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What should the next Federal Government do on retirement incomes?

Speakers:

Joanna Mather, *The Australian Financial Review*
Brendan Coates, *Grattan Institute*

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Australia spends *less* on public pensions than most other OECD countries

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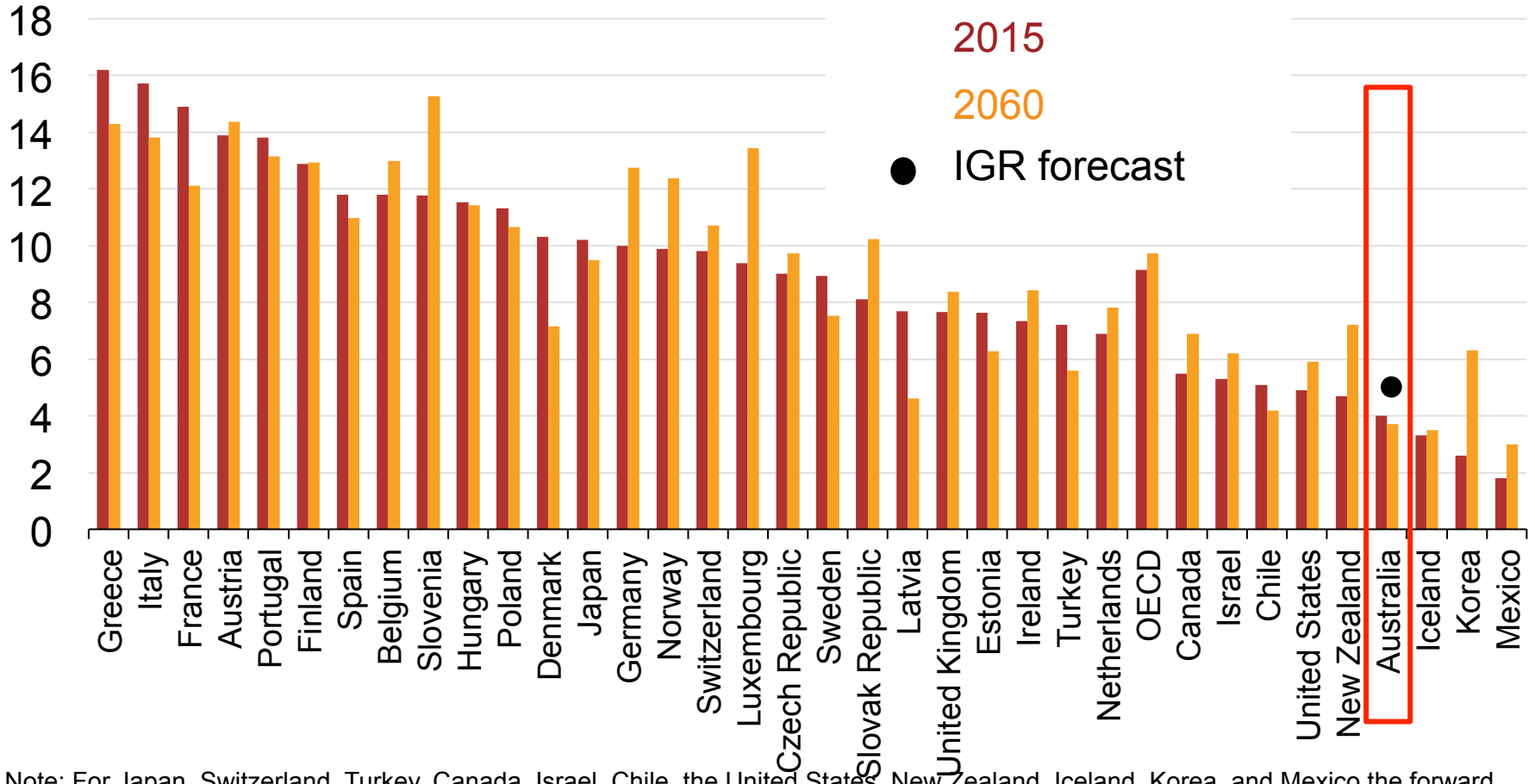
Projected expenditure on public pensions for OECD countries, 2015 to 2060, per cent of GDP

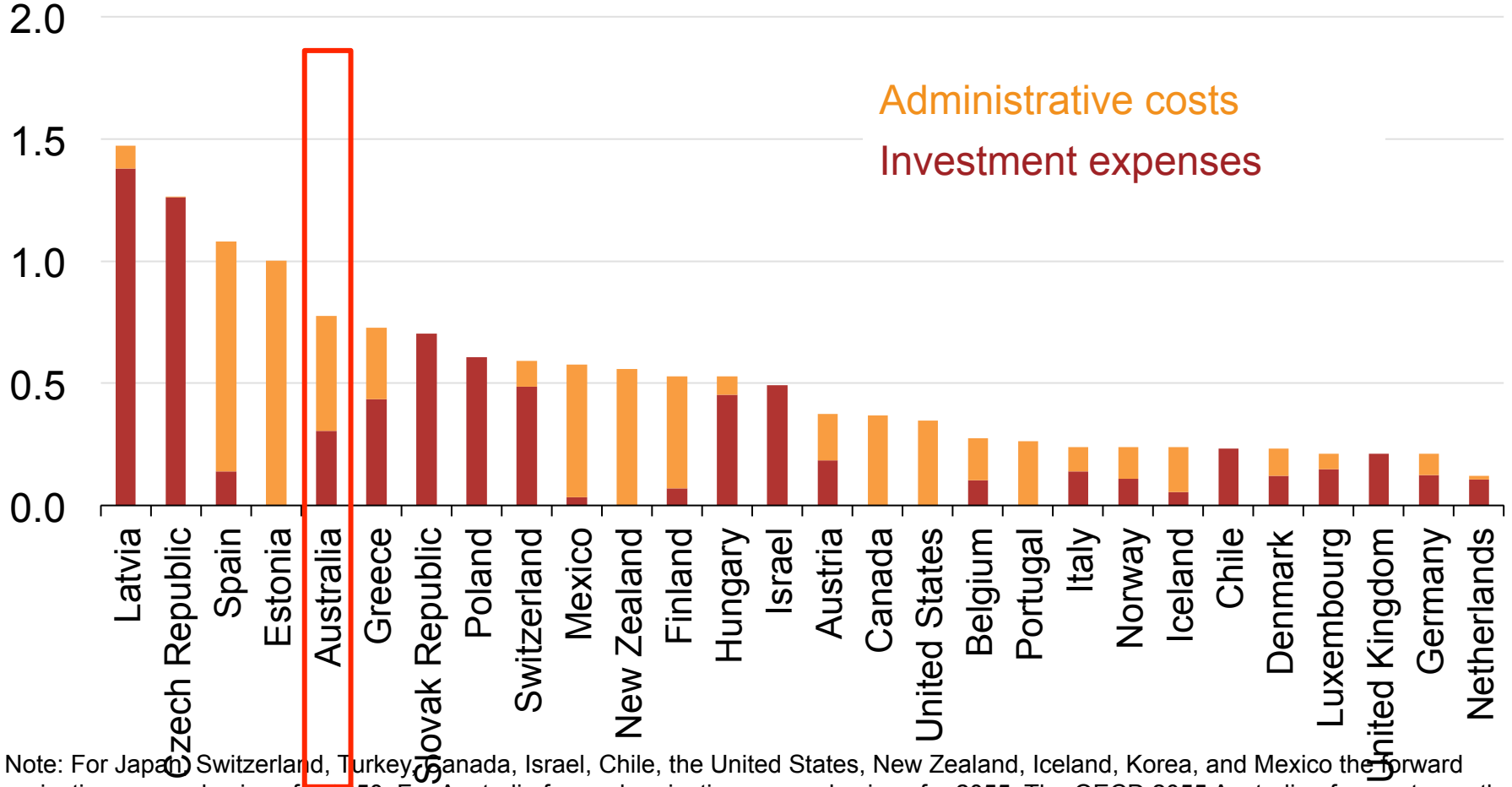


Note: For Japan, Switzerland, Turkey, Canada, Israel, Chile, the United States, New Zealand, Iceland, Korea, and Mexico the forward projections are only given for 2050. For Australia forward projections are only given for 2055. The OECD 2055 Australian forecasts are the "proposed policy" scenario from the 2015 IGR, which include changes increasing pension eligibility age and reducing payment growth. The IGR forecasts are the "currently legislated" scenario from the 2015 IGR. Both forecasts exclude changes in the pension taper rates, and Disability Support Pension Indexation.

Source: OECD (2017)

Super fees in Australia appear very high

Operating expenses of private pension systems in selected OECD countries, 2016, as a percentage of total investment



Note: For Japan, Switzerland, Turkey, Canada, Israel, Chile, the United States, New Zealand, Iceland, Korea, and Mexico the forward projections are only given for 2050. For Australia forward projections are only given for 2055. The OECD 2055 Australian forecasts are the "proposed policy" scenario from the 2015 IGR, which include changes increasing pension eligibility age and reducing payment growth. The IGR forecasts are the "currently legislated" scenario from the 2015 IGR. Both forecasts exclude changes in the pension taper rates, and Disability Support Pension Indexation.

Source: OECD (2017)

Existing retirees feel less stressed on subjective measures of financial wellbeing

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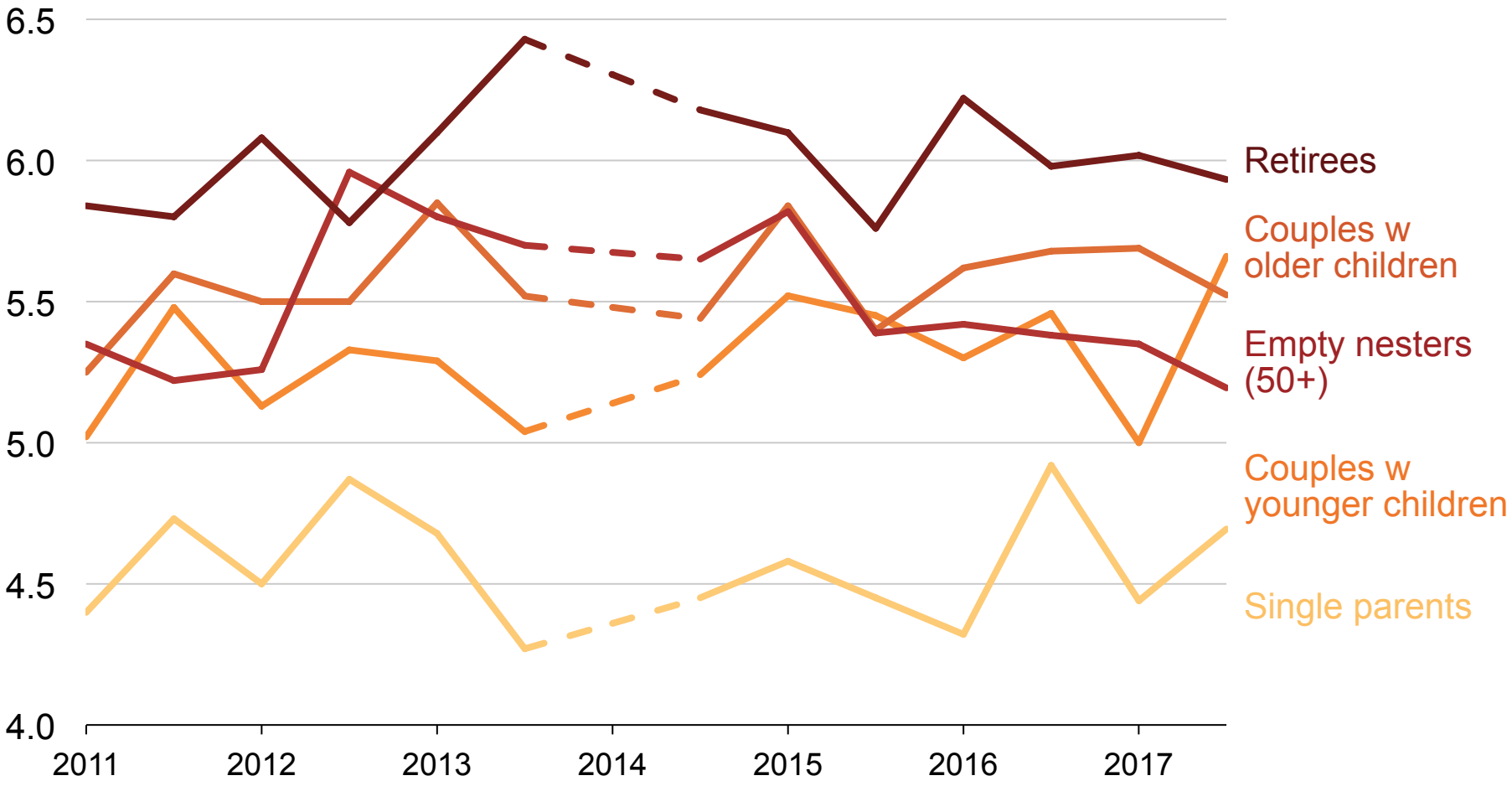
Self-assessed financial comfort



