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Australian superannuation:

an equitable and sustainable arrangement in a post crisis world?

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Providing support for retirement in Australia

Australia has a classic three pillar retirement system, namely:

- A mandatory contribution (made by employers) which is currently 9% of wages, increasing to 9.25% from July 2013 and then gradually to 12% from July 2019.
- Voluntary contributions, many of which attract tax concessions.
- A government means-tested Age Pension commencing at age 65 for males and (currently) 64 for females but increasing to age 67 over the next decade. Veterans (pensioners who have been in the armed services) receive identical benefits but receive them five years earlier than civilians.

All elements have been subject to changes for fiscal and other reasons.

The voluntary contributions are from a number of sources:

- Employers (usually large companies and governments) which pay a higher rate than the law requires.
- Members paying pre-tax contributions from their salary package. The limit of concessional contributions has fallen significantly in recent years.
- Members paying after-tax contributions, which are subject to a contribution cap of $150,000 a year or $450,000 in a three year period.
- The government co-contribution which matches after-tax contributions up to $1,000 a year for low income earners.

The taxation structure for superannuation is relatively complicated but in broad terms most members of defined contribution funds are taxed concessionally in regard to contributions and investment earnings. Benefits, both lump sum and in income stream form, are tax free when received at age 60 and over.

Despite the regular changes which governments have made for fiscal or equity reasons, the broad structure is robust and is supported by voters, politicians and industry.

A critical element of Australia's retirement system is that members generally carry all the investment risks themselves. While around 10% of employees are in defined benefit arrangements, most of these are closed to new members. In the long-term, almost all members will hold accumulation (defined contribution) accounts. However, there will be at least some defined benefit pensioners in the system for many decades to come.

Also important for the living standards of retirees are:

- a high level of home ownership amongst retirees; and
- government funding on a means tested basis of residential aged care and some other aged care.

The focus of this paper will be on superannuation and the Age Pension.

A brief history of superannuation in Australia

Occupational superannuation in Australia first emerged in mid-nineteenth century. The term "superannuation" was in common usage in the early 19th century to refer to the pension received after retirement from the former employer. In most other countries the term "private pensions" tends to be used to describe what is known as superannuation in Australia. While it is not entirely clear why the term superannuation is used in Australia, the term does provide a clear distinction for private arrangements from the government provided Age Pension. It also is more consistent with the availability of lump sum benefits in Australia, which are taken by a substantial number of retirees.

From its earliest days in Australia (with the establishment of a superannuation fund for its staff by the Bank of Australasia in October 1842) up to the 1940s superannuation was only available to a select, mostly male, group of salaried employees in the public sector and some large companies. Employer supported superannuation for wages staff tended to be less generous, with smaller benefits and smaller employer contributions in schemes that were non-compulsory.

By 1974, 32.2% of wage and salary earners were covered by superannuation, made up of 40.8% of male wage and salary earners but only 16.5% of females. Most superannuation assets were in defined benefit funds.

In 1983 the newly elected Labor Government expressed support for the principles of employee superannuation and initiated discussions with the Australian Council of Trade Unions (ACTU) on the possibility of broadening access to superannuation as part of the Government's Prices and Incomes Accord with the trade unions.

The process of making employee superannuation a more or less universal entitlement began in September 1985 when, with the support of the Government, the ACTU sought a 3% superannuation contribution to be paid by employers to industry funds specified in relevant industrial awards, which set the minimum wages and conditions for many but not all employees in Australia.

This submission was supported by arguments addressed to:

(i) the implications arising from the trend towards an ageing of the population including the workforce;
(ii) the effects of the trend for earlier retirement;
(iii) the existing dependency on age pensions and the projected significant increase in the dependency of the aged on the working population with an explosion of age pension costs;
(iv) the fact that a large percentage of the work force was not covered by existing superannuation schemes and that wide disparities existed in coverage according to sex, industry, occupation and income levels. In particular, it was submitted that women, manual workers and those in the lower income level are less adequately covered than others.

As new industrial awards and agreements were progressively negotiated according to the guidelines in the national wage case decision, there was a rapid increase in superannuation coverage. In the four years after the introduction of award superannuation coverage grew from around 40% of employees to 79%. In the private sector coverage grew from 32% in 1987 to 68% in 1991.

This was a major achievement for award superannuation, but more was needed in terms of coverage and rate of contributions. Accordingly, the then government announced in the 1991-92 Budget that it would introduce a mandatory superannuation system through the implementation of the Superannuation Guarantee (SG). The SG system is based on using the taxation power of the Australian government to provide a very powerful incentive for employers to make superannuation contributions of the required amount. The Guarantee part of the SG is more about a requirement for contributions being made than a guarantee of investment earnings or eventual retirement income.

The SG system came into effect on 1 July 1992, starting a minimum contribution level of 3%. A schedule of future increases in the rate of the SG was also set, with a rate for all employees of 9% of earnings applying from 1 July 2002. Employers already making contributions that met the requirements of the SG were not required to make additional contributions. Employees now generally are able to choose the fund contributions are made to but many employees have contributions made to the fund that their employer has selected as the default fund or which is specified as a default fund in an industrial award. There are some hundreds of corporate, retail, industry and public sector funds and nearly 500,000 small Self Managed Superannuation Funds. While there has been growth in the number of SMSFs the numbers of the other types of funds have decreased over time.

The coverage of the system was very broad, using a wide definition of employer and employee. However, there were some exceptions, chiefly those earning less than $A450 a calendar month, part-time employees aged under 18, and those aged over 65. As well, the SG does not apply to the self-employed (other than to owner-managers who receive wages and technically are employees of a company they control). Around 30% of the self-employed make contributions, partly driven by the tax concessions available for this.

In May 2010, the Australian Treasurer announced that compulsory employer superannuation contributions were to increase to 12% by July 2019. The increase in SG contributions is a gradual process starting with 0.25% in the 2013-2014 financial year, and then a 0.25% increase in the 2014-2015 year. For the following 5 years after the 2015 financial year, the SG rate will increase by 0.5% until it reaches 12% from July 2019.

