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SUBMISSION TO THE FINANCIAL SYSTEMS INQUIRY

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# CONTENTS

## Executive Summary

1. Introduction
2. Australia's superannuation system
  - 2.1 Australia's superannuation system: the envy of the world
  - 2.2 Changes since Wallis
  - 2.3 A global perspective
  - 2.4 The importance of policy stability
  - 2.5 Existing system is working
3. Emerging issues
  - 3.1 Increased life expectancy
  - 3.2 An ageing population
  - 3.3 Changing retirement expectations
  - 3.4 Changing the politics of Australia
  - 3.5 Increasing pension and health care subsidies
  - 3.6 Slowing economic growth
  - 3.7 Commonwealth budgetary pressures
4. Retirement incomes policy: ready for the challenges?
  - 4.1 Unrealistic expectations
  - 4.2 Australians want super to do more
  - 4.3 Abolition of compulsory retirement
  - 4.4 Lump sums are not misused
  - 4.5 Mandatory annuities/pensions are poor policy
  - 4.6 Superannuation should be for retirement
5. Superannuation and infrastructure
  - 5.1 The superannuation system and investment in infrastructure
  - 5.2 What drives investment in infrastructure
  - 5.3 A new model for private sector development of economic infrastructure
  - 5.4 Improving conditions for infrastructure and nation building investment
  - 5.5 Why invest in equities?
6. Improving competition in the banking sector
  - 6.1 A short history of bank capital regulation
  - 6.2 Introduction of Basel II in Australia
  - 6.3 Capital regulation and improving competition
  - 6.4 Other considerations: too big to fail?

Appendix 1      Access Economics Report: Super and the Future Financial System

## EXECUTIVE SUMMARY

- Emerging issues for the Australian economy and financial system are longevity, an ageing population, healthcare costs and budget sustainability. The situation will become more problematic over time.
- Nevertheless, the financial system (and within it, the superannuation system) appears to be working well; there is no need for radical change (2.1)
- In order to fund adequate retired incomes, Australia – like all other developed nations – has the limited choice of either increasing taxes, increasing retirement age or increasing savings (2.3).
- Our recommendations with respect to the superannuation system are that:
  - the existing SG system has worked well and must be allowed to reach maturity without further significant policy change (2.5);
  - the role voluntary savings plays in ensuring adequate retirement incomes is crucial. In order to restore optimal interaction between the three pillars, Australians should be encouraged to make voluntary contributions to reduce pressure on the other two;
  - superannuation savings should not be used for other purposes (eg housing, education) (4.6);
  - That there is no substantiated evidence that individuals spend their superannuation savings immediately on retirement and then revert to the pension (4.4)
  - mandatory annuities or pensions should not be introduced (4.5); and
  - with an ageing population, increased longevity, greater retirement expectations and likely greater health care costs, additional policy measures may be needed to ensure adequacy.
- Superannuation already plays an important role in infrastructure provision (5.0).
- Institutional investors are increasingly viewing infrastructure as an alternative to fixed income (5.2).
- Institutional investors prefer mature assets and there is a demand by fund managers for brownfield developments (5.2).
- The federal government could play a role in the development of economic infrastructure through targeted investment (5.4).

## 1. Introduction

Australia has been well served by its financial system since Wallis reported in 1997.

Our resilient system has withstood three major economic shocks – the Asian crisis in the late 1990s, the dotcom crisis in the early 2000s and the Global Financial Crisis which began in 2008. Indeed, Australia's financial system is perceived as one of the world's most robust.

From AMP's perspective, superannuation savings and the strength of our superannuation system is of the greatest importance. Australia's three-pillar policy is recognised as a world-leading long-term approach to the pervasive problem of inadequate retirement incomes.

There have been significant changes in the superannuation system – and the broader financial system – since Wallis reported. Indeed, today's superannuation landscape is almost unrecognisable compared to that of 1997.

Changes include:

- growth in FUM to around \$1.8 trillion in 2014;
- a substantial restructuring of the industry, with wealth management companies being acquired by the banks (BT by Westpac, MLC by NAB, Colonial by CBA);
- significant growth in industry funds;
- substantial consolidation in the sector, with the fifth and sixth pillars identified in the Wallis report (AMP and National Mutual) merging in 2012; and
- an exponential growth in SMSFs, which now account for one-third of superannuation savings.

Many believe we are at a mid-point in a transformation of the sector, with further consolidation expected, combined with significant growth in assets (expected to reach \$5 trillion in the next six to seven years).

While AMP considers the financial system to be in good shape overall, in recent years concerns have emerged. These include whether there is sufficient competition in the banking sector, the costs of regulation and whether the twin regulatory peaks model is appropriate. Australia's relationship with the Asia Pacific region is critical and the implementation of the Johnson Committee's recommendations is vital for our future.

In crafting our submission, AMP was aware it could not address all the issues in the Terms of Reference. Therefore our submission focuses on the superannuation sector and the emerging issues for wealth management and retirement incomes.

We have taken a market-based, national interest approach in our recommendations, with a focus on the key issues for the future: an ageing population, increased longevity, greater retirement expectations and increased health costs.

Nevertheless we are still vitally concerned about ongoing issues such as the costs of regulation and the regulatory burden. We have made substantial input into the FSC, ASFA and ABA submissions in relation to these matters. Similarly, we have concerns about life insurance and how that market can be enhanced and, again, we are providing input to the inquiry through that avenue.

This submission focuses on three broad areas:

1. the challenges facing the superannuation sector;
2. how superannuation can assist national development; and
3. how competition in the banking sector can be enhanced by levelling the playing field between the larger and smaller banks.

In terms of the first issue, we believe there are a number of critical emerging issues not envisaged at the time of Wallis. These include population ageing, increased longevity and greater expectations from the superannuation system.

These trends lead to three key questions.

1. Will existing arrangements provide for an adequate retirement given Australia's ageing population and the increased longevity of that population?
2. Whether the current superannuation tax concessions are sustainable in the longer term given Australia's ageing population?
3. Does the system do enough to encourage the right savings behaviours for individuals, and, in doing so, serve the economy more broadly?

As we have indicated previously, we believe Australia's national interest should always be at the forefront of policy development. Good public policy that is in the national interest will ultimately be good policy for AMP.

Finally, attached to this submission is a report prepared by Deloitte Access Economics analysing the impact of Australia's ageing population, the adequacy of the super system and the sustainability of the super system. The conclusions and recommendations contained in this submission draw heavily from this research.

## 2. Australia's superannuation system

### 2.1 Australia's compulsory system: the envy of the world

Australia's compulsory superannuation and retirement incomes system is the envy of the world.

Superannuation is an integral part of the financial system and one that is growing in importance. It has boosted national savings to nearly 100% of GDP, provided capital for financial markets and guaranteed retirement savings for millions of Australians. The existence of such a large pool of stable assets underpins financial stability in Australia by adding depth and liquidity to financial markets and provides an important buffer against external shocks.

Since Keating's introduction of a compulsory Superannuation Guarantee in 1992, Australia's superannuation savings have grown to \$1.8 trillion as at 31 December 2013. Australian superannuation is now the world's fourth largest retirement savings pool. The pool of assets held in superannuation is projected to grow to \$7.6 trillion by 2033, which in real terms equates to around 180% of GDP.<sup>1</sup>

However, superannuation is only one element of Australia's retirement income system. Keating's vision involved three pillars which would together fund Australians' retirement: the safety net of the Commonwealth age pension; a compulsory Superannuation Guarantee; and voluntary superannuation contributions. The importance of voluntary contributions for the success of the policy cannot be underestimated, and is discussed further in this submission. (It is important to note that voluntary contributions have declined over the past few years, in spite of a recovery in financial markets<sup>2</sup>.)

These three components working together will ensure that the majority of Australians should be able to retire with adequate income. Few other nations in the world are fortunate enough to be in this situation.

### 2.2 Changes since Wallis

There have been dramatic changes to the superannuation industry since Wallis reported in 1997, so much so that the landscape is almost unrecognisable.

Changes have included:

- massive growth in the sector, with FUM increasing to \$1.8 trillion in 2014;
- significant growth in industry funds;
- the acquisition of wealth management companies by the big four banks including BT by Westpac, MLC by NAB, and Colonial by CBA;
- consolidation in the sector, with the fifth and sixth pillars (AMP and National Mutual) merging in 2012;
- exponential growth of SMSFs, which now account for around one third of superannuation savings;

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<sup>1</sup> Deloitte projections – see [http://www.deloitte.com/assets/Dcom-Australia/Local%20Assets/Documents/Industries/Financial%20services/Deloitte\\_Dynamics\\_of\\_Superannuation\\_2013\\_report.pdf](http://www.deloitte.com/assets/Dcom-Australia/Local%20Assets/Documents/Industries/Financial%20services/Deloitte_Dynamics_of_Superannuation_2013_report.pdf)

<sup>2</sup> FSC (2012), Submission to the 2013-14 Federal Budget, pp20 - 21

- an unprecedented increase in the regulatory burden imposed by both domestic and international policymakers and regulators; and
- the introduction of a range of transformative policy measures, including choice of fund and MySuper.

Many analysts predict further changes will take place as the industry evolves. For example, it is forecast that smaller industry funds will consolidate into larger funds (with Rice Warner predicting in 2012 that the number would reduce from 65 to 42), further rationalisation will occur in the retail sector (from 141 to 95) and structural change and rationalisation will continue to occur due to FoFA and MySuper policies<sup>3</sup>.

### 2.3 A global perspective

The challenges faced by Australia's superannuation system are by no means unique.

Lord Adair Turner, Chairman of the UK Pensions Commission from 2003 to 2006, perceived the UK's ageing population as a great, though not insurmountable, challenge.

Turner put the position succinctly: he explained that, faced with an ageing population, society and individuals must choose from a mix of four options:

1. pensioners becoming poorer relative to the rest of society;
2. taxes devoted to pensions rising;
3. savings rising; and/or
4. average retirement ages rising.

Turner argued that having poorer pensioners was the least attractive option. Given the scale of the change required in the UK – the proportion of GDP transferred to pensioners would have to rise from 10 to 15% to maintain pensioners' living standards – Turner made the point that none of the three options would be able to shoulder the load alone. The consequence was that major adjustments to retirement ages, private savings and pension provision were necessary.

The majority of recommendations made by the UK Pensions Commission were adopted.

The Turner options are equally applicable to Australia, although not quite so starkly. Fortunately, over the last 20 years our emphasis has been on increasing retirement savings and raising the retirement age, so Australia is better placed than almost all other nations. The key question is, given that the system is meeting its core objectives, what policy refinements –if any – are necessary to ensure sustainability over the coming decades in light of the likely developments?

### 2.4 The importance of policy stability

The superannuation system in Australia is complex and interdependent. Small taxation or regulatory changes can elicit major behavioural changes which reverberate throughout the economy.

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<sup>3</sup> See Cerulli Associates, Asia-Pacific Edition 2Q, Issue 30, '*Pension in a Mansion: Clues to how Asia might develop*', (2012)

Regular changes to policy by successive federal governments have undermined public confidence in the superannuation system over the last decade. This needs to change.

Significant changes made between 2006/07 and 2012/13 include:

- in 2006/07, abolition of tax on lump sums and pension payments made to members over age 60, abolition of Reasonable Benefit Limits, new minimum standard rules for pensions and annuities and removal of compulsory cashing of superannuation benefits for those over age 65;
- on 1 July 2009, concessional contributions limited to \$25,000 per person per year (with a transitional cap of \$50,000 per year until 2011/12);
- in 2012/13, introduction of a new government super contribution rebate for low income workers, and contributions tax doubled from 15 to 30% from 1 July 2012 for individuals earning more than \$300,000 per annum; and
- From 1 July 2013, a higher concessional cap of \$35,000 per annum applied for all Australians aged 60 and over.

Stability has always been a concern. Frequent policy changes have damaged the system and both sides of politics recognised this in the last election campaign.

If the goal of public policy is to maintain confidence in superannuation as a retirement savings vehicle, predictability and stability in policy settings is a must.

## 2.5 The existing system is working : let it reach maturity

The existing compulsory superannuation system is working, and working well.

It has not yet reached maturity, so any assessment of the long-run adequacy of current arrangements is a forward-looking exercise.

But despite this, all our forecasts (using AMP's retirement income adequacy index) suggest most individuals will have adequate retirement incomes if present policy continues, and a stable long-term approach is maintained.

Facing the kinds of challenges Australia faces, it is often easy to tinker with the system, expecting that outcomes will not change. Unfortunately this may not be the case, as small changes may elicit major behavioural changes (such as changes in spending and savings habits) which result in unintended consequences in the long term.

However, we can say with some degree of confidence that:

- the existing system is achieving its core objectives and should be allowed to reach maturity without further major changes;
- our analyses indicate that with a 12% SG, adequacy is achieved, but that in the short term some individuals who are about to retire will have a less-than-adequate retirement income; and



- discretionary savings are crucial to an adequate retirement income – and the recent decline in discretionary savings is of concern.

Each of the above is discussed in more detail below, and further analysis included in the attached Deloitte Access Economics report.

***Projected outcomes for today's workers (see page 20 of the attachment)***

Estimates of future retirement incomes are a critical component of policy impact analysis in assessing whether current retirement savings policy is right for Australian workers.

While superannuation represents both the largest and the most effective way most workers save for retirement, other pools of savings and income from the age pension are also important sources of retirement income.

Analysis included in the latest *AMP Retirement Adequacy Index* (the Index) projects retirement incomes for today's workers based on data for the six months from June to December 2012.

In analysing retirement incomes, AMP uses the benchmark of an income stream of 65% of pre-retirement disposable income. Unlike other models, ours includes an individual's other savings when assessing adequacy.

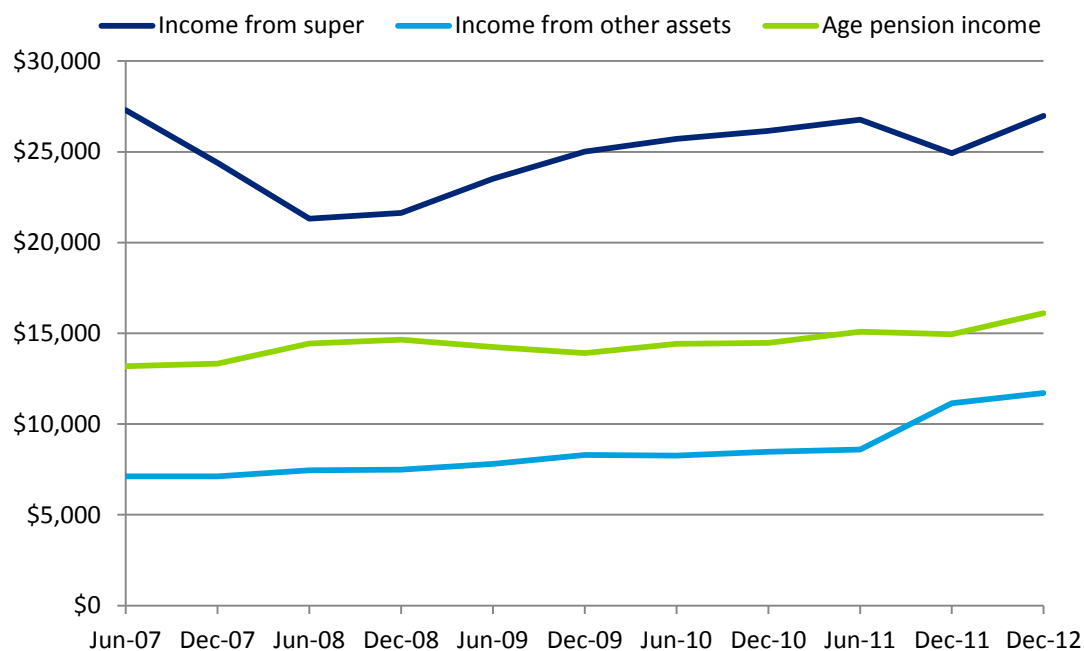
The analysis underlying the Index shows that the average value of assets (in 2011-12 dollars) of Australian workers at retirement, if current savings trends continue, will be \$752,162.

As Australia's compulsory superannuation system is not yet mature, it will achieve better outcomes for younger workers than it does for today's older workers. Our analysis shows that, in today's dollars, younger workers (those aged 20-24) can expect to amass \$1,114,526, and this falls progressively as age increases, with those aged 65-69 achieving an average of \$328,330 in assets at retirement.

A clear majority (70%) of assets at the time of retirement are projected to be held in super.

Projected average net retirement incomes from each of these three sources for all Australian workers are presented in Chart 2.1 below.

**Chart 2.1: Projected average annual retirement income by source– Jun 07 to Dec 12**



Together with the age pension and other investments, (in today's dollars) workers will achieve average retirement incomes of just under \$52,000 per year. We must remember, however, that these figures are averages over time and not absolutes. In addition, the projections assume an unbroken work pattern, an increase in SG to 12% by 2019 and no changes to the pension rules.

The Index uses a relative benchmark based on living standards before retirement, rather than an absolute measure based on budget standards. In broad terms, these results would see the average worker more than meet the 'modest lifestyle' as measured by the Westpac/ASFA retirement standard, but fall short of achieving that standard's measure of a 'comfortable lifestyle'.

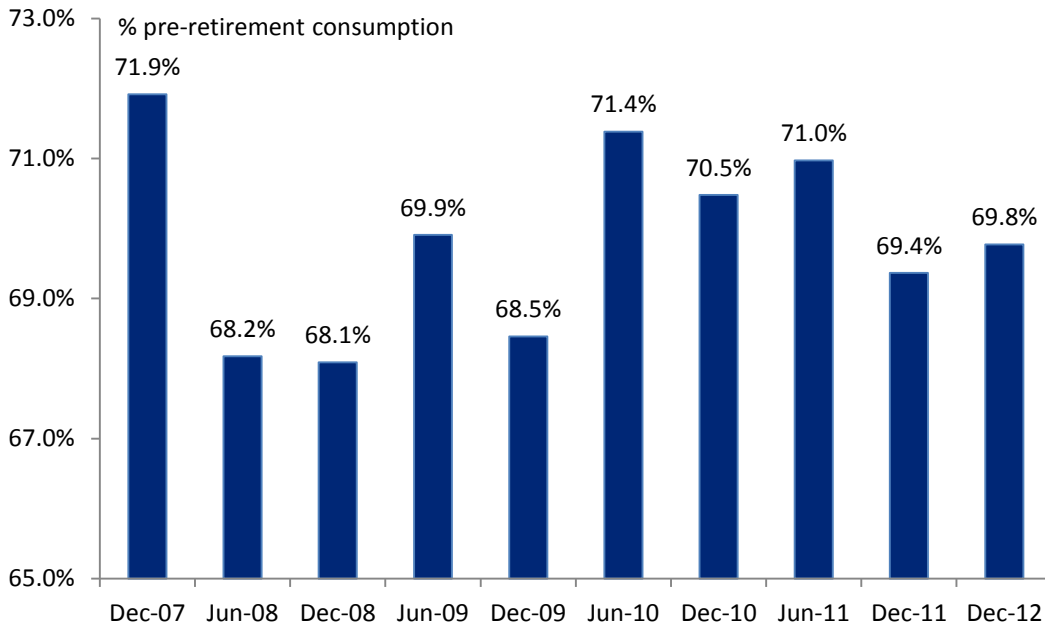
Just over half of the income that today's worker will receive in his or her retirement years will come from superannuation. The age pension will make up less than one third of retirement income.

Chart 2.2 below shows the value of the Index over time. Average retirement income adequacy levels peaked in 2007 as sharemarkets peaked and members responded to shifts in contemporary superannuation policy. Adequacy fell in 2008, due to poor market performance and a fall in voluntary contribution rates.

Adequacy then rose again in the first half of 2009 as markets recovered and the pension was increased in the 2009 Budget. However, the largest increases in adequacy were in June 2010, when the decision was made to increase the Superannuation Guarantee rate from 9% to 12%.

More recently, projected adequacy levels have declined in the face of lower voluntary contributions, particularly from higher income earners who have seen their contributions constrained by recent capping of concessional contributions.

**Chart 2.2: The AMP Retirement Adequacy Index – Dec-07 to Dec-12**



### ***The role of voluntary savings***

Voluntary superannuation savings are critical to achieving adequacy in retirement.

While the *AMP Retirement Adequacy Index* indicates that the average Australian worker can expect to receive adequate retirement incomes, that result hides a number of important distributional issues. In particular, by measuring the average level of adequacy, the Index spreads the benefits of voluntary superannuation contributions across all current workers.

The reality is, however, that many Australians do not make voluntary superannuation contributions.

It is therefore useful to consider the replacement rates available to those workers who do not make voluntary contributions.

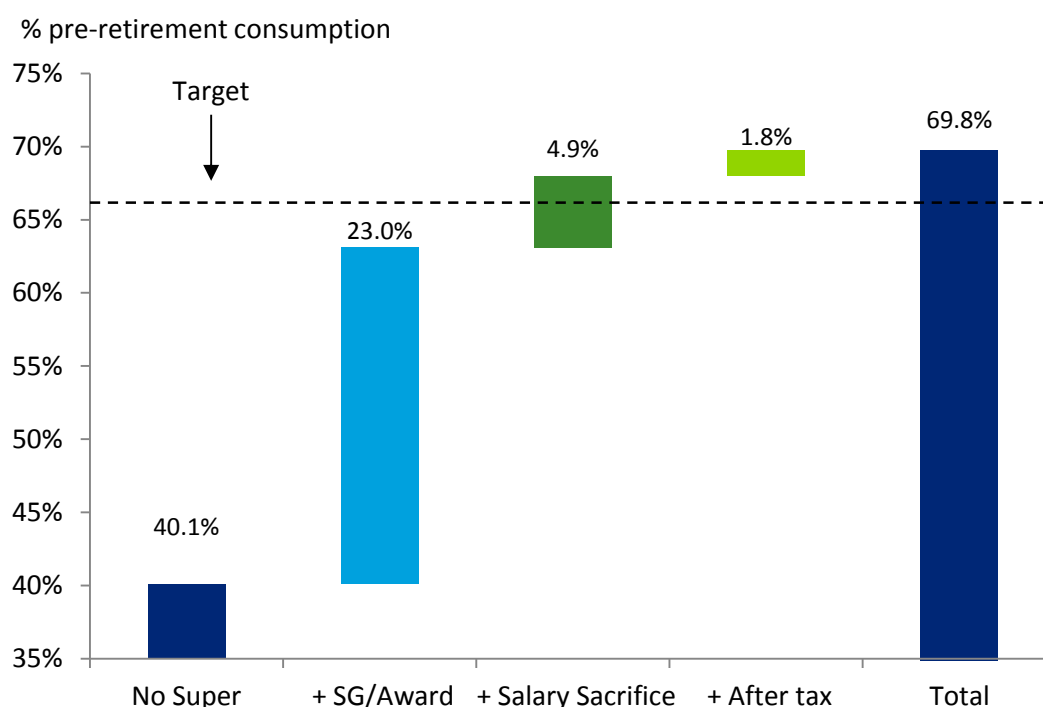
The replacement rates used in AMP's modelling measure the ratio of average consumption spending in retirement to average consumption spending in the final year in the workforce, adjusted to account for taxes and savings. The 'target' for that ratio is set at 65% of an individual's own pre-retirement living standards.

As Chart 2.2 shows, this measure stood at 69.8% on average across all workers for the six months to December 2012.

Chart 2.3 provides a breakdown of this result into a number of separate components.

It shows that the combination of the age pension with assets held outside of superannuation would result in an average 40.1% replacement rate.

**Chart 2.3: Breakdown of average net retirement incomes by source – Dec 12**



The addition of existing super balances, along with compulsory super contributions<sup>4</sup>, leads to a total replacement rate of 63.1%, which is still below the Index's 65% target. This means that people who do not make voluntary super contributions may not have adequate retirement savings.