Notes: Excludes anomalous Dec 2014 survey
Sources: Members equity, Financial comfort survey

Retirees are less financially stressed than those of working age

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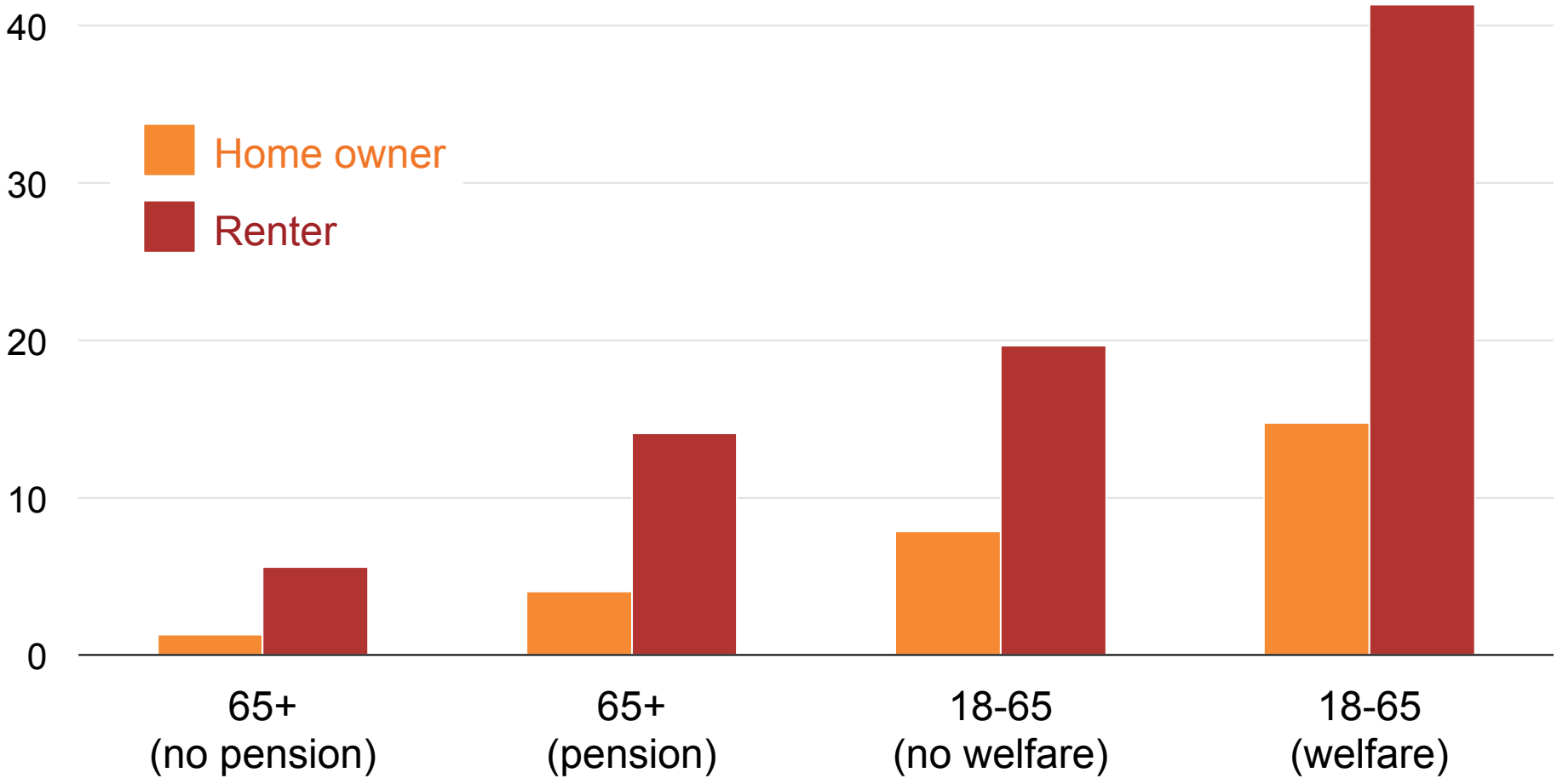
Percentage of households facing at least one financial stress, 2015-2016

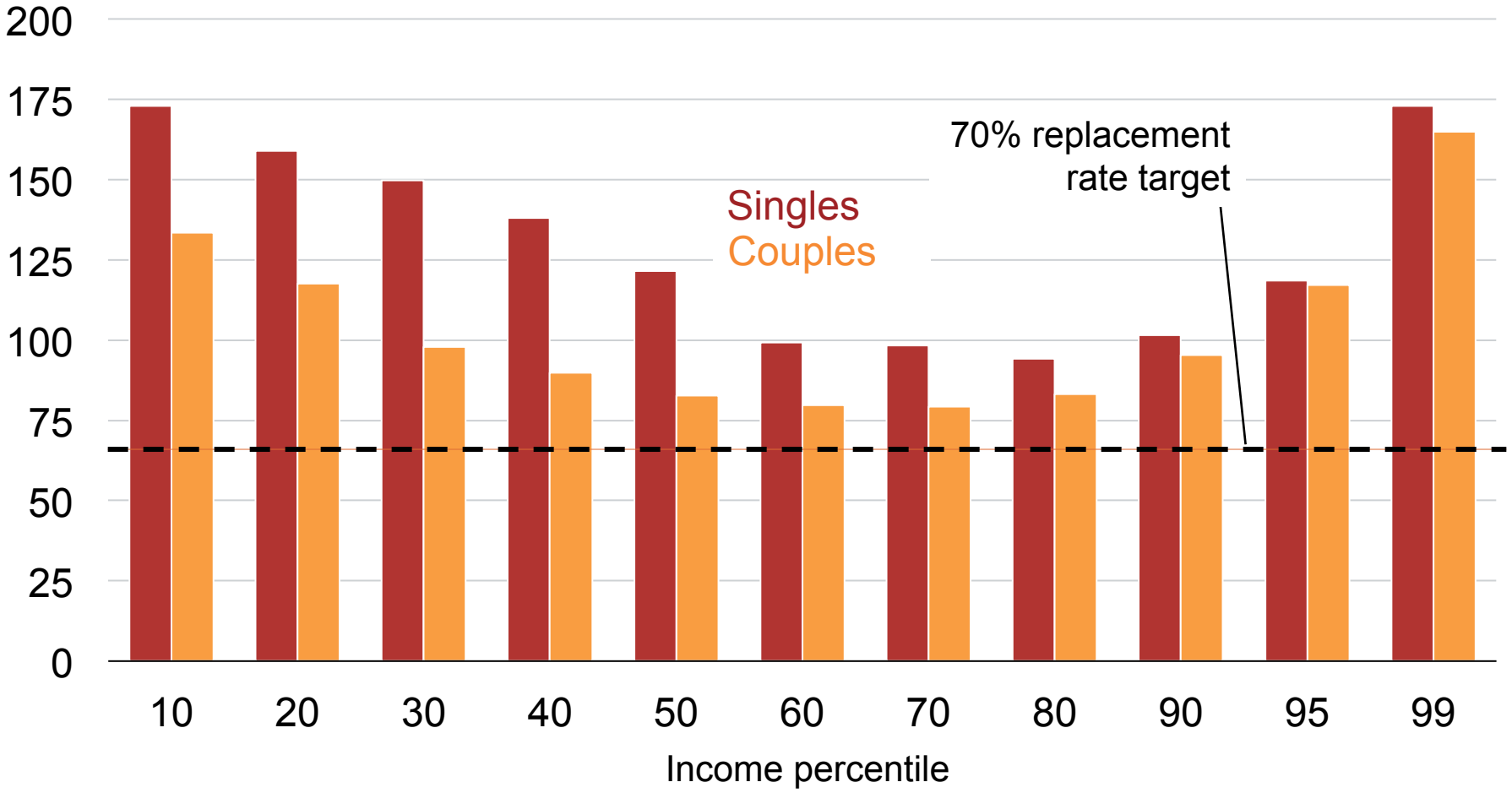


Notes: Financial stress defined as money shortage leading to 1) skipped meals; 2) not heating home; 3) failing to pay gas, electricity or telephone bills on time; or 4) failing to pay registration insurance on time. 'Pension' and 'welfare' includes all those receiving cash benefits of more than $100 per week

Sources: ABS Household Expenditure Survey 2015-16, Grattan analysis.

Many retired low income households have higher incomes than when they were working

Disposable income for households aged 65-84 in 2015, relative to income for households aged 45-64 in 1995, $2015-16



Notes: Disposable income includes income of head of household and their partner, but not children. Incomes adjusted due to changes in how the ABS defines incomes between surveys.
Source: ABS Survey of Income and Housing; Grattan analysis.

Those entering the workforce today will be able to maintain their standard of living in retirement

