

Appendix 5

Objectives of the superannuation system

This appendix provides an outline of characteristics for three possible objectives of Australia's superannuation system. It is based on the written submission of PricewaterhouseCoopers to the inquiry.¹

Table: An outline of characteristics for three possible objectives of Australia's superannuation system

	Basic	Adequate	Replacement
Objective - explained	To provide a basic income to all retired Australians and thereby relieve the Government of future age pension cost for these retirees.	To provide an adequate income to all retired Australians and thereby provide a level of comfort and security.	To provide a replacement income to all retired Australians that is linked to their pre-retirement income thereby ensuring a continuation of their living standards.
Retirement Income – goal	An income slightly greater than the age pension (say 50% AWE) for all retired workers. However, once this limit is obtained, no additional retirement income is encouraged.	Replacement income that varies by income. For example, it could be 90% for low income workers declining to 40%-50% for very high income workers.	At least 75% of the individual's pre-retirement income for all retired workers.
Consequences for incentives	Significant incentives are provided to reach the prescribed minimum level of retirement income. Limited or no incentives are provided once the retirement income goal is achieved.	Ongoing and flexible incentives are required for all income earners, with a target towards low and middle income earners. Flexibility is also required as income levels can change significantly during a working career.	Ongoing, flexible and significant incentives are required for all income earners. Contribution and benefit limits linked to income levels would be reduced or removed.
Contribution limits	Significant limits, once income objective is obtained.	Limits should be related to <u>both</u> income and current accumulation. Flexibility should recognise changes in life experience.	Very generous, if any, limits. Flexibility should recognise changes in life experience.

1 *Submission 110, PricewaterhouseCoopers, Attachment I.*

	Basic	Adequate	Replacement
Benefit format rules	Once the minimum income is achieved, no further prescription of benefit format is needed.	The majority of the benefit should be taken as income.	The majority of the benefit should be taken as income.
<i>Possible outcomes in respect of participation in future age pension payments</i>			
Full pension	30-40%	25-35%	20-30%
Part pension	40-50%	30-40%	25-35%
No pension	20-30%	30-40%	40-45%

Source: *Submission* No 110, PriceWaterhouse Coopers, Attachment I

PWC expanded on each of the Basic, Replacement, and Adequate approaches in the following terms:

In the **Basic** approach, the goal of superannuation would be to replace future age pension payments only. This would mean that once an individual's accumulated superannuation benefit is sufficient to exclude them from receiving the age pension, the Government would not require or encourage any further superannuation contributions. The consequences would include reduced superannuation contributions and lower superannuation benefits. However, if the objective is limited to 'replace future age pension costs', it is probable that a higher proportion of retired Australians would receive a part age pension. This result is due to several reasons including the lower contribution levels and the fact that with increasing longevity, any fixed amount (in current values) is unlikely to be sufficient to prevent retirees from receiving any age pension in the future.

The **Replacement** approach represents the other extreme where the superannuation system, through a combination of compulsion and encouragement, promotes a continuation of pre-retirement living standards at all income levels. In view of the significant changes in the labour market, this approach would require significant flexibility and encourage substantial 'catch up' contributions to be made, particularly at later ages. Whilst this approach is likely to have the largest impact on future age pension costs and superannuation savings, intra-generational equity concerns may arise. It should also be recognised that even with the most generous system, it is likely that at least 20% of aged Australians will receive a full aged pension due to their previous limited work experience due to sickness, unemployment or family and other responsibilities.

We recommend that the **Adequate** approach is the best way forward. Under this objective, twin goals exist; namely:

- . To reduce future age pension costs; and

- . To encourage most Australians to save during their working years so that their retirement is comfortable and, within reason, bears some relationship to their pre-retirement living standards.

To achieve these goals, a number of changes are needed. These include:

- . A continued combination of a compulsory and voluntary structure, but with the complementary roles of both clearly spelt out;
- . Greater flexibility in the incentives to make voluntary contributions, recognising that superannuation savings should be assessed over many years and not considered to be a single year proposition; and
- . Stronger controls over the form of benefit payments, thereby encouraging the provision of income streams.