Adding future voluntary contributions to super, both salary sacrifice and after tax, contributes the final 6.7% to average replacement rates.

Importantly, the latter ignores the role that voluntary savings have played in building the existing super balances of today's workers. The impact of past voluntary contributions is included in the SG/award category in the chart (along with that of total balances).

The estimates in Chart 2.3 are therefore very much a lower bound on the importance of voluntary contributions.

The latter lifts retirement incomes to being just ahead of the target level, highlighting the importance of voluntary savings via super in supporting adequate retirement incomes for today's workers. Research by the FSC has demonstrated that for every 1% increase in discretionary contributions, the retirement savings gap shrinks by \$77 billion<sup>5</sup>.

<sup>4</sup> Note that the SG/award contribution category included in this analysis is slightly broader than the legislated SG rate in the short term, as many employers contributed more than the minimum 9% on behalf of their employees in the six months to December 2012. Average contributions under this category were around 9.5% of member salaries, though it is assumed that such above-SG contribution arrangements will be discontinued as part of the transition to the higher 12% SG rate.

<sup>5</sup> FSC (2012), Submission to the 2013-14 Federal Budget, pp 20 - 21

### 3. Emerging issues

Despite the perceived success of the superannuation system, several issues have emerged that were not foreseen when the system was designed in the 1990s. Nor were these issues addressed in the Wallis report. They include:

- increased life expectancy;
- an ageing population;
- changing retirement expectations;
- potential changing politics in Australia;
- increasing pension and health care subsidies;
- slowing economic growth; and
- Commonwealth budgetary pressures.

All these trends reinforce the needs to have a robust retirement incomes policy that ensures Australian retirees do not run out of funds. (Further details are in section 1 of the Attachment).

#### 3.1 Increased life expectancy

Increases in life expectancy have been outpacing experts' predictions. The 2002 Intergenerational Report (IGR) predicted life expectancy at birth in 2042 of 82.5 for men and 87.5 for women. Just eight years later, the 2010 IGR predicted life expectancy would reach 86.1 for men and 89.2 for women by 2040.

One quarter of Australians will be aged 65 years or more by 2044/5 and half of the population now aged 65 will live to be 100.

Longevity rates are increasing. Demographers have traditionally underestimated longevity, so the problem could get worse.

#### 3.2 Ageing population

This dramatic increase in life expectancy is transforming Australia. An ageing population has significant implications for labour force participation and economic growth.

The share of the population aged 65 and over rose from 12.7 to 14.4% over the past decade. The rate of increase is projected to grow in the coming years, with around 20% aged over 65 by 2050.

Currently, each person of retirement age is supported by 4.6 Australians of working age. By 2050, there will be only 3 workers for each person over 65.

The share of adults participating in the labour force is predicted to fall from 65.3% today to 63.7% by 2050.

These demographic changes also have implications for the makeup of Australia's retiree population. In 2010, Australians aged 85 and over made up 13% of Australian pensioners. By 2050, this figure will rise to 22%.

### 3.3 Changing retirement expectations

As baby boomers retire, expectations of retirement are also changing.

Many Australians now view retirement as an opportunity for a whole new chapter in life, rather than a winding down period.

AMP referred to this shift in our 2009 NATSEM report, noting that improved health, increased longevity and compulsory saving for retirement have led to some great expectations of what can be done in retirement, including:

- overseas holidays;
- continuing a current high standard of living (two cars, frequent restaurant meals, etc);
- an active lifestyle; and
- interstate visits to children.

Research commissioned by AXA as early as 2006 reinforced this view, noting that:

- 55% of working Australians expected to travel overseas during retirement;
- 49% expected to at least maintain their standard of living (with 12% expecting it to increase); and
- 83% expected to maintain, or improve, their quality of life during this period.

Retirees also have rising expectations of consumer choice and quality of services, and believe they are entitled to individualised care. These changes in social attitudes, values and behaviour are increasingly driving demand for more flexibility and options for meeting the care and standard of living needs that arise through longevity.

The ability of people requiring care to continue to live an independent and flexible lifestyle depends on the availability of care in the community and the individual's ability to pay for that care. Superannuation provides a sustainable base for private contributions to the cost of health and aged care.

However, retirement incomes emerging from current superannuation arrangements may not be enough to meet these expectations.

The Association of Superannuation Funds of Australia's Retirement Standard<sup>6</sup> estimates a home-owning couple needs \$57,195 a year for a 'comfortable retirement' and \$33,120 for a 'modest retirement'. The age pension for a 'basic' retirement is \$32,417. For singles, the respective figures are \$41,830, \$23,032 and \$21,505 a year.

Table 3.1 outlines the pre-tax income required to yield an after-tax income equivalent to the 'comfortable retirement' level. It then compares this figure against average earnings in the Australian economy.

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<sup>6</sup> (based on November 2013 data and a retirement age of 65)

**Table 3.1: Comparison of Incomes**

<b>Presumed replacement Rate</b>	<b>Required pre-tax income indicative of a 'comfortable' retirement income</b>	<b>Average Yearly Earnings* (full-time employees)</b>	<b>Average Yearly Ordinary Time Earnings (full-time employees)</b>	<b>All employees average yearly earnings</b>
RR 65%	\$78,462	\$78,106	\$74,962	\$58,157

Source: ABS, Cat 6302.

\*Average yearly earnings are calculated as average weekly earnings multiplied by 52.14.

The key question is this: how can individuals be incentivised to save for retirement to the level that will generate this level of pre-tax income?

We know that with existing policy settings, today's workers will receive average retirement incomes of just under \$52,000, which appears to be above the Westpac/ASFA benchmark required for comfortable retirement.

However, it needs to be recognised that our Index uses a relative benchmark based on living standards before retirement, rather than an absolute measure based on budget standards. In broad terms, these results would see the average worker more than meet the 'modest lifestyle' as measured by the Westpac /ASFA retirement standard, but fall short of achieving that standard's measure of a 'comfortable lifestyle'. It also needs to be remembered that our index assumes that an individual's other assets are included as a component of the retirement income streams.

While it might be unrealistic to expect further tax concessions to encourage superannuation savings, it is vital that the existing concessions are not reduced.

### 3.4 Changing politics in Australia

An ageing population could well alter politics in Australia.

The older cohort (65 +) is already a political force to be reckoned with. They influence marginal seats and election outcomes. As their numbers rise, so will their influence.

There is a concern that this baby-boomer cohort (with enhanced expectations of quality of life and living standards upon retirement) will influence political directions that could lead to a blowout in borrowing. If this happens, the economic discipline shown by successive governments post-Whitlam could disappear and national debt could reach unsustainable levels.

It would be unfortunate if constraints were lifted and borrowing as a percentage of GDP increased to the levels of Greece, Italy or Ireland.

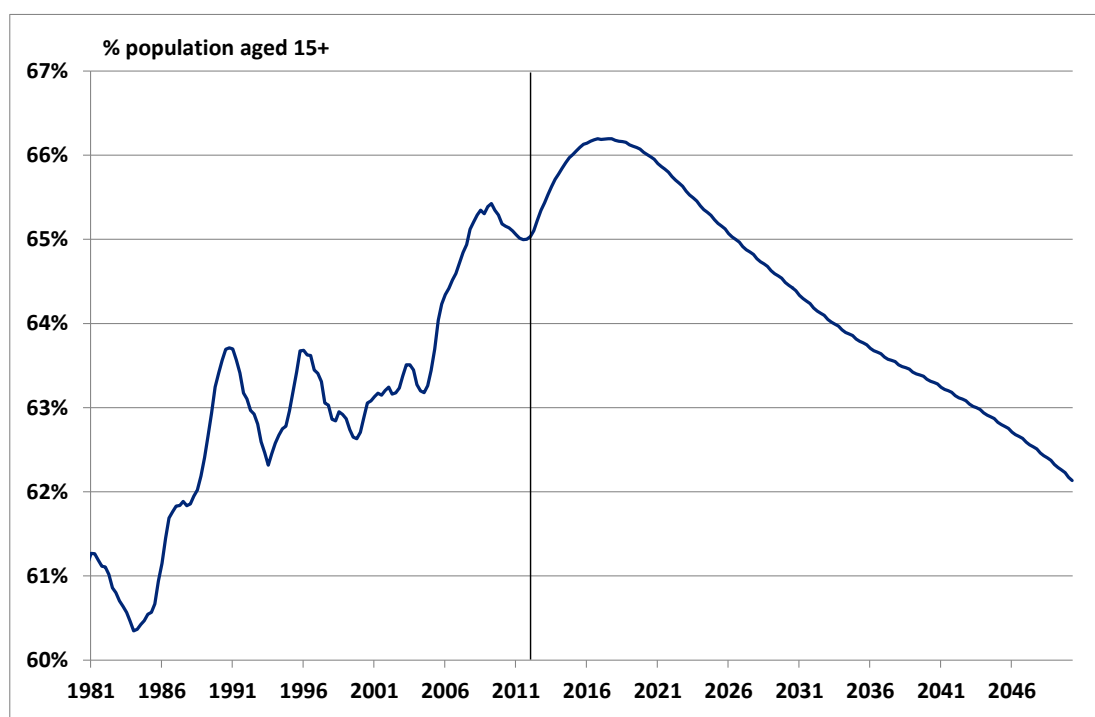
### 3.5 Slowing economic growth

Economic output has three basic drivers:

- population: how many people are in the economy;
- participation: how many of those people choose to work and for how long; and
- productivity: how much each of those workers can produce.

The participation rate is the share of those of working age who are employed or looking for work. Projections indicate that increasing rates of retirement among baby boomers will see Australia's participation rate fall over time (see Chart 3.1 below).

**Chart 3.1 Total labour force participation rates<sup>7</sup>**



The expected slowing in overall population growth combined with a drop in the participation rate will mean that two of Australia's three economic drivers are in decline.

The consequence of this could be increased budgetary pressure on the retirement income system.

Australia's participation rate peaked in 2009-10 at 65.6%, approximately matching the prediction in the 2002 IGR. That year, someone born in the middle of the baby boom in Australia would have turned 56, and the oldest of the baby boomers were turning 65.

This year marks the 54<sup>th</sup> birthday of those born in 1960: the last year of the baby boom. This means Australia will feel the sharpest impacts of ageing on labour force participation over the next ten to fifteen years.

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<sup>7</sup> Participation rate projections are based on a transition of age-specific participation rates from the most recent values to long run values included in the 2010 IGR.



### 3.6 Increasing pension and health care subsidies

Projections contained in the 2010 IGR show that even when the Superannuation Guarantee system reaches maturity, around three quarters of retirees will continue to rely on some level of government support through the age pension.

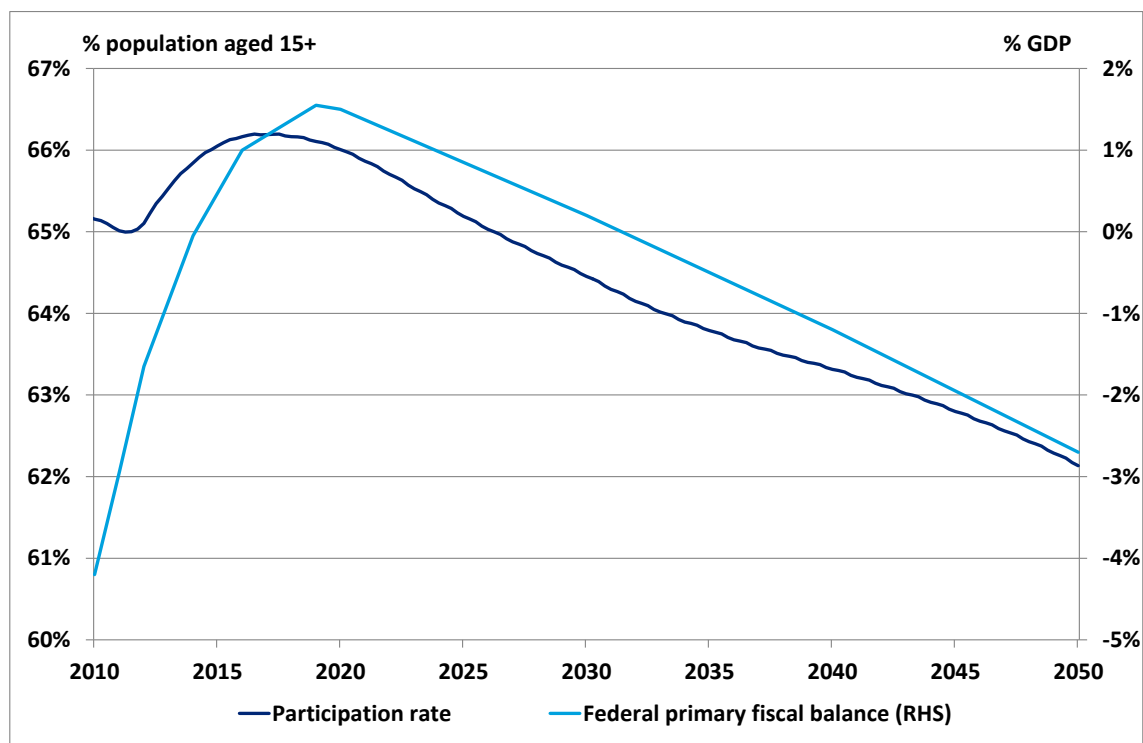
Older Australians also have more substantial health and aged care needs. More older patients will mean more health and aged care spending.

Simultaneously, the cost of care has tended to rise more quickly than other costs in the economy over time, due to advances in technology and treatment options. The 2010 IGR projected that health costs per person will increase by 1.1% a year in real terms over the next 40 years.

The combined effects of population ageing on labour force participation and the rising cost of pensions and health care subsidies will lead to rising federal deficits (see Chart 3.3).

These challenges highlight the need for increases in private savings to support living standards in retirement, as well as long term fiscal planning to meet the challenges of an ageing population.

**Chart 3.3: Projected Federal deficits and labour force participation**



Source: 2010 Intergeneration Report, Federal Treasury

### 3.7 Commonwealth budgetary pressures

The Commonwealth Government faces unprecedented budgetary pressures. Each of the factors mentioned, including an ageing population and slower economic growth, will place greater pressure on the budget. Deficits for the next four years are on track to double to more than \$100 billion. The Prime Minister has declared there is a “budget emergency” and deep cuts are expected in May’s federal budget.

Much has been made of the cost of superannuation tax concessions in recent public debate as an argument to reduce the tax concessions for superannuation. The figure usually placed on the cost of superannuation concessions is \$33.1 billion in 2013-14. This reflects the total of superannuation-related tax expenditures from the Tax Expenditure Statement (TES) produced by the Treasury.<sup>8</sup>

It is true that tax incentives around voluntary contributions carry a significant upfront budgetary cost, because the earnings from superannuation are subject to a lower tax rate than the average wage, which is taxed at a marginal rate.

However, the true cost of superannuation to the federal budget is much lower than headline Treasury figures suggest.

There are three reasons for this:

- alternative approaches to measuring current tax expenditures from superannuation produce a substantially lower estimate of \$11.2 billion;
- the TES measure does not account for behavioural change combined with concessional or deferred capital gains outside of superannuation, which would lower the estimate to at least \$28 billion; and
- any assessment of the cost of voluntary superannuation contributions must also account for the role of superannuation in reducing future age pension payments and other federal government outlays.

More details behind each of these three elements is contained in para 3.1 of the attachment.

#### ***Accounting for the long-term benefits of superannuation***

Any assessment of the cost effectiveness of super in providing retirement incomes needs to account for the role of super in reducing future age pension payments, and the costs of publicly funded health and aged care.

While difficult to quantify, there is no doubt the fiscal benefits associated with the superannuation system are substantial.

The long-term benefits of voluntary contributions outweigh the cost of tax concessions. Maintaining and expanding the incentives for higher voluntary contributions will reduce the burden on government in the long term.

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<sup>8</sup> Tax expenditures C4-C13 cover superannuation related tax expenditures, though often the combination of the two major tax expenditure items C5 (concessional taxation of employer contributions) and C6 (concessional taxation of fund earnings) is quoted (see for example <http://www.treasury.gov.au/Policy-Topics/SuperannuationAndRetirement/supercharter/Report>). The latter measured \$32.1 billion in 2013-14.

In short, the use of a tax-foregone estimate of \$31.1 billion massively overtakes the cost to government of the superannuation system and a figure closer to \$11 billion would be more appropriate.

As a consequence, the overall budgetary pressures resulting from the concessional taxation of superannuation are not as great as thought.

AMP believes that when the budgetary costs of superannuation policy are being debated, the cost estimate used in public debate should be \$11.2 billion rather than the figure of \$33.1 billion from the Tax Expenditure statement.

## 4. Retirement incomes policy: ready for the challenges?

Many Australians believe the mandatory super contributions their employer makes on their behalf will ensure they are self-sufficient in retirement – but this is an unrealistic expectation. Recent experience shows many Australians who had expected to be self-funded retirees have, in fact, become reliant on the pension in retirement.

ABS data show that, of those who retired between 2004–05 and 2012–13, fewer were mainly self-funded at retirement than had expected to be when surveyed in 2004–05. Interestingly, estimates from the *AMP Retirement Adequacy Index* show that today's higher income workers face the largest relative decline in living standards when they retire.

### 4.1 Changed Expectations

Super is already aimed at meeting big policy targets, and it is still maturing over time. While the super system slowly grows to meet the policy targets of today, there is a risk, however, that rising expectations mean it will fall short of tomorrow's expectations. If super is to meet the rapidly changing expectations of Australians, policy will need to keep pace with changes in community attitudes to retirement. Otherwise, many Australians may ultimately be disappointed by the retirement choices available to them.

Australia's retirement income system sits on the foundation of the aged pension, which was introduced in 1909.

At its heart, the aged pension is designed to ensure that older Australians are able to meet the day-to-day costs of living, without undue hardship. Or, in other words, its goal is to meet the minimum standards of the community, rather than the living standards that individual households enjoy during working life.

### 4.2 Australians want super to do more

However, this approach does little to meet the changing expectations of tomorrow's retirees.

Instead, the role of providing additional resources over and above the minimum level prescribed by the pension system falls to private savings – both within and outside the super system.

That view of a safety net topped up by private retirement savings stands in contrast to the welfare replacement role that many ascribe to the super system.

Policymakers will increasingly be looking to private sources of funding for services which have traditionally been publicly provided – particularly in health and aged care.

In this regard, policy flexibility is enhanced by increased retirement income. Requiring income support recipients to meet their own costs ultimately does little to benefit fiscal sustainability, as any such change would imply compensating increases in income support payments from government. Only private sources of income, such as that provided by retirement savings, give individuals the capacity to truly contribute to the funding of the services they consume.

For example, the abolition of ‘compulsory retirement’ is a relatively recent development in Australia, while even today age eligibility for the age pension is lower for women than for men – reflecting past attitudes to the role of women in the workforce more generally.

Similarly, changes that allow superannuation contributions from older workers have also been slow to emerge, with workers aged over 70 allowed to contribute to super for the first time due to measures announced in the recent Budgets.

#### 4.3 Abolition of Compulsory retirement

##### **Encouraging older Australians to stay in the workforce**

A black and white line between work and old age is rapidly becoming a thing of the past.

Forty per cent of people over 45 surveyed by the ABS and working full time indicated they intended to move to part-time work before retiring. Among those aged 45 and over who are still working, almost one in five now plans to work beyond his or her 70<sup>th</sup> birthday. Retirement is also becoming less ‘final’, with many who had considered themselves retired now find themselves returning to paid work.

This changing pattern of behaviour should be encouraged by the government. Older people staying in the workforce longer will increase participation and reduce the strain on public funds.

The government can create incentives for Australians to stay in the workforce by abolishing a fixed age of retirement and offering an enlarged pension to those who draw upon it at a later age.

Despite the inherent challenges in designing such a system, it is crucial to create incentives that encourage older Australians to continue to contribute to the economy.

It is equally important to reduce barriers for mature-age participation in the workforce. Although the concept of a ‘mandatory retirement age’ was abolished in Australia with the introduction of the *Age Discrimination Act* in 2004, age bars continue in some laws and policies that fall outside the protections of the Age Discrimination Act, including:

- workers compensation – most workers compensation schemes contain an age bar (usually 65) where income replacement payments cease or are limited; and
- income protection insurance – most income protection insurance ceases at 65 years.

Until 1 July 2013, the Superannuation Guarantee was subject to an age limit of 70; however, this age limit has now been abolished.

The Age Discrimination Commissioner has noted that there is also increasing age discrimination in employment.<sup>9</sup> The practice leads to able and willing workers being pushed out of paid work before they are ready, and means that older Australians have difficulty finding work. For the period 1 July 2011 to 31 October

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<sup>9</sup> <http://www.humanrights.gov.au/news/speeches/age-discrimination-waste-human-resources-2012>

2011 complaints lodged about age discrimination increased by 4% compared to the previous reporting year. According to 2010 ABS data, one in five Australians aged 55 years or older who were actively looking for work claimed their age was a major factor preventing them from securing a job.

#### 4.4 Lump sums are not misused

Several studies indicate it is a myth that individuals spend their retirement savings and then revert to the state pension. Cerulli research shows that while Australia's baby boomers are entering retirement super assets aren't declining, which indicates retirees are leaving their money in their super.

#### 4.5 Mandatory annuities/pensions is poor policy

As the SG arrangements highlight, there are sound economic arguments in favour of compulsory retirement savings. One of the reasons for this is key market failures in private decisions around retirement income provision.

However, there are no "products" available that will compensate for an individual's failure to save enough for retirement.

Recently, a number of policy proposals have been made calling for the purchase of longevity risk insurance via lifetime or deferred annuities.

AMP does not support proposals for mandating income streams or annuities.

The reason for this is threefold:

1. It could change people's behaviour during the accumulation phase, and discourage voluntary savings – a critical component of superannuation adequacy (see paras 2.5).
2. The sense of 'ownership' of superannuation savings could be lost. A key feature of the Australian super system is the sense of ownership felt by members over their own retirement savings. If new rules restrict the use of those savings, Australians could see super as a less flexible investment option – or worse, as money 'locked up' and at the mercy of government.
3. It is important to note that just recently the UK Treasury proposed radical changes to the retirement income market by removing the compulsion to buy an annuity, thereby improving flexibility during the withdrawal phase.

While these concerns can be easily overstated, the point is that when it comes to voluntary retirement savings, the population's perceptions matter.

In considering proposals to mandate the purchase of annuities, the benefits of improved longevity risk protection for retirees need to be weighed against the potential for people to become less willing to make voluntary super contributions.

Australia would be foolish to pursue a mandating policy which is currently being reversed in other parts of the world.

#### 4.6 Alternative goals for the superannuation system

Super already has big, long-term goals that are in the national interest.

Moves to introduce new short-term policies into the super system should be avoided. In short, super should focus on ensuring retirement income adequacy.

If other policy goals arise, they should be dealt with in their own right. Using super to meet competing goals runs the risk of adding complexity and compromising adequacy.

##### ***Early access for housing***

A common proposal for the early release of super balances relates to assisting first home buyers with saving for a home deposit. Such a proposal usually involves the following broad features:

- access to super by first home buyers with the funds to be used as a deposit or part deposit on a residential property;
- eligibility subject to an income test based on current annual income, and a limit on the price of the home in question; and
- the amount withdrawn limited to some fixed dollar amount, or to a share of the person's superannuation balance. This withdrawal decreases the balance and does not have to be paid back.

Proposals of this kind are by no means new. Indeed, the Labor Party floated a very similar proposal more than 20 years ago in its 1993 election campaign launch, while during the 1996 election campaign the Coalition undertook to examine the full implications of implementing such a scheme.

However, such a policy has been resisted by policymakers in the past, because it not only undermines the important role played by preservation arrangements in reserving super savings for future retirement incomes, but also, the risks it involves outweigh the benefits.

