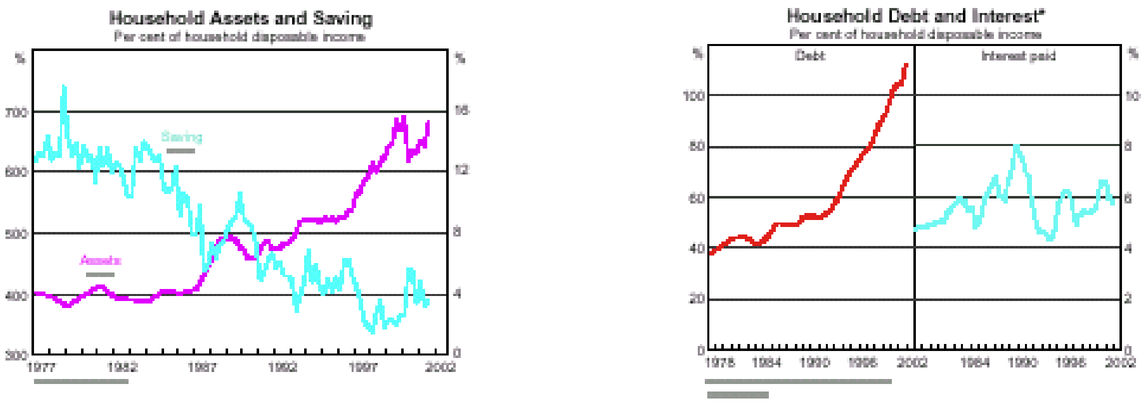
12 *Submission* 64, AMP, p. 18.

13 *Submission* 64, AMP, p. 18.

> By encouraging those who can, to make additional contributions, should go some way to addressing the expected pressures on future Government Budgets in relation to aged pensions, aged care and health expenditures. If the future expenditure issues are not addressed, then it will be the younger generations who will be under pressure to fund retirees needs. Introducing measures that encourage baby boomers (as well as younger generations) to fund their own retirements today should be supported, as it also allows the cost of these incentives to be spread across today's tax payers.[14]

3.17 While there appears to be an ability to save, the need for incentives to increase voluntary long-term superannuation savings is reflected in Australia's low household savings record. The following charts demonstrate the downward trend in household savings and the upward trend in household debt.

Chart 3.3: Household Assets and Savings and Household Debt and Interest[15]



Source: RBA tables cited in *Submission* 70, IFSA, p.7.

3.18 According to IFSA, the message from these Reserve Bank of Australia (RBA) charts is that Australians are saving about a third as much of their income as they did 25 years ago, while the value of their household assets as a percentage of disposable income has increased by 70 per cent.

3.19 The IAA submitted that it was necessary to provide incentives for individuals to make voluntary contributions to superannuation in the following terms:

> The IAA considers that the national debate should move away from a focus on increasing the level of compulsory SG contributions. Rather, Government and industry commentators should focus on how best to target incentives for voluntary saving for retirement and better integrate the superannuation and social security systems. A desirable outcome from the retirement income system would be compulsory SG superannuation (in conjunction with the Age Pension where required) that provides a foundation retirement income for all. This should be combined with

14 *Submission* 64, AMP, p.18.

15 Cited in *Submission* 70, IFSA, p. 7.

> appropriate incentives for voluntary saving that provide the flexibility for individuals to achieve retirement incomes that reflect their personal circumstances and expectations.[16]

3.20 CPA made the following comments about incentives for voluntary contributions:

> It is apparent that the pillar of voluntary savings is not supporting the pillars of the safety net of the age pension and compulsory superannuation system. Australians seem to be taking comfort in compulsory contributions and are not actively planning and providing for their own retirement. According to a recent Australian Bureau of Statistics (ABS) survey, only 25% of workers aged between 15 and 54 years make voluntary contributions. (ABS 2000, Table15).
>
> Policy reform clearly needs to focus on providing adequate incentives for Australians to make superannuation contributions. Public confidence in, and public awareness of, superannuation are also essential issues.[17]

3.21 Another suggestion raised in evidence to the inquiry to provide additional incentives to save was through Government co-contributions matching voluntary member contributions. For example Dr Vince FitzGerald submitted:

> The mention of co-contributions prompts me to comment, having been implicated in the research that IFSA sponsored. The idea of co-contributions as a supplementary mechanism within the system has found favour at different times and in different forms with both sides of politics. If you are stuck with a system where the overall architecture is much like the one we have now—with taxes all over the place and difficulties in targeting—and your concern about equity was really about the situations of people on low to middle incomes, then co-contributions are not a bad thing to look at. In that research, we found that dollar for dollar matching is an extremely generous incentive; in fact, you can induce people to make a bit of an effort themselves. We are not talking about the people right down the poverty end but about the battlers—if that is still an acceptable term—who have to make a bit of an effort to save.
>
> According to the research and modelling we did, $1 for $2 would allow you to either extend the coverage of the co-contribution well towards average earnings—certainly past median earnings—or to go a certain distance on the same or a smaller budget while also inducing a substantial flow of additional private contributions. That mechanism is one of the variants that is available. If you do not believe we can address all these equity issues by a big bang or a roll-up or a transition model, it offers an opportunity to look at

16 *Submission* 74, IAA, p. 3.

