Submission to Senate Standing Committees on Economics Inquiry into Economic Security for Women in Retirement

John Daley, Brendan Coates and Danielle Wood

December 2015

1 Introduction

We welcome the Senate Standing Committees on Economics Inquiry into *Economic Security for Women in Retirement*.

As the Inquiry's Terms of Reference acknowledge, the gender retirement savings gap has several causes. The biggest driver of the savings gap is that women have lower average lifetime earnings. On average women spend less of their working lives in paid work than men, are more likely to work part-time, and earn lower wages than men even when they work the same hours. Beyond the Age Pension, Australia has a *contributory* retirement incomes system. Those that save more and accumulate greater assets have higher incomes in retirement. Since women tend to earn less than men over the working lives, they accumulate fewer retirement savings, and receive lower incomes in retirement.

Closing the gender gap in lifetime earnings would do the most to improve the retirement savings of women. Yet this will require a range of policy responses that go well beyond the scope of retirement incomes policy, including cultural changes to promote gender wage equality and achieve a better balance in caring responsibilities between men and women, as well as measures to further improve the workforce participation of women.

This submission instead focuses on potential changes to retirement incomes policies that could help address the gender gap in retirement savings, and argues against policy changes that could make the problem worse. We propose two reforms that together could provide a boost to the retirement incomes for the most vulnerable women.

First, better targeting super tax breaks to the purposes of superannuation would reduce the gender gap in superannuation savings. As our recent report for the Grattan Institute, *Super tax targeting* shows, super tax breaks provide the greatest boost to high-income earners that don't need them.[1] Most of these high-income earners are men. Better targeting of super tax breaks could free up revenue to provide more targeted support for retirement incomes for those that need it most, and to reduce marginal effective tax rates for low- and middle-income earners to encourage greater female workforce participation.

Second, a targeted boost to the Age Pension for retirees that do not own their own home, possibly delivered as higher Commonwealth Rent Assistance, would do the most to alleviate poverty in retirement. Single women who are retired and do not own their own homes are the group most likely to rely almost solely on the Age Pension, and are at the greatest risk of experiencing poverty in retirement.

The remainder of this submission identifies particular problems related to the economic security of women in retirement, and evaluates commonly cited proposals for solving them. We conclude by expanding on how our preferred reforms to retirement incomes policy would help close the gender gap in retirement savings, and boost the incomes of retired women at the greatest risk of poverty.

[1] Daley, *et al.* (2015), p.26.

2 What is the problem we are trying to solve?

An important starting point when considering reforms is determining the problem we are trying to solve. The gender gap in retirement savings is a complex issue with a number of causes. This submission identifies two particular problems related to the economic security of women in retirement, which are:

1. Women retire with comparatively less savings than men, resulting in relatively lower incomes in retirement.

2. Women are at much greater risk of experiencing absolute poverty in retirement due to their smaller retirement savings, especially when they do not own their own home.

We identify the causes of each of these two problems and offer solutions to each. Importantly, we identify how many other proposals intended to solve one of these two problems may in fact worsen the other, in addition to their significant budgetary costs.

A third problem, which is beyond the scope of this submission, is ensuring that women's interests are protected under family law in the event of separation.

While it is clear that there is a considerable gender gap in retirement savings, it does not necessarily follow that women will suffer worse outcomes in retirement as a result. Most Australians approaching retirement are living with a spouse or partner, where the household pools their resources to fund living standards in retirement. However, it is important that an equitable distribution of household assets occurs in the case of separation.

2.1 Problem: women save less for retirement since they earn less

The first problem the Committee may wish to address is the relatively lower retirement savings of women. On average, women have just over half the superannuation savings of men at retirement age. As of 2013-14, the latest data available, a man aged 60 to 64 years could expect to retire with average superannuation savings of $292,000, whereas a woman had an average super balance of only $138,000.[2]

As noted above, women accumulate fewer retirement savings than men because they earn less over their working lives. While this is particularly the case for older women that earned less and did not benefit from compulsory superannuation contributions for much of their careers, it is equally true for younger women today. For example, the average woman aged 30 to 49 years makes pre-tax superannuation contributions of $4,300 a year, or over one-third less than a male of the same age ($6,800).[3] As a result, men aged 35 to 39 years had average superannuation savings of $55,000 in 2013-14, compared to less than $35,000 among women of the same age.[4]

[2] Median account balances are much lower, especially for women, reflecting the larger portion of women that report no superannuation savings at retirement. The median account balance for a man age 60 to 64 years was $100,000 in 2013-14, compared to just $28,000 for women of the same age. Clare (2015), pp.6-7.

[3] Grattan Institute analysis of ATO (2015a).

[4] Clare (2015), p.6.