##### ***Summary***

Our system works well, and if existing policy were to be continued, most Australians would be on track for an adequate retirement income.

However, the emerging trends of an ageing population, increased health care costs, increased longevity and a lift in retirement expectations are all putting pressure on the system. Accordingly, it might be necessary to fine-tune the system to ensure the optimal interaction between the three pillars, as well as minimise adverse interactions. Options for consideration should include:

- an increase in retirement age to 70;
- enhancement of measures to encourage voluntary savings; and
- no change to current SG policy

## 5. The financial system and infrastructure

### 5.1 The financial system and investment in infrastructure

The AMP Group, through AMP Capital, has significant experience with investment management. AMP Capital is one the largest investment managers in the Asia Pacific region with more than \$135 billion under management (as at 30 September 2013). We are Australia's longest established manager of infrastructure investments with more than \$6 billion of assets under management in the asset class. Our clients range from small retail investors through to large institutions. This means we have a deep understanding of infrastructure as an asset class from both asset management and investor perspectives.

Fundamentally, policies designed to invigorate investment in infrastructure must:

- increase the total level investment in infrastructure — in a period of constrained public funding, this means we must find ways to increase the attractiveness of new economic infrastructure to private sector investors; and
- ensure the funds are used efficiently – this includes maximising both the allocative efficiency of the use of those funds, i.e. by focusing on projects with higher leverage to economic growth, and delivery efficiency.

Institutional investors and superannuation funds are among the best potential sources of funds for increased total investment and have long been courted by governments to fund new infrastructure. However, greenfield economic infrastructure is not necessarily aligned with many investors' requirements.

It is possible to address this issue. AMP Capital recently identified and explored a potential model for the development of economic infrastructure in its submission to the Productivity Commission's Public Infrastructure Inquiry.<sup>10</sup> We submitted a model which better targets federal government support that can act as an effective catalyst for increased private sector investment. We considered:

- how to achieve better alignment between investment opportunities and investor requirements; and
- how this investor focus will require a revised model for the development of new economic infrastructure in Australia, if significant additional sources of private sector capital are to be mobilised.

Assistance along the lines we suggested should prove to be budget neutral, at worse, for the federal government. For the benefit of the inquiry, we refer to our other submission and outline our relevant findings here in summary. We welcome the opportunity to participate further in the inquiry's deliberations on these and related topics.

### 5.2 What drives investment in infrastructure?

Investment capital is not constrained by international boundaries. Institutional and superannuation investors have a fiduciary obligation to provide the best risk-adjusted returns to their clients irrespective of geography. This means that an investment in Australian infrastructure must be attractive from both risk and return

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<sup>10</sup> [http://www.pc.gov.au/\\_\\_data/assets/pdf\\_file/0016/132028/sub086-infrastructure.pdf](http://www.pc.gov.au/__data/assets/pdf_file/0016/132028/sub086-infrastructure.pdf)



perspectives on a globally comparative basis, otherwise local and foreign capital will be deployed in other jurisdictions.

Also, surveys have confirmed an increased interest from institutional investors generally in infrastructure investment<sup>11,12</sup>. According to these surveys, institutional investors are increasingly viewing infrastructure as an alternative to fixed income. Infrastructure is seen as a particularly good fit for pension funds and insurance companies, given their long duration liability profiles. This should be welcome news for Australian governments, provided the capital can come here.

The success of recent secondary market transactions in Australia, including privatisations, clearly demonstrates that institutional investors are particularly interested in mature assets. These transactions are characterised by quantifiable demand and future brownfield development risks. This suggests that newly developed economic infrastructure could be equally attractive to institutional investors if this risk profile could be matched. This would require a degree of de-risking these assets and the provide conditions for the re-emergence of specialist developers of economic infrastructure who would fill much the same role as property developers in taking the initial development risks. These developers could sell the asset, once it reached maturity, through secondary markets to institutional investors. As long as the project meets its planned performance objectives, the developer would realise a development profit and have the option of recycling their capital into new projects.

Removing impediments to secondary market transactions involving infrastructure assets would encourage the emergence of both developers of new economic infrastructure and long-term institutional investment. Consequently, this issue is consistent with the inquiry's objectives.

### 5.3 A new model for private sector development of economic infrastructure

Governments access the financial benefit of economic infrastructure through taxes on the resulting economic growth. Many existing economic infrastructure projects have demonstrated a high benefit-cost ratio. For example, the M7 toll road in Sydney, developed at a cost of \$1.35 billion, has a claimed benefit cost ratio of 3.4<sup>13</sup>. In contrast to government and the broader community, private sector investors in economic infrastructure assets can only rely on raising revenues directly, usually through tolling mechanisms. In most cases, these direct revenues are a fraction of the overall economic benefit created by the project, but must still be sufficient to meet financing and operating requirements for private sector ownership to be viable. The federal government's tax on GDP growth is around 24%, making it one of the major beneficiaries of such projects. This is much greater than the typical returns on investment available to private sector developers.

Even in cases where privately developed economic infrastructure fails to generate sufficient toll revenue to meet financing and operating costs, the overall economic benefits to the community may still far exceed the cost of developing the asset in the first place. If the project had not been built, neither the government nor the

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<sup>11</sup> Trends in Large Pension Fund Investments in infrastructure: OECD, 2012

<sup>12</sup> The 2013 Preqin Global Infrastructure Report

<sup>13</sup> Australian Government, Dept of Infrastructure and Transport; Infrastructure Planning and Delivery: Best Practice Case Studies; Dec 2010

community would benefit from taxes generated by increased economic activity or by the improved transport utility created.

This provides a rationale for government to assist in the development of projects which have a high excess economic benefit. Such assistance should not be open ended. A limit could reasonably be set to ensure that, even under adverse patronage outcomes, government financial support does not exceed the present value of the expected future tax revenues.

In recent times, the private sector has shown a marked reluctance to accept greenfield patronage risk in such projects, given the commercial failure of a number of high-profile toll roads. In all cases, commercial failure was the result of actual patronage failing to meet expectations. In the absence of public funding or private sector interest, many high-value projects will not proceed under current delivery models and their potential benefits to the community will remain unrealised.

Availability-based tariffs are an example of the financial support state governments have provided to some transport projects. In this approach, the government accepts patronage risk and provides an 'availability payment' to the project which is not linked to patronage levels. Availability payments have been utilised for some time in social PPPs and their recent use in toll roads is a logical extension. While they have been successful in attracting private sector developers, credit rating limitations also limit the amount of underwriting that state governments can provide through such mechanisms. An increase usage of this approach for economic infrastructure may then be at the expense of existing social infrastructure projects. State government sponsored availability payments, are, therefore, not a long-term solution to the problem of increasing the overall level of private sector investment in greenfield economic infrastructure.

Given governments' interest in having such projects proceed and the limitations in state government funding, an alternative approach would see governments (collectively) co-invest equity with the private sector in the development of high economic benefit projects. Assuming the federal government was willing to take a first loss equity position, the process could proceed along the following lines:

- State governments, or private entrepreneurs, would seek federal government support for projects with a high, independently reviewed, economic benefit-cost ratio as determined by a standardised methodology;
- The federal government would select the best projects based on economic benefit and the level of support required for development;
- For a state sponsored toll road, for example:
  - o the qualified project could be tendered by existing state-based authorities;
  - o target traffic volumes would be determined by the tendering authority with the tenderers providing a development price and target equity return based on this volume;
  - o the tenderer would also provide a minimum return on equity that it could accept in the event of lower than expected traffic volumes, together with the implied traffic volume at this level of return. This traffic volume would be known as the threshold volume;

- the tendering authority would calculate the level of assistance required to support this level of return; and,
  - the tenderer would provide details of patronage risk sharing mechanisms above the threshold and target volumes.
- Federal support would be provided up to the minimum of that required to support the threshold volume, or the maximum break-even level of federal support, as determined above; and
  - Any resultant gap could be plugged by additional state government support subject to the state's priorities.

The advantage of this model is that the party who receives greatest potential benefit accepts the major part of patronage risk, but also receives the greatest benefits if the project exceeds original expectations, while the tenderer still has a strong incentive to minimise development costs and, subsequently, maximise the benefit of the available securitisation.

After the project reaches maturity, both privately provided senior and federal sub-ordinated equity could sell their stake into secondary markets. We anticipate that the operational cash flows at this point would be sufficiently de-risked to be attractive to institutional investors.

Effectively, the proposed model:

- is expected to de-risk private sector patronage exposure sufficiently to attract private sector development capital;
- provides strong incentives to develop projects with the highest economic value, thus improving the allocative efficiency of the economy;
- allows the Federal Government to recycle its capital, preserving the government's overall budgetary position;
- effectively aligns the risk profile of mature economic infrastructure with institutional requirements; and
- most importantly, attracts significantly more private sector capital from institutional investors through the development of a deep secondary market for mature infrastructure assets.

#### 5.4 Improving conditions for infrastructure and nation building investment

Given that superannuation funds and other institutional investors are among the best potential sources of funds for increased total investment in infrastructure, it will be important for the inquiry to consider viable proposals to improve the attractiveness and efficiency of infrastructure investment for these and other investors. With the significant growth in the size of available investment capital and the return characteristics often sought by superannuation funds and institutional investors, access and efficiency of this capital will be critical for the efficient funding of Australia's growth. AMP Capital would propose in relation to infrastructure investment the following key principles:

- Although state governments have traditionally been the sponsors of new economic infrastructure, the federal government is the largest single economic beneficiary from the development of high value-add economic infrastructure projects;
- Targeted federal government assistance could attract significantly greater levels of private sector development capital into the development of economic infrastructure;
- Such targeted assistance would create a pipeline of mature projects which would be attractive to institutional investors;
- Removing impediments to the development of deep secondary infrastructure markets would also assist in attracting institutional investment into Australian infrastructure;
- The federal government could recycle a large proportion of its invested capital into new projects by accessing such secondary markets;
- Additional private sector investment in economic infrastructure can be achieved without cannibalising current levels of private sector investment in social infrastructure; and
- This stimulus can be achieved in a manner which is no worse than budget neutral from the federal perspective.

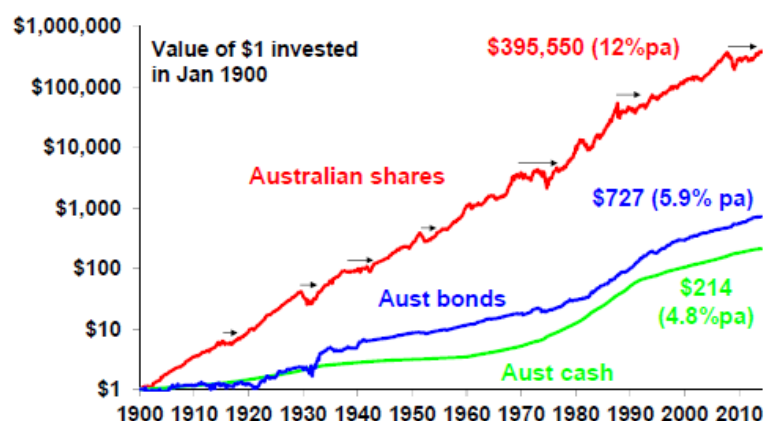
### 5.5 Why do Australian fund managers invest in equities?

Finally, the question is often asked as to why Australian fund trustees invest in equities, while overseas fund managers often prefer other asset classes?

There are two answers to this question.

First, the performance of equities has far outstripped the performance of other asset classes. Chart 5.1 below shows the performance of shares vs bonds and cash over 110 years. Equities have a compound growth rate of 12% over the period, well above that of cash and bonds.

#### Shares versus bonds & cash over very long term – Australia



Secondly, overseas superannuation policies have traditionally been more heavily weighted towards defined benefit (DB) schemes. Infrastructure, with its predictable cash flows is more suited to DB policies because of their more predictable income streams.

## 6. Enhancing Competition in the banking sector

### 6.1 A short history of bank capital regulation

The Basel Committee on Banking Supervision introduced new reforms known as Basel II in 2004. The goal of these reforms was to align capital adequacy assessment more closely with the key elements of banking risks.

Basel II retained the basic features of the Basle Accord (known as Basel I) and enhanced it with a range of approaches for determining capital requirements. Regulatory capital requirements were now calculated for the three major components of risk that a bank faces: credit risk, market risk, and a new risk, operational risk. Basel II assigned risk weights based on the quality of assets. The *standardised* approach allowed the use of external ratings or other simple measures to refine the risk weightings of a bank's assets. The *foundation internal ratings based* ('IRB') approach allowed banks to calculate the capital charges for each lending exposure from the bank's own estimate of the probability of default ('PD') and, in the *advanced* IRB approach the loss given default ('LGD') and the exposure at default ('EAD'). This advanced approach requires complex modelling and data aggregation, and can offer banks with the appropriate expertise the opportunity to derive significantly lower risk weightings for less risky assets (such as home loans), and significantly higher weightings for risky assets – subject to the approval of the bank's regulatory supervisor.

### 6.2 Introduction of Basel II in Australia

In June 2003 APRA wrote to Authorised Deposit-Taking Institutions (ADIs) advising that it intended to adopt the new Basel II Accord. In the communication, APRA advised that it expected the four major banks, as large internationally operating banks, to implement an IRB approach for credit risk, and that other locally incorporated less complex banks to initially adopt the standardised approach for credit risk. In September 2004 APRA again wrote to ADIs giving a timeline for Basel II implementation, including the transition periods from the original Basel Accord.

A hallmark of the Australian Basel II implementation between 2004 and 2009 was the conservative approach adopted by APRA in a number of areas (as noted in the November 2009 IMF Basel II Implementation Assessment). For example, under the advanced IRB approach a 20% LGD floor was adopted for residential mortgages, above the Basel II floor of 10%, and for ADIs under the standardised approach higher risk weights were required for certain residential mortgages.

The IMF assessment also highlighted that unlike that of other jurisdictions, APRA's prudential standards restricted an ADI's choice of methods should they want to move to an advanced IRB approach. In particular, APRA do not allow an ADI to use an advanced approach for one risk class in isolation (market risk, credit risk, or operational risk); rather they must use an advanced approach across all risk classes or remain standardised. This requirement potentially imposes a cost and resource burden on smaller ADIs who would prefer to use an advanced approach for only one risk class, for example credit risk.

### 6.3 Capital regulation and improving competition

Allowing standardised ADIs to use the advanced approach for one risk class could improve the competitive position of smaller ADIs, particularly those that only participate in lower risk residential lending. This could be through two outcomes:

- a more effective allocation of the ADI's capital pool, allowing for additional lower risk residential lending off the same capital base; and
- a lower allocation of capital, and therefore a lower absolute capital cost per loan, translating into more competitive per loan customer pricing.

#### 6.4 Other considerations – too big to fail

While the Australian economy has benefited from financial stability stemming from strong bank supervision, the concept of higher capital requirements for systemically important banks should be considered. The significant market share of the four major banks means they could be considered 'too big to fail' and that their failure would potentially pose a fiscal risk.

# Superannuation and the Future Financial System

AMP

31 March 2014

# Contents

Executive Summary .....	i
1 Australia's ageing population .....	1
1.1 Demographic challenges .....	1
1.2 Policy challenges .....	7
1.3 The role of super .....	16
2 Adequacy of the super system.....	20
2.1 Projected outcomes for today's workers.....	20
2.2 The role of voluntary savings .....	22
2.3 Changing expectations of retirement .....	26
3 Sustainability of the super system .....	36
3.1 The cost of tax concessions in super .....	36
3.2 The importance of policy stability.....	41
3.3 Tackling longevity risk .....	43
3.4 Alternative goals for the super system .....	44
Limitation of our work.....	48

# Charts

Chart 1.1 : Age shares of the Australian population by gender .....	2
Chart 1.2 : Projected age dependency ratios for Australia .....	3
Chart 1.3 : Projected life expectancy at birth – 25 year improvement scenario .....	4
Chart 1.4 : Changes in life expectancy at birth and at age 65.....	5
Chart 1.5 : Projected life expectancy at 65 – 25 year improvement scenario .....	6
Chart 1.6 : Labour force participation rates.....	8
Chart 1.7 : The rate of retirement from the Australian workforce .....	10
Chart 1.8 : IGR projections of age related pension recipients .....	11
Chart 1.9 : Real total maximum periodic pension payments – 1950 to current.....	12
Chart 1.10 : IGR projections of spending on age and service pensions .....	13
Chart 1.11 : Relative health spending per person.....	14
Chart 1.12 : Projected Federal deficits and labour force participation.....	15
Chart 1.13 : Super assets at 30 June – ratio to nominal GDP.....	18
Chart 1.14 : Projected super benefits as a share of assets at retirement.....	19
Chart 2.1 : Projected average annual retirement income by source– Jun 07 to Dec 12 .....	21

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Chart 2.2 : The AMP Retirement Adequacy Index – Dec-07 to Dec-12.....	22
Chart 2.3 : Breakdown of average net retirement incomes by source – Dec 12 .....	23
Chart 2.4 : Net retirement income sources, by age .....	24
Chart 2.5 : Net retirement income sources by income decile .....	25
Chart 2.6 : Average age at retirement by year of retirement .....	27
Chart 2.7 : Retirement intentions in 2004-05 and outcomes in 2012-13 .....	28

## Tables

Table 1.1 : Period and cohort life expectancies – 2005-07 .....	7
Table 2.1 : Comparison of Incomes.....	31

# Executive Summary

## Population ageing

### Population ageing is a major challenge for Australia

- As the original *Intergenerational Report* (IGR) made clear a decade ago, coming increases in life expectancy mean Australia's population is ageing – with implications for labour force participation and economic growth:
  - The share of population aged over 65 rose from 12.7% to 14.4% in the past decade, with the rate of increase projected to grow in coming years. By 2050 the share will be 20%.
  - The age dependency ratio – the share of adult population over 65 is expected to rise from 22% today to 32% by 2050.
  - Each person of retirement age is currently supported by 4.6 people of working age; by 2050 this ratio will have fallen to 3.1.
  - Labour force participation – the share of adults in the labour force – peaked in 2009-10. It will fall from 65.3% today to 63.7% by 2050.
- Population ageing is due largely to increases in life expectancy:
  - The average boy born today can expect to live 9 years longer than his father did, the average girl 7 years longer than her mother.
- Older Australians in particular are predicted to continue living longer. That has implications for the makeup of Australia's retiree population:
  - In 2010, Australians aged 85+ made up 13% of Australians of age pension age.
  - By 2050, this figure will rise to 22%.

### That challenge has been growing

- Increases in life expectancy have been outpacing the predictions of the experts.
  - The 2002 IGR predicted life expectancy at birth in 2042 of 82.5 for men and 87.5 for women. Just eight years later, the 2010 IGR predicted life expectancy at birth would reach 86.1 for men and 89.2 for women by the year 2040.
  - That is, official expectations of life expectancy were adjusted upward by more than 5 months per year for men and 2.5 months for women over the 8 year span between the first IGR in 2002 and the latest report in 2010.

### And its effects are already being felt

- At the time of the 2002 IGR it was easy to dismiss population ageing as a problem for the future. In reality, the economic effects of ageing are already being felt:
  - In trend terms, Australia's participation rate peaked in 2009-10 at 65.6%, with the timing of the latter more or less matching the prediction in the 2002 IGR. In that year, someone born in the middle of the baby boom in Australia would have turned 56, and the oldest of the baby boomers were turning 65.

- This year marks the 54<sup>th</sup> birthday of those born in 1960 – the last year of the baby boom. That will see Australia facing the sharpest impacts of ageing on labour force participation over the next ten to fifteen years.

## **Policy implications of ageing**

### **Ageing will affect government budgets**

- As successive IGRs have noted, Australia's ageing challenge means Federal Governments are facing a 'quantity' challenge in coming decades, as older Australians receive greater levels of government spending on both pensions and health care.
- At the same time, the Budget will be under further pressure from a 'price' challenge, as newer and more expensive treatments become available in health and aged care:
  - Even without an ageing population, these effects are expected to see Australian government health spending per person increase by 2.9% a year in real terms over the next four decades.
- Similar effects are facing State Governments, who are also facing higher health related costs.

### **But it will also mean higher costs for households**

- Yet this isn't only about public finances: family finances are affected too.
- Individuals already face a range of age-related private health care costs, including private health insurance and co-payments linked to the public health system.
- At the same time, cash-strapped governments will be looking to older Australians to fund a greater share of their own retirement income and health care needs.

### **Super can help to deal with these challenges**

- Australia's superannuation system is designed to help meet some of the enormous challenges associated with ageing by:
  - Reducing age pension outlays.
  - Providing private income to help fund increased provision of health and aged care.
  - Assisting Australians to achieve their own retirement income goals.
- As a policy, super has ambitious goals and long time horizons. The system remains relatively young, and its importance in funding retirement incomes will continue to grow over time.

### **At a cost to revenue that is lower than the headline figures suggest**

- Treasury regularly measures the tax expenditures associated with current super incentives.
  - The latest estimates for 2013-14 show annual tax expenditure costs in super of \$32 bn.
- Yet the 'true' cost of super to the tax system is likely to be much lower than that. In practice behavioural change combined with concessional or deferred capital gains outside of super would limit the revenue gained from abolishing super incentives.

- After accounting for such behavioural change, Treasury estimates the ‘revenue gain’ from removing current super concessions at \$28 billion.
- Alternative approaches to measuring current tax expenditures from super start from similar foundations but produce very different results, reflecting the immature nature of the superannuation system.
  - Using a ‘pre-paid’ expenditure tax benchmark, the Henry Review estimated costs in 2007-08 would have been around \$5 billion in 2007-08. That would mean an estimate for the cost of tax concessions to the super system in 2013-14 of more like \$6 billion.
  - Using a ‘post-paid’ expenditure tax benchmark, the cost would be lower still.
- Superannuation also has a payoff for Federal (and State) Governments via lower age pension and associated payments. This not accounted for in the cost estimates in the Tax Expenditures Statement.

## Super policy settings

### Current settings are broadly consistent with adequate retirement incomes

- Importantly, ever since the *AMP Superannuation Adequacy Index* began in 2007, it has remained above the benchmark 65% that is considered an ‘adequate’ retirement:
  - Over that time a number of factors have boosted adequacy: increases in the Super Guarantee (SG), increased asset values outside of super (particularly investment property), and increases in the aged pension.
  - At the same time a number of policy and behavioural factors have had offsetting influences on adequacy, meaning the overall trend has been broadly flat.

### But the 12% SG alone is not enough to ensure adequacy for everyone

- A 12% SG rate does not ensure that everyone will have adequate retirement savings.
  - Our *AMP Super Adequacy Index* analysis shows that the SG alone would provide today’s workers with around 60% of what’s needed for adequate retirement incomes.
- Voluntary savings both inside and outside super are vital to projections of broadly adequate retirement incomes. Without them, system-wide estimates of adequacy would fall short. Those who don’t save voluntarily are falling behind on their retirement incomes:
  - Salary sacrifice and after tax contributions account for around 11% of projected net retirement income, of today’s workers.
  - Savings outside of super (other than business assets and the family home) will account for a further 21%.
- That is particularly true for higher income earners, where voluntary savings account for a significant share of projected retirement incomes:
  - While voluntary savings make up 11% of projected retirement incomes, they represent 14% of retirement incomes for workers on above-median incomes (and almost 20% for the richest 10% of workers).

### **Super should stay focused on its goals**

- Super already has big, long term goals that are in the national interest.
- Moves to introduce new short term policies into the super system should be avoided. In short, super should stick to its day job. That includes avoiding policies aimed at:
  - Allowing ‘early access’ to super, including for housing- and health-related costs.
  - Directing the investment decisions of super funds to support anything other than the best interests of members.
- In general, if other policy goals arise, they should be dealt with in their own right. Using super to meet competing goals risks both adding complexity and compromising adequacy.