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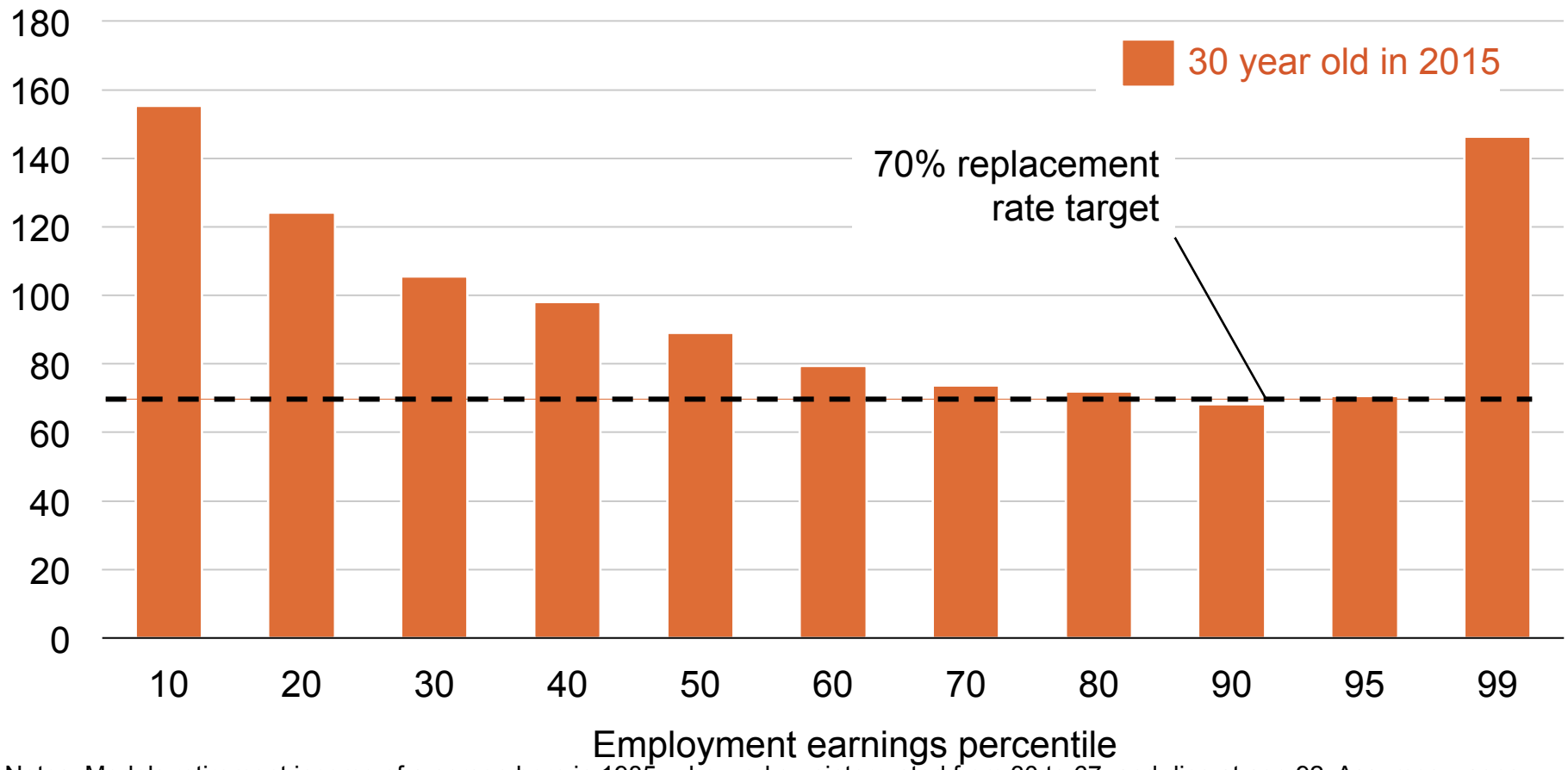
Replacement rates, by employment earnings percentile, CPI deflated, per cent



Notes: Models retirement income of a person born in 1985, who works uninterrupted from 30 to 67, and dies at age 92. Assumes wages growth falls by the amount of any Super Guarantee increase. Includes savings outside super. Employment earnings adjusted to account for movements up and down the earnings distribution. Retirement savings drawn down over 26 years to leave a small bequest in addition to the home. Retirement income deflated by CPI

Source: Grattan Retirement Income Projector

Two assumptions really matter: the retirement standard; and the deflator

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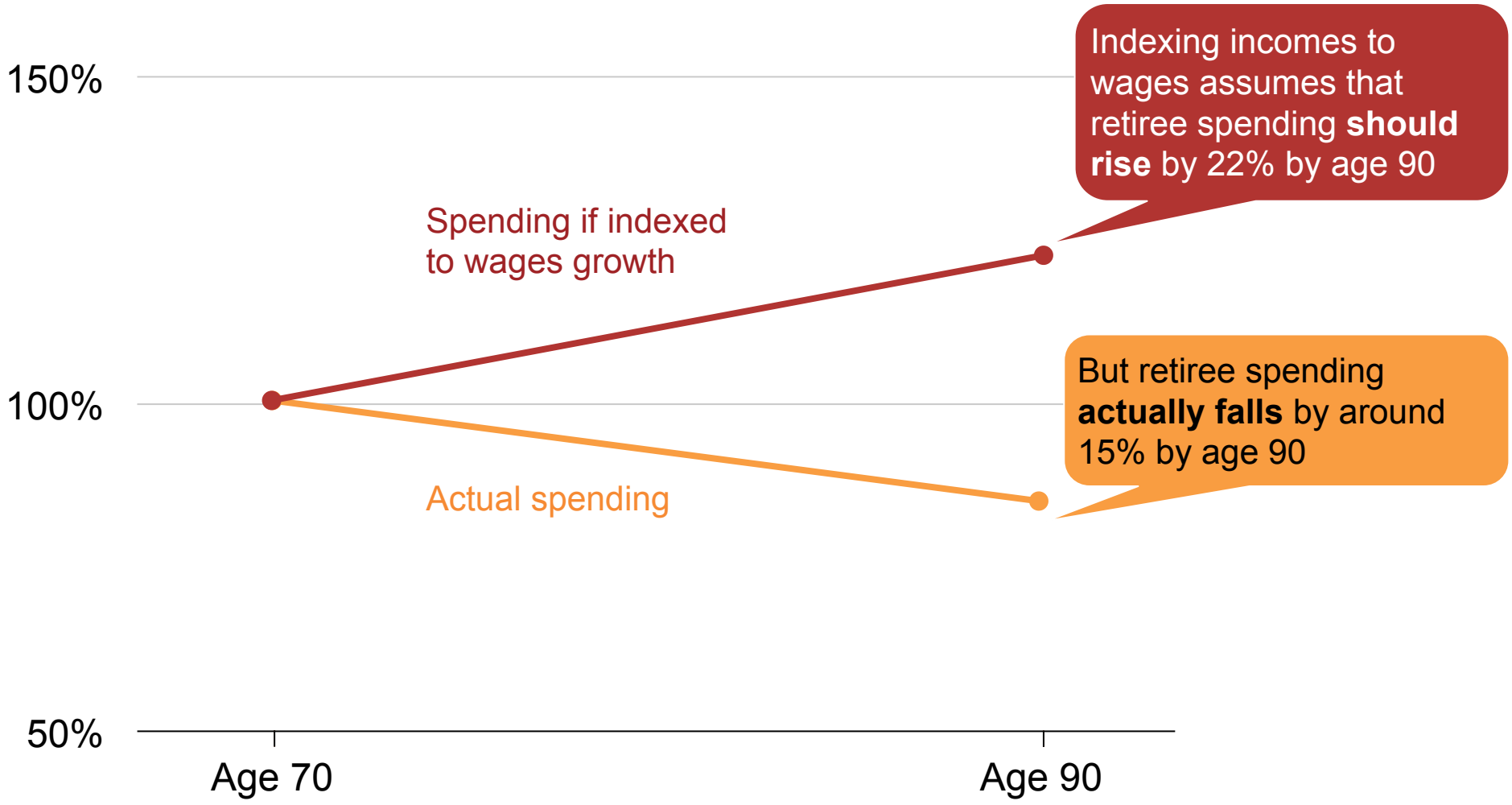
Study	Metric	Assets included	Incomes grow by
Treasury (2004)	Individual replacement rates, five years either side of age 65.	Super only.	CPI
Treasury (2011)	As above	Super, non-super financial assets, and non-home property	CPI and wages
Henry (2009)	Individual replacement rates for both working life and final working year	Compulsory and salary sacrifice super contributions.	CPI
Rice Warner (2015)	62.5% of pre-retirement gross earnings	Super only, with small estimate for investment property for high-income earners.	Wages
CSRI (2016)	ASFA comfortable standard; lifetime replacement rates and other measures	Super only	Wages
Burnett *et al.* (2014)	ASFA comfortable standard	Super, non-super financial assets, and non-home property	Wages
Actuaries Institute (2015)	ASFA comfortable and modest standards	As above	Wages
Industry Super Australia (2015b)	ASFA comfortable standard	As above	Wages

Other studies assume retirement spending needs rise as retirees age…

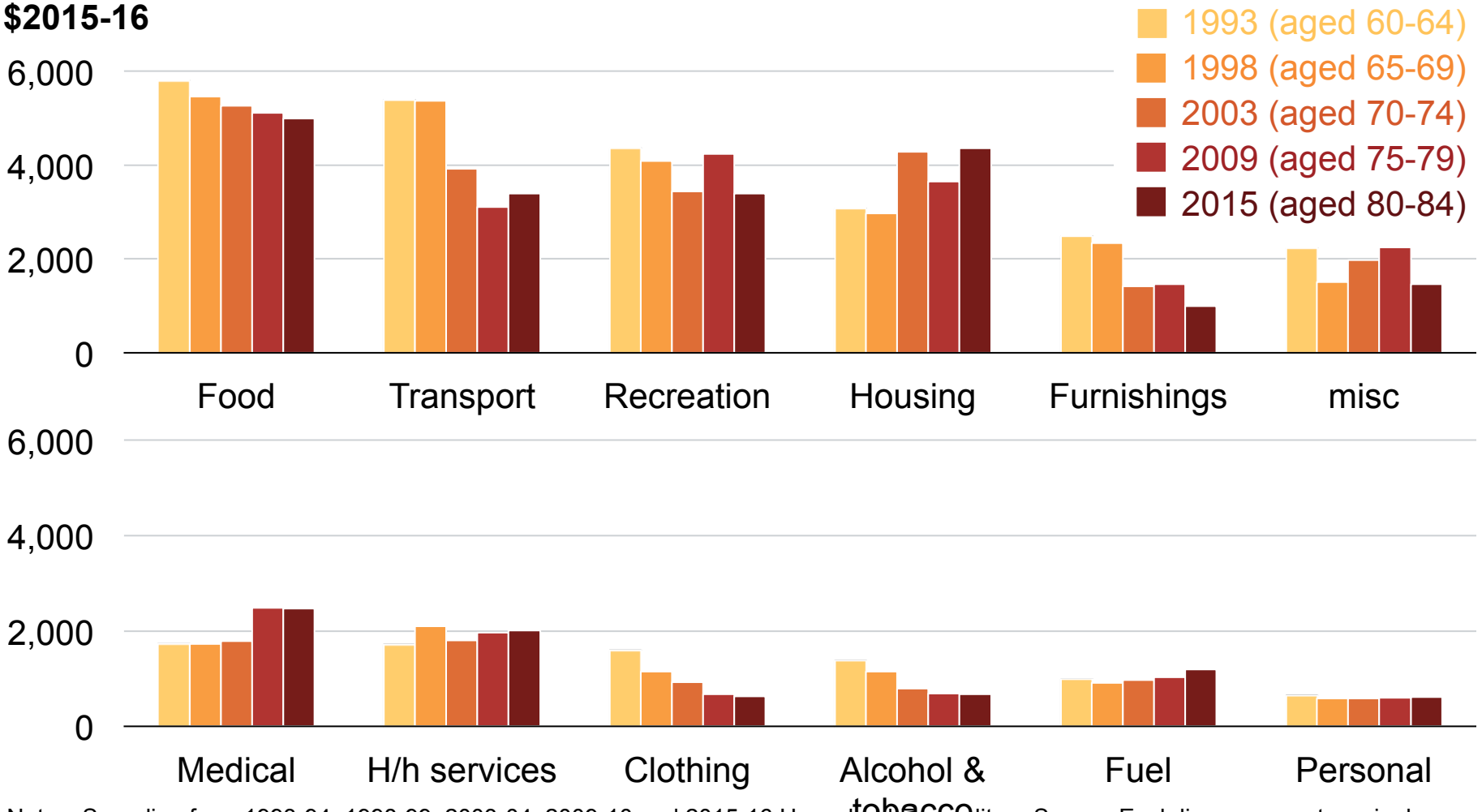
Real (inflation adjusted) retiree spending as a proportion of their spending at age 70



Notes: Assumes annual real wages growth of 1 per cent.
Source: Grattan analysis.