The poor targeting of superannuation tax breaks exacerbates the gender gap in retirement savings since tax breaks deliver the largest boost to the retirement incomes of high-income earners, more of whom are men. Over half the value of superannuation tax breaks boost the retirement incomes of the top 20 per cent of income earners. Superannuation tax breaks cost a lot – over $25 billion in foregone revenue, or well over 10 per cent of income tax collections – and the cost is growing fast.[5] Lower-income earners, who tend to be women, have to pay more in other taxes – both now and in the future - to pay for the tax breaks that largely benefit high-income men.

A number of submissions to this inquiry have put forward proposals to close the gender gap in superannuation savings. Many submissions recommend that Australia's already generous tax breaks for superannuation savings should be expanded further. Others have proposed expanding increasing compulsory superannuation savings by increasing the Superannuation Guarantee, or extending compulsory super contributions to the self-employed.[6] Further proposals call for targeted 'top ups' to the superannuation of superannuation savings of low-income earners, and particularly for women.

Measures to close the gender gap in retirement savings must be balanced against their fiscal costs. In particular, introducing even more generous tax breaks to boost superannuation savings come at a cost to government revenue, requiring either higher taxes elsewhere, fewer services (including for retirees) or a further expansion in government debt that will have to be paid back by future generations.[7] The benefits of increasing compulsory super contributions by raising the Super Guarantee must be weighed carefully against their costs, especially any falls in the living standards of working age households. Retirement incomes, measured as a replacement rate relative to pre-retirement incomes, already exceed 100 per cent for many low-income earners.[8]

At the very least, reforms to superannuation should avoid making the problem worse. However, many of the proposals put forward to address the gender gap in retirement savings would do precisely that. For example, it is often suggested that more generous super tax concessions would improve the ability of women to make 'catch-up' super contributions once they return to work. Such proposals typically take the form of increasing the annual cap on pre-tax contributions from $30,000 (or $35,000 for those aged 50 and over), or replacing the annual cap with a lifetime cap.[9]

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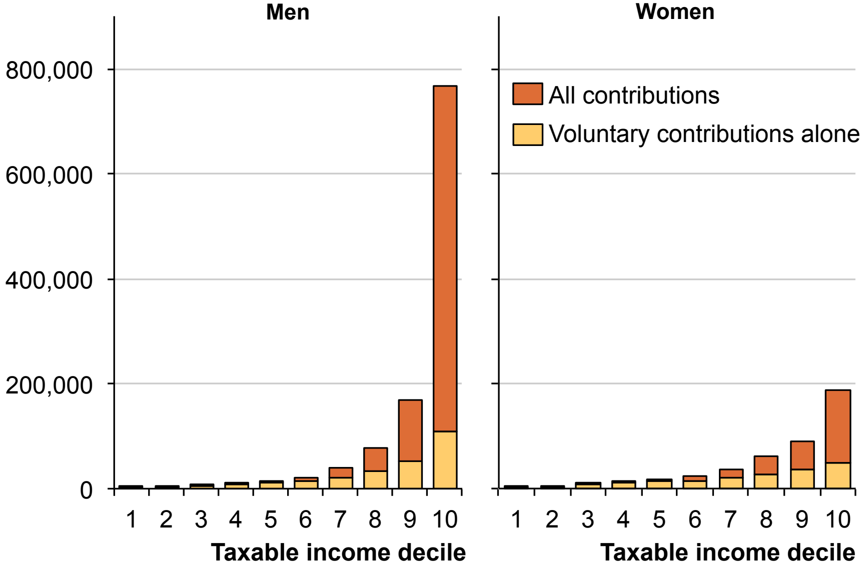
[5] Daley, *et al.* (2015), p.2.
[6] AIST (2015), pp. 6-7; Women in Super (2015), p.17.
[7] Daley, *et al.* (2014).
[8] Treasury estimate that existing retirement income policy settings are likely to deliver replacement rates in retirement of around 80 per cent of pre-retirement income for a median income earner, and replacement rates of well over 100 per cent for low-income earners (Morrison (2015)). By comparison, the Mercer Global Pension Index suggests that a benchmark replacement rate of 70 per cent is a suitable rate of pre-retirement income for a median income earner (Mercer (2015)).
[9] For example, ASFA (2015a), p.39 has suggested a lifetime cap on pre-tax contributions of $1 million, along with a higher annual cap of $45,000. Deloitte (2015), p.18 have proposed a lifetime cap on pre-tax contributions of $580,000. ASFA (2015b), p.5 has also proposed a lifetime cap on post-tax contributions of $1 million.

Figure 1: Few people other than high-income earners contribute over $10,000 a year

Number of individuals in each decile making pre-tax contributions more than $10,000, 2012-13



Note: Compulsory Super Guarantee contributions estimated from salary and wage income; includes reportable salary sacrifice contributions and contributions from post-tax income for which the taxpayer has claimed a tax deduction. There were 1.27 million people in each taxable income decile in 2012-13.
Source: ATO (2015a); Grattan analysis.