The Age Pension now and into the future

The Age Pension is funded out of general tax revenue by the Australian government. It does not require any history of social security contributions but rather receipt is determined by reaching the eligibility age, being resident in Australia for 20 years and qualifying under the applicable asset and income tests. The maximum rate of the Age pension as at 1 July 2012 of $A19,696 for a single and $A29,695 for a couple. The Age Pension is taxable but due to a variety of rebates those receiving the maximum rate generally do not pay any income tax.

Table 1 shows the most recent budget standards for a modest and comfortable lifestyle as indicated by the ASFA Retirement Standard. These are based on a typical retiree at age 65. These budget standards are widely used in Australia as an indicator of adequacy of retirement income. They are updated regularly on the ASFA website.

While these values do not reflect the situation of every retiree, they allow us to gauge the average needs for different lifestyle expectations given costs of living in Australia. These are compared with the maximum annual rate of Age Pension as at July 2012.

TABLE 1: THE AGE PENSION COMPARED TO THE ASFA REIREMENT STANDARDS

	Modest lifestyle – single	Modest lifestyle – couple	Comfortable lifestyle – single	Comfortable lifestyle – couple
Yearly Total	$21,970	$31,675	$40,412	$55,316
Age Pension	$20,088	$30,285	$20,088	$30,285
Difference from Age Pension	$1,882	$2,061	$20,324	$25,702

It is clear that the Age Pension is close to meeting the modest lifestyle needs of retirees. As the benefit is linked to wages and the modest lifestyle is linked to prices, the Age Pension will gradually close in on the modest lifestyle for at least a period of some years. The ASFA Retirement Standard is adjusted for changes in prices every quarter but every four or five years is adjusted more substantively for changes in the pattern of expenditure by retirees and for increases in the general living standard of the community.

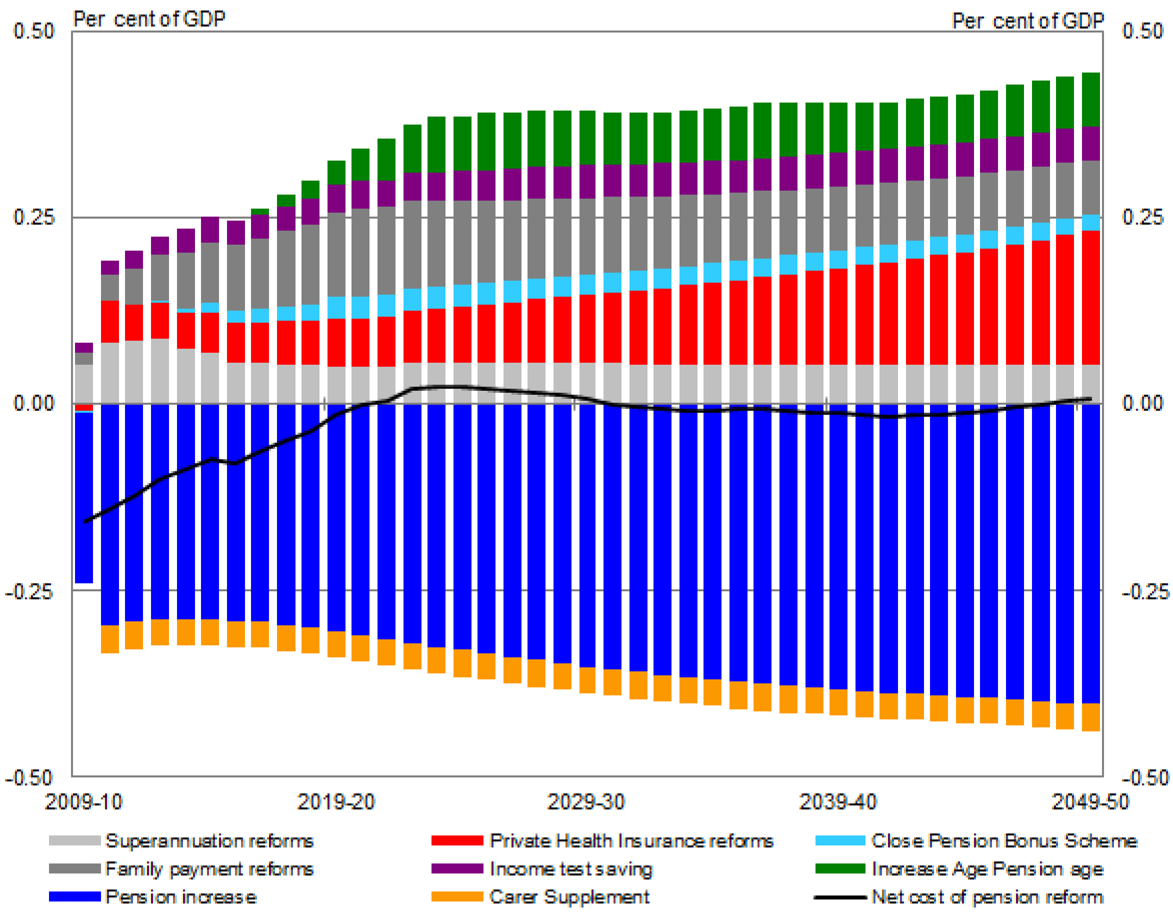
For a comfortable lifestyle, retirees need to build their own superannuation as the Age Pension by itself will be inadequate.

The fiscal sustainability of the Age Pension

Australia is unusual in that the future financial impact of programs such as the Age Pension is required to be assessed on a regular basis in what is known as the Intergenerational Report (IGR). The IGR came to life as a key requirement of the 1998 Charter of Budget Honesty Act. The Charter requires an intergenerational report to assess the long term sustainability of policies over the 40 years following the release of the report, including the impacts of demographic change. The IGR has played a major role in raising community awareness of long-term fiscal challenges and, in so doing, placed greater focus on Government decisions with long term consequences.

