2015 Pension Policy Notes

AUSTRALIA

- **Increase contributions to Superannuation to help ensure adequate income.**
- **Create an effective annuity market and improve incentives for pensioners to annuitise their pensions.**

The mandatory two-pillar system is performing well. The first pillar, the Age Pension, provides a means-tested safety net for people with insufficient assets or income, and is financed from general revenue. The second pillar, Superannuation, is a mandatory defined-contribution pension that is financed through employer contributions, with only voluntary payments from employees. The combination of these two pillars generates long-term replacement rates that are high for low-wage earners but fall below the OECD average for those above average earnings because of the gradual withdrawal of the Age Pension. Overall, the relative average income of people aged over 65 (versus that of the whole population) is the second lowest within OECD countries. Consequently the old-age poverty rate is the second highest in the OECD, and more than twice the poverty rate for the total population. However, the poverty figures are inflated, as pensions are mostly taken as a lump-sum, and therefore not regarded as a regular annual income. Moreover as Superannuation reaches full maturity from 2042, pension income will be higher, assuming that the recent trend of increased frequency of annual payments continues.

Key indicators: Australia and OECD average

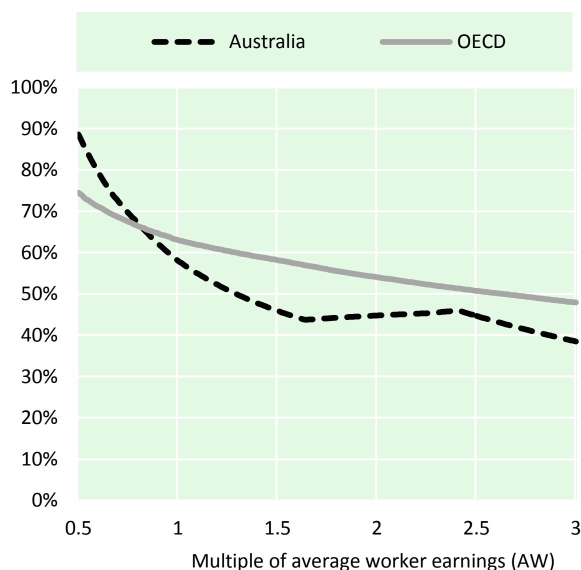
	Mid-1980s	Mid-1990s	Mid-2000s	latest available	latest OECD	long-term	long-term OECD
Pensionable age for a full-time career starting at the age of 20	65.0 (60.0)	65.0 (60.0)	65.0 (61.0)	65.0 (64.5)		67.0	
Retirement age	65.0 (60.0)	65.0 (60.0)	65.0 (61.0)	65.0 (64.5)	62.9 (61.8)	67.0	64.6 (64.4)
Net replacement rate, avg earner						58.0 (53.4)	63.2 (62.7)
Total mandatory contribution rate		4.0	9.0	9.5	19.1		
Total pension spending, % of GDP	3.5	6.7	6.8	7.7	10.3		
Public pension spending, % of GDP	3.5	4.2	4.5	5.2	8.4		
Public debt, % of GDP	..	42	22	45	115		
Employment rate 55-64, %	57.1 (19.5)	55.7 (27.3)	63.8 (43.1)	69.1 (54.1)	66.1 (49.1)		
Labour-market exit age	62.6 (58.9)	62.4 (59.4)	63.7 (61.5)	65.3 (63.0)	64.6 (63.1)		
Old-age poverty rate, %		22.3	30.2	35.5	12.6		
Life expectancy at 65, years	14.7 (18.6)	16.3 (20.0)	18.5 (21.6)	19.8 (22.5)	18.4 (21.5)	24.1 (27.0)	22.9 (25.9)
Old-age dependency ratio	0.18	0.20	0.21	0.25	0.28	0.46	0.57
Fertility rate	1.9	1.8	2.0	1.9	1.7	1.8	1.8

Note. The figures for women appear in parenthesis where they differ from those for men.
Long-term: Around 2060 based on all legislated reforms up to mid-2015.

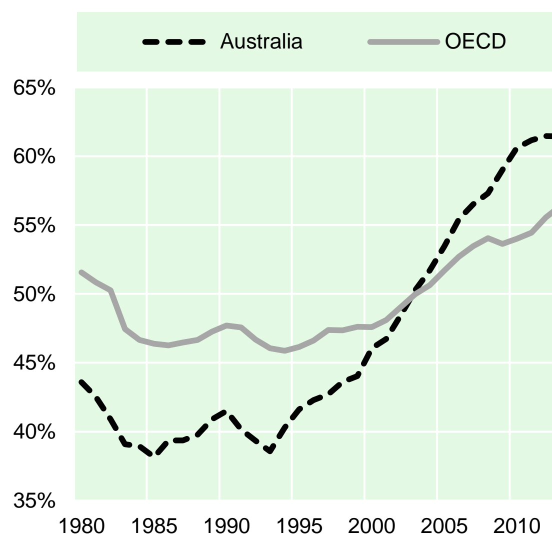
The government has passed legislation to improve the financial sustainability of the pension system. Currently the Age Pension is indexed by the higher of CPI inflation and the change in the Pensioner and Beneficiary Living Cost Index but the combined benefit for couples cannot fall below 41.8% of national pre-tax Male Total Average Weekly Earnings level. This ensures that this portion of retirement income cannot decrease in relative terms throughout retirement. As the population ages, financing the Age Pension will place greater pressure on the public budget. This pressure will be partially alleviated by the enacted increase in the retirement age, from 65 currently to 67 in 2025, with a further increase to 70 proposed for 2035. Assuming that career lengths are effectively extended the

increased years of coverage under Superannuation will reduce reliance on the Age Pension. The 2015-16 budget legislated an increase to the pension asset threshold (incorporating everything apart from the family home), above which payments will be withdrawn at a higher rate, thereby improving both targeting to the poorest and financial sustainability.

Long-term net replacement rates (%), by earnings level



Employment rate for those aged 55-64



Sources: OECD pension models; OECD Employment Outlook

More individual savings are likely to be required to ensure an adequate income in retirement. With the proposed changes in the indexation of the Age Pension its relative value will decline over time. Therefore pensioners will need to ensure that they have sufficient personal savings through the Superannuation. Contribution levels to the Superannuation recently increased from 9% to 9.5%, but the proposed increase to 12% by 2019 has been delayed until 2025. This proposal will need to be reconsidered if the indexation of the Age Pension becomes less favourable. Despite tax incentives initially being offered for annual payments from pension savings the majority of funds used to be taken as a lump-sum; these tax incentives have now been removed. Recently though, as people have been retiring with larger account balances, there has been a gradual increase in purchasing annuity products, but around half of pension fund assets are still paid as lump-sums. Taxing lump-sum withdrawals to encourage lifetime annuities may help protect against the risk of poverty in later life, a risk that increases with improvements in life expectancy. Otherwise if the elderly poverty levels remain high the government may have to legislate for at least a partial annual payment from pension savings restricting the amount of lump-sum that can be taken. Developing an effective annuity market should remain a priority.

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