### **Super has clear goals, it needs clear rules**

- To meet its long term goals, and to attract voluntary savings, the super system needs the confidence of the public. Constant changes to policy have undermined that confidence.
- Given the nature of the political debate, an independent umpire may be appropriate to oversee the operation of the super system and, consistent with the aims of the policy, to ensure the rules are as simple and as stable as possible over time.

## **Expectations of retirement are changing**

### **Retirement isn’t what it used to be**

- Retirement itself is changing, with the idea of a black and white line between work and old age rapidly becoming a thing of the past.
- Survey evidence from the ABS shows that Australians are staying on longer at work:
  - Not only are Australians retiring later than they used to, on average they are retiring later than they expected to a few years ago.
  - Among those aged 45 and over who are still working, almost one in five now plan to work beyond their 70<sup>th</sup> birthday.
- Australians are increasingly embracing the relatively new approach of stepping down from full time work to part time work before leaving the workforce entirely:
  - 40% of the over 45s surveyed by the ABS and working full-time indicated they intended to move to part time work before retiring.
- Retirement is also becoming less ‘final’, with many who had considered themselves retired now find themselves returning to paid work.

### **Future retirees have high expectations.**

- With the retirement of the baby boomers, expectations of retirement are shifting rapidly.
- With longer, healthier lives today’s workers expect to enjoy a similar lifestyle in retirement to the one they enjoy now.

- That includes the sorts of activities and spending that aren't open to many of today's retirees – such as regular travel within Australia and overseas, as well as buying and maintaining a new car.

### **But is retirement income policy ready to meet those expectations?**

- Many Australians have unrealistic expectations that mandatory super contributions alone will mean they are self-sufficient in retirement.
- Recent experience shows many Australians who had expected to be self-funded retirees have, in fact, become reliant on the pension in retirement.
  - ABS data show that, of those who retired between 2004-05 and 2012-13, less were mainly self-funded at retirement than had expected to be when surveyed in 2004–05.
- Estimates from the *AMP Superannuation Adequacy Index* show that today's higher income workers face the largest relative decline in living standards when they retire.

### **Australians want super to do more**

- Super is already aimed at meeting big policy targets, and it is still maturing over time.
- Yet while the super system slowly grows to meet the policy targets of today, there is a risk that rising expectations mean it will fall short of the expectations of tomorrow.

If super is to meet the rapidly changing expectations of members, policy will need to keep pace with changes in community attitudes to retirement.

### **Deloitte Access Economics**

# 1 Australia's ageing population

It is now well known that Australia has an ageing population structure. While general improvements in health have lifted traditional measures of life expectancy and helped boost population, two additional factors will have a dramatic effect on the number of older Australians over time:

- Particularly strong improvements in health and the resultant falls in specific mortality rates for older Australians, and
- The continued move of the demographic bulge of the baby boomers into and beyond retirement age – a factor that has only just begun to have any real economic impact.

In raw terms the numbers are stark. Over the next forty years the number of Australians aged 85 and over will go up by a factor of 4 – with a larger factor (close to 5) for men, and around 3½ times for women.

Yet it is the broader implications of this trend for government finances and public policy more generally which are of greater concern.

## 1.1 Demographic challenges

The forces of demographic change move slowly, but can have a notable impact on the makeup of Australia's society and economy over time.

The joint challenges of structural population ageing and increased longevity are central to the policy objectives of super, and we explore them in turn below.

### 1.1.1 Population ageing

Population ageing has been identified as a looming challenge for Australia over many years now.

As the three iterations of the Federal Treasury's Intergenerational Report (IGR) have made clear, Australia's population is ageing – with unprecedented change in the demographic structure of the population having significant implications for economic growth and public finances over coming years.

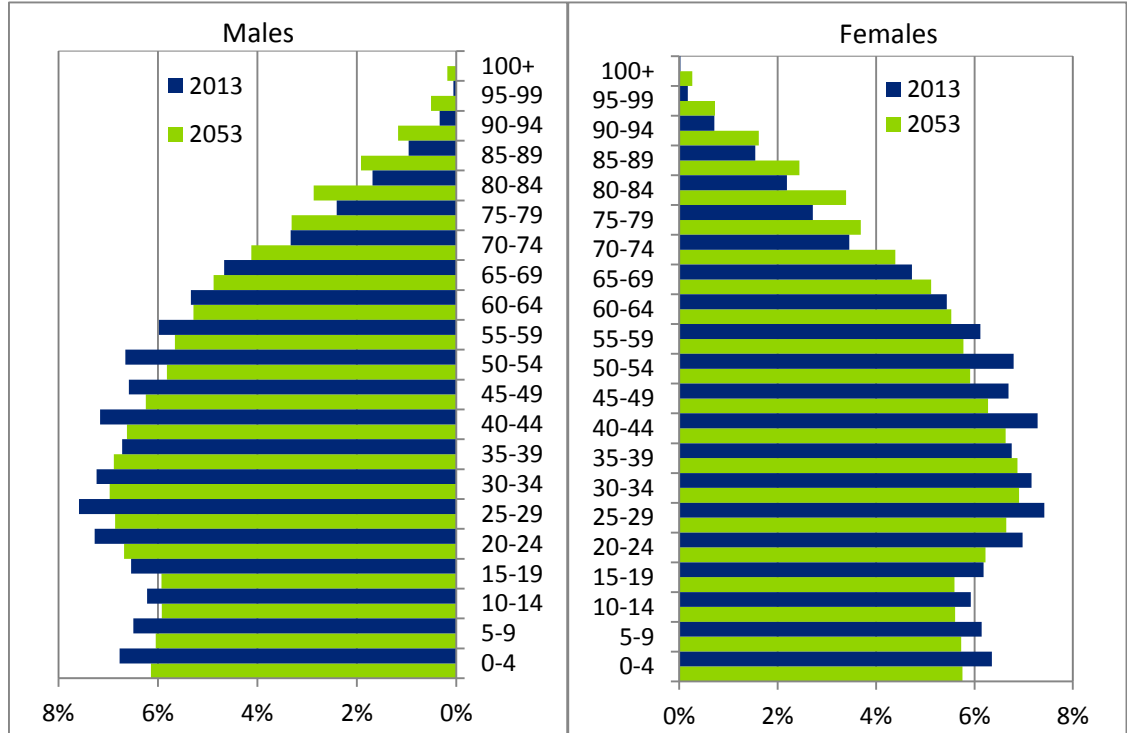
Due in no small part to the very strong rate of migration into Australia, and the relatively young demographic structure of these migrants, Australia does face a much smaller challenge than many countries, such as Japan, the countries of southern and eastern Europe and even China, where very rapid increases in the relative number of older persons in their populations are now all but certain.

Even so, changes in the structure of the Australian population will reshape both the economy and society over coming decades.

The share of population aged over 65 rose from 12.7% to 14.4% in the past decade, with the rate of increase projected to accelerate until the end of the decade.

As Chart 1.1 shows, the share of the population in older age groups will increase dramatically over the next five decades, with relative growth strongest among the oldest age groups – those aged in their 80s, 90s and beyond.

Chart 1.1: Age shares of the Australian population by gender



Source: Deloitte Access Economics projections based on ABS data

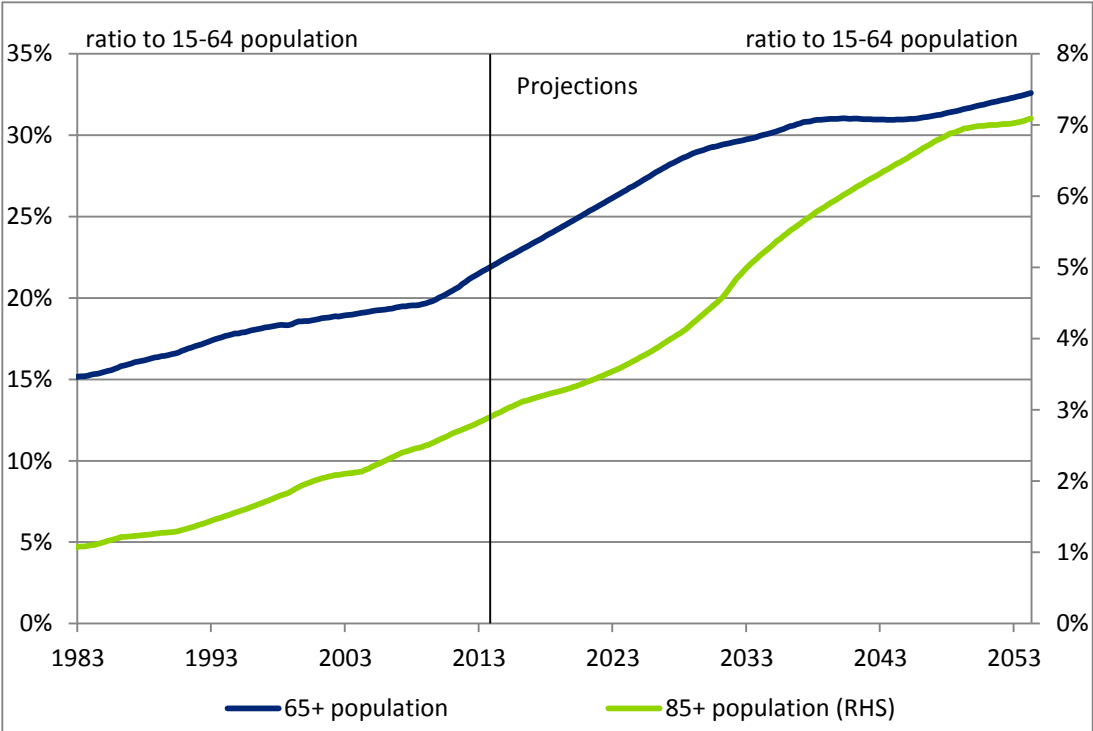
As a result of these trends, the age dependency ratio – the number of persons aged 65 and over for each person aged 15 to 64 –has increased from 19.0% to 21.6% across the last decade.

As seen in Chart 1.2 below, that ratio is projected to reach 31.8% by 2050.

That is, **each working age person currently supports just under 3 retirees, yet by 2050 they will each need to support closer to 5 retirees.**



Chart 1.2: Projected age dependency ratios for Australia



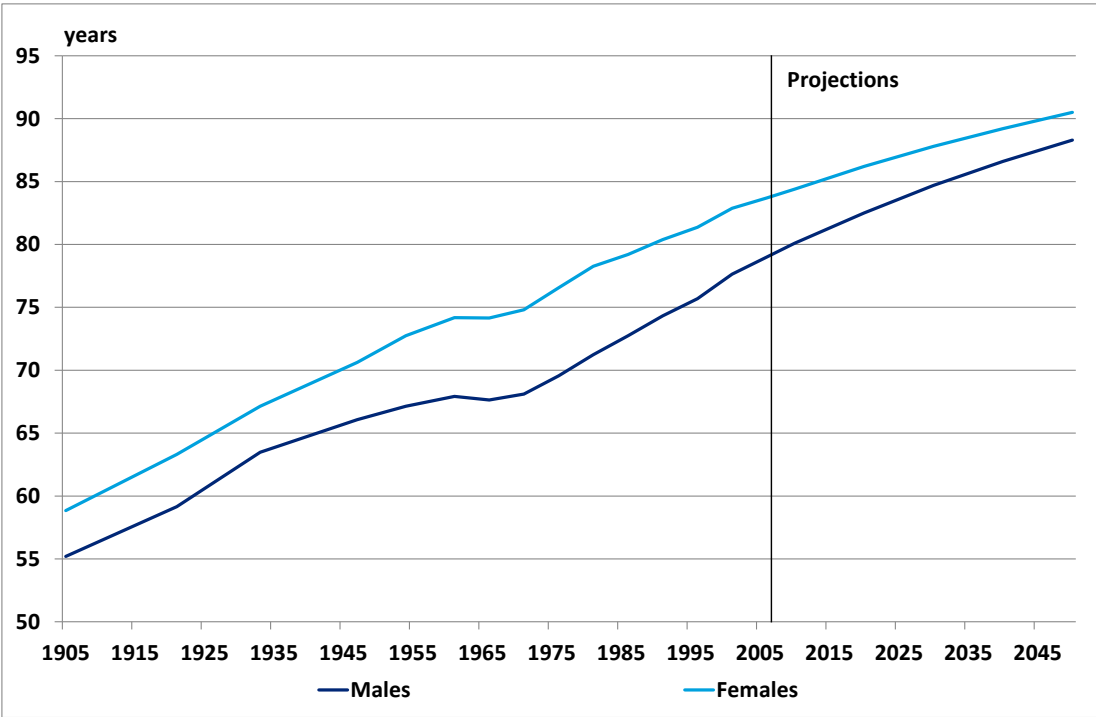
Source: Deloitte Access Economics projections based on ABS data

1.1.2 Changes in life expectancy over time

Structural ageing of the population has been driven by a combination of a sharp rise in birth rates in the years following 1945, a sharp decline in rates from the early 1970s and sustained (and continuing) declines in mortality rates over time.

The crudest possible measure of the latter trend is highlighted by Chart 1.3, which shows the life expectancy at birth for males and females in Australia over the past century. While this is the generally quoted figure for life expectancy, it needs to be remembered that it is a measure of how long a person would be expected to live if they showed the some mortality profile at each age as people who are currently that age – that is, it assumes that when the child born today is 50, they are just as likely to die as 50-year-olds are at present, implying they will not benefit from any medical breakthroughs that may occur across the next half century.

Chart 1.3: Projected life expectancy at birth – 25 year improvement scenario



**It is therefore not surprising that, while the trend of increasing life expectancies has been known for some time, the pace of change in recent years has tended to surprise even the experts.**

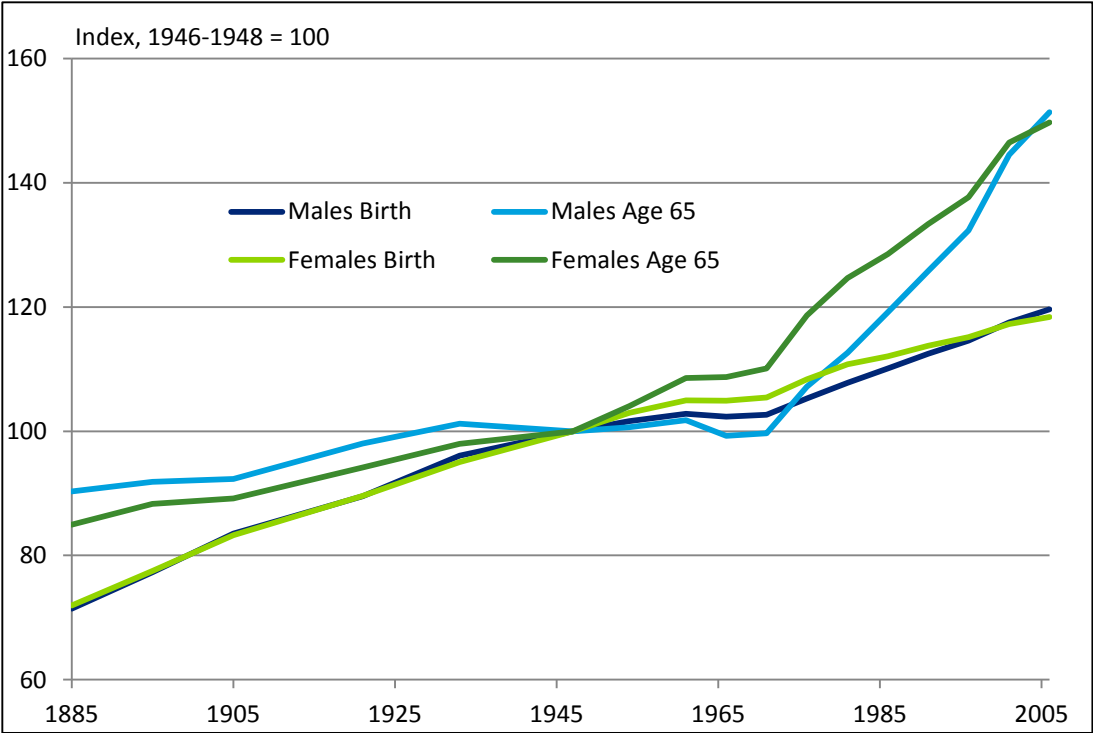
In 2002, the first IGR predicted life expectancy at birth in 2042 of 82.5 for men and 87.5 for women. Just eight years later, the 2010 IGR predicted life expectancy at birth would reach 86.1 for men and 89.2 for women by the year 2040.

That is, official expectations of life expectancy were adjusted upward by more than 5 months per year for men and 2.5 months for women over the 8 year span between the first IGR in 2002 and the latest report in 2010.

The underlying cause of this continued upward revision in expectations is the changing cause of health improvements. While earlier increases in life expectancy were driven primarily by major improvements in child and maternal mortality rates brought on by advances in disease control and broader public health measures such as basic hygiene, much of the change in longevity over recent years has been focused on improvements in the health of older Australians.

Chart 1.4 compares the relative movement in life expectancy at birth with that of life expectancy at age 65 over time.

Chart 1.4: Changes in life expectancy at birth and at age 65



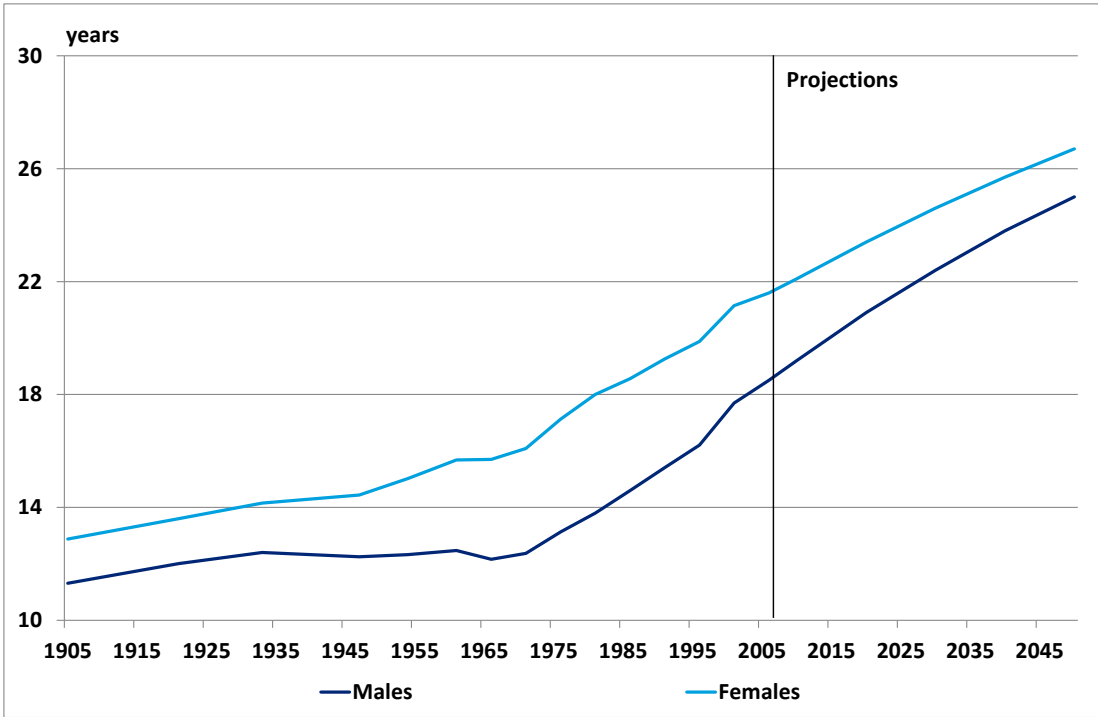
Source: Australian Government Actuary, Deloitte Access Economics

It shows a long period prior to the Second World War when gains in life expectancy among older Australians lagged those of the population at large.

In more recent decades however, life expectancy among older Australians has been rising more quickly than for the population as a whole – particularly among men.

Chart 1.5 shows projected life expectancy at 65 if historic improvements in mortality were to continue.

Chart 1.5: Projected life expectancy at 65 – 25 year improvement scenario



Source: Australian Government Actuary

If the more recent 25 year improvement experience is used, much of the increase in overall life expectancy will flow through to life expectancy at 65.

The latter is a reminder that while Australians will be living longer, those extra years are largely being gained at the end of our lives – meaning Australians are not merely living longer, but also spending a greater share of their lives at older ages.

The life expectancies presented above are period or cross-sectional life expectancies. They are calculated from current information about the entire population of each gender, and do not allow for improvements in mortality over an individual's lifetime.

Estimating the longevity of an average Australian requires the construction of a cohort life expectancy – a slightly different measure which allows for improvements in mortality over an individual's remaining lifetime.

Table 1.1 reports these two measures for males and females of different ages based on the 2005-07 Australian Life Tables.

**Table 1.1: Period and cohort life expectancies – 2005-07**

		Period life expectancy	Cohort life expectancy	
			100 year improvement	25 year improvement
<b>Males</b>	<b>At birth</b>	79.0	85.6	91.8
	<b>At age 30</b>	50.2	53.9	58.6
	<b>At age 65</b>	18.5	19.4	20.6
<b>Females</b>	<b>At birth</b>	83.7	90.2	93.5
	<b>At age 30</b>	54.4	58.4	60.9
	<b>At age 65</b>	21.6	22.7	23.5

Source: Australian Government Actuary

It shows that, while life expectancy stood at 79 years for men in 2006, a man born in that year could expect to live almost 22 years longer than that if the mortality trends of the past 25 years were to continue.

Similarly, while the standard life tables would suggest males aged 65 in 2006 could expect an extra 18.5 years of life (that is, expect to live to 83.5), if mortality rates continue to decline in line with the past 25 years, a more accurate expectation would be for an additional 2.1 years of life – meaning the actual average life expectancy might be 11% longer than commonly believed.

This difference is highly significant, particularly when attempting to plan to fund this additional period of life.

## 1.2 Policy challenges

Life cycles can be usefully divided into three: childhood, working age and retirement. These three ages of life are important because, as a society, we treat them differently.

In essence every society makes an intergenerational compact with itself. Society subsidises investment in children through both health and education costs, and also subsidises retirement, by paying pensions to the less well-off and by subsidising the healthcare costs of the aged.

Society pays for these subsidies to the young and the old by taxing the incomes of workers. There is therefore a budget balance over the life cycle, as workers subsidise the young and the old.

However, as the Australian Government's Intergenerational Reports (IGRs) have effectively noted, key quantity and price effects will change the nature of Australia's current intergenerational compact with itself.

Structural ageing of the Australian population will have a dramatic impact on both the economy and the Federal Budget:

- **Economic growth will slow** as a smaller share of the community will be of working age, reducing overall workforce participation.
- **Government finances will come under pressure** as pension and health care subsidies extended by society to the aged will be more substantial in the future than they are at the moment.