For instance, in the 2009-10 Budget, the Government announced increases to age pension payments, particularly for single persons following an inquiry process which indicated the desirability of increasing such payments. These increases were introduced along with a suite of budget saving measures designed to offset their long term costs. The budget saving measures included a gradual rise in the qualifying age for the age pension (to be phased in from 2017 to 2023), means testing of the private health insurance rebate, as well as reforms to family payments and superannuation. The package of changes was projected to be budget neutral by 2021-22 and through to 2049-50 (Chart 1)

CHART 1: 2009-10 BUDGET PENSION REFORM PACKAGE



Source: Australian Government, 2009-10 Budget, Budget Paper No. 1, p 1-37.

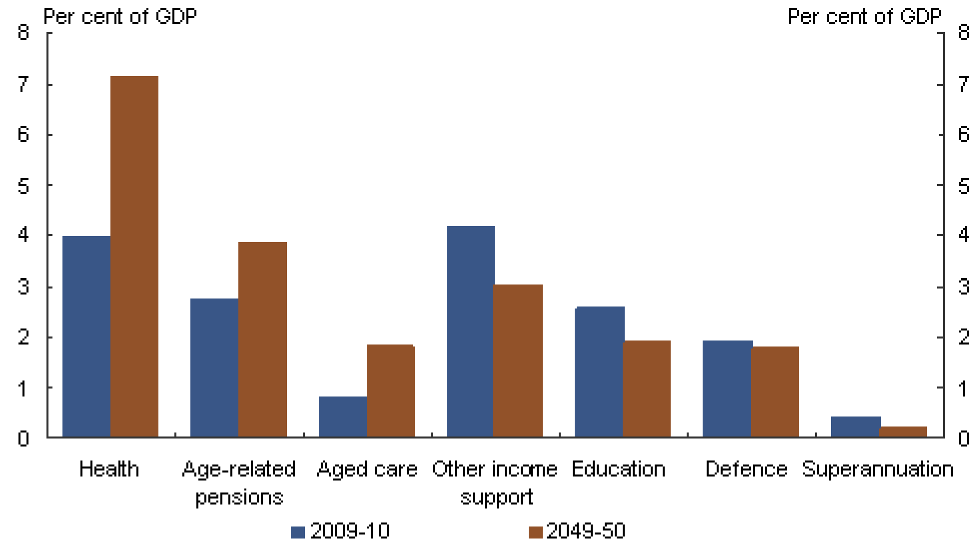
Australia was relatively unusual in the international community in that it weathered the Global Financial Crisis without significant impacts on economic activity, unemployment or fiscal outcomes. While the current budgetary situation is not without challenges, with the Government recently formally announcing that a target of a budget surplus in 2012-13 will not be met, the budgetary situation has been sufficiently robust to support both the increase in the Age Pension and the increased tax expenditures associated with higher compulsory contributions to superannuation. In regard to the latter, there was an explicit linking of the introduction of a new resources rent tax with the legislation increasing the SG rate.

However, over a longer time period, ageing of the population will still contribute to pressure on government spending and fiscal sustainability. The IGR projects total spending to increase to 27.1 per cent of GDP in 2049-50, around 4¾ percentage points higher than its projected low point in 2015-16. In today's terms, that is the equivalent of adding around $60 billion a year to government spending.

Around two-thirds of the projected increase in spending over the next 40 years is related to health; reflecting pressures from ageing, increasing community expectations and the funding of new technologies. Growth in spending on age-related pensions and aged care is also significant, both as a proportion of GDP and in real spending per person. Currently, about a quarter of Australian Government spending is directed to health, age-related pensions and aged care. The IGR projects that Australian Government spending on these functions will increase significantly over the next 40 years, pushing their share of spending to almost one-half.

As a proportion of GDP, spending on health is projected to rise from 4.0 per cent to 7.1 per cent. Age-related pensions and aged care are projected to rise from 2.7 per cent and 0.8 per cent of GDP to 3.9 per cent and 1.8 per cent in 2049-50.

CHART 2: PROJECTED EXPENDITURE BY MAJOR CATEGORY



Excluding public debt interest, the IGR projects a fiscal gap of 2¾ per cent of GDP (or around $30 billion in today's dollars) by 2049-50.

Much of the increase in expenditure on Age Pensions is due to ageing of the population structure. While unlike some countries the Australian population will continue to grow, annual rates of population growth are projected to slow gradually, from 2.1 per cent in 2008–09 to 0.9 per cent in 2049–50. Australia's population is projected to grow from around 22 million people currently to 35.9 million people in 2050.

As well, average Australian mortality rates have fallen significantly, with life expectancies rising for both men and women. These falls have added to population growth and the proportion of older people in the Australian population. As a result the number of Australians aged 65 and over is projected to grow from around 3 million in 2010 to 8.1 million by 2050, from 2.1 per cent of the population to 5.1 per cent. As a result the number of people of eligible age for the Age Pension is projected to increase by around 150 per cent by 2049–50.

Other factors affecting the projections of age-related pension spending include:

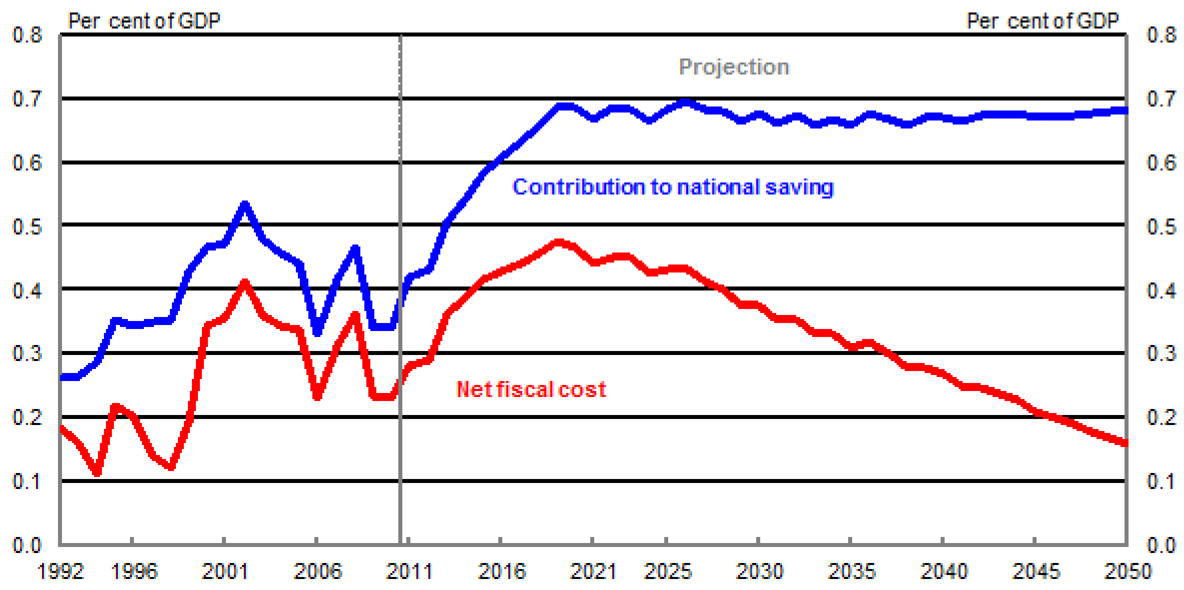
- A decline in the proportion of pensioners receiving a full Age Pension, because of the increased value of individuals' superannuation and other private assets and income.
- The proportion of people with a part Age Pension is projected to increase significantly while the proportion of the eligible age group not receiving any Age Pension is projected to rise slightly.
- As noted earlier, the increase in the rate of the Age Pension has been largely offset by other policy measures such as raising eligibility age.

