

Key findings

- Australia is ageing more slowly than the OECD average. The old age dependency ratio is 25 in 2015 and will be 41 in 2050 compared to the OECD averages of 28 and 53 respectively.
- Replacement rates in Australia are lower than the OECD average. The net replacement rate for an average wage earner is 43% compared to 63% for the OECD.
- The earnings test for the Age Pension limits flexible retirement after the normal retirement age. Earning more than 14% of the average wage will reduce the Age Pension.
- Combining work and receiving benefits from superannuation funds after the retirement age is unrestricted.
- Superannuation funds can also be taken as a lump sum which creates additional flexibility. These lump sum withdrawals of superannuation funds are likely to skew income poverty figures which stand out among OECD.
- Reforms over the last two years in Australia have focused mainly on tax incentives.

Overview – Ageing is relatively slow but replacement rates are low

Australia is ageing more slowly than the OECD average. The OECD average old-age dependency ratio currently stands at 28 and will likely increase to 53 by 2050. However, for Australia these numbers are 25 and 41 respectively, mainly because of the high rate of immigration of young adults. This gives Australia more time to take measures to limit the effect of ageing on the pensions system.

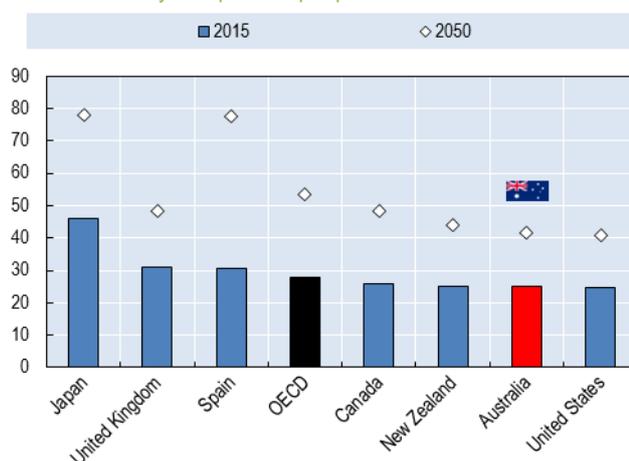
Given the relatively limited involvement of the government in pensions and the slower ageing process, public spending on pensions is low and expected to remain low. Public expenditure on pensions is currently 4% and will be 4% in the 2050s versus 9% and 10% for the OECD. Financial sustainability of the pension system therefore seems to be less of a concern in Australia than in many other OECD countries. Three-quarters of the older population (65+) receives an Age Pension (safety net) compared to roughly a quarter on average for OECD countries with safety net or minimum pensions. However, almost 42% of all recipients

in Australia have their Age Pension benefits reduced by the means test. Moreover, the maturing of the superannuation system (introduced in 1992) is likely to reduce poverty rates.

Retirement income replacement rates in Australia can be a problem. Net replacement rates for average wage earners in Australia are relatively low at 43% compared to 63% for the OECD on average. The old age income poverty rate in Australia is high at 26% compared to 13% across the OECD in 2015. This is partly related to the high prevalence of taking superannuation funds as lump sums rather than annuities at retirement, which obscures the comparison of relative income poverty measures between age groups and between countries. While taking out lump sums create flexibility in retirement it can also increase the risk of falling into poverty in case retirees outlive their assets, a risk which increases with higher longevity. However, it should be noted that poverty depth (the ratio by which the mean income of the poor falls below the poverty line) in Australia is relatively low. This is largely due to the Age Pension, which provides a floor for pensions, below but close to half the average wage (the OECD relative poverty line).

Australia is ageing more slowly than the OECD on average

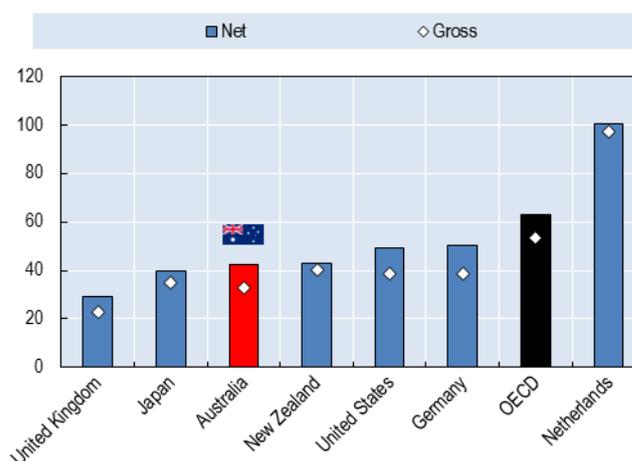
Old age dependency ratio, number of people older than 65 years per 100 people of 20-64



Source: [Figure 1.1].

Australia has low projected replacement rates

Gross and net pension replacement rate of average wage earner



Source: [Table 4.8].