17 *Submission* 43, CPA, p. 5.

> some of the middle income adequacy and equity issues and target such a thing, which would not disturb the rest of the system.[18]

3.22 Mr Davidson from the Australian Council of Social Service considered that any proposed Government co-contributions should apply to compulsory SG contributions as well as voluntary contributions:

> We oppose a general reduction in the contributions tax because the people who will benefit the most from it per dollar contributed are by definition those on higher incomes. I think that is very clear. Matching contributions are much more equitable than the present system and would be more equitable still if they applied to compulsory as well as voluntary contributions. One of the problems with restricting them to voluntary contributions is that the most income constrained groups in the population will not benefit: by definition, they still will not save more and, therefore, will not receive the concession. There will be a certain amount of leakage to the partners of high income people. Having said all of that, matched contributions are certainly much fairer than the present tax treatment, but we would prefer matched contributions to apply to the compulsory as well as the voluntary contributions. In that way, they are an equity measure for the bottom end as well as being an incentives measure.[19]

3.23 The ACTU also supported the thrust of this approach, indicating that it supported measures to assist low and middle income earners increase their retirement savings.[20]

3.24 The AMP made the following additional suggestions:

> The Government could increase the take up of voluntary saving by adopting two measures. First, is an incentive program along the lines of the co contribution, and second, making it easier for anyone, whether working or not, to make a voluntary contribution.[21]

3.25 In addition, the AMP also suggested extending the Government co contribution, currently available to those with an assessable income below $32,500, to those with an assessable income of $60,000:

> Extending the co-contribution to those with an assessable annual income of $60,000 (the highest income tax threshold), would provide an incentive for employees to make additional superannuation contributions.

---

18 *Committee Hansard*, 8 October 2002, p. 700.

19 *Committee Hansard*, 8 October 2002, pp.700-701.

20 *Submission* 57, ACTU, p. 3.

21 *Submission* 64, AMP, p. 17.

> The co-contribution could remain capped at $1,000 for those on less than $20,000, reducing by $0.025 per extra dollar of income, up to the $60,000 threshold.[22]

3.26 Similarly, ASFA made the following comments about expanding the recently implemented co-contributions in respect of low income earners:

> …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.[23]

3.27 In addition ASFA also submitted that moving 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.' In support of this ASFA submitted 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

---

22 *Submission* 64, AMP, p. 17.

23 *Submission* 73, ASFA, p. 62.

> earners have greater capacity to make contributions without the need of a co-contribution.[24]

Widening access to superannuation as a savings vehicle

3.28 A number of submissions called for the widening of access to superannuation, including through changes to the employment and age-based tests. For example the AMP submitted:

> Taking in to account the Government's recent election commitments relating to voluntary superannuation (first child tax rebate, super for children, increasing the age for voluntary contributions from 70 to 75), access to superannuation will be much improved. Although access will still be restricted to certain groups.
>
> The Government should widen access to super even further, allowing anyone between the ages of 18 and 75 to make undeducted voluntary contributions, regardless of their employment or spouse status.
>
> This would avoid complex rules being designed to classify who can and cannot make contributions.
>
> It would also simplify the fund trustees' role in determining who could and could not make voluntary contributions, particularly in relation to satisfying work test criteria.
>
> This will be beneficial for older workers who might wish to move in and out of the workforce once they have retired from full time work, but wish to save more for their retirement.[25]

3.29 IFSA noted that, following the 2002 Budget announcements, very few people are now prevented from making personal contributions to superannuation. In its submission, ISFA made the following points about the employment nexus:

> Rather than stating who may not contribute, superannuation regulations contain multiple categories of people who can. This seems to result in complicated systems and costly administrative processes, all of which come at cost to fund members saving for their retirement. All can be traced to the original employment nature of superannuation – the employment nexus.
>
> The obvious and simple solution – to remove the employment nexus from personal superannuation contributions – warrants exploration. It would not be difficult to assess who would benefit, who (if anyone) might lose, and to scope the costs and benefits to superannuation fund members, superannuation funds, and retirees. Assessing Commonwealth fiscal cost

---

24 *Submission* 73, ASFA, pp. 62-64.

25 *Submission* 64, AMP, pp. 17-18.