When the next IGR is prepared in 2015 it can be expected to take into account the increase in compulsory contributions from 9% to 12%. This will further moderate the increase in age-related pension spending, particularly towards the end of the projection period.

Of course, there are consequences flowing from compulsory superannuation contributions for the public sector's contribution to private (and therefore national) saving as a consequence of the compulsory superannuation system. This is shown by the blue line in Chart 3. This public sector contribution arises from the tax-preferred status of compulsory super and the assumption by the Australian Treasury that other expenditure are cut back to allow for this tax expenditure. The public sector's contribution is estimated to be about 0.4 per cent of GDP currently, rising gradually to nearly 0.7 per cent of GDP by the end of the decade, and then staying around that level to the middle of the century.

The estimated net fiscal cost to the budget, shown in the red line in Chart 3, is smaller than the public sector's contribution to private saving, because budget savings arising from the compulsory super system reduce the net fiscal cost of compulsory super. This is because growth in wages is less than it would otherwise be because of the increase in superannuation contributions, leading to increases in expenditure on Age Pension and other government payments indexed to movements in average wages being less than they would otherwise be.

CHART 3: PUBLIC SECTOR CONTRIBUTION TO NATIONAL SAVING AND THE NET FISCAL COST



Source: Treasury.

Equity clearly is a key issue in the debate about superannuation and retirement income reform. There is strong government and community concern that the assistance provided to retirement income should be spread fairly according to need. There also is a strong tradition in Australia of support for what we colloquially call a “fair go”. In the context of superannuation this means that no groups should face barriers to participation in the retirement income system.

One statistic that gained some currency in public debate in Australia was that 5% of individuals account for 37% of concessional contributions. However, this is now something of an urban myth in that the figure, calculated by the Treasury, related to 2005-06 when superannuation policy settings were significantly different to now. For instance, in 2005-06 a maximum deductible contribution limit of $A100,587 applied for each employee aged 50 and over and for the self-employed aged 50 and over. For those aged 35 to 49 the figure was $A40,560 a year.

By 2009-10 a new set of concessional contribution caps was in force (after a number of variants along the way). These caps permitted annual contributions of no more than $A25,000 a year for those aged less than 50 and $A50,000 a year for those aged 50 and over. However, the $A50,000 a year cap is a transitional one and expired on 30 June 2012. The Government has announced its intention to replace these caps with a general cap of $A25,000 a year except for those aged 50 and over with less than $A500,000 in superannuation where a $A50,000 a year cap would apply. However, the introduction of this higher cap for those aged 50 and over has been delayed due to budgetary reasons.

Concessional contributions include:
- employer contributions (including contributions made under a salary sacrifice arrangement); and
- personal contributions claimed as a tax deduction by a self-employed person.

Tax assistance for super after the new concessional contribution caps

Clear empirical evidence indicates that the contribution caps have reduced the concessional contributions made by upper income earners. This is reflected in Table 2 which sets out estimates of the proportion of concessional superannuation contributions made on behalf of wage earners in the various marginal income tax bands applying in 2009-10. These estimates are based on data especially extracted for ASFA from a large scale survey of Australian households, namely the Household, Income and Labour Dynamics in Australia (HILDA) Survey.

These estimates of employer contributions are consistent in broad terms and produce overall results consistent with aggregate superannuation contributions as reported by APRA and Australian Taxation Office statistical publications.

TABLE 2: EMPLOYER CONTRIBUTIONS BY INCOME RANGE, 2009-10

Taxable income range ($)	**Marginal income tax rate**	**% of wage earners**	**Value of employer contributions(a)** $Am	**% of employer contributions(a)**
0 - 6,000	0%	5.4	54	0.1
6,001 - 37,000	15%	31.5	4,255	7.9
37,001 - 80,000	30%	42.7	23,120	43.0
80,001 - 180,000	38%	18.0	20,280	37.7
180,001+	47%	2.4	6,050	11.3

(a) Based on data extracted for ASFA from Wave 10 of the HILDA survey

As is clear from the table, superannuation contributions are not spread entirely evenly across all taxpayers or income ranges. This is because one of the basic characteristics of superannuation is that contributions are linked to employment, particularly full-time employment. Those taxpayers on very low incomes are not receiving superannuation contributions or are receiving the benefit of only relatively small contribution amounts.

Individuals on a low income in any given year will not necessarily be on a low taxable income for all of their life. Many individuals who have low taxable incomes from employment are undertaking part-time employment when they are studying or when they also have family responsibilities that prevent them from undertaking full-time work. However, over their lifetime they will have many years, usually decades, of full-time work. As well, wages often increase in real terms over the course of a career. The distribution of taxable incomes and tax concessions for superannuation contributions in any given year is not a good indicator of assistance delivered over a lifetime.