### 1.2.1 Economic growth

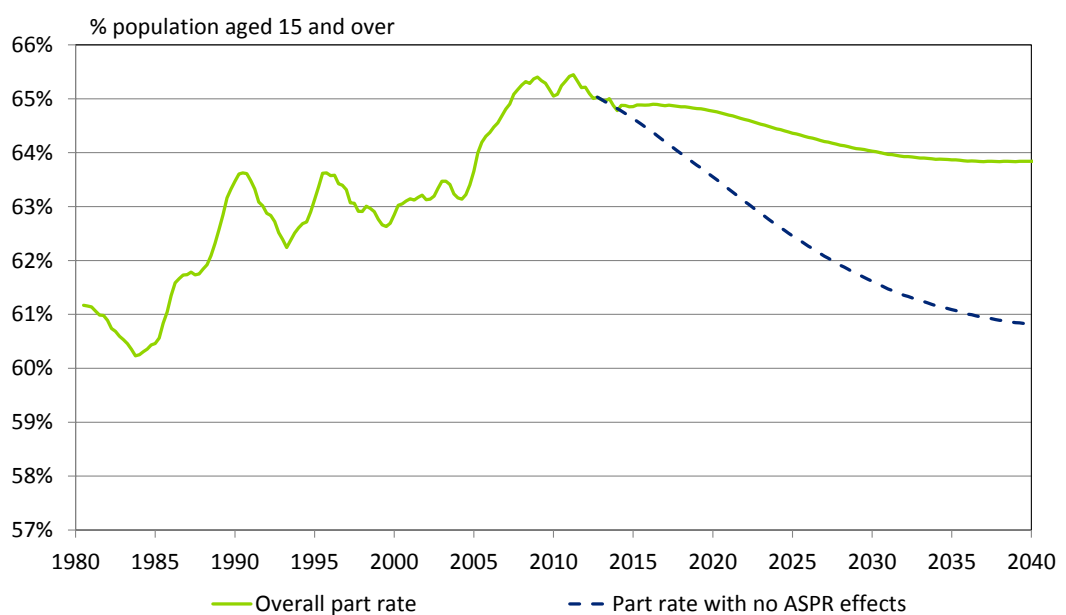
Economic output – or the size of the national ‘pie’ – has three basic drivers:

- **Population:** How many people there are in the economy.
- **Participation:** How many of those people choose to work.
- **Productivity:** How much each of those workers can produce.

In one sense, population provides a basic proxy for underlying demand growth in the economy. The supply growth implied by those overall population numbers will depend on how many Australians seek work in coming decades.

Overall participation rates are traditionally defined as the share of those in the working age population (those aged 15 and over) who are in work or looking for it. Projections indicate that increasing rates of retirement among baby boomers will see Australia’s participation rates fall over time (see Chart 1.6 below).

**Chart 1.6: Labour force participation rates**



Source: Deloitte Access Economics

It should be noted that while rates are expected to decline, the situation will be far more dramatic if participation rates for older Australians remain static. The lower line in Chart

1.6 shows the effect on overall participation rates if current age-specific participation rates (ASPRs) were to remain unchanged into the future.

That might drive a decline four times as great as currently expected across this period – pushing participation rates back to early 1980s levels.

For a long time rising retirement ages put off the inevitable impact of ageing on Australian job markets (and our economy). But the participation rate peaked back in late 2010 – a key moment in Australia’s demographic destiny – and the trend has been downhill ever since.

At the time of the 2002 IGR it was easy to dismiss population ageing as a problem for the future. In reality, **the economic effects of ageing on the Australian economy are already being felt:**

- In trend terms, Australia’s participation rate peaked in 2009-10 at 65.6%, with the timing of the latter more or less matching the prediction in the 2002 IGR. In that year, someone born in the middle of the baby boom in Australia would have turned 56, and the oldest of the baby boomers were turning 65.
- While falls so far have been marginal, 2014 will see the 54th birthday of those born in 1960 – the last year of the baby boom. That will see Australia facing the sharpest impacts of ageing on labour force participation over the next ten to fifteen years.

Even after factoring in expected increases in retirement ages, the next phase of retirements among baby boomers will have a substantial impact on the Australian labour market.

In the last quarter of a century, about one in every 75 workers retired every year. But that rate crept up to one in 70 workers over the last five years, and will accelerate further to one in every 55 workers in the next three years.

Chart 1.7 shows the projected rate of retirement from the Australian workforce.

**Chart 1.7: The rate of retirement from the Australian workforce**

Source: Deloitte Access Economics *Employment Forecasts*

It highlights that following a period of postponed retirement for some workers due to a combination of strong economic conditions over the first decade of this century and the impact of the GFC on retirement savings, the boomers are now leaving the workforce in droves.

The effect will be most pronounced through to 2020, with the rate of withdrawal from the labour force rising from a low of 1.2% per year to 1.8% per year by early next decade. The impacts on participation from the changes in the past five years have already been significant. However, Chart 3 implies that **these impacts will not just continue, they will accelerate sharply** across that period before stabilising around the middle of the next decade.

Note that these projections include an assumption that the current generation of workers will remain in employment for longer than they have in the past (that is, retirement ages will keep rising) and that migration levels (which help to offset some of these effects) will remain at or above current levels. If either of these assumptions is not achieved, then the impacts on labour supply would be even more dramatic.

To that impact of ageing on likely numbers of workers may be added the effect of the expected slowing in overall population growth, with both factors implying that the first two 'Ps' – population and participation – will wane over coming decades.

### 1.2.2 Income support for the aged

Income support for Australian retirees is currently the largest single expense item in the Australian Government Budget.

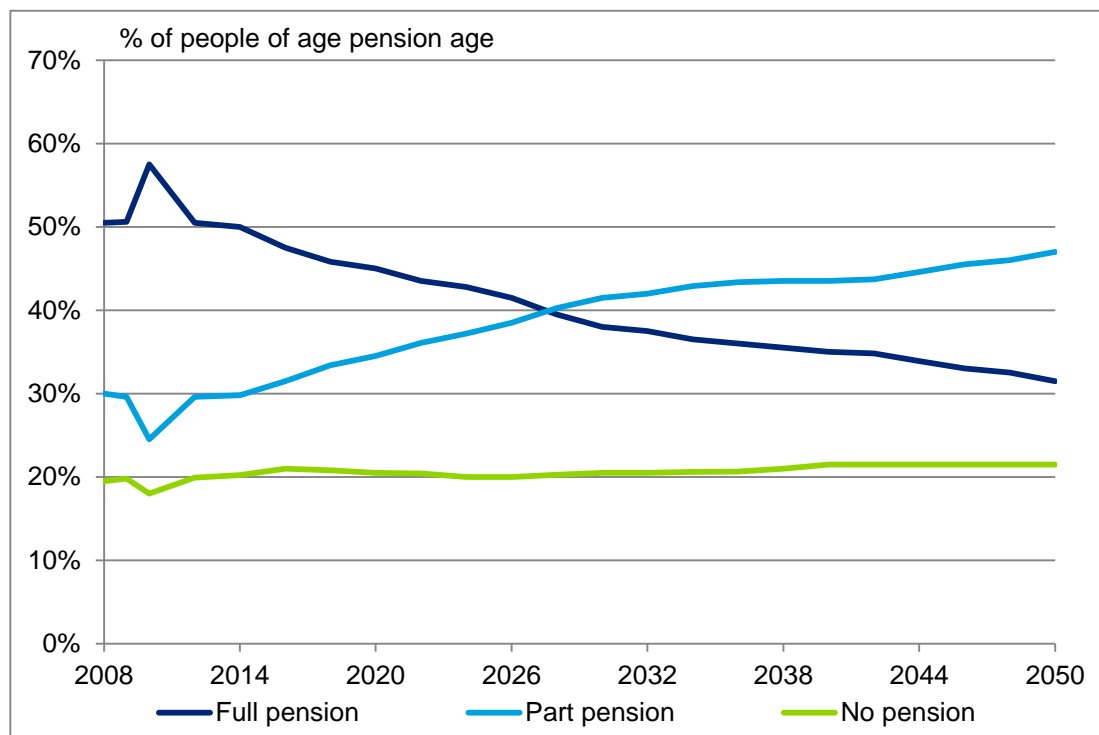


With the number of Australians of age pension age set to grow rapidly as the population ages, that spending is likewise facing a period of strong and sustained growth.

While the operation of the super system will act to contain this spending over time, the relationship between private savings and the government safety net is a complex one, aiming to strike a balance between incentives to save through super and individual responsibility.

Official projections contained in the latest IGR show that, even after accounting for the maturing super system, more than three quarters of retirees will continue to receive government support through the age pension in future years (as seen in Chart 1.8 below).

**Chart 1.8: IGR projections of age related pension recipients**



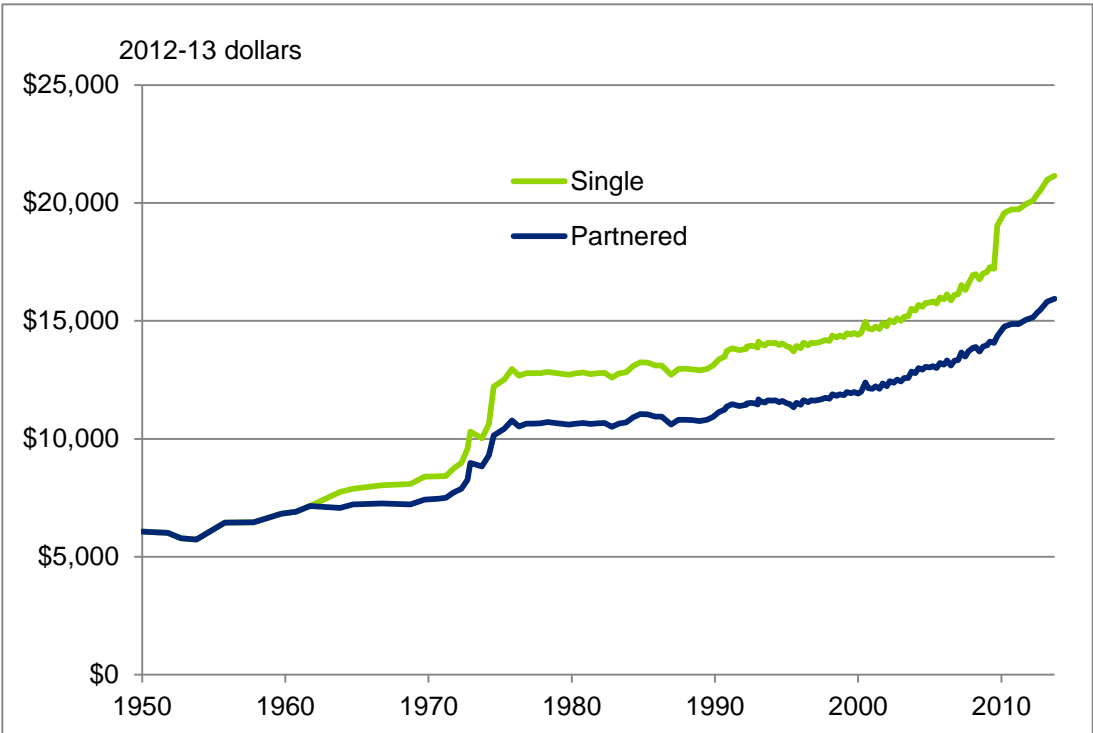
Source: IGR 2010

Adding to effect of increases in the retiree population over time is the operation of indexation arrangements for Australian Government pensions, which effectively see the latter increase with wages, rather than prices, over time.

Not enough people realise that “growing with wages” may not be affordable from a budgetary viewpoint. The retirement of the boomers means that the average Australian will be less likely to work in coming decades. In turn, that means the income of the average Australian will grow by less than wages, while that of an increasing number of pensioners will grow in line with them.

This is illustrated by the recent growth in the real value of the maximum periodic pension payment, which is shown in payments

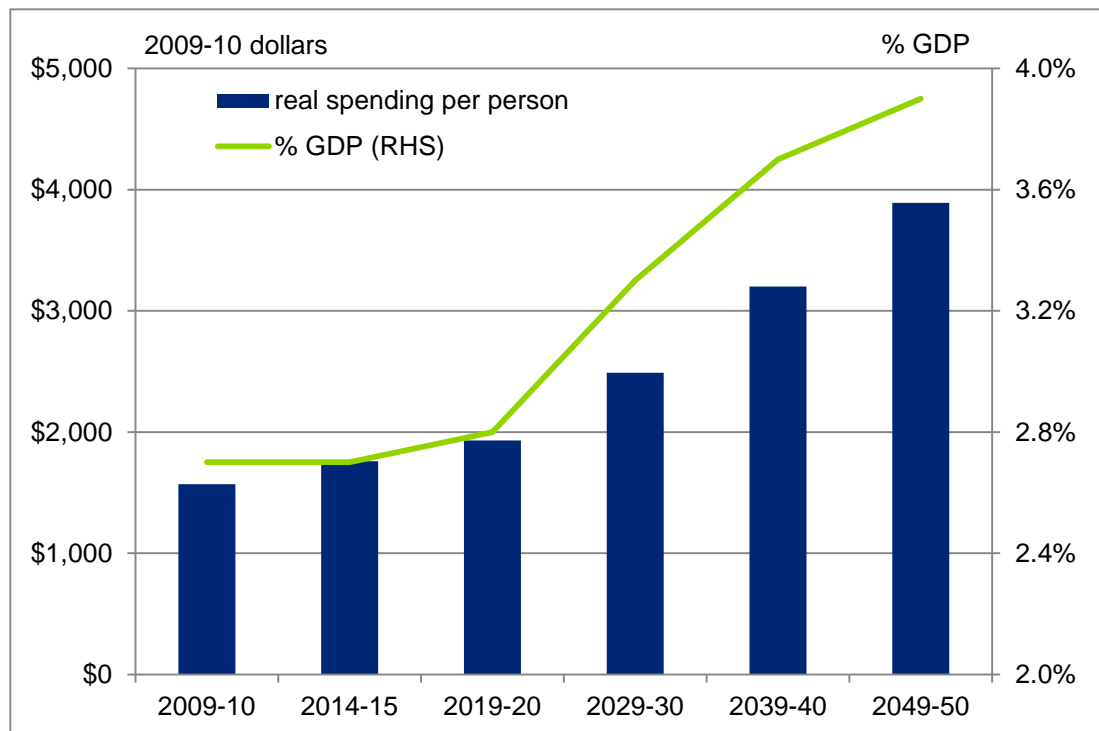
Chart 1.9: Real total maximum periodic pension payments – 1950 to current



Source: FaCHSIA, ABS 6401.0, Deloitte Access Economics

Combined with population ageing, the latter effects mean spending on age related pensions is projected to grow substantially faster than economic output over coming decades.

Chart 1.10 shows the latest IGR projections of age-related pension payments, which include the effect of the coming increase in the qualifying age for the pension to 67 years beginning in 2017.

**Chart 1.10: IGR projections of spending on age and service pensions**

Source: 2010 IGR

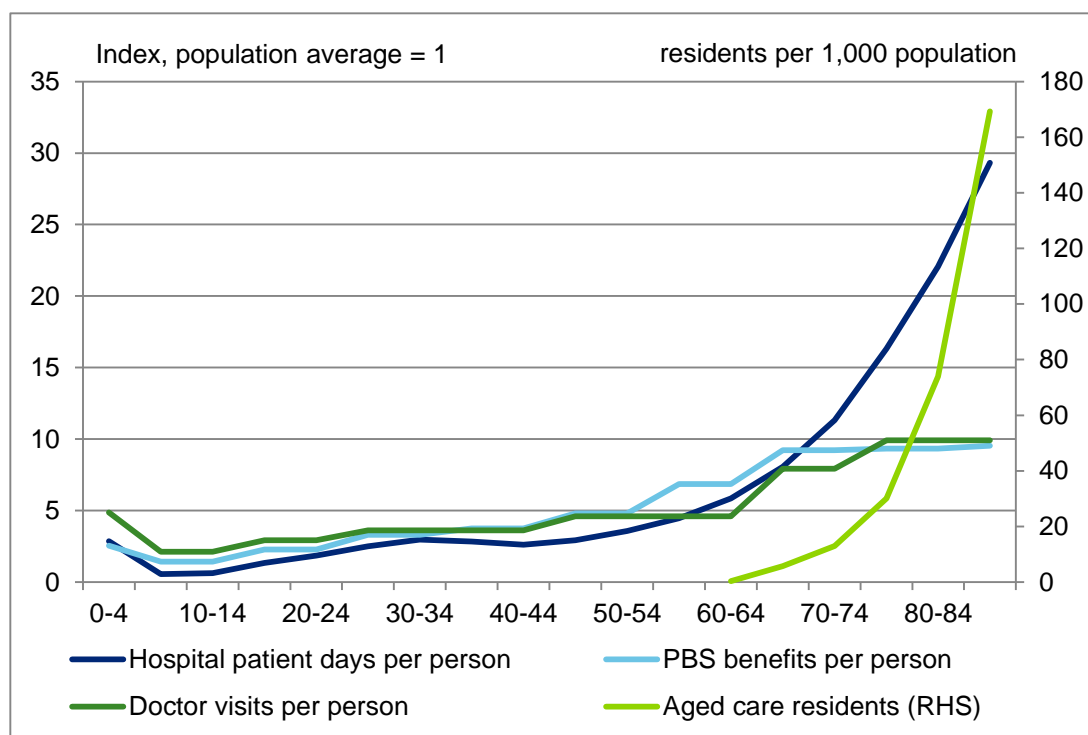
It shows substantial fiscal challenges remain as a result of increased pension payments to older Australians in coming decades, with the share of the nation's income devoted to age and service pensions increasing substantially through to 2049-50.

### 1.2.3 Health and aged care

Another key area of demographic pressure on government finances comes through funding of health and aged care – both of which are heavily weighted toward older Australians.

Health and aged care spending are under pressure on two fronts:

- **From a 'quantity' challenge** due to Australia's ageing population. Older Australians have more substantial health and aged care needs (as seen in Chart 1.11 below), and these groups will be growing fast relative to the number of workers.
- **From a 'price' challenge.** The costs of delivering the latter have tended to rise more quickly than other costs in the economy over time due in part to advances in technology and treatment options. With the latter trend expected to continue in future, that places an additional strain on government finances over and above the effects of population ageing.

**Chart 1.11: Relative health spending per person**

Source: AIHW, DoHA, Medicare Australia, University of Sydney Family Medicine Research Centre – Bettering Evaluation of Care and Health (BEACH), Deloitte Access Economics.

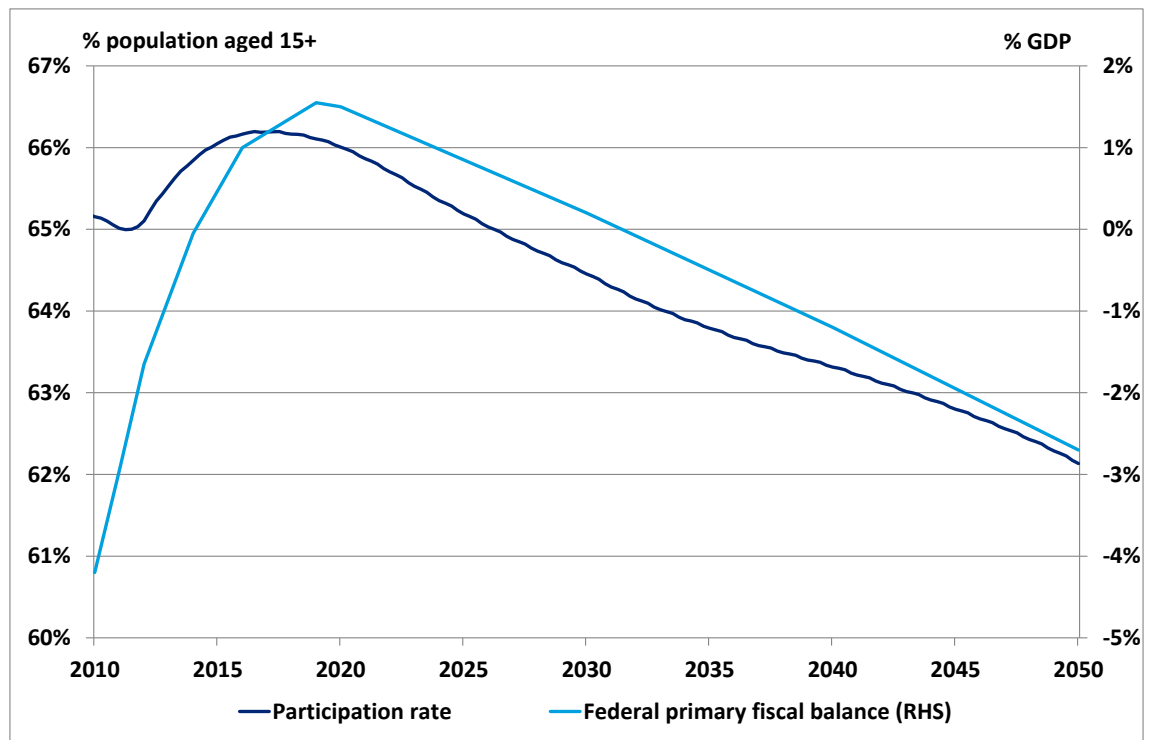
While growth in the population of older Australians is a key driver of the quantity pressures facing health spending, the rising cost of health care over recent decades has also been due to a combination of ‘price’ effects.

Not only are prices for health and aged care services growing faster than those elsewhere in the economy, but the demand for services is also growing rapidly.

Non-demographic growth in the cost of health care – that is after removing the effects of changes in both the size and the age structure of the Australian population –averaged close to 4% in real terms in the 10 years to June 2008.

Similar effects are included in the projections underlying the 2010 IGR, and are expected to see Australian government health spending per person increase by 2.9% a year in real terms through to 2050.

Or, in other words, both quantity and price effects are set to operate to raise the cost of society’s subsidy to older Australians. When combined with the effects of population ageing on labour force participation, and the rising cost of pensions and other age-related spending, these growing costs are predicted to lead to large, rising and ultimately unsustainable Australian Government deficits (as seen in Chart 1.12).

**Chart 1.12: Projected Federal deficits and labour force participation**

Source: 2010 Intergeneration Report, Federal Treasury

Similar effects are facing State Governments, who are also facing higher health related costs which are expected to be unsustainable based on current policies.

With governments struggling to fund the health and aged care needs of future retirees, that places additional pressure on private finances to bear a greater share of this growing funding burden.

As a result, these costs should be considered a major driver of the requirement for long term savings to support living standards in retirement, as well as long term fiscal planning to meet the challenges of an ageing population.

Both health and aged care costs are relevant to retirement incomes policy for the same reason that the age pension is relevant – as a potential saving to the government from boosting the adequacy and efficiency of retirement savings.

In addition, increased private income and assets among older Australians will be an important driver for the development of competition, innovation and choice in health and aged care over coming decades.

By expanding the capacity of private individuals to contribute to the cost of their own health and age care services, robust retirement incomes policies can therefore help to provide future governments with greater policy flexibility in these areas, and ultimately improve the sustainability of funding for the health and aged care systems of the future.

## 1.3 The role of super

Super is, at its heart, designed to meet the challenges of the future, rather than those of today. Just as Australia's future demographic and policy challenges are substantial, so too are the policy objectives of super.

Australia's strong retirement income system has long been recognised as a key factor helping to address the economic and fiscal challenges associated with an ageing population.

By providing a robust framework for individuals to fund their own retirement spending, the super system ensures Australia is well placed to meet the challenges ahead, with a substantial pool of savings ready to fund retirement incomes.

Not only does the super system reduce the intergenerational equity concerns associated with traditional 'pay as you go' pension models, but it has supported Australia's targeted age pension and its focus on poverty alleviation – resulting in a public pension system which is significantly more sustainable than that of many other developed nations.

### 1.3.1 Australia's retirement income system

Retirement income policy's central aim is to ensure that Australians maintain a reasonable standard of living after they choose to retire from paid work.

Australia's retirement income policy is currently designed around three key policies known as the 'three pillars'. They are:

- **Pillar one:** Providing a safety net through the Commonwealth aged pension.
- **Pillar two:** Increasing private provision for retirement through the compulsory 9% Superannuation Guarantee (SG).
- **Pillar three:** Encouraging voluntary contributions to super by offering tax concessions and co-contributions to those who choose to save more for their retirement.

While superannuation is the primary vehicle for retirement savings in Australia, the aged pension and assets outside of super are also important to ensuring adequate standards of living for Australia's retirees.

That said, Australia's superannuation system lies at the heart of private saving for retirement. It enjoys significant tax advantage over other investments, and is preserved solely for supporting retirement incomes. For most workers, super represents both the largest and the most effective pool of retirement savings.