However, as shown in our *Super tax targeting* report, and by Figure 1, most women do not make any additional voluntary contributions to their super, let alone additional contributions sufficient to close the gender gap. All the evidence shows that very few middle-income earners, and even fewer women, make large catch-up contributions to their super funds. Less than 5 per cent of median income earners make pre-tax contributions of more than $10,000 a year. Instead, the current generous annual caps on pre-tax contributions are predominately used by older, high-income men to reduce their tax bills. 79 per cent of men (and 61 per cent of women) in the top taxable income decile contribute more than $10,000 a year.[10]

Only 163,000 women earning less than $77,000 making pre-tax contributions of more than $10,000. In contrast, there are more than 900,000 men earning more than $77,000 that contribute more than $10,000 a year from pre-tax income.

Therefore providing greater flexibility in accessing generous superannuation tax breaks is a very expensive way to reduce the gender gap in retirement incomes because these tax breaks are poorly targeted and could in fact widen the gender gap in superannuation savings.

[10] Daley, *et al.* (2015), p.43.

Other proposals to provide more top ups to the superannuation savings of low-income earners, or particularly to women, are at least somewhat targeted at the problem.[11] In particular, retaining the Low Income Superannuation Contribution (LISC) beyond 2016-17 would ensure that low-income earners are not disadvantaged when contributing to superannuation, at a cost of around $1 billion a year.[12]

However, it is unclear that topping up superannuation accounts is the best way to improve retirement incomes for low-income earners. Those on low incomes accumulate relatively less superannuation, and casual employment with multiple employers often leads to multiple small superannuation accounts. Administration fees can erode much of their final account balances.[13] Further, measures to boost the retirement incomes of low income earners delivered through the tax and superannuation systems are inherently less well targeted than an increase in income support payments as they are directed at individuals, not households. For example, it is likely that a large number of people making voluntary post-tax super contributions to obtain the government co-contribution are in fact the spouses of high-income earners.[14]

While most attention focuses on women's lower superannuation savings, women also save less outside of superannuation than men, which further exacerbates the gap in retirement incomes. We therefore caution the Committee to consider retirement savings beyond superannuation when evaluating the gender gap in retirement savings. As shown in our recent report, *Super tax targeting*, superannuation is in fact the least important pillar of Australia's retirement incomes system.[15] Australians continue to save a great deal outside of superannuation, both in the family home and in other assets. In particular, it is unreasonable to expect superannuation savings alone to fund a comfortable living standard in retirement. Rather, most retired Australians will draw on a range of assets to support their retirement – including housing and other investments outside of superannuation.

We also caution the Committee against adopting the ASFA comfortable retirement standard as the benchmark for what the retirement incomes system should achieve. As we show in *Super tax targeting*, the ASFA comfortable standard entails an 'affluent' lifestyle in retirement that is more luxurious than what most households achieve during their working lives.[16] Such a high living standard is an inappropriate benchmark for the retirement incomes system. The fact that many households <u>aspire</u> to this level of retirement income[17] is irrelevant. We would all like to be rich. Given that average living standards before retirement are less than the ASFA comfortable benchmark, the only way living standards can reach this level in retirement is by many households living even <u>less</u> comfortably before retirement.

[11] For example, Industry Super Australia (2015), pp.39-40 propose a government-funded *Super Seed* contribution of $5,000 to be paid automatically into the superannuation accounts of younger low-income workers.
[12] The Low Income Super Contribution currently refunds contributions tax paid by low-income earners, but is due to be abolished from 2017-18 onwards. Daley*, et al.* (2015), p.46.
[13] Minifie*, et al.* (2015), pp.12-13.
[14] Over 60 per cent of post-tax contributions made by those with taxable incomes of less than $37,000 are made by individuals with superannuation account balances in excess of $500,000, or some $4.5 billion in post-tax contributions in 2012-13. Grattan analysis of ATO (2015b).

[15] Daley*, et al.* (2015), p.12.
[16] Ibid., p.30.
[17] State Street Global Advisors and Rice Warner (2015), p.5

2.2 Problem: women are at greater risk of experiencing poverty in retirement

A second problem highlighted in the Inquiry's Terms of Reference is that women's lower average savings through their working lives leaves them much more vulnerable to poverty in retirement than other retirees, especially when living alone. Single women households aged 65 and over had average financial assets of $143,000, compared to financial assets of $394,000 for the average single man of the same age, and $620,000 for a couple household.[18] Women can also expect to live longer than men, and so may spend a greater period in retirement.