However, even in regard to a single year, as indicated by Table 2, around 90% of employer contributions relate to individuals on less than the top marginal tax rate, with over 50% of contributions relating to individuals on a marginal income tax rate of 30% or less.

The top 5% of employees (in terms of income) accounted for less than 20% of the total superannuation contributions in 2009-10.

While upper income earners typically have more superannuation contributions than lower income earners, the amount related to upper income earners is now much lower than previously. While a higher figure may have applied back in 2005-06, the impact of the contribution caps has been considerable. The various changes that have been made to the superannuation tax rules also may have impacted on confidence in contributing to superannuation, also leading to lower discretionary contributions.

Table 3 provides estimates of the amount of tax concession by personal income tax rate. It also factors in the receipt of the co-contribution, which is only available to low income earners making personal contributions.

The Table indicates that less than 15% of the government assistance for superannuation contributions flows to those on the top marginal rate. This compares to the around 30% of aggregate personal income tax collections that is paid by that group of taxpayers. While upper income earners do receive assistance for their superannuation contributions the overall personal tax system imposes a substantially higher tax burden on upper income earners compared to those on lower incomes. It could be argued that the general tax and transfer system in Australia should and does do most of the "heavy lifting" in terms of improving vertical equity.

The Table also indicates that the bulk of government assistance for superannuation flows to those on either the 30% or 38% tax rates. Such taxpayers make up a very large part of the full-time work force in Australia. Providing the bulk of tax assistance to this group makes sense from a public policy point of view. In contrast to very low income earners and those who never have significant wage income during their life, they have the potential to finance through savings significant income in retirement.

For those on the top marginal tax rate achievement of significant savings in the form of superannuation has the potential to make them totally self-funded in retirement with no reliance on the Age Pension.

TABLE 4: EMPLOYEE TAX CONCESSIONS BY INCOME RANGE – 2009-10

Taxable income range ($)	Marginal income tax rate	Value of tax concession(a) $Am	% of total tax concession for employer contributions	Value of tax concession and co-contribution $m	% of total tax concession and co-contribution
0 - 6,000	0%	-8	-0.1	192	1.5
6,001 - 37,000	15%	68	0.6	1.068	8.3
37,001 - 80,000	30%	4,462	39.2	4,662	36.4
80,001 - 180,000	38%	4,968	43.6	4,968	38.8
180,001+	47%	1,906	16.7	1,905	14.9
All employees		11,397	100	12,797	100

(a) Takes into account the Medicare levy, the phasing out of the Low Income Tax Offset, and the phasing in of the Medicare liability.

The Government has also legislated to provide a new super contribution of up to $500 annually for eligible low-income earners from the 2012-13 income year. The payment will be 15% of the eligible concessional contributions (including employer contributions) made by or for individuals with adjusted taxable incomes of up to $37,000. Individuals will also need to meet a test where at least 10% of their income must be from employment or business sources and they are a resident of Australia or New Zealand.

By its very nature this measure will only provide assistance to low income earners on either the zero or 15% tax rate.

As well, the phased increase in the rate of compulsory superannuation to 12 will have its greatest impact on low and middle income earners given that those on higher incomes commonly already receive the benefit of contributions in excess of 9% of wages and/or will adjust salary sacrifice contributions if there is an increase in compulsory contributions.

Table 4 compares the distribution of government assistance for superannuation in 2009-10 for employees on the basis of current policy settings and what it would have been if a 12% SG, the low income superannuation contribution payment and the current rate of co-contribution had applied in that year. While it will be some years before all the measures are fully in place this approach illustrates what the eventual impact on the distribution of government assistance by income level will be.

TABLE 4: CURRENT AND PROPOSED GOVERNMENT ASSISTANCE FOR SUPERANNUATION CONTRIBUTIONS BY INCOME RANGE

Taxable income range ($)	Marginal income tax rate	Current value of tax concession and co-contribution (a) $m	% of current total tax concession and co-contribution	Value of proposed total tax concession and government contributions (a) $m	% of proposed total tax concession and government contributions
0 - 6,000	0%	192	1.5	210	1.4
6,001 - 37,000	15%	1.068	8.3	1,640	11.0
37,001 - 80,000	30%	4,662	36.4	5,732	38.3
80,001 - 180,000	38%	4,968	38.8	5,465	36.6
180,001+	47%	1,905	14.9	1,905	12.7
All employees		12,797	100	14,953	100

(a) Takes into account the Medicare levy, the phasing out of the Low Income Tax Offset, and the phasing in of the Medicare liability. Based on 2009-10 tax rates

The combined effect of the government proposed measures would have, if they had applied in 2009-10, increased the assistance for retirement saving for employees earning less than $A80,000 a year from $A5,920 million to around $A7,580 million. Expressed as a percentage of total government assistance, the share of those earning less than $A80,000 a year would have increased from 46.2% to 50.2%. Clearly the measures strongly favour those on lower incomes.

Government assistance for both superannuation and the age pension

There is also a direct link between the level of retirement savings and the subsequent reduction in the government age pension. In considering the equity of government assistance for retirement income it also is necessary to take into account the amount of Age Pension that will eventually be provided on average to persons on various levels of earnings and superannuation during their working life.

This was done in research conducted in 2009 by Dr George Rothman of the Treasury Retirement & Intergenerational Modelling & Analysis Unit. This research places emphasis on a 'whole of life' or lifecycle perspective where Age Pension benefits in the retirement phase are included. The cost to government of its retirement income policies as a whole is modelled using Treasury's comprehensive RIMGROUP model.

The base case for this analysis is the retirement income framework following the 2009 budget. Significant changes in that budget included:

- A significant increase in Age pension Payments of $32.49 a week for single pensioners and $10.14 a week combined for couple pensioners together with changes to the income test whereby the pension taper rate for new pensioners is 50% rather than 40%.
- A gradual increase in the age for eligibility for an Age Pension beginning in 2017 so that this age reaches 67 in 2023.
- A reduction in the annual cap on concessional superannuation contributions from $50,000 to $25,000 for those aged under 50 and the transitional cap for over 50's from $100,000 to $50,000.