In its strategic report on the retirement income system, the Henry Review found that the system has strong community support and broadly addresses the five objectives of the system – adequacy, acceptability, robustness, simplicity, and sustainability.

The concessions available in super reflect the unique role that it plays in supporting long term saving for retirement. They are designed to achieve a number of objectives, including:

- **Addressing disincentives to save created by Australia's income tax system**, which taxes nominal, rather than real, returns to saving. As the latter include a component to compensate investors for inflation, this can lead to over-taxation of the real income from saving which grows larger the longer a particular asset is held. The latter is a particular problem for long term savings such as those designed to fund retirement incomes.
- **Compensating investors for 'locking up' their savings until retirement**. Even voluntary super savings are subject to an element of compulsion – they are unable to be withdrawn until preservation age. Given a simple choice, investors would prefer to retain control over their capital, so after-tax returns to super are higher to balance out this concern (as well as to encourage private provision of retirement incomes).
- **Recognising the role of super in smoothing income over a lifetime**. Super is, by nature, designed to spread income from working over an individual's entire remaining lifetime. Since income in retirement is generally lower than that during working life, and Australia's income tax system is broadly progressive, that suggests a lower rate of tax should apply to retirement incomes.
- **Recognising the role of super in achieving long term savings for governments** in areas such as the age pension and the out-of-pocket costs of health and aged care (where increased capacity to pay can reduce public subsidies).

That is, governments have long recognised that super has a number of benefits – both for individuals and for taxpayers as a whole – and that its importance in addressing long term policy challenges merits reductions in government revenue in the short term.

### 1.3.2 A super system in transition

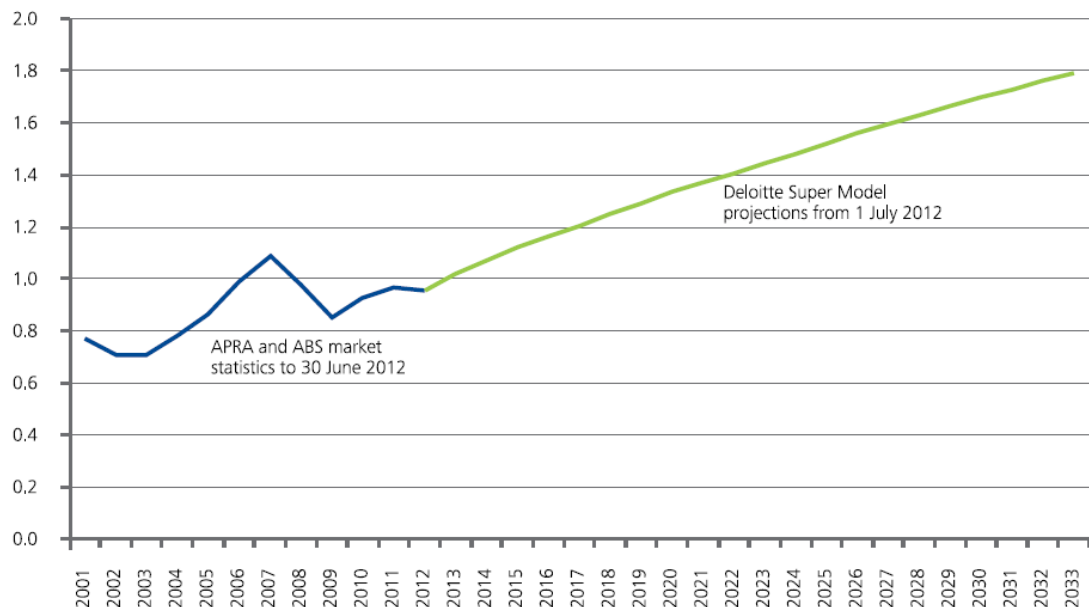
More than 20 years on from its introduction, Australia's compulsory superannuation system remains a relatively new feature of the retirement incomes landscape. Understanding how the outcomes from that system will change as younger workers make their way toward retirement is important to identifying the role that super will play in funding retirement over coming decades, and further into the future.

Current benefits from super reflect the experience of workers who have spent only a fraction of their working lives making contributions to super under the SG arrangements. As workers who have spent a greater share of their working lives within the system retire, benefits from super will rise to reflect that longer period of accumulation.

That period of transition has been extended by the ongoing increase in the SG rate from 9% to 12%. Originally scheduled to finish in 2019, the new Federal Government is seeking – but has not yet achieved – parliamentary approval to push that timing back to 2021, with the super system reaching full maturity once the youngest workers in that year have retired more than five decades later.

That combination of a maturing system with rising compulsory contributions can be expected to result in substantial growth in the stock of super assets over the next few decades. Results from the Deloitte Super Model indicate that total super assets will lift to around 180% of GDP by 2033 (as seen in Chart 1.13).

**Chart 1.13: Super assets at 30 June – ratio to nominal GDP**



Source: ABS national accounts, Deloitte Actuaries & Consultants

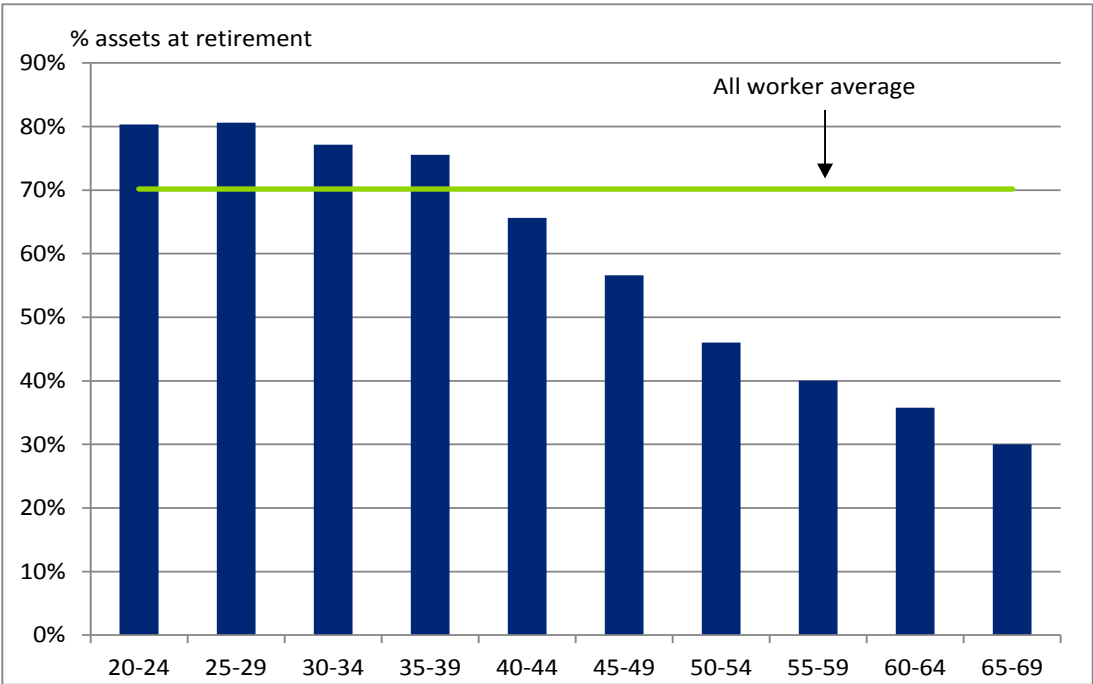
As the super system matures, its importance in providing funds to support Australians in their retirement will grow, with the level of benefits paid rising to reflect higher asset stocks.

Chart 1.14 shows projected super benefits from the *AMP Retirement Adequacy Index* analysis as a share of total assets at retirement<sup>1</sup>.

<sup>1</sup> Where the latter include financial assets outside of super and investment housing, but exclude the value of small business assets and the family home.



Chart 1.14: Projected super benefits as a share of assets at retirement



Source: AMP Retirement Adequacy Index 2012

Incomes available to retirees from super assets will also rise, but tend to follow behind the rise in benefits. This highlights the fact that outcomes from super do not stop at retirement. Retirees can continue to rely on their super savings to provide income long after those benefits are removed from the system.

That shift will be felt across the super system, as the balance between contributions and benefits shifts. Importantly, it will also be felt by individual Australians as the choices open to them in retirement change to reflect the new opportunities offered by a lifetime of super.

Or in other words, outcomes from the super system for today’s retirees are very different from those that will occur once the system is fully mature – highlighting the importance of long term approaches to dealing with retirement income policy and the role of super in the financial system.

Such a long term approach is a key feature of Australia’s three pillars system, but it is also a challenge for policymakers and individual Australians, as we must all make today’s choices based on our expectations of the future.

## 2 Adequacy of the super system

A key objective of the retirement income system is to ensure that all Australians have access to adequate retirement incomes.

In this chapter, we examine the adequacy of retirement incomes emerging from current arrangements in the super system, and explore emerging issues in retirement income adequacy in Australia.

### 2.1 Projected outcomes for today's workers

As noted above, Australia's compulsory super system remains in transition, meaning that any assessment of the long run adequacy of retirement incomes is, by nature, a forward looking exercise.

Estimates of future retirement incomes are therefore crucial to assessing the adequacy of current retirement savings among Australian workers.

While super represents both the largest and the most effective pool of retirement savings for most workers, pools of savings outside of super as well as income from the age pension are also important sources of retirement income.

The latest *AMP Retirement Adequacy Index* analysis projects retirement incomes for today's workers based on data for the six months from June to December of 2012.

#### THE AMP RETIREMENT ADEQUACY INDEX

The *AMP Retirement Adequacy Index* compares the savings of Australian workers against a target for an adequate income in retirement – set at 65% of an individual's pre-retirement living standards. The *Index* uses data from more than 328,000 AMP members, along with estimates of the age pension (for those who qualify) and 'other investments' (excluding the family home) to estimate whether Australians are on track for an adequate retirement.

Projections prepared for the *Index* represent a 'no change' picture of the future for retirees based on the latest information on salaries, balances and contribution rates. All results are shown in 'today's dollars' (that is, adjusted for the effects of inflation).

In projecting future retirement incomes, the modelling assumes that retirement ages are unchanged in future and that real wages grow over time, reflecting gains in productivity.

The latter assumption means that younger workers will have higher incomes in 'today's dollars' when they retire in the future, and so need to aim for higher retirement spending so as to meet the relative benchmark.

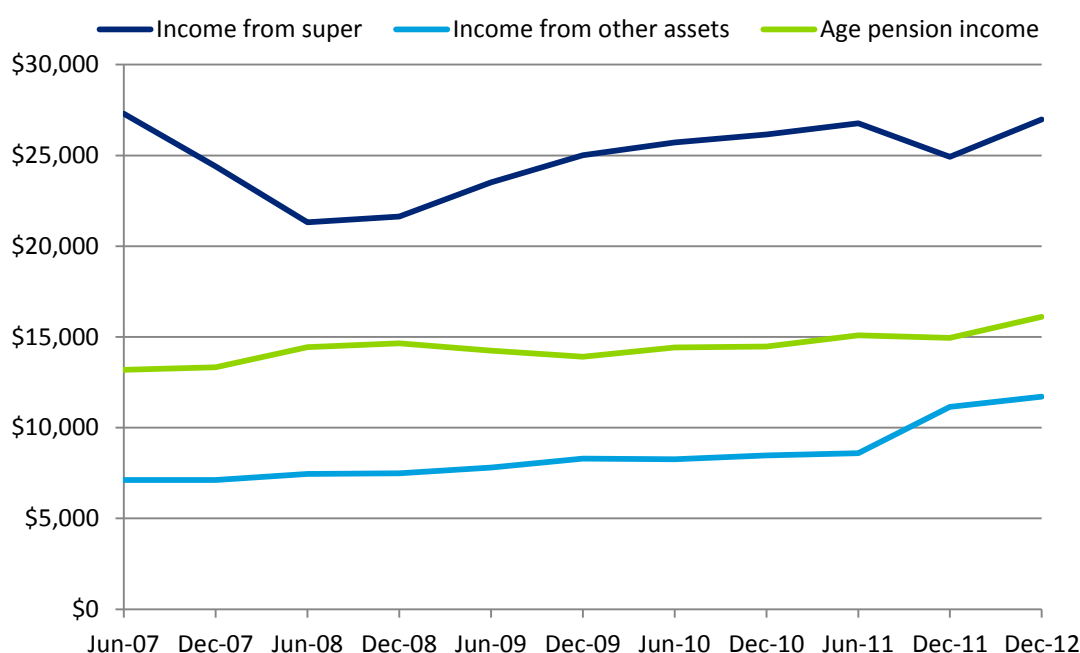
The analysis underlying the *Index* shows that the average value of assets (in 2011-12 dollars) of Australian workers at retirement – if current savings trends continue – will be \$752,162.

Given that Australia's compulsory superannuation system is not yet mature – meaning it will achieve better outcomes for younger workers than today's older workers – this amount is greater for younger workers, with those aged 20-24 expected to amass \$1,114,526, and falls progressively as age increases, with those aged 65-69 achieving an average of \$328,330 in assets at retirement.

A clear majority (70%) of assets at the time of retirement are projected to be held in super.

Projected average net retirement incomes from each of these three sources for all Australian workers are presented in Chart 2.3 below.

**Chart 2.1: Projected average annual retirement income by source– Jun 07 to Dec 12**

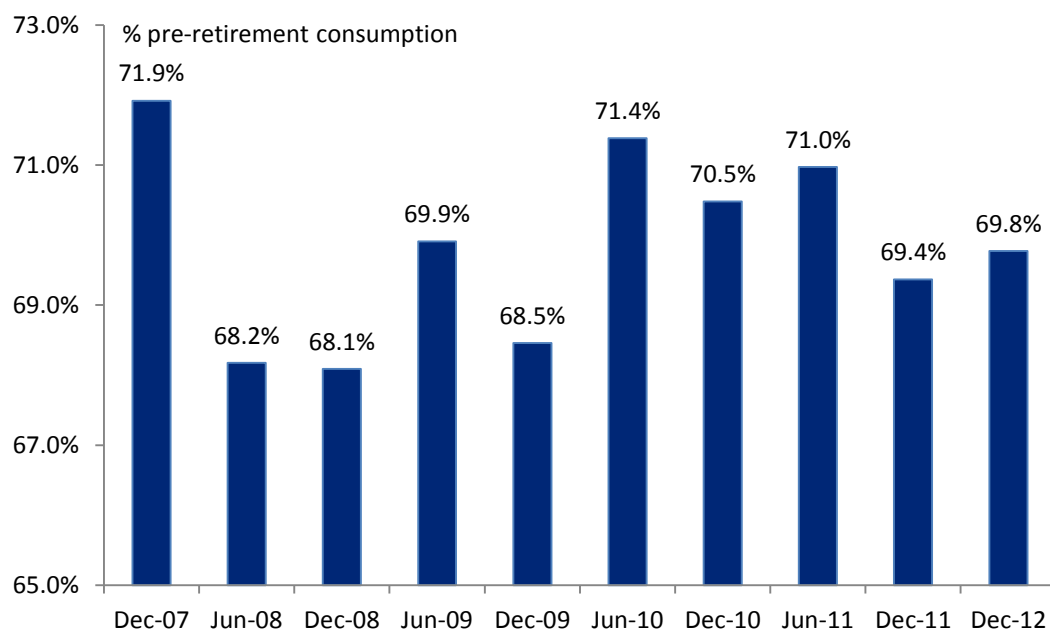


Together with the age pension (for those who qualify) and other investments, in today's dollars workers will, on average, achieve average retirement incomes of just under \$52,000 per year.

This result is based on average outcomes for workers across their time in retirement.

Just over half of the income that today's average worker will receive in their retirement years comes from super income; the age pension makes up less than one third of retirement income.

Chart 2.2 below shows the value of the *Index* over time. Average retirement income adequacy levels peaked in 2007 as sharemarkets peaked and as members responded to key shifts in super policy at that time. Adequacy then fell back through 2008, partly due to market falls, but also partly due to a fall in voluntary contribution rates.

**Chart 2.2: The AMP Retirement Adequacy Index – Dec-07 to Dec-12**

Adequacy then rose again in the first half of 2009 as market recovery combined with pension increases in the 2009 Budget. However, the largest increases in adequacy were in June 2010 as a result of the decision to increase the SG rate from 9% to 12%.

More recently, however, projected adequacy levels have declined in the face of lower voluntary contributions – particularly from higher income earners who have seen their contributions constrained by recent changes to concessional contribution caps.

Yet to say that overall adequacy has been declining is not the same as saying that it is 'bad'. Although measures of retirement income adequacy are the same as when this *Index* was first compiled, it remains true that today's 'average' workers look set to be able to retire on incomes above the benchmark for an adequate retirement.

## 2.2 The role of voluntary savings

Yet while the *AMP Retirement Adequacy Index* indicates that the average Australian worker can expect to receive adequate retirement incomes, that result hides a number of important distributional issues that are important for both policymakers and individuals.

In particular, by measuring the average level of adequacy, the *Index* spreads the benefits of voluntary contributions to super across all current workers.

In reality, however, most Australian workers do not make voluntary contributions to super.

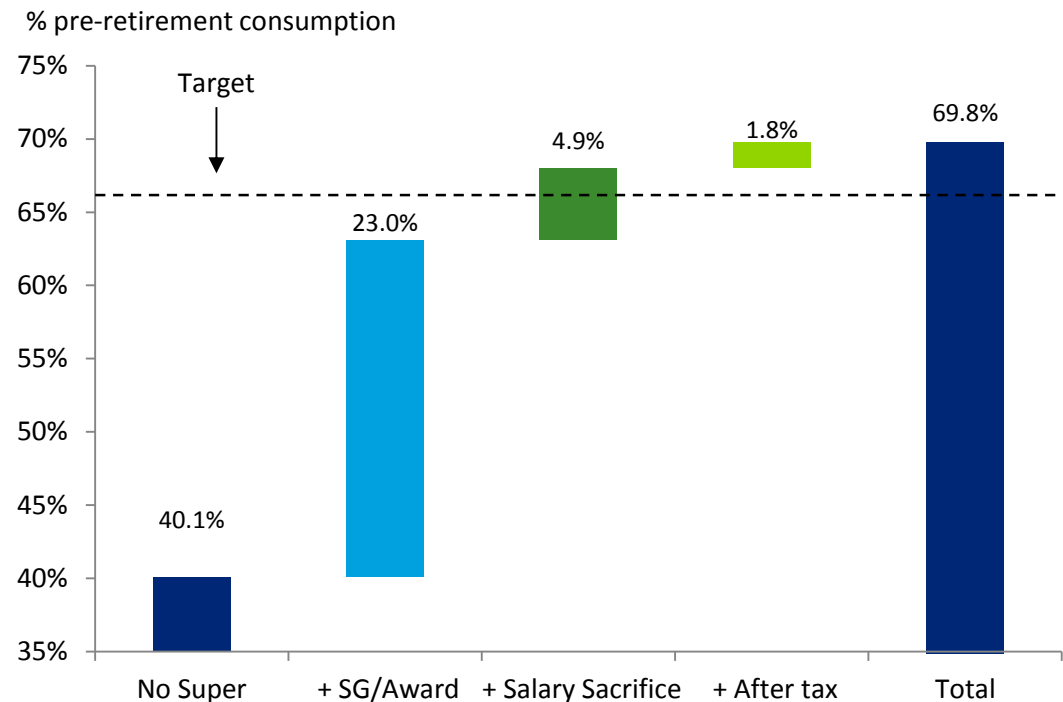
It is therefore useful to consider the replacement rates available to those workers who do not contribute to super voluntarily.

The replacement rates used here measure the ratio of average consumption spending in retirement to average consumption spending in the final year in the workforce, adjusted to account for taxes and savings. The ‘target’ for that ratio is set at 65% of an individual’s own pre-retirement living standards.

As Chart 2.2 above shows, this measure stood at 69.8% on average across all workers for the six months to December 2012.

Chart 2.3 provides a breakdown of this result into a number of separate components.

**Chart 2.3: Breakdown of average net retirement incomes by source – Dec 12**



It shows that the combination of the age pension with assets held outside of super (such as bank accounts) would result in an average 40.1% replacement rate.

The addition of existing super balances, along with compulsory super contributions<sup>2</sup>, leads to a total replacement rate of 63.1%, which is still below the 65% target for the *Index*. That is, **among those members who choose not to make voluntary super contributions, adequacy levels will ultimately fall short.**

Adding future voluntary contributions to super, both salary sacrifice and after tax, contributes the final 6.7% to average replacement rates.

<sup>2</sup> Note that the SG/award contribution category included in this analysis is slightly broader than the legislated SG rate in the short term, as many employers contributed more than the minimum 9% as the default contribution on behalf of their employees in the six months to December 2012. Average contributions under this category were around 9.5% of member salaries, though it is assumed that such above-SG contribution arrangements will be discontinued as part of the transition to the higher 12% SG rate.

Importantly, the latter ignores the role that voluntary savings have played in building the existing super balances of today's workers. The impact of past voluntary contributions is included in the SG/award category in the chart (along with that of total balances).

That is, the estimates in Chart 2.3 are very much a lower bound on the importance of voluntary contributions.

Even so, the latter lift retirement incomes to being just ahead of the target level, highlighting the importance of voluntary savings via super in supporting adequate retirement incomes for today's workers.

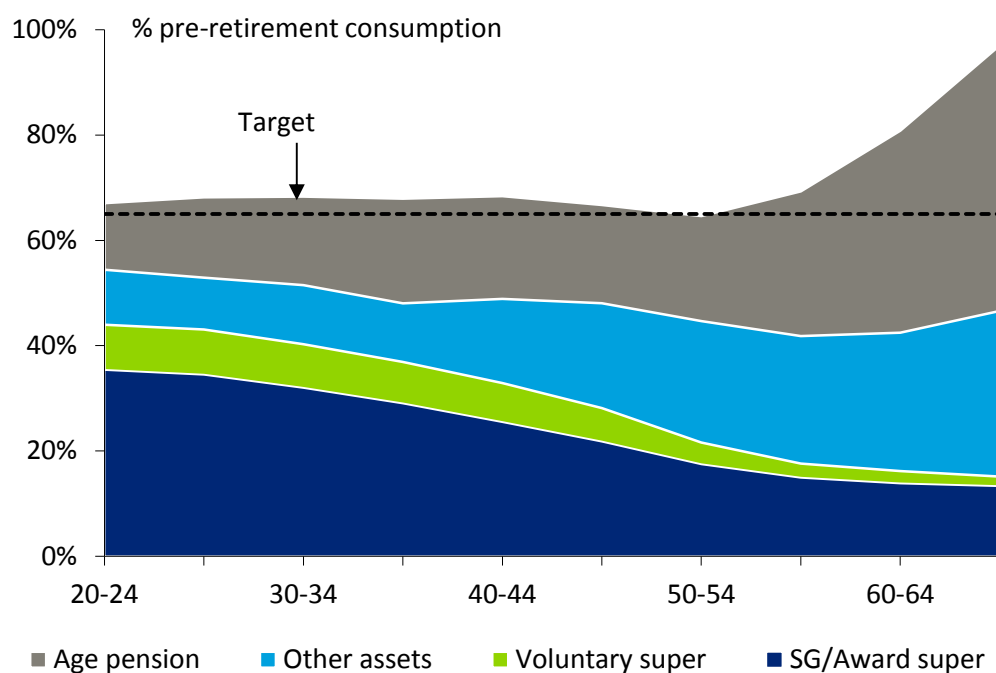
Applying a similar analysis to outcomes across the various age and income groups within the modelling provides also highlights the role played by voluntary super contributions.

Levels of pre-retirement consumption are higher among younger age cohorts, as they will receive the benefits of increased productivity (and hence rising incomes and savings) over a longer period of time remaining in the workforce.

While workers aged over 55 may withdraw their super at any time, the average time to retirement for 20 year olds is around 45 years.