When they actually fall…

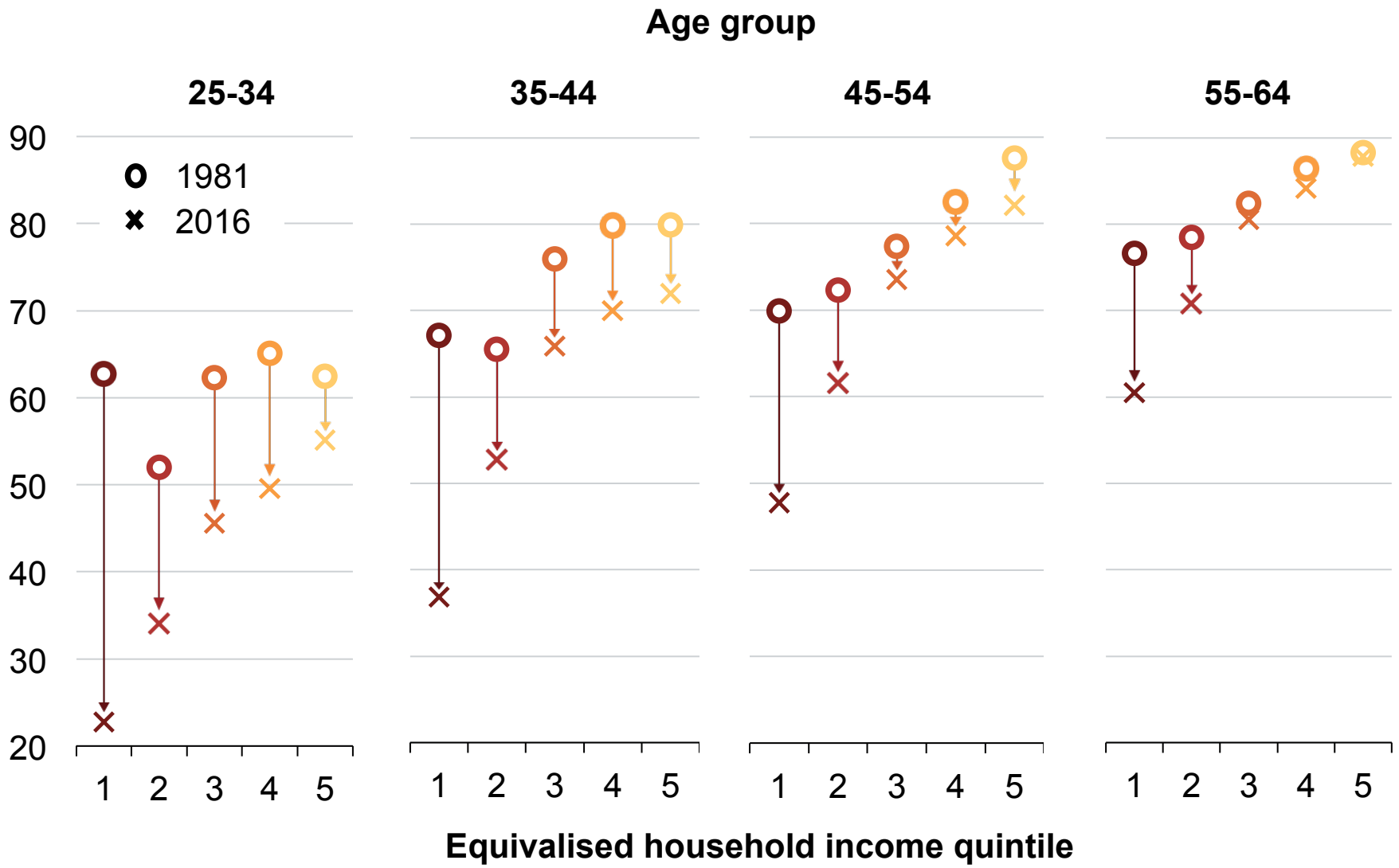
Equivalised household annual expenditures for cohort of retiree households as they age, $2015-16



Notes: Spending from 1993-94, 1998-99, 2003-04, 2009-10 and 2015-16 Household Expenditure Survey. Each line represents a single cohort across time as they age. While the age cohorts are 5 years apart, there was a gap of 6 years between the last three HES surveys. Spending deflated by CPI.
Source: ABS Household Expenditure Survey (multiple years); Grattan analysis.

Many more retirees will be renting in the future

Home ownership rates by age and income, 1981 and 2016



Source: Census; Burke et al 2014; ABS.

Far fewer retirees will own their own homes in future

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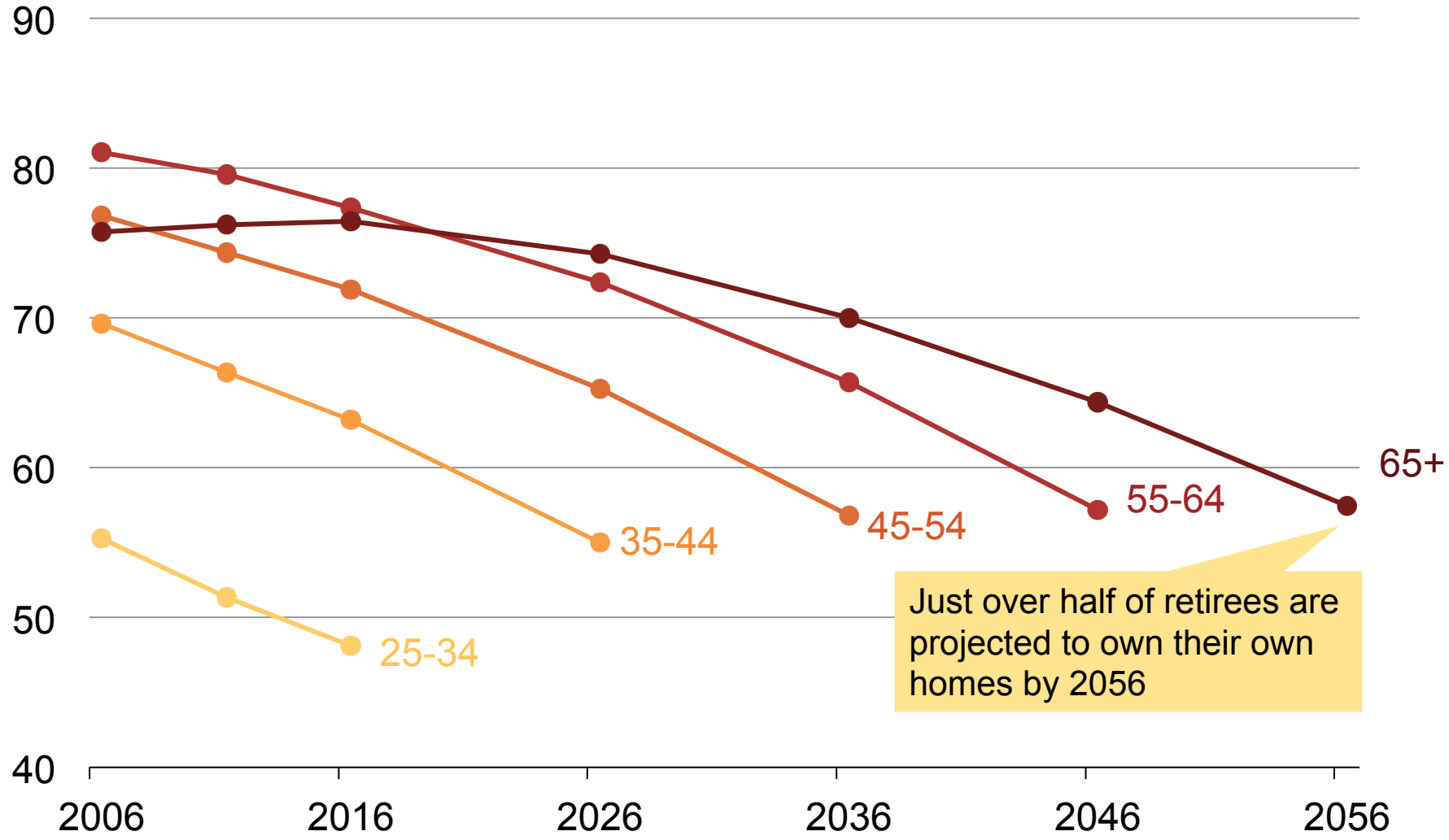
Home ownership rates by age, 2006 to 2056



Source: ABS (2018); Grattan analysis.

What is the trade-off between wages and superannuation?

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"The cost of superannuation was never borne by employers. It was absorbed into the overall wage cost …. In other words, had employers not paid nine percentage points of wages, as superannuation contributions, they would have paid it in cash as wages."

Paul Keating, "The story of modern superannuation" 31/10/2007

"The increase in minimum wages we have determined in this Review is lower than it otherwise would have been in the absence of the superannuation guarantee increase."

Fair Work Commission, *Annual Wage Review 2012-13*, 3/6/2013

See also Freebairn, J. (2007), *Some Policy Issues in Providing Retirement Incomes*; Keegan, M. and Brown, L. (2012) (NATSEM) *Impact of the increase in the Superannuation Guarantee on wage costs in the health sector;* Rothman, G (2012) (Treasury) *Modelling the sustainability of Australia's retirement income*

Daley says that if you get super you forgo a wage increase…. It's an outrageous claim without any basis in fact. It's basically a nasty polemic."

Paul Keating, *730 Report*, 12/11/2018

12% super will cost Australian workers $20bn a year in foregone wages by 2025-26

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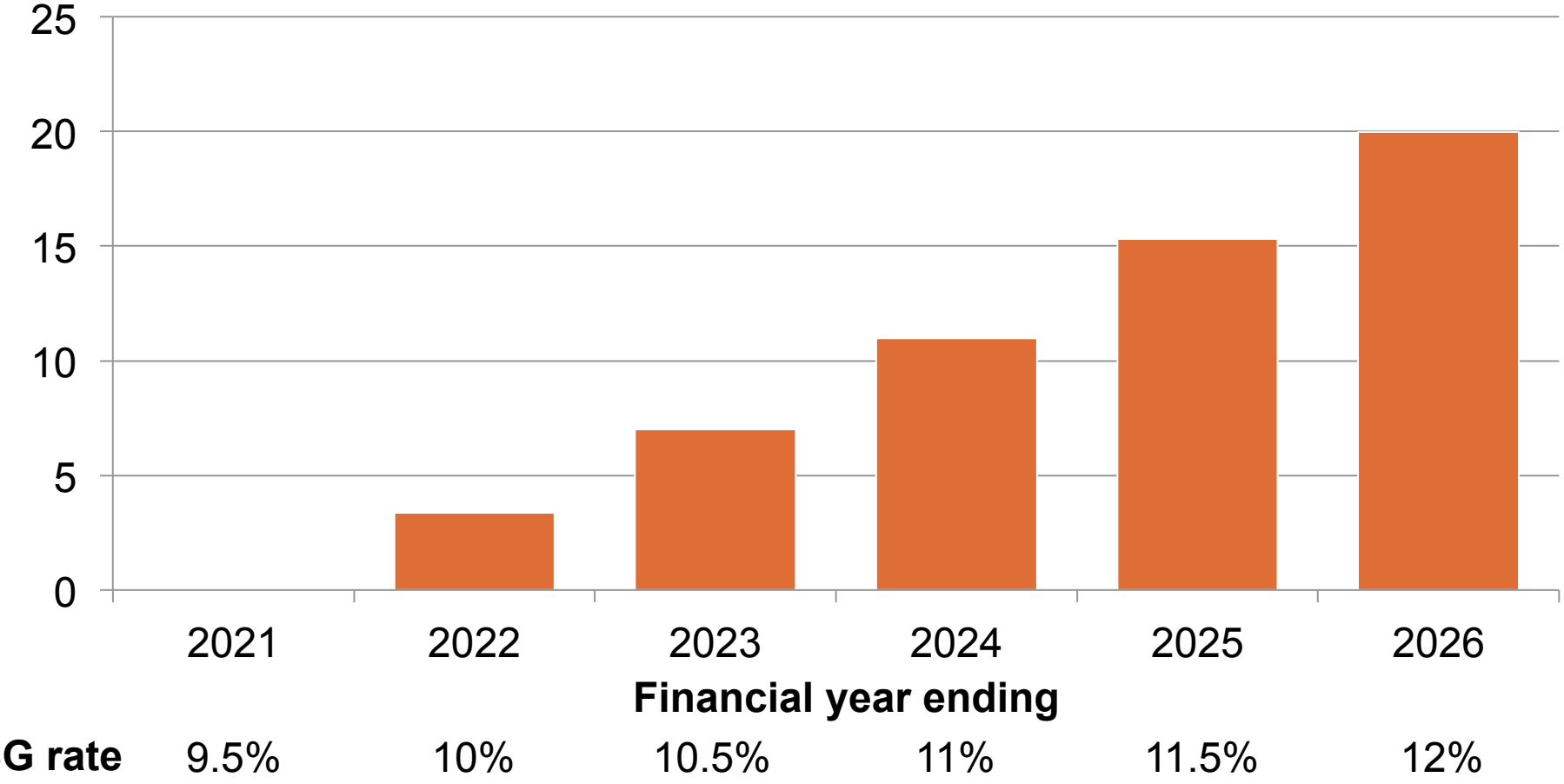
Foregone wages from scheduled increasing the rate of compulsory super contributions from 9,5% to 12%, $ billions



SG rate	9.5%	10%	10.5%	11%	11.5%	12%

Notes: Foregone wages are in nominal dollars. Compulsory super contributions projected from ATO estimates using actual and forecast nominal GDP growth to 2025-26. Assumes 10 per cent of employees would not see an increase in compulsory super contributions from the rise in the Super Guarantee rate because they are paying compulsory contributions in excess of 12 per cent negotiated as part of collective agreements.