The analysis in the Treasury paper indicates that these measures have added considerably to the equity of Australia's retirement income system, both by gender and income.. The concessional contribution caps budget measure also was found to add even more to vertical equity to the system with the saving to government revenue impacting mostly on the top two deciles of the income distribution for both men and women.

The research also indicates that the total amount of government support does not vary much across the income deciles or by gender. Table 5 sets out the Treasury forecasts of government assistance for those born in 1960 and retiring in 2027. The proportion of assistance provided in the form of tax expenditures on superannuation increases with higher income with a more or less equivalent decrease in the value of Age Pension expenditures.

TABLE 5: NET PRESENT VALUE OF COST TO GOVERNMENT OF RETIREMENT INCOME SYSTEM BY INCOME LEVEL

decile	NPV1-women $m	NPV1-men $m	NPV1-both $m
1	$1,750	$1,600	$3,350
2	$1,700	$1,600	$3,350
3	$1,650	$1,600	$3,300
4	$1,650	$1,600	$3,300
5	$1,650	$1,600	$3,200
6	$1,650	$1,750	$3,400
7	$1,900	$1,800	$3,700
8	$1,850	$1,950	$3,800
9	$1,850	$2,050	$3,950
10	$1,800	$2,450	$4,250
all	$17,500	$18,050	$35,550

Overall government support for the Age Pension was found to account for 82% of the government assistance to women for their retirement and 68% of the assistance provided to men.

One group that receives above average assistance is men in the top income decile. For the other income deciles the withdrawal of the Age Pension largely matches the assistance given to higher superannuation contributions. However, this became irrelevant for those who are not entitled to even a part Age Pension. Limiting the concessional contribution cap to $A25,000 a year for those aged 50 and over with more than $A500,000 in superannuation is a policy response to this distributional finding.

The real equity challenge

The real issue in regard to equity is that too many Australians have too little in retirement savings rather than too much. While much public debate has focussed on the top 1% or 5% of income earners there has been little or no debate on how to advance outcomes for the other 99% or 95%.

If excessive government assistance is a problem it is restricted to a very small number of individuals. This is particularly the case since the introduction of progressively tighter caps on both concessional and non-concessional contributions. When properly measured, the total government assistance for retirement income in the form of both the Age Pension and tax concessions for superannuation is broadly even across the entire income distribution.

Nearly 90% of the tax concessions for superannuation flow to individuals on less than the top marginal tax rate. The share of total concessions flowing to individuals on the top marginal tax rate was around 50% in 2007-08 with the reduction in the share since them due to the introduction of contribution caps and higher rates of tax on the contributions of certain upper income earners.

Assisting those who really need assistance

Evidence from surveys of superannuation account balances held by individuals indicates that compulsory superannuation has been very effective in lifting coverage rates and average superannuation balances (Table 6).

The increase in the SG to 12% will further improve balances at retirement but it will be forty or fifty years before the system is fully mature.

TABLE 6: SUPERANNUATION COVERAGE AND SUPERANNUATION HOLDINGS OF MEN AND WOMEN WHO WERE NOT YET RETIRED, BY ANNUAL AND SALARY INCOME, 2006 AND 2010

	2006			*2010*		
		Superannuation balance of those with super ($)			*Superannuation balance of those with super ($)*	
Annual wage and salary income	*% with superannuation*	*Mean*	*Median*	*% with superannuation*	*Mean*	*Median*
Men						
< 28000	75.1	37312	5700	79.9	43553	5000
28000 – < 58000	96.7	70698	30000	96.8	62853	25000
58000 – < 80000	98.1	134981	65000	98.7	108092	50000
80000+	97.8	207801	110000	98.6	212025	110000
Total	91.4	99506	35000	93.9	109609	40000
Women						
< 28000	80.7	32807	9000	80.9	37622	8500
28000 – < 58000	96.8	56253	25000	96.6	52885	29000
58000 – < 80000	98.6	102844	55000	98.2	98071	50000
80000+	97.7	158652	88000	98.9	142855	75000
Total	89.4	55433	21000	90.9	63412	26000

***Note*:** Population weighted results.
Source: HILDA data

However, voluntary contributions have remained flat in recent years in response to both tax changes and investment return developments. In particular, contribution caps and other changes to superannuation are limiting the amount of salary sacrifice contributions, including by individuals seeking to catch up on contributions late in their career. Longitudinal data indicate that a significant proportion of the population have higher incomes (with associated capacity to make higher contributions) for a relatively limited portion of their working career. A higher contribution cap generally or at least for those aged 50 and over would assist those who need to catch up and have a capacity to do so.

While the superannuation co-contribution has been effective in lifting personal contributions of low income individuals the design parameters of the co-contribution and recent changes (cutbacks) to them have made the co-contribution less effective than it could be. There is a case for both a higher maximum co-contribution and a lower matching rate in order to encourage greater additional contributions.

The $450 a month threshold for receiving the SG

While there may have been a rationale for the threshold when the SG was first introduced, it would make sense to remove it now given that nearly all employees have a superannuation account and processes for making contributions are now more efficient. Around 250,000 individuals, the majority women, would benefit from removal of the threshold through higher eventual retirement savings. The cost to both employers and to the Commonwealth budget from removing the threshold would be very modest.

The self employed

Nearly 10% of the labour force are self-employed. While tax concessions have led to some self-employed saving for retirement through superannuation, average balances and coverage have remained relatively low. Around 29% of the self-employed have nil superannuation, with no superannuation being more common for males than females. There is a strong case to extend compulsory superannuation to include the self-employed.

Individuals on paid parental leave

Paid parental leave is considered by the government to be equivalent to wages in terms of income tax and other treatment of individuals. Consistent with this it would be appropriate for the Superannuation Guarantee to apply to such payments.

One of the reasons that the average superannuation balance of women is lower than that of men is time out of the paid workforce for parental reasons. Paying SG on parental leave payments would help reduce this difference in entitlements. The effects of compound interest also would be very favourable in regard to superannuation contributions made on behalf of women mostly in their 20s and 30s, who take parental leave.

The cost to the Commonwealth Budget would be just over $20 million a year.