However, while older members will have lower levels of consumption in retirement, the relative 'drop' in consumption is lowest among older members. This is reflected in the higher replacement rates evident for these age groups in Chart 2.4 below.

**Chart 2.4: Net retirement income sources, by age**



Consistent with the average replacement rates seen earlier in Chart 2.2, Chart 2.4 shows that replacement rates across most age groups are above the 65% benchmark applied by the *Index*.

Indeed, if current savings patterns are maintained, these results suggest today's 'average' workers will be able to retire on incomes above the benchmark for adequate retirement.

However, that result is dependent on voluntary super savings, with the latter a key contributor to adequacy for younger members in particular on the measures seen here.

Without the benefit of the substantial non-super savings that support retirement incomes among older generations, voluntary saving through super will play a greater role for these members over time.

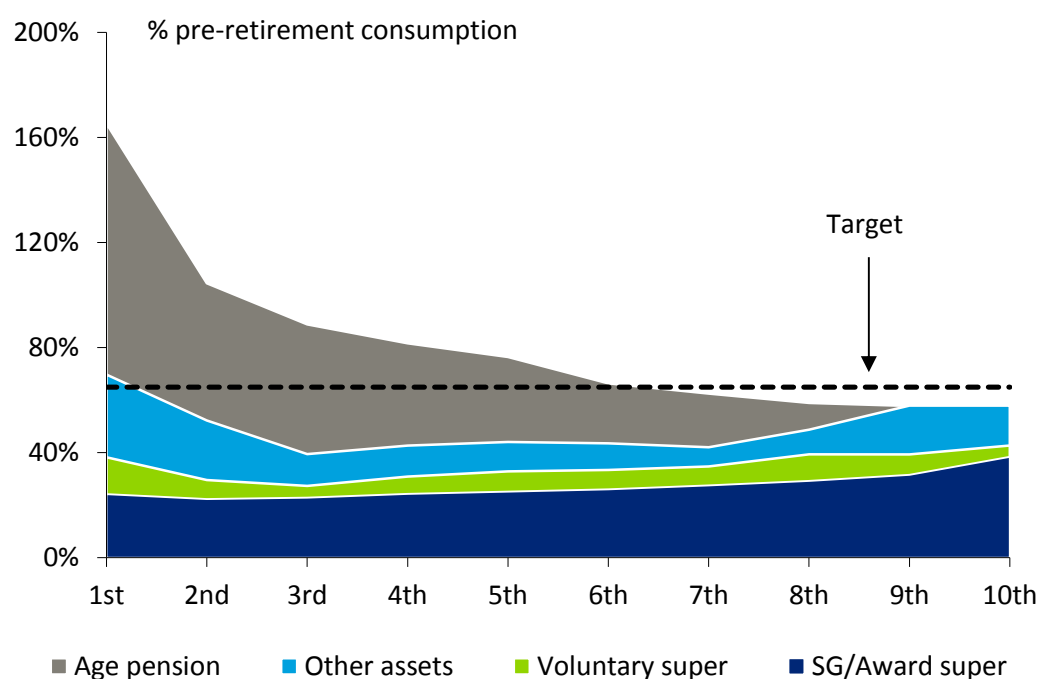
While that is true in the average figures reported in Chart 2.4, those averages hide substantial issues around the distribution of voluntary savings. Importantly, and as noted, **among those members who choose not to make voluntary super contributions, adequacy levels will ultimately fall short.**

In assessing the adequacy of future retirement incomes, the *AMP Retirement Adequacy Index* compares the living standards that retirees can expect to achieve in retirement with the consumer spending future retirees will undertake in their final years in the workforce.

This 'target' is a relative one, making the implicit assumption that individuals on higher incomes during their careers will expect to maintain that relative advantage in retirement.

Chart 2.5 shows projected replacement rates by income decile.

**Chart 2.5: Net retirement income sources by income decile**



While higher income members will enjoy a greater level of retirement consumption than those on lower incomes, low income members will have higher replacement rates. That is, the super system will promote broadly ‘progressive’ outcomes.

Indeed, for those members among the 10% with the lowest salaries, retirement will mean an increase in consumption potential – with average replacement rates estimated at more than 100% for this group.

In contrast, among higher income earners average replacement rates are as low as half of pre-retirement consumption.

This result is due to the relative importance of the aged pension to lower income retirees.

It is also a reminder that voluntary retirement savings, including those outside the super system, are an important source of retirement income for higher income workers.

## 2.3 Changing expectations of retirement

In examining policies aimed at supporting the incomes of future retirees, it is important to consider changes over time in the nature of retirement itself.

With rising living standards, better health and aged care and longer lifetimes, today’s retirees have access to choices and experiences that were not available to past generations of older Australians.

As the super system matures, those choices and opportunities will continue to expand in ways that are difficult to predict.

Changing attitudes are seeing working Australians rethinking their expectations for retirement. Those expectations have implications for the super system, as Australian workers see super as the key to meeting their retirement goals.

At the same time, policymakers are changing their own approaches to retirement incomes and the role of private individuals in funding their own use of publicly subsidised services.

These shifting expectations and priorities add to the complex task of ensuring super is prepared to meet the aims of both policymakers and the broader Australian community.

### 2.3.1 Community attitudes

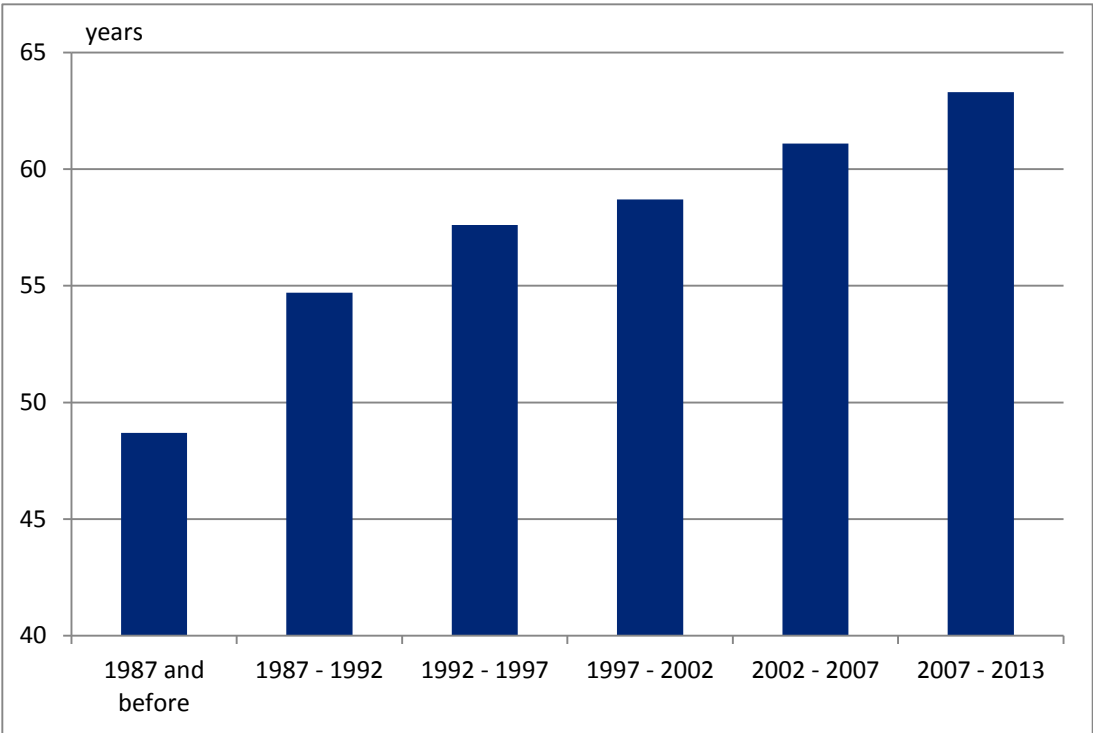
With our retirement income system maturing and population ageing already having an effect, it is no surprise that Australians have been revising their attitudes and expectations around retirement.

Nowhere is that more evident than in the rapid increases in retirement age seen over recent years, as workers look to remain at work longer and employers increasingly value the contribution of older employees.

As Chart 2.6 shows, Australians have been staying on longer at work for some time, with the average age at retirement increasing by more than 8 years over the past two decades.



Chart 2.6: Average age at retirement by year of retirement

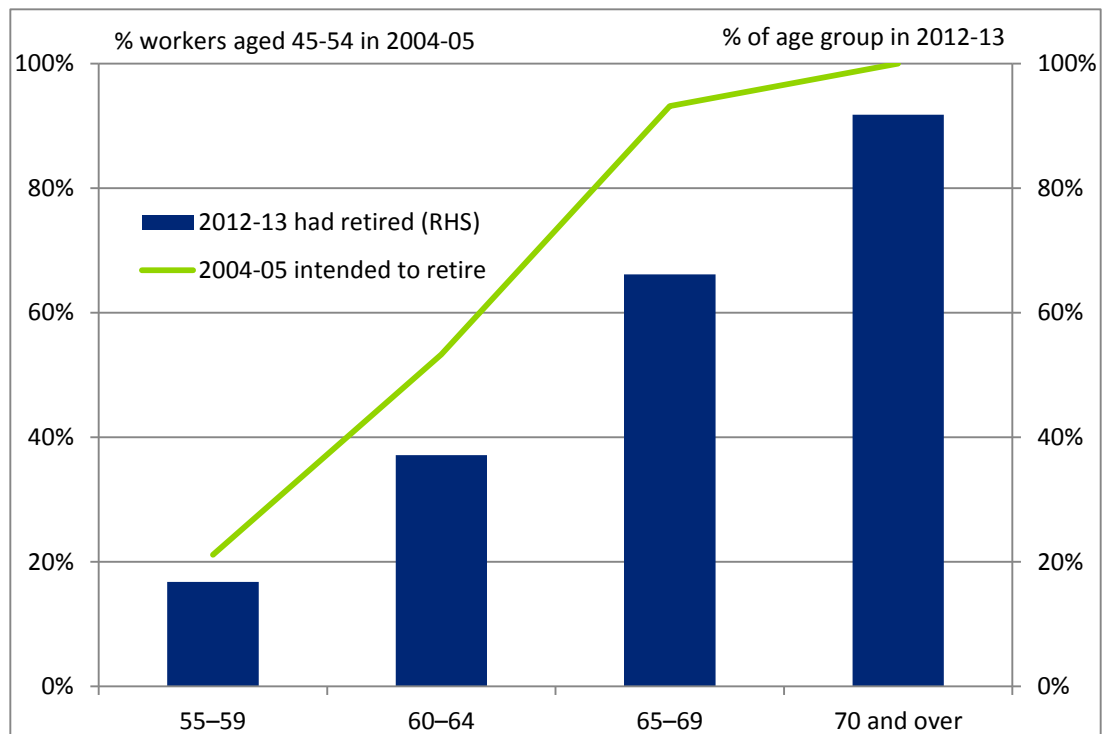


Source: ABS 6238.0, Deloitte Access Economics

That trend shows no sign of slowing, with almost one in five of those aged 45 and over who are still working planning to continue beyond their 70<sup>th</sup> birthday.

Not only are Australians retiring later than they used to, that delay in retirement has been outpacing expectations from only a few years earlier.

Chart 2.7 below shows the share of workers aged 45-54 in 2004-05 who intended to retire within or before reach each age range. This is compared with the share of the same age groups who were actually retired by 2012-13.

**Chart 2.7: Retirement intentions in 2004-05 and outcomes in 2012-13**

Source: ABS 6238.0, Deloitte Access Economics

Of the workers surveyed in 2004-05, close to half of those who specified an intended retirement age had intended to retire before the age of 65.

By 2012-13, those workers would be aged between 53 and 62 – old enough to be acting on those earlier retirement plans. But among similar age groups, the share of Australians who had actually retired from the workforce was substantially lower than the intentions from the 2004-05 survey would indicate.

While not a perfect comparison, that difference between the expectations of earlier survey respondents and more recent retiree numbers provides an indication that many older Australians are surprising themselves by retiring later than they had originally expected.

At the same time as measured retirement ages are lifting, **the nature of retirement is changing**, with the idea of a black and white line between work and old age rapidly becoming a thing of the past.

Australians are increasingly embracing the relatively new approach of stepping down from full time work to part time work before leaving the workforce entirely. According to the ABS, 40% of full-time workers over 45 intend to move to part time work before retiring.

Retirement is also becoming less 'final', with many who had considered themselves retired now returning to paid work.

With the retirement of the baby boomers and the maturing system of compulsory super, **expectations of retirement income are shifting rapidly**.

In part, that is a natural response to the maturing super system, with retirement incomes set to rise rapidly over coming years as compulsory super contributions make up a more important source of assets for successive waves of retirees.

However, there is some evidence that expectations are in fact outpacing the reality of the retirement income system.

Of workers aged 45 and over in 2012-13, some 53% expected to be fully self-funded in retirement, a figure which stands in stark contrast to the Treasury projections seen earlier in Chart 1.8, which indicate a steady share of around 20% of retirees can expect to receive no government pension over coming decades.

Similarly, less than one quarter of workers expected to be reliant on government benefits as their main source of income at retirement, while more than half nominated super as their expected primary source of income.

As the superannuation system matures, retirees are expected to become increasingly self-sufficient and less reliant on government pensions and allowances. That said, many of today's workers are likely to fall short of their own retirement expectations.

Evidence from the ABS's *Retirement and Retirement Intentions 2012-13* publication shows that recent retirees who had expected to rely on super as their main source of income when asked in 2004-05 have instead been mainly reliant on government pensions and benefits.

As the Federal Treasury projections shown earlier in Chart 1.8 show, close to half of those retiring in the next few years will rely on the age pension as their primary source of retirement income – meaning a substantial share of workers will ultimately be surprised by their reliance on the pension to support them in retirement.

#### **ASSUMPTIONS MADE BY MEMBERS**

Rapidly changing expectations around retirement are a reminder that Australia's retirement income system is full of assumptions. Those assumptions can be useful, but the future is unlikely to play out in the way we expect.

That's not to say the predictions are wrong. A lot has changed in the last 20 years, not only in super, but also in the broader economy. There is no reason to expect the next 20 years to be any less uncertain.

But that's the point – over the course of decades things change in ways that are difficult to predict.

If we as individuals have formulated our plans for retirement based on assumptions about what we will earn, what we will spend, when we will retire and the rates of return expected on our savings, then we may still not have allowed for developing effects on our living standards.

With that in mind, it is worth looking briefly at some assumptions members might make to explore how retirement savings will perform in meeting the expectations of Australians.

#### **The government thinks the 12% SG will be enough**

For many Australians, the very existence of compulsory super sends a message that the government has taken responsibility for retirement savings, and that the SG alone will deliver adequate retirement incomes.

In reality, as the discussion earlier in this chapter notes, many members who don't make voluntary contributions will ultimately fall short of an adequate level of retirement income. In this respect, complacency on the part of members risks individuals falling behind in providing for their own retirement incomes.

#### **I earn a good wage, so I won't need the age pension**

Many Australians assume that the super system will be sufficient to support them in retirement, and that they won't need to rely on the age pension.

While the goal of being a 'self-funded retiree' is a worthy one, the reality of current retirement income policy means that the majority of Australians won't achieve it.

Australians who want to avoid placing any burden on the public purse will need a good wage during working life, but will also need to have a solid savings strategy and a sound plan to ensure their savings last in retirement.

#### **As long as we have the house, we'll be OK**

Australians have long had a love affair with property, and buying a home remains the largest financial transaction that the majority of us will ever make.

While the tax and means test advantages of the family home make it a very attractive investment, the reality is that owner occupied housing is only one part of a balanced retirement strategy.

Unlike super assets, retirees cannot readily 'spend' the home they own – leaving many with the lion's share of their retirement assets effectively 'locked up' in bricks and mortar. That can leave retirees with valuable housing assets, but reliant on the age pension to fund their everyday expenses.

Not only are more Australians expecting to be fully self-sufficient in retirement, but **the level of retirement living standards expected by today's workers when they retire is also shifting**. With longer and healthier lives, today's workers expect to enjoy a similar lifestyle in retirement to the one they enjoy now.

That includes the sorts of activities and spending that aren't open to many of today's retirees – such as regular travel within Australia and overseas, as well as buying and maintaining a car.

Similar expectations are also increasingly becoming a part of the policy debate. A widely quoted benchmark for retirement incomes is the Association of Superannuation Funds of Australia (ASFA) Retirement Standard. The latter, based on November 2013 data and a retirement age of 65, estimates a home-owning couple needs \$57,195 a year for a 'comfortable retirement' and \$33,120 for a 'modest retirement' – both being higher than the 'basic' standard of \$32,417 set by the age pension. For singles, the respective figures are \$41,830, \$23,032 and \$21,505 a year.

As an illustration of the lifestyle represented by the 'comfortable' standard, it is worth exploring the implications of such an absolute figure in the context of the relative measures presented above.

Through modelling the interaction of personal income tax rates with relevant offsets and the Medicare levy – it is possible to calculate the gross income level during working life that is consistent with both a 65% net pre-retirement income replacement rate similar to that used in the *AMP Retirement Adequacy Index* and the absolute target represented by the 'comfortable' retirement standard<sup>3</sup>.

Table 2.1 below compares the resulting estimates with estimates of average earnings for employees.

**Table 2.1: Comparison of Incomes**

<b>Replacement rate</b>	<b>Pre-tax income consistent with 'comfortable' retirement income</b>	<b>Average Yearly Earnings* (full-time employees)</b>	<b>Average Yearly Ordinary Time Earnings (full-time employees)</b>	<b>Average yearly earnings (all employees)</b>
65%	\$78,462	\$78,106	\$74,962	\$58,157

Source: ABS, Cat 6302. Deloitte Access Economics

\*Average yearly earnings are calculated as average weekly earnings multiplied by 52.14.

As this comparison shows, the budget standards commonly applied in the current retirement income adequacy debate are appropriately compared with relatively high working life incomes.

That is, the standards broadly represent an average standard of living for full time workers, and better than average living standards when compared to working age Australians more generally (as many of the latter are not in the labour force at all).

Looking more specifically at the expectations of Australians themselves is an interesting exercise to compare what Australians hope to get out of retirement, with what the retirement income system is expected to deliver.

<sup>3</sup> Here it is assumed that the single retiree has no private income outside of superannuation, and therefore has no tax liability.

In 2013 SunSuper commissioned a Galaxy survey of retirement expectations among more than 1,500 Australians. It found that:

- 57% wanted to indulge in whatever food they wanted
- 55% wanted to regularly travel to see friends and family
- 50% wanted to dine out every month
- 49% wanted an annual domestic holiday
- 41% wanted to travel overseas every 1 to 2 years

When asked to estimate the cost of this retirement lifestyle, respondents underestimated the monthly income required by more than one quarter – highlighting the disconnect between growing expectations of retirement and an understanding of the savings required to fund such a lifestyle.

Overall, it is clear a comfortable retirement is envisioned by many Australians – certainly one beyond the financial opportunities offered to most current retirees.

With lifestyle expectations rising fast, **ageing and health cost pressures will place greater strain on the retirement savings of future retirees**. Retirees expect the best standard of health and aged care, but that standard is becoming increasingly more expensive over time.

Moreover, while the health and aged care services of the past have been largely government funded, the long term structural issues in government finances at both the State and Federal level will see governments looking to reduce health and aged care subsidies.

That combination of higher costs and a shift towards user pays approaches to funding will be occurring at a time when changes in social attitudes, values and behaviour are increasingly driving demand for more flexible options for meeting the increased care needs that arise through improved longevity.

Structural change in the delivery of these services is needed, and will be driven by rising expectations of consumer choice and quality of services, as well as a sense of entitlement to individualised care following years of dedicated participation in the national workforce.

In coming decades, rising incomes among retirees will be further reinforcing this shift in the values of older Australians towards greater independence, and more flexible lifestyle choices.

The ability of people requiring care to continue to live an independent and flexible lifestyle depends on the availability of care in the community and their ability to pay for that care. In this context, **retirement savings play a vital role in providing a sustainable base for private contributions to the cost of caring for Australia's older population**.

With that in mind, it is worth remembering that the widely quoted Westpac/ASFA budget standards assume that retirees are relatively healthy. In practice, many retirees with chronic health conditions may face higher health and aged care costs in future.

### 2.3.2 Policy approaches

Community attitudes to retirement are not the only thing that is shifting as the baby boomers move from working life to retirement. Governments too are looking at policy issues in new ways as the pressures associated with an ageing population make themselves felt on finances at the State and Federal level.

These shifts will also play an important part in the outcomes for future retirees.

#### **ASSUMPTIONS MADE BY POLICYMAKERS**

Members aren't the only ones who need to make assumptions about the future. Policymakers too may be relying on some assumptions which ultimately prove to be less than perfect.

Here we look at some examples of assumptions that may need to be closely examined over time.

##### **Retirees are generally home owners**

Retirement income policy has typically been formulated on the assumption that the vast majority of older Australians will be home owners or have access to affordable rental housing through State Government housing programs.

Home ownership rates are indeed likely to remain high among retirees given the substantial tax and social security advantages that owner occupied housing assets enjoy.

Yet the lifetime cost of obtaining a home has shifted sharply higher over recent decades, and is expected to continue to do so, while significant funding and demand pressures on social housing programs mean the latter will be less well placed to pick up the slack.

That points to a risk that many future retirees miss out on achieving home ownership, and face significant housing costs in the private rental market. It also presents a challenge for those who do buy a home, who may have less opportunity to accumulate non-housing assets to support retirement incomes.

##### **Members are best placed to make choices about their retirement savings**

Efficient markets rely on informed decisions by consumers. A key issue in the operation of the super system is that complexity and a lack of engagement mean that choices are often not well informed, or not made at all.

Financial literacy and financial advice can and do play a role here, but there remain aspects of the system that are defined by the lack of consumer choice, rather than the results of that choice. Default super fund arrangements in modern awards and the MySuper changes are clear examples that the limitations of consumer choice in super need to be addressed.

### **The self-employed can look after themselves**

Retirement income policy has typically been focused on workers, and prepared to let business owners fend for themselves. With the rise of self-employed contractors blurring the line between business owners and workers, those distinctions may be less useful in future.

With self-employed Australians lacking compulsory super coverage, policymakers will need to carefully monitor the rise of self-employment arrangements to ensure the integrity of the super system is maintained.

Developments in retirement income policy have tended to be slow to emerge in response to changes in the economy and community attitudes over time.

For example, the abolition of ‘compulsory retirement’ is a relatively recent development in Australia, while the age of eligibility for the age pension was aligned for men and women on 1 January 2014 – reflecting a slow transition from past attitudes to the role of women in the workforce more generally.

Similarly, changes to allow superannuation contributions from older workers have also been slow to emerge, with workers aged over 70 receiving SG contributions on their behalf for the first time in 2013-14.

To a certain extent, that is a reflection of the success of some long standing policies. After all, Australia’s retirement income system sits on the foundation of the aged pension, which commenced operation in 1909.

At its heart, the aged pension is designed to ensure that older Australians are able to meet the day to day costs of living, without undue hardship. Or, in other words, its goal is to meet the minimum standards of the community, rather than the living standards that individual households enjoy during working life.

From a public policy perspective, Deloitte Access Economics would argue that the latter is indeed the right aim for government assistance.

However, that approach does little to meet the changing expectations of the retirees of the future.

Instead, the role of providing additional resources over and above the minimum level prescribed by the pension system falls to private savings – both within and outside the super system.

It is this role – supporting the retirement incomes of Australians who can realistically support themselves, that will increasingly be seen as a key benefit of the super system as the policy of compulsory super matures.

Not only will such a policy assist in meeting the retirement income aims of government and the community, but it will also support policy flexibility in other areas as well.



Over coming decades policymakers will increasingly be looking to private sources of funding for services which have traditionally been publicly provided – particularly in areas of age-related spending such as health and aged care.