Sources: ATO, *Superannuation Guarantee Gap*; Commonwealth Budget papers (various years); Kelly (2013), *Twenty years of the*

Increasing the Super Guarantee helps the top and the very bottom but not the middle

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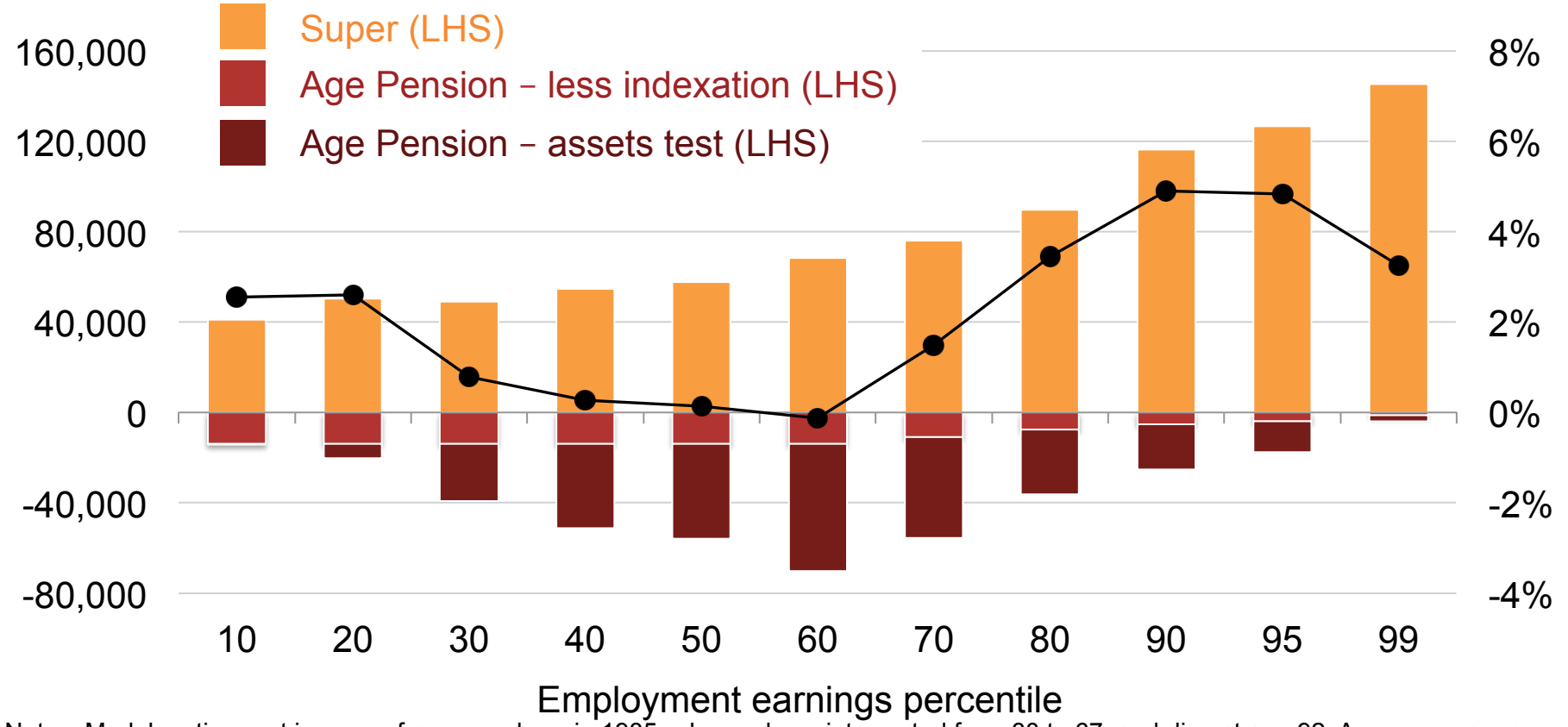
if Super Guarantee increases to 12% compared to remaining at 9.5%

LHS Change in income over 26 years of retirement ($2015-16, CPI deflated)

RHS Change in retirement income (%)



Notes: Models retirement income of a person born in 1985, who works uninterrupted from 30 to 67, and dies at age 92. Assumes wages growth falls by the amount of any Super Guarantee increase. Includes savings outside super. Employment earnings adjusted to account for movements up and down the earnings distribution. Retirement savings drawn down over 26 years to leave a small bequest in addition to the home. Assumes voluntary super contributions partially offset lower compulsory contributions if Guarantee remains at 9.5%.

Source: Grattan Retirement Income Projector

Lifting the Super Guarantee to 12% costs the Budget – in both short and long term

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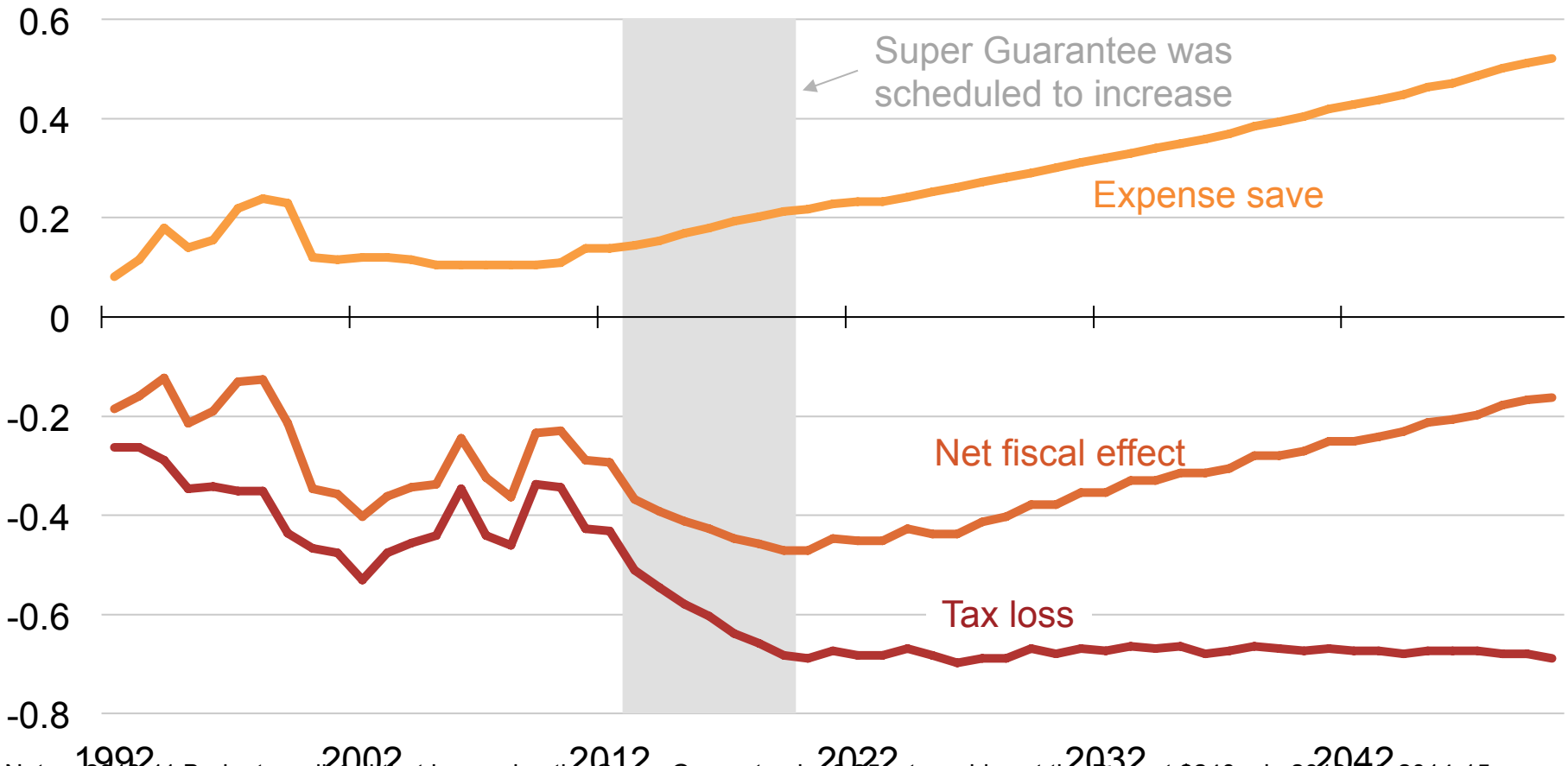
Impact on budget balance, percentage of GDP



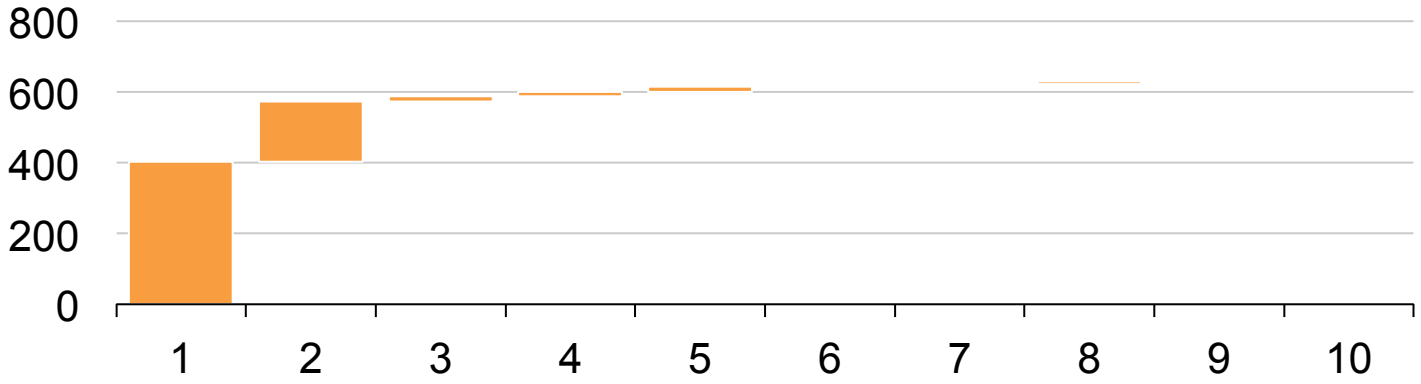
Notes: 2010-11 Budget predicted that increasing the Super Guarantee by 0.25ppt would cost the Budget $240m in 2013-14. 2014-15 Budget predicted that not increasing the Super Guarantee by the previous Government's policy of 0.5ppt would save $440m in 2017-18. These cost estimates predated policy changes to increase Age Pension assets test taper rate and tighten of super tax breaks, which would increase fiscal savings by ~0.1% of GDP in 2018-19 (higher taper rate ~$1b, super tax changes ~$0.7b). Shaded area indicates 2010-11 Budget policy.