Indigenous Australians

Indigenous Australians have lower coverage and lower balances on average than the general population, again largely related to differences in paid labour force experience. Superannuation coverage for indigenous Australians is about 70% for men and 60% for women, compared to rates of 85% for men and 80% for women for the population more generally. Average (mean) balances are also lower than for the equivalent Australian population as a whole (Table 7).

TABLE 7: SUPERANNUATION COVERAGE AND SUPERANNUATION HOLDINGS OF *ABORIGINAL AND TORRES STRAIT ISLANDER* MEN AND WOMEN WHO WERE NOT YET RETIRED, 2006 AND 2010

	2006			*2010*		
	% with superannuation	*Superannuation balance of those with super ($)*		*% with superannuation*	*Superannuation balance of those with super ($)*	
		Mean	*Median*		*Mean*	*Median*
Men	68.3	49589	9000	70.7	55743	14000
Women	52.1	42109	10000	60.6	39909	15000
Persons	59.5	46069	10000	65.3	47863	15000

Note: Population weighted results. Not enough cases to break down by age.

Increases in the superannuation coverage and average superannuation balances of indigenous Australians will clearly be associated with improvements in involvement in paid work and in wages. Labour market measures rather than superannuation policies drive labour market outcomes.

However, current superannuation arrangements and administrative requirements do not always mesh well with the circumstances and needs of indigenous Australians, particularly those in remote areas who may have difficulty in communicating with their superannuation fund and in claiming benefits or identifying lost accounts.

There is scope for the superannuation industry and the regulators to work towards a regulatory framework and administrative arrangements which can better cope with the special needs of indigenous Australians. Such arrangements also would be likely to benefit many other Australians.

Recently divorced men and women

Survey data indicate that the distribution of superannuation is now much more even for those who have recently divorced compared to when amendments were made in 2002 to the Family Law Act to allow the splitting of superannuation. The extent of disparities in particular decreased between 2006 and 2010. While a number of factors would have contributed to this, the growing maturity of the compulsory superannuation system leading to higher average account balances for both men and women would have played a role, along with more women having superannuation in their own right. The figures also are consistent with the parties to a marriage making more use of the splitting arrangements.

Exposure to investment risk

Currently in Australia around 90% of individuals in the pre-retirement phase who have superannuation and around 75% of those in retirement with a superannuation interest are exposed to investment risk. The proportion is higher in the pre-retirement phase given that the newer and younger fund members have been predominantly enrolled in defined contribution arrangements.

As shown by Table 8, investment returns in Australia, as in many other countries have not been favourable in recent years. The GFC had a significant impact, particularly given the 65% to 70% exposure on average of most funds to equities.

TABLE 8: AVERAGE ANNUAL FUND INVESTMENT RETURNS TO 30 JUNE 2012 (%)

1 Year	0.3
5 years	-0.7
10 Years	5.2
15 Years	5.5
20 Years	7.0
25 Years	7.2
30 Years	10.0
35 Years	10.8
40 Years	9.9
50 Years	9.9

The rationale for relatively high levels of exposure to growth assets in accumulation funds is that this will lead to higher retirement benefits for members. Most individuals will be a member of a superannuation fund for a period of 40 years or more. Subject of course to individual decisions in regard to exposure to investment risk and volatility, there is an argument that such exposure should be sustained throughout a member's career.

However, the volatility of markets means that at least some members will wish to shift assets into cash over the five years before retirement to prevent 'Sequencing Risk'. This will allow them to cater for any required lump sum benefit and their initial pension draw downs. Life cycle investment options can provide such an investment strategy. However, while they are suitable for some individuals they may not be suitable for others.

Historical analysis also indicates that a typical life cycle fund would have delivered poorer outcomes for most members over most periods in Australia, such as 1900 to 1970, 1970 to 1999 and 1900 to 1999. Now is also not a good time to switch allocations from equities to bonds as returns to bonds are at historical lows and recent returns from equities, especially Australian equities, have been relatively strong with double digit returns in calendar 2012, particularly the second half of 2012.

While consumer satisfaction with superannuation tends to follow with a lag developments in investment returns, there has been little pressure in Australia for the government to cover any investment losses faced by fund members due to general developments in investment markets. The only policy response to the GFC was to reduce the minimum drawdown factor for individuals who have an account based income stream in retirement. There are compensation arrangements that can be called upon in the case of members suffering loss due to fraud or theft in a regulated fund but fortunately frauds or theft are relatively rare in the regulated superannuation funds. Compensation in these cases is effectively funded by members of other regulated superannuation funds through special levies struck by the government in such cases.

Income streams in retirement

In an ideal world, the objective of superannuation should be focused on the provision of income during the whole of retirement. However, there are a number of reasons why it is difficult to structure the Australian system around regular reliable pension payments. These include:

- Award Superannuation was introduced in 1986 as deferred pay (in lieu of a possible productivity wage rise). It was promoted to members as an addition to the Age Pension. The Superannuation Guarantee has increased the value of contributions but the message has not changed – members consider that superannuation is their own money and they expect flexibility of payments.

- The government allows all members above age 60 to retire and draw a tax-free lump sum or pension. Most older Australians also are subject to low or nil rates of personal income tax given low average incomes and various tax rebates. As a result, there is only a limited incentive for individuals to leave money in the system during retirement.

- There are no longer maximum withdrawal factors on account-based pensions, so no-one is forced to draw their benefits over time.

- Members can buy lifetime annuities from the private sector (albeit from a small number of suppliers), but current sales are well under 100 a year in total. Consumer research indicates that most Australians are unrealistic about the pricing of an indexed lifetime annuity and expect much more than fair value. Without compulsion or incentives, most members will not buy these products.

- Many members retire with small benefits and they appear comfortable with leaving the money in an interest-bearing bank account rather than in superannuation. This may be influenced by their perception of safety in the bank or by a short time horizon where they do not value higher (but uncertain) returns. They may also value instant access to their funds.

- Many people today retire with some debt (including mortgages) or the need to carry out home repairs or consumer durable purchases and it is a rational decision to take a superannuation lump sum to clear all such expenses or debts before retiring.

- Around a third of total superannuation savings and around half of post-retirement superannuation balances are held in Self-Managed Superannuation Funds which have less than five members and where each member is also a trustee of the fund. Such fund members generally value control highly and are wary of purchasing an income stream from a third party such as life insurance company or managed fund.