In this regard, **future policy flexibility is enhanced by strong retirement incomes**. After all, requiring income support recipients to meet their own costs ultimately does little to benefit fiscal sustainability, as any such change would imply compensating increases in income support payments from government.

Only private sources of income, such as that provided by retirement savings, give individuals the capacity to truly contribute to the funding of the services they consume.

More generally, policymakers would do well to closely examine any emerging gaps between what Australians expect from their retirement and what current policy settings are likely to deliver.

While the super system grows to meet the policy targets of today, there is a risk that rising expectations mean it will fall short of the expectations of tomorrow.

If super is to meet the rapidly changing expectations of members, both policy approaches and member behaviour will need to keep pace with changes in community attitudes to retirement. Otherwise, many Australians may ultimately be disappointed in the retirement choices available to them.

By understanding the evolution of the retirement income system and our relationship with it, Australians as a whole can be better placed to ensure our expectations and our opportunities align.

## 3 Sustainability of the super system

As the above discussion notes, Australia's superannuation system has a key role to play in meeting the looming challenges posed by an ageing population.

In this chapter, we explore policy approaches aimed at ensuring super remains ready to meet those goals over the long term.

### 3.1 The cost of tax concessions in super

In assessing the performance of the super system in funding future retirement incomes, policymakers must not only consider the effectiveness of the system in providing adequate retirement incomes, but also its efficiency – that is, whether the government's up-front investment via tax incentives represents good value for money for taxpayers as a whole.

That's not easy to do. Such an assessment involves measuring a number of complex relationships over very long periods of time in a maturing super system. Measuring the costs and benefits of the super system is a difficult task – even for technical experts. As a result, there is a risk that imperfect measures are misinterpreted by policymakers, and by the public at large.

In recent times, there has been much attention given to the notional value of tax expenditures in super as measured by the Tax Expenditure Statement (TES) produced by the Federal Treasury.

While this is often interpreted as the 'cost to government' of the super system, the truth is less straightforward.

#### 3.1.1 'Revenue forgone' estimates

Much has been made of the cost of superannuation tax concessions in recent public debate. The most widely quoted measures of the overall cost of super concessions is the total of superannuation related tax expenditures from the TES, estimated at some \$33.1 billion in 2013-14.<sup>4</sup>

Yet using this total to 'value' the tax concessions on offer in the super system can be misleading, as it is not the purpose for which the individual estimates have been designed.

Further, there are known issues with aggregating tax expenditures.

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<sup>4</sup> Tax expenditures C4-C13 cover superannuation related tax expenditures, though often the combination of the two major tax expenditure items C5 (concessional taxation of employer contributions) and C6 (concessional taxation of fund earnings) is quoted (see for example <http://www.treasury.gov.au/Policy-Topics/SuperannuationAndRetirement/supercharter/Report>). The latter measured \$32.1 billion in 2013-14.

The 2013 TES states that:

*Previous editions of the TES have stated that tax expenditure estimates are not strictly additive. Tables aggregating tax expenditures have therefore been removed from the 2013 TES.*

In reality, the Treasury estimates are good at measuring what they are meant to measure, but less suited to the role that has been forced upon them in the public debate in recent times.

Due to a lack of reliable alternatives, there has been a tendency to interpret the tax expenditure estimates out of context, as a measure of the longer term cost or value of tax concessions in super.

Tax expenditures are defined and measured as deviations from the relevant tax 'benchmark' – a hypothetical tax system based on the major features of the Australian tax system, but without any concessional treatment for particular types of taxpayers or payments.

The latter benchmark, and the no-behavioural change assumption, differ from the reality of the Australian tax system in a number of ways. These are discussed in the following sections.

### 3.1.2 Alternative tax benchmarks

Tax expenditures are defined and measured as deviations from the relevant tax 'benchmark' – a hypothetical tax system which includes the major features of the tax system, but does not allow any concessional treatment for particular types of taxpayers or payments.

There are three broad types of tax benchmark that can be applied to retirement savings in this framework:

- **An income tax benchmark**, under which super contributions are taxed like any other income in the hands of the fund member, earnings are taxed like any other investments in the hands of the investor and benefits from superannuation are untaxed. Any costs associated with superannuation investments are deductible under the benchmark.
- **A pre-paid expenditure tax benchmark** based on direct taxation of labour income with an exemption for income from saving. That is, all returns to savings are exempt from tax, and there is no tax on the payment of retirement benefits. Under the pre-paid expenditure tax benchmark, superannuation contributions are taxed at an individual's personal tax rate with both earnings and benefits tax-exempt.
- **A post-paid expenditure tax benchmark** is intended to reflect the taxation of a direct measure of expenditure on goods and services. Under such a benchmark, both contributions and earnings would be tax-exempt, but benefits would be fully taxable when they are received.

Most retirement income systems around the world use an expenditure tax approach, while Australia has opted to embed tax concessions for retirement savings into an income tax framework.

Consistent with that approach, the current treatment of super taxes in TES uses an income tax benchmark – meaning that taxes received from super are assessed relative to the taxes expected under the income tax benchmark. The benchmark treats all contributions and earnings as taxable income (applying marginal income tax rates) and there is no taxation of benefits. Current levels of tax on benefits are a minor offsetting factor in the tax expenditure calculations.

The latter benchmark is the appropriate one for the task of measuring the revenue foregone as a result of the full range of tax expenditures undertaken by the Federal Government.

It does not, however, reflect the alternatives tax rates faced by Australians in the tax system.

Indeed, it could be argued that a more appropriate yardstick to apply when considering individual policy measures would be one that includes the effects of other concessions available to taxpayers. Even in the absence of behavioural change, it may be more reasonable to ask how much revenue is forgone by treating super differently to all other forms of investment earnings including, for example, negatively geared property.

While such an approach would be hard to apply in practice, it is a reminder that by applying the particular benchmark it chooses, the TES estimates are likely to overstate the alternative tax revenue on offer to governments by removing super incentives.

More importantly still, the benchmark applied in the TES is not a reflection of an ideal alternative to current arrangements. As Treasury notes on page 3 of the 2013 TES:

*The choice of benchmark should not be interpreted as indicating a view on how an activity or taxpayer ought to be taxed.*

That is a particular issue in super, as the comprehensive income tax benchmark applied in the TES is arguably less appropriate for long term savings than it is for other forms of income.

An alternative approach based on an expenditure tax benchmark has strong theoretical underpinnings, and experimental estimates based on this alternative approach were included for the first time in the 2013 TES.

Expenditure tax benchmarks in general avoid the problem of increasing over-taxation of income from saving as assets are held over time. The latter, as the Henry Review notes, is a feature of comprehensive income tax systems such as that applied in Australia.

A post-paid expenditure tax approach has the added benefit of accounting for differences in income over the life-cycle. If, as is true in Australia, tax rates are broadly progressive and income in retirement is less than that during working life, then – other things equal – an income tax benchmark also applies higher marginal tax rates to retirement savings than a post-paid expenditure tax benchmark would.

Further, the tax treatment of the most significant asset holding of Australian households – the family home – is consistent with the treatment under an expenditure tax, rather than under an income tax.

That is, there are strong arguments in favour of assessing super tax concessions relative to a post-paid expenditure tax benchmark, rather than a comprehensive income tax benchmark.

While taxing super based on an income tax base can, in theory, produce the same outcomes as an expenditure based tax system, the timing of payments in a maturing super system means this choice of benchmark can have a material impact on measures of tax concessions offered in the super system.

In particular, the application of an expenditure based benchmark results in the conclusion that super taxes are far less concessional than the estimates in the TES suggest.

Experimental estimates included in the 2013 TES indicate that, using a pre-paid expenditure tax benchmark, the sum of super tax expenditures in 2013-14 would be \$11.2 billion – substantially lower than that estimated based on the income tax benchmark.

Using a ‘post-paid’ expenditure tax benchmark would result in an estimate that is lower still.

Yet this result is subject to an important timing related caveat. Using current year tax receipts understates the level of benefit taxes that can be expected from the current arrangements in the long term.

**In other words, both an expenditure tax and an income tax approach suffer from important limitations, and there is no perfect measure which takes account of the maturing of the super system over time.**

While a short term measure of the level of super taxes is appropriate for measuring the revenue forgone by the government in a given year or forward estimates period – the purpose for which Treasury’s estimates are constructed – short term static measures of the tax concessions on offer in super can be misleading if taken in isolation.

Indeed, the reporting of the TES estimates for superannuation typically reflect exactly that.

### 3.1.3 Accounting for behavioural change

Longer term assessments of super taxes also need to take account of other issues as the system matures.

For example, the ‘revenue foregone’ estimate of tax expenditures in super is compiled on the basis of a strict ‘no behavioural change’ assumption.

That is, it measures the revenue that would be raised if the hypothetical income tax benchmark were applied to the super system, but no members changed their contributions to super in response.<sup>5</sup>

As a result, these estimates are not a measure of the extra revenue on offer if the Government were to abolish super tax concessions.

On page 1 of the TES, Treasury therefore notes that:

*These estimates therefore do **not** indicate the revenue loss to the Australian Government budget of specific tax expenditures, as there may be significant changes in activity were tax expenditures to be removed. [emphasis in the original]*

In the case of superannuation tax concessions, a stated objective of those concessions is to change behaviour by encouraging voluntary contributions in order to support future retirement incomes. That is, the no behavioural change assumption is particularly problematic in this case.

In practice behavioural change combined with the concessional or deferred taxation of investment returns on offer outside of super would limit the revenue gained from abolishing super incentives.

That is because, while the estimates in the TES compare taxes in super to an ideal benchmark tax system, investors are comparing them to the next best available tax treatment – which results in lower effective rates of tax.

In recent times, Treasury has sought to address these concerns by producing alternative estimates of the ‘revenue gain’ if super tax concessions were to be abolished.

These estimates attempt to account for the behavioural changes that would occur if such a policy were enacted, given the concessional tax treatment available to investors outside of super.

Under this measure, Treasury estimates the ‘revenue gain’ from removing current super concessions at \$28 billion.

While Treasury quite rightly notes that these estimates are subject to significant caveats, they do provide an indication of the importance of behaviour in assessing the costs to revenue associated with the concessional tax treatment of superannuation.

### 3.1.4 Including the benefits of super

Any assessment of the cost effectiveness of super in providing retirement incomes needs to account for role of super in reducing future age pension payments.

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<sup>5</sup> Indeed, the ‘no change’ assumptions in the TES are even stronger than this. Increases in earnings taxes in the out years are applied to super balances that accrue under the current, concessional treatment of contributions and earnings.

That is, when measuring the costs of super, it is important to balance those costs against the matching benefits that super will provide to government finances in the future.

Such ‘cost benefit analysis’ is a cornerstone of economic assessments, yet these benefits are not accounted for in the cost estimates provided in the TES – raising the risk that the debate focuses on measured ‘costs’ without considering the associated future benefits that are substantially more complex to estimate.

While they are difficult to quantify, there is no doubt that the fiscal benefits associated with the super system are substantial.

## 3.2 The importance of policy stability

To meet its long term goals, and to attract voluntary savings, the super system needs the confidence of the public. Regular changes to policy by governments on both sides of the political divide have undermined that confidence over the last decade.

In this regard, changes which are announced but not implemented are almost as damaging to trust in the super system as those which are legislated.

Since 2004, the super system has seen a number of significant policy changes announced or implemented, with many later altered, abandoned or reversed. These include:

- Changes to tax incentives for higher income earners:
  - The introduction in 1996 of the 15% superannuation contributions surcharge on contributions for those with incomes over \$70,000 per year. The surcharge rate was lowered in 2003-04 and 2004-05 before its subsequent abolition in 2005.
  - The more recent introduction of the high income contribution tax of 15% on those with incomes over \$300,000 per year.
- The introduction of the government co-contribution in 2003, and subsequent changes to:
  - Increase the matching rate from 100% to 150% with effect from 1 July 2004.
  - Change the income test rules to include employer super contributions in the definition of income, with effect from 1 July 2007.
  - Reduce the matching rate from 150% to 100% for the 2009-10 and 2011-12 financial years, before restoring the rate to 150% over two years.
  - Impose a freeze on indexation of the minimum income threshold for the 2010-11 and 2011-12 financial years.
  - Reduce the matching rate from 100% to 50%, impose a further one year freeze in indexation of the minimum income threshold and double the rate of withdrawal with effect from 1 July 2012.
- The introduction of concessional contribution caps:
  - Introduced as part of a broader set of changes with effect from 1 July 2007, the cap was initially set at \$50,000 for those under 50 with a temporary level of \$100,000 for those over 50 applying for five years.

- Reduced to \$25,000 (with a transitional cap of \$50,000 per year for those aged over 50 until 2011-12) with effect from 1 July 2009.
- A new level of \$50,000 was announced to apply from 1 July 2014 for individuals aged 50 years and over with superannuation balances below \$500,000. This was later abandoned in light of feedback from the industry that the balance requirement would prove difficult to administer.
- An increase in the general level of the cap to \$35,000 (unindexed) for those aged 60 and over with effect from 1 July 2013, to be extended to those aged 50 and over from 1 July 2014.
- Taxes on super benefits:
  - All tax on super benefits was removed for those aged over 60 from 1 July 2007.
  - This was followed by the proposed imposition of a new tax on earnings from assets supporting a superannuation pension of over \$100,000 from 1 July 2014.
  - Following consultation with industry, the latter was abandoned.

While the above list is by no means comprehensive, members could be forgiven for finding it both daunting and confusing. Indeed, a number of these changes contradict or unwind changes made just a few years earlier.

Moreover, the damage here is cumulative – the more that the system changes, the more that public distrust increases. After all, the super system asks them to tie up their money for a very long period of time, but they increasingly lack confidence that money will be ‘safe’ from further policy tinkering.

While the problems associated with the detail complexity of arrangements in super are well understood, constant changes to the rules have served to add a layer of dynamic complexity to the system – with all the costs that such additional complexity involves.

Australians are aware that changes in super can affect their retirement savings. Given regular changes to superannuation rules, it is only rational for individual members to factor the risk associated with adverse changes to their super into their retirement savings plans.

The result is a system in which long term savers are discouraged from making voluntary contributions, while those members who see a short term benefit from a particular policy change are quick to take advantage of what is seen as a short window of opportunity before the rules are changed once again.

That combination represents a poor outcome for policymakers, as it poses fiscal risks associated with those who can afford to contribute in order to achieve short term goals, while reducing the effectiveness of incentives aimed at long term savers to secure future retirement incomes.

**The best way to reassure members that their retirement savings are safe from adverse rule changes is to provide long term stability in the rules and incentives around super.**

Given the nature of the political debate, there may be a need to consider a role for an independent umpire to oversee the operation of the super system and, consistent with the aims of the policy, to ensure the rules are as simple and as stable as possible over time.



### 3.3 Tackling longevity risk

As the SG arrangements themselves highlight, there are sound economic arguments in favour of compulsion in retirement savings. These arise due to key market failures in private decisions around retirement income provision.

Importantly, some of these externalities remain a concern once individuals begin to draw down on their accumulated savings in retirement:

- **Information asymmetry** is a significant issue for many retirees. Given the complex array of choices available to fund retirement incomes, retirees may struggle to plan appropriately to meet their own retirement goals. Without considering a range of possible longevity and market outcomes, it can be difficult for individual retirees to properly plan for their long term future during the early years of retirement.
- **Short-sightedness** can lead retirees to draw down on their assets too quickly, just as individuals are likely to save less than they need during working life to adequately support themselves in retirement. That is because the benefits of that spending come now, while the potential costs are often felt many years later – a problem exacerbated by the fact that people simply do not recognise how much life expectancies have advanced. (The average boy born today can expect to live 9 years longer than his father did, the average girl 7 years longer than her mother.)
- **Moral hazard** is also a concern for policymakers, as individuals are aware that after exhausting their private savings, they are able to rely on the age pension to cover a significant degree of their longevity risk.

That is, just as externalities provide a justification for compulsory savings during working life, similar arguments support policies aimed at improving the use of those savings to fund retirement incomes which improve the welfare of both themselves and society more broadly.

In recent times the policy debate has seen a number of proposals aimed at mandating the purchase of longevity risk insurance via lifetime or deferred annuities.

Such proposals have a number of advantages from the perspective of governments, and may also improve outcomes for retirees – especially those who outlive their peers. However, there are also important behavioural considerations to be addressed in any assessment of such proposals.

A key feature of the Australian super system is the sense of ownership felt by members over their own retirement savings.

To the extent that new rules restrict the use of those savings, there is a risk that members see super as a less flexible investment option – or worse, as money that is locked up at the mercy of government.

While these concerns can be easily overstated, the point is that when it comes to voluntary retirement savings, the perceptions of members matter.

In considering proposals to mandate the purchase of annuities, the benefits of improved longevity risk protection for retirees need to be weighed against the potential for voluntary contributions to super to be reduced by a behavioural response to the changes.

## 3.4 Alternative goals for the super system

Super already has big, long term goals that are in the national interest.

Moves to introduce new short term policies into the super system should be avoided. In short, super should stick to its day job of ensuring retirement income adequacy.

In general, if other policy goals arise, they should be dealt with in their own right. Using super to meet competing goals risks both adding complexity and compromising adequacy.

### 3.4.1 The theory of targets and instruments

Through their governments, Australians have a number of policy instruments to help achieve the targets of prosperity and fairness. These instruments include interest rates, workplace relations policy (the regulation of wages and employment conditions), other regulations, industry policy, budget policy (including taxes and welfare), education policy, and/or health policy.

That list is long, and it could easily be longer still.

It is worth examining such a list against one of the most basic tenets of economics: the principle of targets and instruments, also known as the principle of goals and policies.

The underlying rationale here is simple – you can't kill two birds with one stone.

Some policy instruments are most effective when aimed at one particular target rather than another.

For example, economists are hardly likely to recommend that interest rate policy focus on achieving fairness – that simply is not its strength. Rather, it is better aimed at keeping inflation low, which thereby tends to keep real (inflation-adjusted) interest rates low, which allows the economy to grow faster than it would otherwise, which aids prosperity.

Nor would economists recommend that, say, trade policy should be directed at fairness rather than prosperity. Free trade is a particularly strong instrument for achieving prosperity, so loading up trade treaties with social policy objectives risks failure on both targets.

That raises the fundamental question – is super policy better suited to achieving 'prosperity' or 'fairness'?

The answer to that question – assigning super to the appropriate target – can help to inform the best policy approach for the system over time.

Historically, superannuation policy has been aimed squarely at improving future prosperity. In fact, the nature of compulsory super involves an inherent degree of ‘unfairness’, as it is designed to force low and middle income earners to save more for their own retirement.

Many economists would argue that fairness is better achieved through taxes (direct and indirect) and transfers (such as social security and housing assistance), while superannuation policies are better at achieving prosperity (maximising future retirement incomes).

Why? Because, at its simplest, the private sector is best suited to the job of creating wealth (‘prosperity’), and the public sector’s tax/transfer system is best suited to the job of redistributing that prosperity (‘fairness’).

Aiming the wrong instrument at the wrong target usually results in unintended (and often perverse) outcomes.

From its outset, Australia’s compulsory superannuation system has been focused on providing Australians with long term investments to support retirement income.

By seeking to use super to meet other aims new directions in super policy could see the super system aiming to meet two very different goals.

That raises the risk that future decisions around super would not be solely focused on retirement incomes.

It also raises the risk that, in attempting to improve the welfare of the less well off, one lever (the super system) is trying to hit two targets – both prosperity and fairness.

Or, in other words, if there are policy targets outside the existing role of super, then there are likely to be other policy instruments which are better suited to meeting those targets than the super system.

Super is best left squarely aimed at its own policy target – that of providing future retirement incomes for Australian workers.

### 3.4.2 An example: early access for housing

A common proposal for the early release of super balances relates to assisting first home buyers with saving for a home deposit.

Such a proposal usually involves the following broad features:

- **Access** to super by first home buyers with the funds to be used as a deposit or part deposit on a residential property.
- **Eligibility** subject to an income test based on current annual income, and a limit on the price of the home in question.
- The **amount** withdrawn limited to some fixed dollar amount, or to a share of the person’s superannuation balance. This withdrawal decreases the balance and does not have to be paid back.

Proposals of this kind are by no means new. Indeed, the Labor Party floated a very similar proposal more than 20 years ago in its 1993 election campaign launch, while the Coalition gave an undertaking to examine the full implications of implementing such a scheme during the 1996 election campaign.

However, such a policy has been resisted by policymakers in the past, both because it undermines the important role played by preservation arrangements in reserving super savings for future retirement incomes, and because it involves more risks than benefits.

Those risks are largely related to a number of potential unintended consequences of any such policy change that are cause for concern:

- **Targeting risks.** Both Federal Treasury and the Productivity Commission (PC) have noted in the past that lower income households don't have much by way of super assets in the first place, making it hard to target earlier home ownership for them using 'early access'.
- **Price risks.** By increasing the demand for housing without altering the existing level of supply, early access may simply result in increased house prices, particularly in the short term. That raises the risk that the policy may effectively mean first home buyers use part of their retirement savings to subsidise existing home owners – and further disadvantage those without access to enough super in the housing market.
- **Behavioural risks.** Those who already have a home deposit saved could simply use their super for a deposit, and spend their savings. Even without sufficient savings ahead of time, individuals could simply sell the house after purchase to access the equity paid for with super savings. In both cases, the policy effectively bypasses the preservation arrangements designed to secure super for future retirement incomes.
- **Complexity risks.** The rules and regulations surrounding both super and home ownership are already complex, and a further layer of interaction via 'early access' policies could be at considerable further compliance and admin cost.
- **Policy risks.** Australia's super system has long been the envy of countries around the world, and is squarely focused on saving for retirement. Using super to assist a separate policy goal risks creating something of a tug-of-war over future policy directions in super.

From a purely economic perspective, the balance is less clear, but is also likely to be against early access. Most of the benefits to individuals under such a scheme would come at a direct cost to taxpayers, but the policy may make society better off given that:

- **Transaction costs are lower in owner-occupied housing.** Assuming total returns (including capital gains) are the same across asset classes, that means that people can be better off investing in owner-occupied housing. Homeowners are both landlord and tenant rolled into one, thereby saving on considerable 'middlemen' costs compared with the alternative of leaving assets in super (attracting fees) and renting (generating property management fees for real estate agents). This efficient elimination of middleman costs is the main economic argument in favour of early access.
- **There may be a "flower box" effect.** Any benefits to society resulting from greater pride in ownership of homes as opposed to other assets – the "flower box" effect – would also argue for early access. There is a literature that argues "social capital (better, cleaner neighbourhoods, lower crime) is seen to correlate with home ownership.

Yet there are also some factors that point to ‘early access’ policies having downsides too:

- **Early access may contribute further to the problem of ‘asset rich but income poor’ retirees.** Unlike super assets, retirees cannot readily ‘spend’ the home they own – leaving many with the lion’s share of their retirement assets effectively ‘locked up’ in the family home. Allowing early access to super to fund home purchase risks entrenching significant financial stress among retirees with valuable housing assets, but who remain reliant on the age pension to fund their everyday expenses.
- **Helping people achieve home ownership earlier may then encourage them to try less hard to save for a deposit (as policy would be providing them with extra help to do so).** ‘Early access’ may see retirement incomes stay flat or even fall if the beneficiaries have less incentive to save so as to meet the upfront costs of home purchase.

An alternative option for expanding home ownership rather than ‘early access’ to super could be an expansion of (or supplement to) existing schemes aimed at supporting first home buyers. **While some of the negatives outlined above also apply to such schemes, the latter can be more progressive (by not excluding those with little super assets, and if the benefits of the scheme are means tested), and could prove to be administratively simpler than ‘early access’.**

Or, in other words, **it isn’t clear that policy should change.**

**If it does change, then an adjustment to an existing policy may be a better alternative than adding a new policy.**

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