Sources: The Treasury Charter Group 2013; Budget papers; Grattan analysis

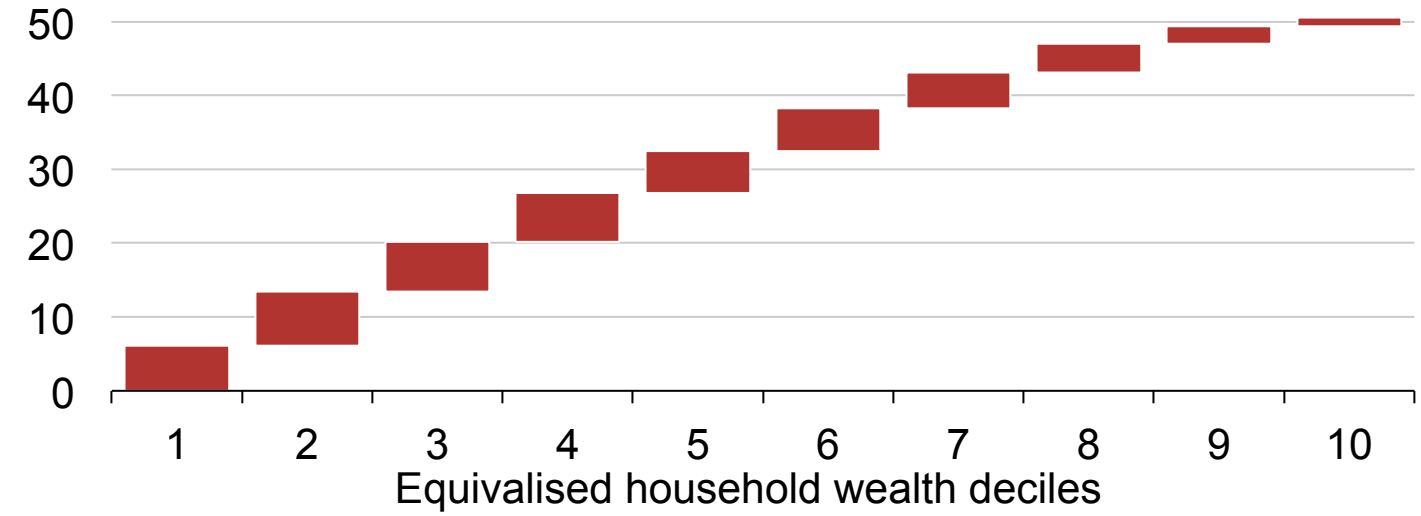
Boosting Rent Assistance is more targeted than increasing the Age Pension

Benefits from Rent Assistance and the Age Pension for over-65s, 2015-16

Rent assistance spending to over-65s
$ millions

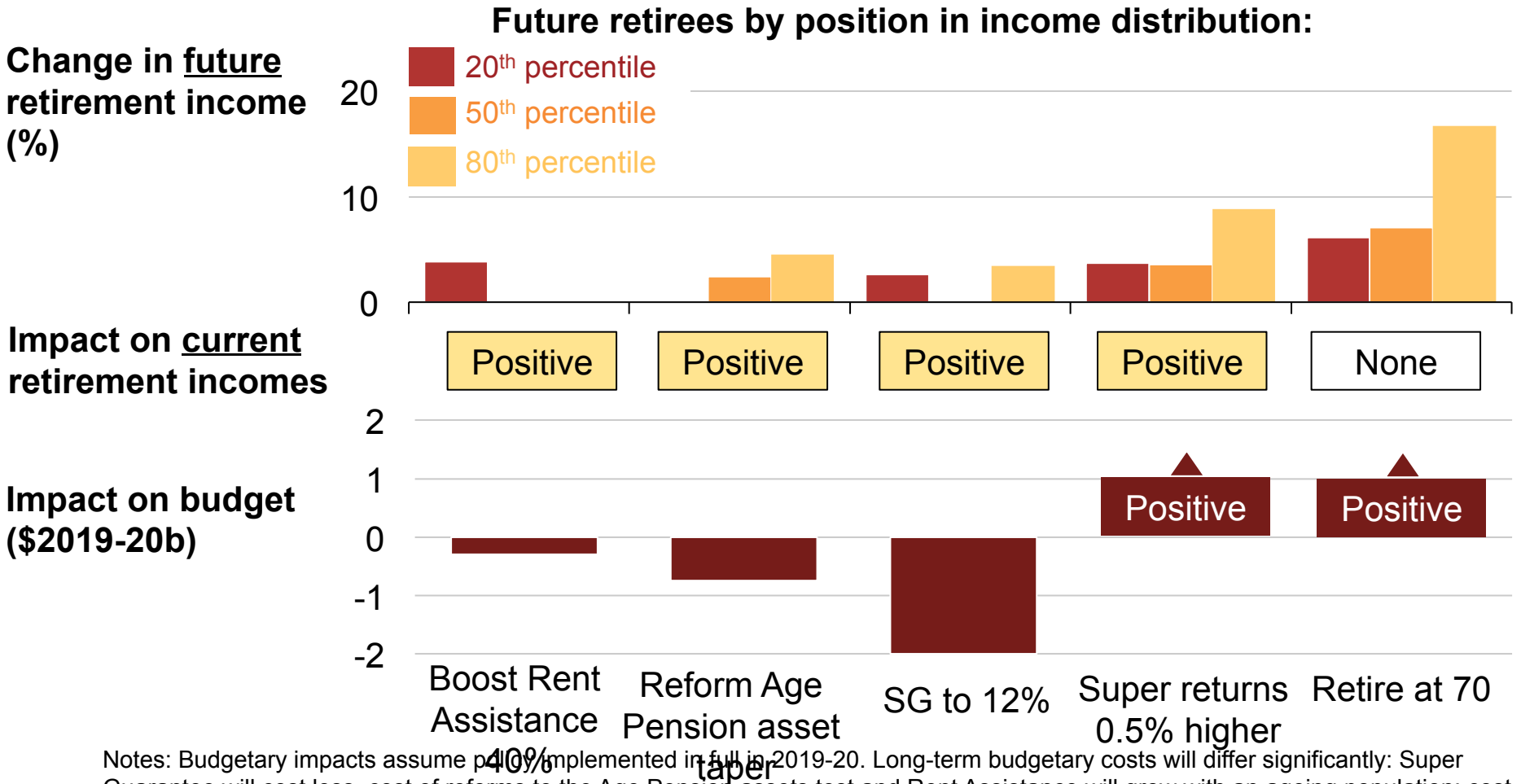


Pension spending to over-65s
$ billions



Notes: "Pension" includes both the Age Pension and other government pensions and allowances, such as disability, carer or family support payments received by younger people in a household with a household head aged 65 and over.
Source: Grattan analysis of ABS Survey of Income and Housing (2017).

Boosting Super Guarantee helps less, and costs more than all other reforms



Notes: Budgetary impacts assume policy implemented in full in 2019-20. Long-term budgetary costs will differ significantly: Super Guarantee will cost less, cost of reforms to the Age Pension assets test and Rent Assistance will grow with an ageing population; cost of Rent Assistance will also rise as rates of home ownership decline. Rent Assistance scenario assumes a retiree at the 20th percentile of the income distribution is a renter and eligible for the maximum rate of Commonwealth Rent Assistance for a single, whereas 50th and 80th percentile retirees are home-owners. All other scenarios assume all retirees own their own homes for the purposes of determining Age Pension entitlements. All retirement income scenarios are for a person born in 1985, who works uninterrupted to age 67 (or age 70 in the "retire at 70" scenario) and dies at age 92 (except the "live extra five years" scenario).
Source: Grattan Retirement Income Model

Retirement incomes are typically adequate even with career breaks: they get more pension instead

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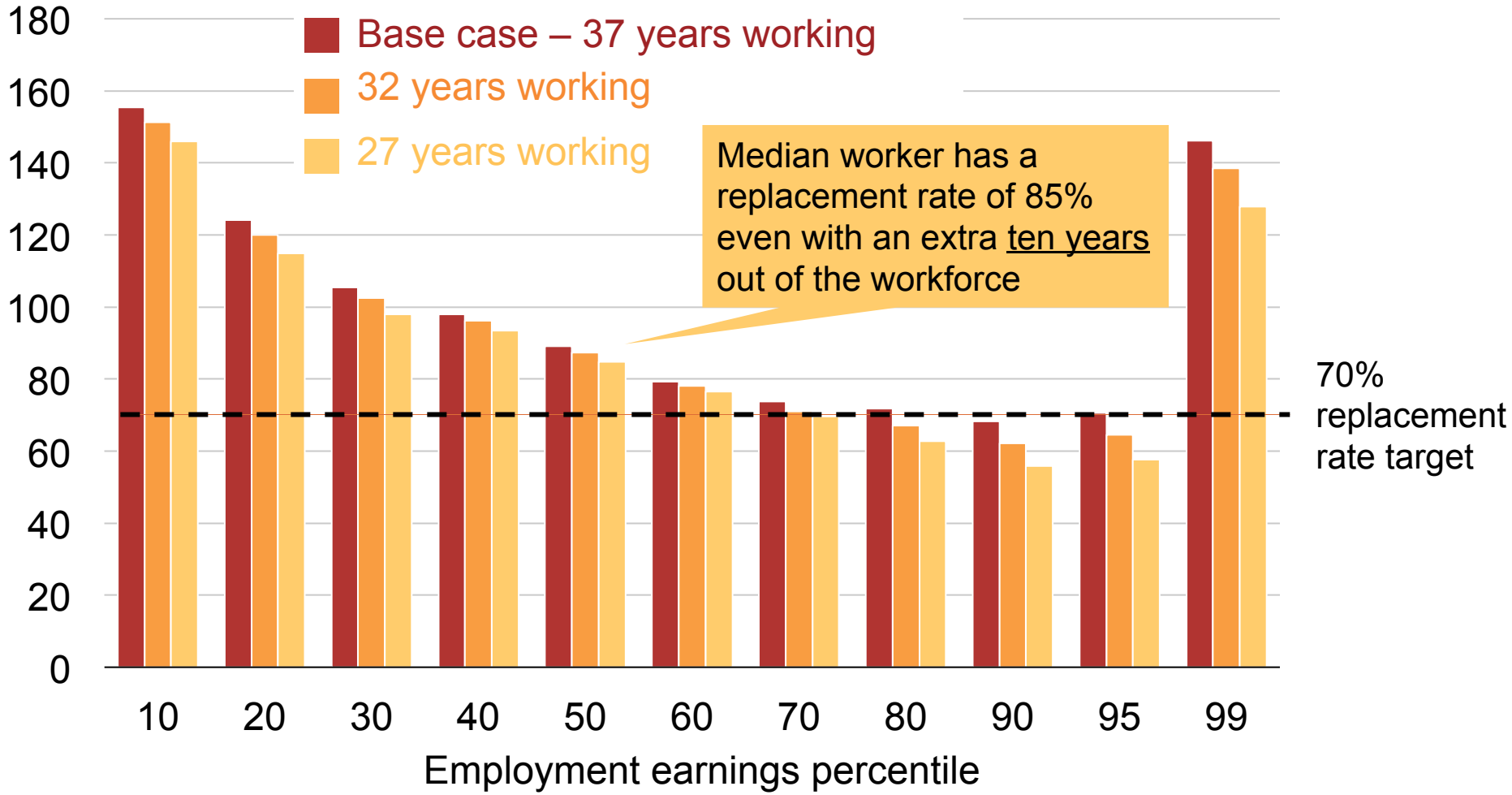
Replacement rates, by employment earnings percentile, CPI deflated, per cent