The above situation has made the provision of income streams, particularly those which protect members from their longevity risk, difficult. In addition, transitional arrangements, especially if compulsion is involved, can be problematic due to the plans made by those approaching retirement.

That said, the evidence available indicates that many Australians do take an income stream from their superannuation in retirement, albeit one that is account based with no maximum drawdown amount. This is particularly the case when larger amounts are involved.

As shown by Table 9, around 70% of males aged 60 to 64 who have recently retired have superannuation, with an average balance of around $380,000. This is a drop in coverage of around 20 percentage points compared to those who have not retired who are in the same age group. The average balance is also higher than for those not retired which suggests that those with lower balances are more likely to cash out and invest (or spend) elsewhere.

For women the drop in coverage is greater, but around 30 percentage points. Again, the average balances for those retaining retirement savings in superannuation at around $255,000 is higher than for those in the same age group who have not retired.

TABLE 9: SUPERANNUATION COVERAGE AND SUPERANNUATION HOLDINGS OF MEN AND WOMEN WHO WERE *RECENTLY RETIRED*, 2006 AND 2010

	2006			*2010*		
		Superannuation balance of those with super ($)			*Superannuation balance of those with super ($)*	
Age group	*% with superannuation*	*Mean*	*Median*	*% with superannuation*	*Mean*	*Median*
Men						
<60	70.2	283430	200000	89.8	528105	386000
60–64	76.7	573228	500000	68.8	381703	250000
65–69	48.1	421618	200000	65.7	299161	164000
70+	41.6	*283938	*162000	32.3	*273218	*90000
Total	60.7	419841	280000	60.8	367336	245000
Women						
<60	62.1	322945	100000	63.7	135501	53000
60–64	53.1	273135	195000	58.6	255485	120000
65–69	46.4	129491	90000	41.7	205855	70000
70+	*41.6	*48358	*15000	*7.1	*184000	*184000
Total	54.5	254647	100000	53.0	191474	102000

***Note*:** Population weighted results. * Estimate not reliable. 'Recently retired' if 'currently retired and observed not retired (i.e., employed) at some stage in the last three years'.

These figures strongly suggest that the great bulk of recent retirees keep their retirement savings primarily in superannuation and draw down an income stream. Those retirees that take their retirement savings out of the superannuation system are a minority. However, even for this minority there is no evidence that the superannuation savings are used primarily for immediate consumption purposes, such as an overseas trip. While some commentators claim that frequently happens, such assertions are more in the line of urban myths than being supported by any objective research.

However, clearly there is scope for more retirement benefits to be taken in income stream form.

Designing better post-retirement arrangements

The primary purpose of superannuation is to provide financial security in retirement. This purpose is not currently being achieved as much as it could be in Australia as there are many potential leakages that are at a cost to the system's integrity and the taxation concessions provided.

These potential leakages include

- using superannuation benefits too fast, which manifests it in several ways including
  - having insufficient longevity protection
  - excessively running down retirement savings when they become available to either fund excessive consumption and/or debts that were built up in the lead up to retirement in the knowledge that a lump sum would be available
- using superannuation benefits too slowly (ie poor lifestyle in retirement) and leaving these benefits for others in the estate.

While the evidence available indicates that most retirees make sensible decisions in regard to their investment of their retirement savings, there is scope to strengthen arrangements in each of advice, defaults and compulsion.

ASFA currently has a major project underway with the aim of facilitating or requiring the better provision of retirement income streams. This work is well underway but is not yet complete.

The following guiding principles have influenced ASFA's thinking:

1 The main focus of superannuation should be on income streams in retirement, as opposed to lump sums or estate planning. Superannuation in the post retirement phase should be designed to ensure that superannuation income streams, in conjunction with full or part age pension payments, provide income and dignity in retirement until death.

2 The retirement income system (including both tax concessions and Age Pension payments) must be perceived to be fair, when assessed across all components of the system and across the lifetime of individuals, including both the pre and post retirement phases.

3 Changes should not undermine confidence in the system; that is, in terms of both the changes made and the need for long lead times.

4 The system must be comprehensive covering people in different types of employment structures e.g. employees, contractors, self-employed.

5 The retirement income system needs to be flexible recognising the need to take into account the varying patterns of work and lifetime income that exist. Phased retirement should also be encouraged as a means of helping people stay in the workforce longer, not as a tax evasion mechanism.

6 The retirement income system should be robust and be able to withstand a range of reasonable economic conditions without significantly reducing the expectations of the individuals involved.

7 The means test for the Age Pension has an important role to play in determining the amount of government assistance that retirees receive. In particular, those individuals or family units who earn below average wages, or who spend time out of the workforce (e.g. to raise a family or because they can't get a job), should receive substantial support from the government to achieve a basic income in retirement. On the other hand, individuals and couples who continue in paid employment past customary retirement age and/or who have substantial superannuation and other assets which support a lifestyle in retirement more substantial than that described in the ASFA Retirement Standard at the comfortable level should receive little or no Age Pension.

8 The super system needs to have a relatively high degree of guidance and constraints (including good default systems) in order to protect people from unwise or excessively short term actions. For example, it needs to

a) require long term savings with restricted access prior to retirement

b) provide income in retirement

c) reduce risks during both the accumulation and retirement phases

9 There needs to be access to deferred annuities – purchase of which could start in either the accumulation or draw-down stage. This will necessitate the removal of prudential supervision and tax regulatory roadblocks in order to allow the offering of deferred annuities in either the accumulation or draw-down phase.

10 Incentives and default settings should be the initial approach to obtaining the desired outcomes. However, if such arrangements are not effective in producing desired outcomes then consideration may need to be given to introducing a degree of compulsion with respect to the taking of income streams in retirement. For instance, this could be achieved through the application of tax penalties with respect to taking benefits in any one of the following:

- as a lump sum;
- in the form of a non-complying income stream
- if there is non-compliance with either the minimum or maximum drawdown factor of a complying account based income stream.

11 The requirements should apply to all superannuation structures, including SMSFs, where provisions are relevant.