In recent years Australia took measures to improve old age income adequacy. A Low Income Superannuation Tax Offset was introduced for individuals with adjusted taxable annual incomes up to AUD 37 000. In addition, Australia reformed the asset test for the Age Pension, increasing the threshold amount of assets before pensions are affected but simultaneously increasing the rate at which payments are reduced once this threshold is exceeded. Pensioners close to the threshold are therefore likely to see their pensions improved but those with more assets might see their pensions drop. At the same time Australia lowered the annual contribution ceiling to superannuation. This could potentially limit the amount that is saved in superannuation funds. However, Australia has also increased the flexibility in making before-tax contributions, allowing individuals with limited superannuation balances to carry-forward any unused cap for 5 years.

Australia has been very active in adjusting tax incentives. It established a cap (AUD 1.6 million) on the amount of superannuation funds of which returns will not be taxed during the retirement phase, it lowered the annual income threshold at which individuals pay an additional 15% contribution tax and it extended retirement phase tax exemptions to new retirement income stream products.

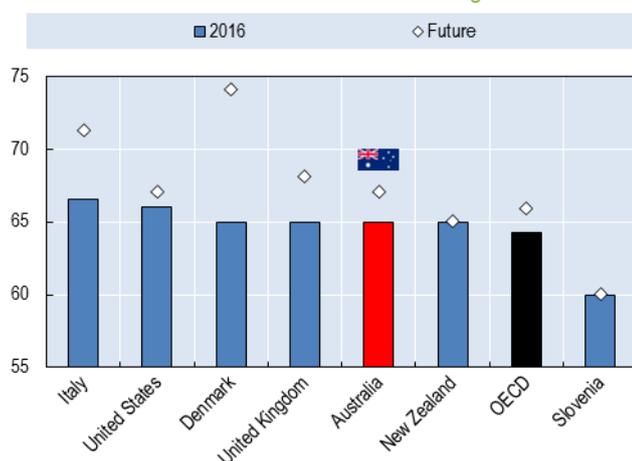
Retiring later would likely improve pensions coming from superannuation funds while simultaneously limiting public expenditure from the Age Pension. The Age Pension was payable from age 65 in 2016 but will increase by six months every two years from 2017 until it reaches 67 by 2023. The minimum age for withdrawing superannuation benefits (preservation age) was 55 in 2015 but is increasing gradually to reach 60 in 2024. In addition, contrary to many other OECD countries, Australia does not allow for mandatory retirement,

meaning that employees cannot simply be fired when reaching the retirement age.

Longer lives, the increasing diversity of work trajectories and the growing desire for more autonomy in the retirement decision are motivating calls for rules that allow individuals to decide when and how to retire. In Australia, there is no restriction to combining work and pension receipt of the superannuation component after the normal retirement age. In addition superannuation funds can be taken as a lump sum which adds flexibility. However, a benefit reduction is likely when someone is eligible to the means-tested Age Pension. Although a small amount of earnings are exempted from the income test in the calculation of the Age Pension, earnings exceeding 14% of the average wage result in a pension reduction, if there is no income from other sources. This is likely to discourage those who are eligible for an Age Pension to work longer. In Australia the effect of deferring pensions and continuing to work for a full-career worker is close to 8%, which is similar for other countries with defined contribution schemes (funded or not), like Chile, Italy, Latvia and Mexico.

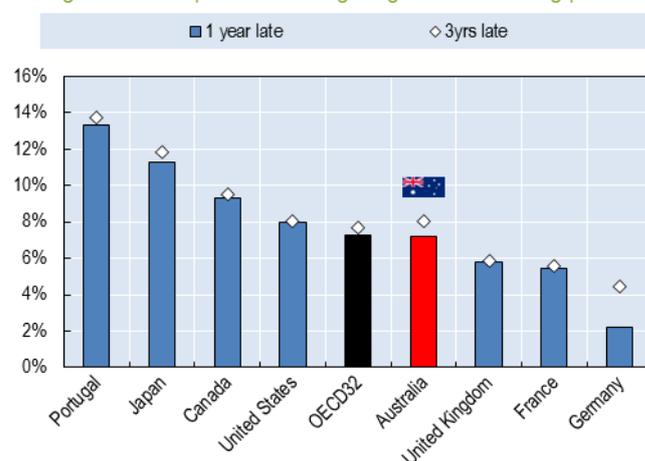
The introduction of the Transition-To-Retirement Income Stream (TRIS) made it possible to gradually reduce working hours while withdrawing part of the superannuation funds before the normal retirement age. In the past, superannuation fund withdrawals were only possible from the normal retirement age or when retiring completely. With TRIS one must have reached the preservation age and superannuation funds cannot be withdrawn in a lump sum. Initially, any earnings on assets financing someone's TRIS were earning tax exempt. However, this exemption was removed from July 2017 onward, earnings from assets under the TRIS scheme are taxed at 15%. This will reduce the attractiveness of taking this option.

The retirement age is rising
Current and future retirement age



Source: [Figure 1.4].

Incentives to work longer around the OECD average
Average annual impact of working longer and deferring pensions



Source: [Figure 2.12].