> and benefit might be more involved, but it would allow reasoned consideration of the issue.[26]

3.30 IFSA also considered that non superannuation monies should also be permitted as contributions to income stream products to assist people achieve adequate superannuation incomes:

> The tax rules also effectively exclude non-superannuation savings from allocated retirement income stream products. The design of these products facilitates the orderly drawdown of capital across retirement, and limits inappropriate tax deferral. As such, these products are important to help retirees achieve adequate income across their whole retirement, and this exclusion militates against adequacy.
>
> It seems to be difficult to quantify the fiscal benefit of this exclusion, if any, and as such it is hard to justify its continuance. The exclusion is not present in social security rules for asset test exempt annuity products, for the reason that retirement income streams meet the policy objectives of retirement incomes policy no matter what the source of the purchase price.
>
> …
>
> The rules excluding non-superannuation monies from retirement income stream products should be removed. If it is appropriate to retain some limitations in order to prevent misuse of this access, these could be implemented in conjunction with removal of the existing impediments.[27]

3.31 In its submission ASFA noted that it could be argued that the occupational link for superannuation is in such disarray that the pretence of maintaining it should be abandoned.[28] The Institute of Chartered Accountants in Australia (ICAA) also recommended a separation from the employment nexus to encourage all Australians with disposable income to invest for retirement.[29]

Committee view – closing the adequacy gap

3.32 The Committee notes that the current available evidence demonstrates that the SG and age pension alone will not provide an adequate income in retirement for most people. The Committee also notes the variety of suggestions to address the shortfall between the expectations and reality of incomes in retirement.

Contribution levels

3.33 The Committee notes the calls for additional compulsory contributions to close the adequacy gap, either with or without additional voluntary savings. The Committee

---

26 *Submission* 70, IFSA, p. 14.

27 *Submission* 70, IFSA, p. 15.

28 *Submission* 73, AFSA, p. 53.

29 *Submission* 31, ICAA, p. 2.

is particularly conscious of the evidence before it advocating an increase in SG contribution levels above the current nine per cent level.

3.34 The Committee notes that there is no consensus among the major groups about the level to which these compulsory SG contributions should go, nor the source of the additional compulsory contributions to fill the identified shortfall.

3.35 The Committee considers that the current economic and employment climates are difficult ones in which to contemplate additional compulsory employer contributions. The Committee is also reluctant to propose compulsory member contributions because of the immediate reduction in living standards that would result. Against that background, the Committee is not satisfied that employers or individuals could afford or support additional compulsory contributions in the current economic circumstances. Accordingly the Committee supports incentives to save in superannuation through voluntary tax effective contributions as the means to fill the adequacy gap.

3.36 The Committee recalls that prior to 1983 the incentives to make compulsory contributions to superannuation were much more generous than they are today. Before 1983 there were no contribution, earnings, or surcharge taxes and only five per cent of lump sum benefits were subject to tax at the person's marginal tax rate. Even so, the record shows that superannuation coverage extended to only some 40 per cent of the population – and these were mainly public sector (where fund membership was compulsory), male, and high income earners. It is clear from this experience that tax incentives alone may not be sufficient to generate significant new voluntary contributions, although the spread of compulsory superannuation has lifted the level of contributions due to increased awareness and understanding of superannuation, as evidenced in paragraph 3.14. The Committee also notes that the existing SG laws do not ensure that salary sacrificed contributions are encouraged, as some employers are able to reduce their contributions.

Co-contributions

3.37 The Committee is therefore attracted to the notion of revisiting the co-contribution concept as a means of boosting voluntary savings. The Committee has received a number of worthy proposals to extend the current arrangement so that more people would be able to make contributions without significant impacts on the Budget bottom line. These include proposals to extend co-contributions to the middle income group where there is more scope to make a voluntary contribution, for example to those on AWOTE, and ensuring that the co-contribution concept assists the less fortunate in society. In addition, the Committee has been informed that the level of voluntary contributions (and presumably the ability to make additional contributions) rises with income. The additional savings that this extension will encourage will also assist in correcting Australia's low household savings record.

Superannuation and employment

3.38 The Committee acknowledges that recent policy developments have reduced but not removed the nexus between employment and access to the superannuation system. For example the Committee notes the developments to provide non working spouses and children with access to superannuation. The Committee also notes that the age limit for older Australians to make personal contributions to superannuation has recently been raised to 75 years. Furthermore, the Committee supports removing the work test for making voluntary contributions.

Increasing access to superannuation

3.39 The Committee notes that non superannuation assets currently are excluded as contributions to superannuation income stream products. The Committee considers that, subject to equity considerations, every chance should be taken to allow people to maximise their income in retirement through topping up their assets from non superannuation money, providing that, as far as possible, there are no adverse tax or age pension means test consequences.

3.40 The Committee also notes that the Government's proposal for superannuation contribution splitting between spouses.

Recommendation

3.41 **The Committee recommends that the Government:**

- **extend the co-contribution concept by raising the threshold to people on average earnings, and improving the coverage to lower to middle income earners;**
- **remove the work test for making voluntary contributions for those under age 75; and**
- **permit the contribution of any non superannuation asset to superannuation income stream products, providing that, as far as possible, there are no adverse tax or age pension means test consequences.**