As a result, single renters, especially women, are most likely experience poverty in retirement.[19] Over 90 per cent of older single women households that rent are what the ABS calls 'low economic resource' (LER) households[20] – income- and asset-poor households who are at risk of experiencing high levels of financial hardship.[21] In contrast, just 4 per cent of elderly home-owning couples are low economic resource households, compared to 70 per cent of elderly couples that rent. In fact it's clear that most retired households at risk of poverty are renters, whereas very few retirees that own their own homes are at risk of poverty in their old age.[22] This suggests that measures to boost the incomes of retirees should focus on those that don't own their own homes.

Proposals to boost superannuation savings of workers, either by expanding tax breaks, raising the Superannuation Guarantee or providing targeted 'top ups' to low-income earners will do nothing to help women (and men) already experiencing poverty in retirement. And as discussed above, future low-income retirees will benefit more from targeted increases to the Age Pension or Commonwealth Rent Assistance than from policies to increase their superannuation contributions, some of which benefit high-income households, and some of which will be eaten up by superannuation administration costs.

[18] AIFS (2015), p.19
[19] For example, ibid., p.21 find that 60 per cent of single women households aged 65 to 69 years had a disposable income of less than the ASFA modest retirement standard, compared to just 34 per cent of single men.
[20] ABS (2013). The ABS define low economic resource (LER) households as those who are simultaneously in the lowest two quintiles of both equivalised disposable household income and equivalised net worth distributions. It therefore excludes from the population of interest people with either relatively high incomes or relatively high wealth, and as a result is more likely to correctly classify people most likely to be at risk of experiencing economic hardship compared to measures using income or wealth alone. Unlike the ABS, but consistent with Yates (2015), we exclude imputed rents from our definition of disposable income.
[21] Grattan analysis of ABS (2013).
[22] Yates (2015), p.73.

3 Two reform priorities

Efforts to address the gender gap in retirement savings, and reduce the risk of poverty for women already retired, should be focused on two areas.

3.1 Better target super tax breaks to those that need them

Super tax breaks provide the greatest boost to high-income earners that don't need them. Our recent report *Super tax targeting*, recommended three reforms to better align tax breaks with the goals of superannuation.[23]

One, annual contributions from pre-tax income should be limited to $11,000 a year. This change would improve budget balances by $3.9 billion a year. There would be little increase in future Age Pension payments since the reductions in tax breaks would mainly affect those unlikely to receive an Age Pension anyway.

Two, lifetime contributions from post-tax income should be limited to $250,000. It won't save the budget much in the short term, but in the longer term it will plug a large hole in the personal income tax system.

Three, earnings in retirement – currently untaxed – should be taxed at 15 per cent, the same as superannuation earnings before retirement. A 15 per cent tax on all super earnings would improve budget balances by $2.7 billion a year today, and much more in future.

For a small proportion of women with higher incomes later in life, the changes would reduce their catch-up contributions. Yet the changes would reduce the tax breaks far more for a lot of high-income earners, particularly men. Low-income earners, and especially women, would need to pay less in other taxes if super tax breaks for the wealthy were wound back.

Reducing super tax breaks to high income earners may provide the fiscal space to alleviate the high effective marginal tax rates experienced by secondary-income earners. Australia's female participation rate is around four percentage points lower than that in New Zealand and Canada. For example, if Australian women did as much paid work as women in Canada — Australia's GDP would be about $25 billion higher.[24]

Smoothing effective marginal tax rates to reduce disincentives to work is a complex task, particularly in the constrained budget environment that Australia currently faces. However, given the economic and fiscal benefits of increased female labour force participation described above, it is a problem worth tackling. Reducing superannuation tax breaks for high-income earners could generate the fiscal space to achieve this.

[23] Daley, *et al.* (2015), p.2.

[24] Daley and McGannon (2014), p.4.

Boost the Age Pension for retirees that don't own their own homes

Second, a targeted boost the Age Pension for retirees that do not own their own home would do the most to alleviate poverty for women already retired, and at the least budgetary cost. While the Age Pension provides a basic income to support a minimum living standard for retirees, it is proving insufficient for some, particularly for older women who live alone and do not own their own home. For example, a $500 boost to the Age Pension for Australia's 2.4 million pensioners would cost roughly $1.2 billion a year.[25]

A boost to Commonwealth Rent Assistance for pensioners – which would specifically target support to retirees that don't own their own homes – would cost much less. Such a boost could be quarantined just to Age Pension recipients, or applied more broadly across other income support payments.[26] Importantly, such a boost would help those that already experiencing poverty in old age, unlike proposals to boost superannuation savings which will only help those that are yet to retire.

[25] Daley*, et al.* (2015), p.65.
[26] For example ACOSS (2015), p.5 notes that Commonwealth Rent Assistance is well below housing costs for the one in ten Age Pension recipients who rent privately.

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