Notes: Results from modelling the retirement income of a person born in 1985, who dies at 92. Retirement savings drawn down so that small bequest is left in addition to home. Career break scenarios assume retirees start work at age 30, and take either a five or ten year career break from age 35 (until either age 40, or 45) before returning to work until age 67. GRIP includes part-time workers.
Source: Grattan Retirement Income Projector

Paying super on Paid Parental Leave will have little impact on women's retirement incomes

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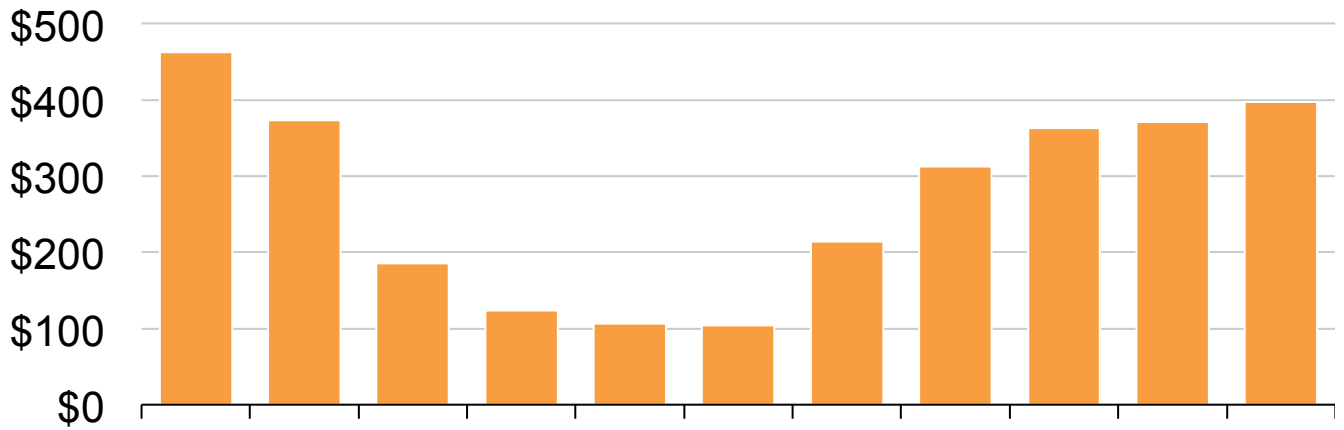
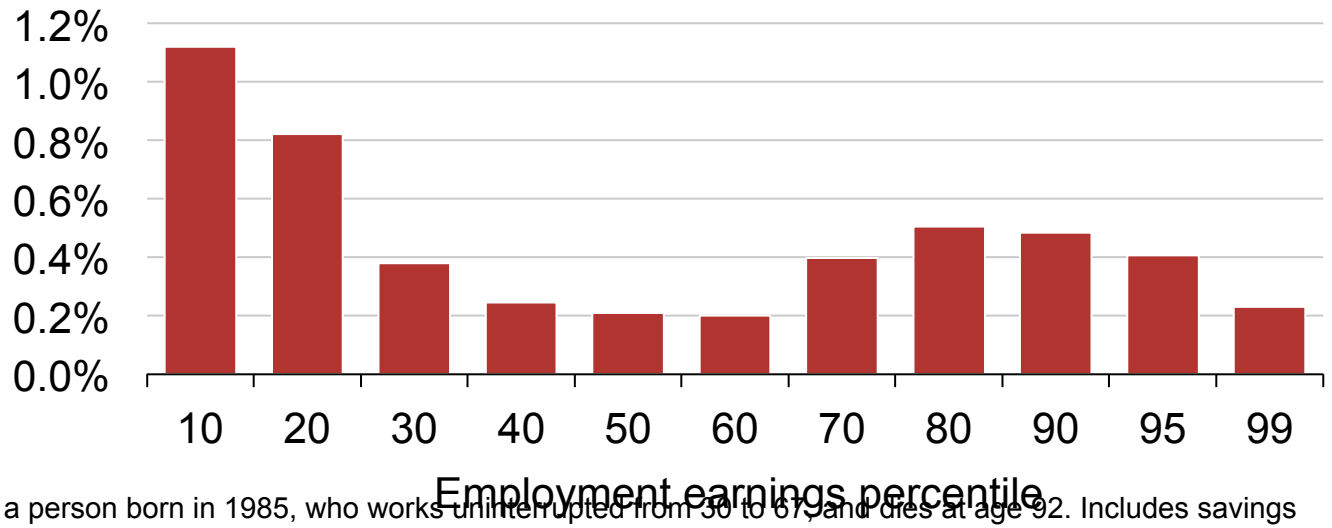
Annual increase in retirement income,
$ per year



Increase in retirement income,
Per cent



Notes: Models retirement income of a person born in 1985, who works uninterrupted from 30 to 67, and dies at age 92. Includes savings outside super. Employment earnings adjusted to account for movements up and down the earnings distribution. Retirement savings drawn down over 26 years to leave a small bequest in addition to the home. Assumes 12% SG paid on 2 periods of 18 weeks of government-funded Paid Parental Leave, at age 32 and age 34. Future retirement incomes deflated using CPI

Source: Coates and Emslie (2018) *Super. If Labor really wanted to help women in retirement, it would do something else.* The Conversation.

Australians retirees pay more each year in super fees than they spend on their energy bills

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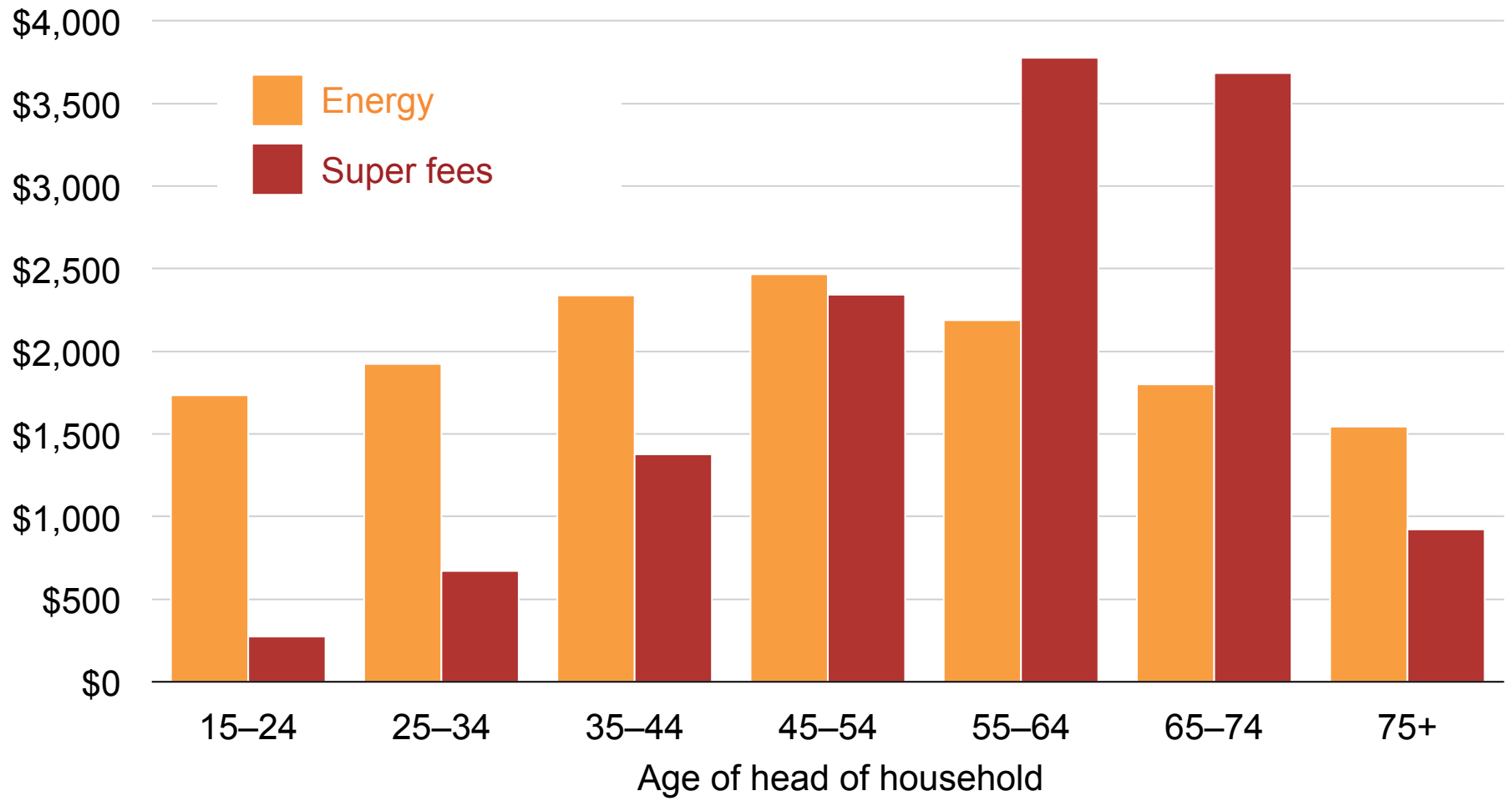
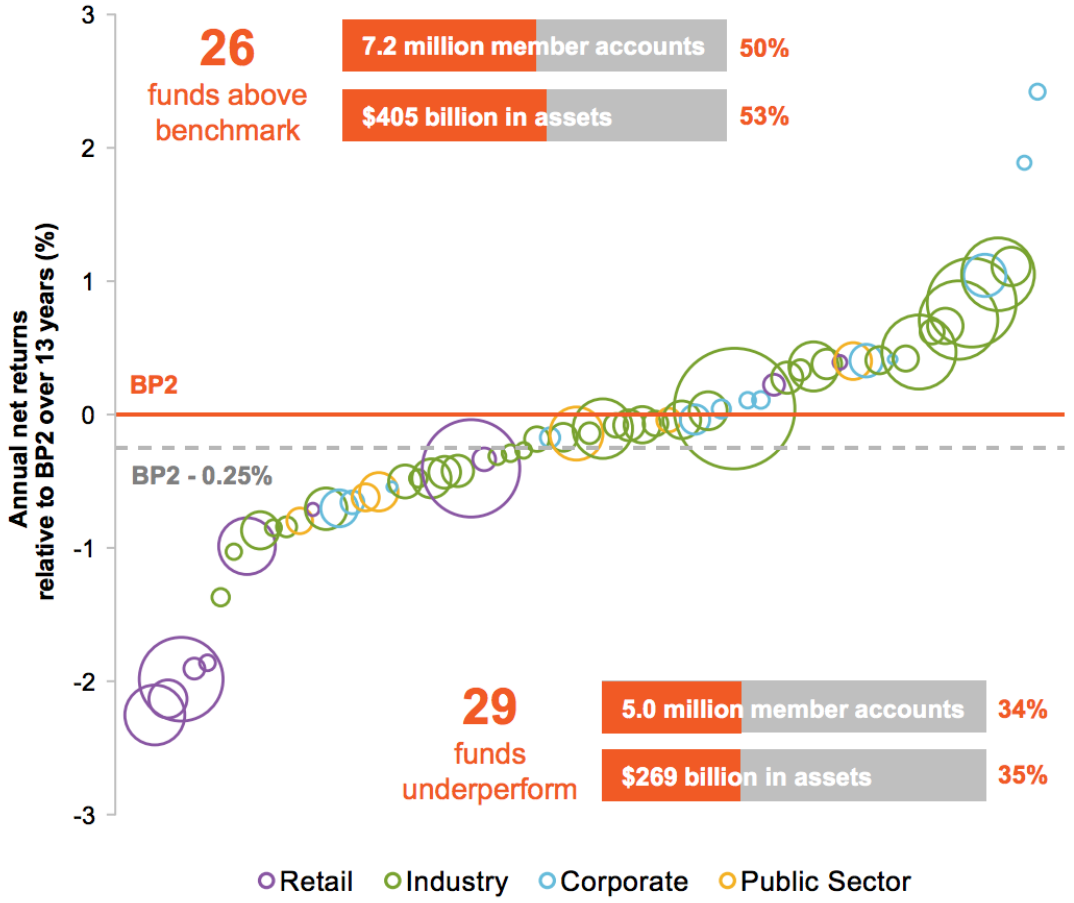
Annual average household expenditure on energy and superannuation fees, 2015-16



Notes: Based on mean total household superannuation balance by age of head of household; based on annual superannuation fees of 1.1 per cent of account balances; energy costs include all domestic fuel and power for main dwelling.
Source: ABS Household Expenditure Survey 2015-16; Productivity Commission, "Superannuation: Assessing Efficiency and Competitiveness" , Draft Report; Grattan analysis

There is a long tail of under-performing super funds in Australia

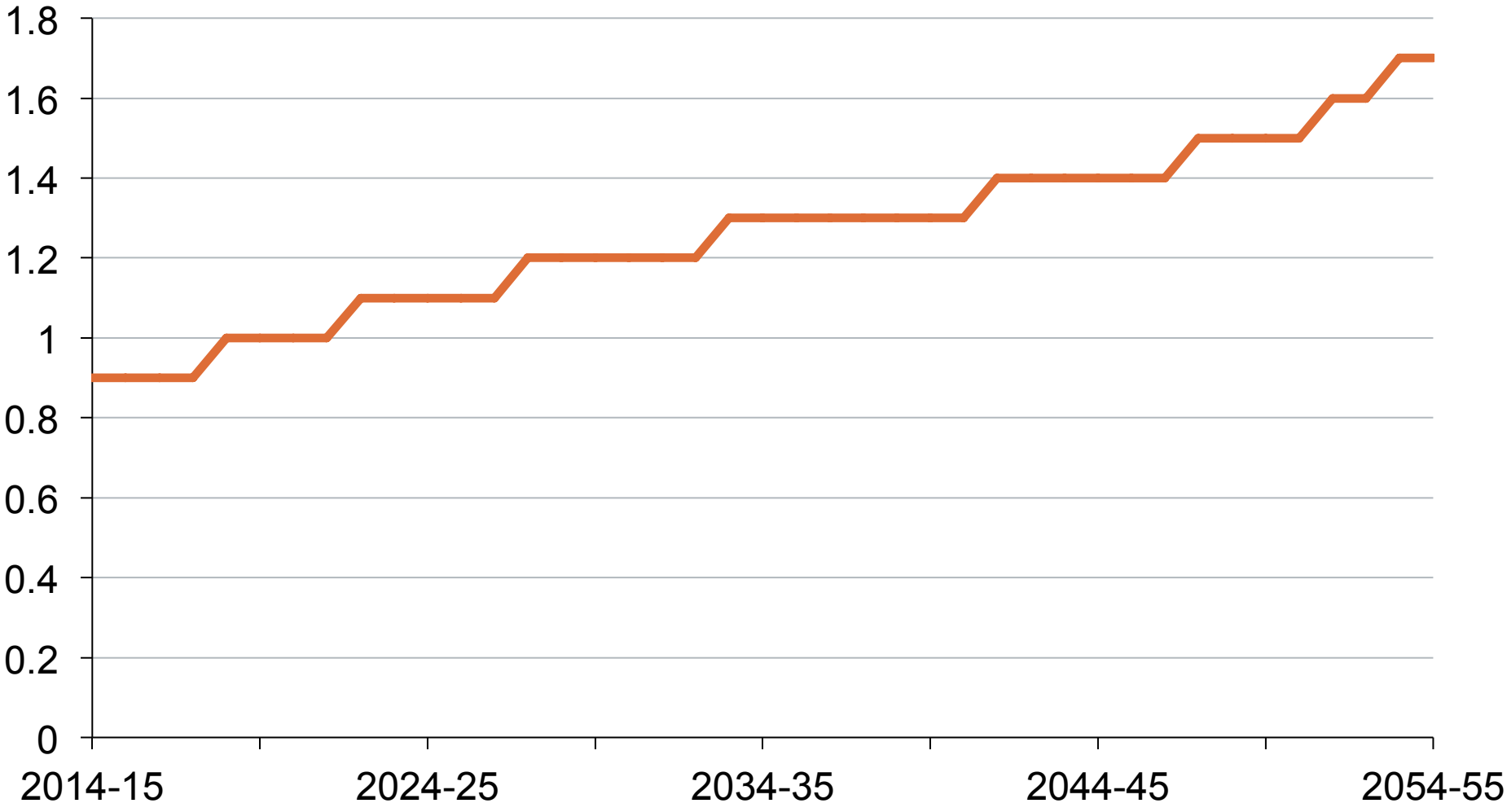
Performance relative to individual funds' benchmark portfolios, 2005–2017



Notes: Size of circles indicates the size of each fund's assets under management. All APRA-regulated funds with a MySuper product in the dataset over the full period (60% of assets and 66% of member accounts in all APRA-regulated funds with a MySuper product in 2017). Over the entire super system, the figure represents 68 funds, 30% of assets and 51% of member accounts in 2017.
Source: Productivity Commission (2019), *Superannuation: assessing efficiency and competitiveness*, Figure 5.

Government spending on aged care is projected to rise rapidly

Age care spending (predicted) as a % of GDP



Note: Included home-based and residential aged care.
Source: Australian Government (2015), *Intergenerational Report*

Most workers exceed 70% benchmark even if they make no voluntary super contributions

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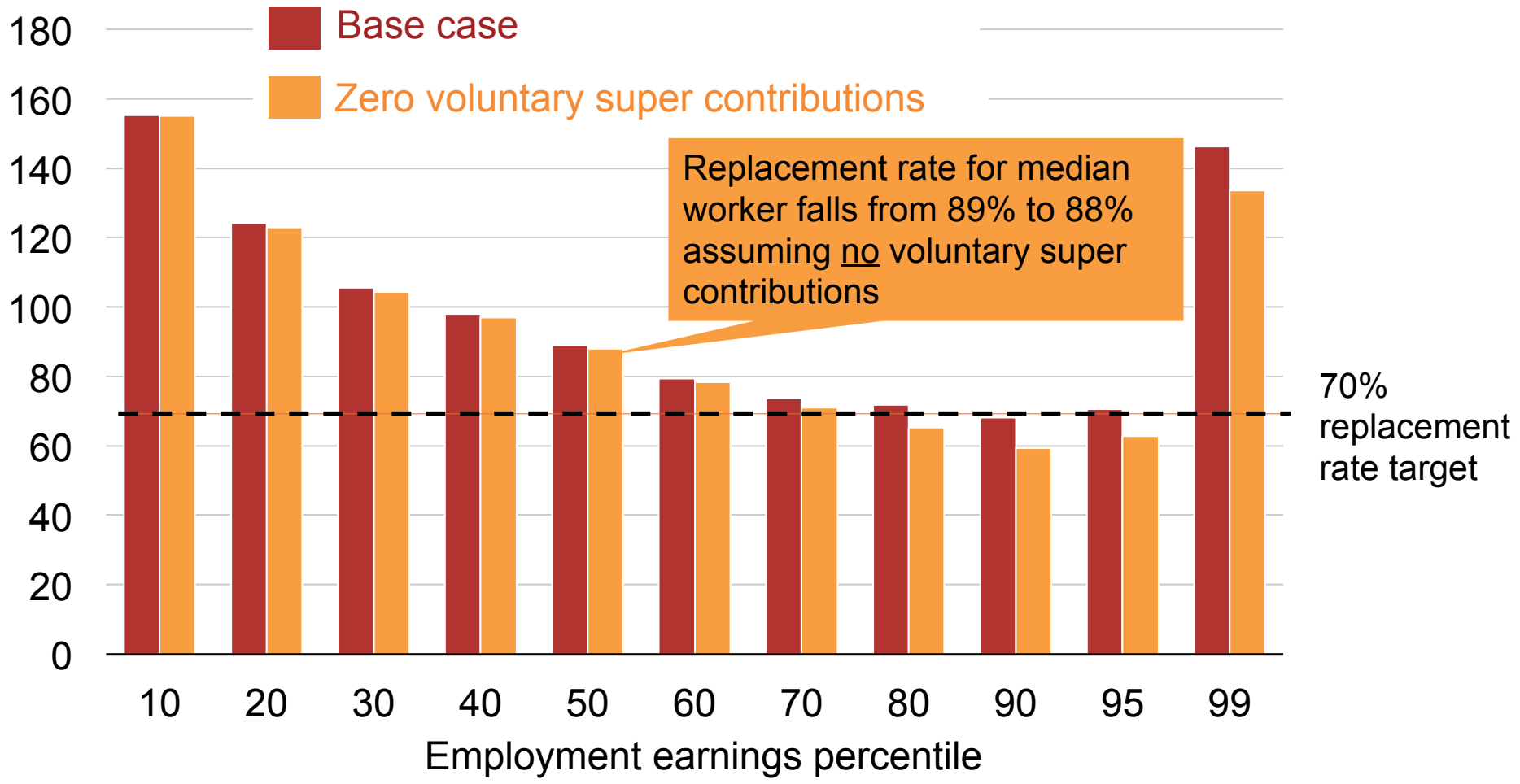
Replacement rates, by employment earnings percentile, CPI deflated, per cent



Notes: Results from modelling the retirement income of a person born in 1985, who dies at 92. Retirement savings drawn down so that small bequest is left in addition to home. "Zero voluntary super contributions scenario" assumes workers make no voluntary pre-tax super contributions – Super Guarantee contributions only. "Base case" assumes workers make voluntary pre-tax super contributions as observed in the ATO 2% sample file. Neither scenario assumes workers make post-tax contributions during their working lives.
Source: Grattan Retirement Income Model

Retirement incomes will be adequate even using less favourable calculations and assumptions

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Replacement rate for median income earner

Retirement age income comparator	Whole of retirement			
Working age income comparator	last 5 years	whole working	last 5 years	whole working
Deflation	CPI	CPI	wage	wage
Current policy	**0.89**	**0.94**	**0.76**	**0.69**
Assumptions				
Lower investment returns	0.86	0.91	0.73	0.67
Minimum draw down	0.81	0.86	0.69	0.63
No non-super savings	0.89	0.94	0.75	0.69
Policy changes				
SG remains at 9.5%	0.87	0.93	0.74	0.68
Assets test taper rate to $2.25	0.92	0.97	0.78	0.72
SG remains at 9.5%; assets test taper rate $2.25	0.89	0.95	0.76	0.70
As above + super tax breaks + SAPTO + M/care levy	0.88	0.93	0.75	0.68
Retirement age to 70 (on its own)	1.00	1.01	0.86	0.74
All of the above	0.99	1.00	0.86	0.73

Notes: "Current Policy": policy as currently legislated, including: 12% Superannuation Guarantee from 2025; retirement age at 67; existing superannuation tax breaks with indexation of relevant caps and thresholds. "Full Grattan package": SG remains at 9.5%; Age Pension asset taper rate lowered so Pension reduced by $2.25 a fortnight per $1,000 in assessable assets; SAPTO and Medicare levy changes as recommended in Grattan Institute's *Age of Entitlement* report; superannuation tax breaks tightened to $11,000 annual cap on pre-tax super contributions, $50,000 annual cap on post-tax super contributions and 15% tax on earnings in the pension phase.

Source: Grattan Retirement Income Model.