Retirement Income Review Secretariat
The Treasury
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PARKES ACT 2600
By email: retirementincomereview@treasury.gov.au

30 January 2020

Dear Secretariat

## *Retirement Income Review*

We are committed to positively contributing to the retirement incomes system by supporting initiatives such as the important work you are doing to develop a fact base upon which sound policy can be built. As a result, we expect this review will contribute to the future prosperity of our country more broadly.

Given the short timeframe within which to provide comment, PwC has not undertaken any detailed modelling to contribute new evidence to the review. We do however make suggestions for additional modelling that could be undertaken by Treasury using the Model of Australian Retirement Incomes and Assets (MARIA) which we would believe would contribute greatly to the development of the fact base. We also provide comments to assist you in answering a subset of your consultation questions.

We note that industry participants have called to make public the MARIA model. We understand that it may be difficult for Treasury to make the model public given the sensitive nature of the underlying data but would encourage the Retirement Income Review to make public many of the detailed model outputs (in spreadsheet form) for further analysis and interpretation by the public and industry.

## *Purpose of the system and the role of the pillars*

We welcome the Panel's desire to help define the objectives of the retirement incomes system collectively and individually for each of the pillars.

***5. The Panel has been asked to identify the role of each of the pillars in the retirement income system. In considering this question, what should each pillar seek to deliver and for whom?***

In assisting the Panel to identify the role of the pillars we note that the primary objective that needs clarification is the competing role of the Age Pension and the Superannuation Guarantee (SG) in the provision of an adequate retirement income.

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There are typically two views for this interaction:

1. The Superannuation Guarantee as a substitute for the Age Pension, with the primary purpose of the Age Pension to provide adequate income / poverty alleviation for those with low wealth or income.
2. The Superannuation Guarantee as a supplement to the Age Pension, in effect a "top up" to allow the majority of retirees to achieve an adequate income above a basic level of poverty alleviation set by the Age Pension.

The *Superannuation (Objective) Bill 2016* (which is yet to be passed by parliament) did not seek to resolve this tension, the primary objective was defined as:

*"to provide income in retirement to substitute or supplement the Age Pension"*[1]

PwC provided its own submission to the objective bill consultation which can be found on the consultation website[2].

Whether the purpose of the SG is to substitute or supplement the Age Pension can result in very different policy settings for the:

- level of the Age Pension,
- means testing taper, rates and thresholds,
- level of compulsory SG,
- level of support (tax concessions) for superannuation.

We note that the current means test taper rate leans towards the superannuation acting as a substitute for the Age Pension as it is relatively high. Work by some industry researchers has suggested that this could reduce the incentive for many (particularly those on middle incomes) to save additional superannuation as the level of Age Pension offset can be relatively high, especially if the individual draws down from their super at the minimum rate.

The optimal balance between the Age Pension and Superannuation Guarantee in contributing towards an adequate retirement income depends on the answer to the question *"to what degree is self-provision of retirement incomes beneficial?"*.

The answer to this question depends on many factors, including the demographic profile of our ageing population, participation rates, the distribution of income (particularly for low income earners), tax policy and the net rates of return that can be earned on invested assets vs. an Age Pension paid on a PAYG basis.

Recent evidence has suggested that current settings have reduced the impact of ageing on the cost of the Age Pension. We note that recent reports by The Australian reported that treasury modelling projected a fall in Age Pension spend as a percentage of GDP[3].

[1] https://www.legislation.gov.au/Details/C2016B00182
[2] https://treasury.gov.au/sites/default/files/2019-03/C2016-010_PricewaterhouseCoopers.pdf

We suggest that Treasury could undertake two modelling exercises to contribute evidence to the fact base on the value of self-provision.

1. Assessing macro risks with MARIA

The MARIA model is well placed to explore the impact of an ageing population on the retirement incomes system and public finances.

Australian population growth, participation and productivity is dependent on relatively high levels of skilled migration. We consider that it would be appropriate to run sensitivity scenarios through the MARIA model to demonstrate the impact of risks such as this on Age Pension expenditure.

For example, the latest ABS Population Projections (cat 3222.0) show that the Old Age Dependency Ratio[4] is projected to increase from 25.8 (in 2017) to 37.2 (in 2066) in the best estimate projections (series B). However, should population growth be slower overall, the ABS Projections estimate this will be 41.2 (in 2066).

This is a simple measure that doesn't fully capture the impact on public finances, but sensitivities on population growth, participation, longevity and other demographic factors can help evaluate the risks of a PAYG system on public finances and intergenerational equity.

The measurement of these sensitivities, would allow Government to assess the effect that compulsory superannuation has on reducing risks to the budget of an ageing population.

2. Cameo modelling for an individual member focus, allowing for all system contributions

We also encourage Treasury to undertake modelling from an **individual member's perspective over a lifetime** that fully captures the member's interaction with the retirement incomes system. This model should allow for a proportion of taxes paid to be treated as a "contribution" to the retirement incomes system and should also examine cohorts to examine potential intergenerational inequities.

Much of the current modelling conducted measures the impact on Government finances separately to the outcomes an individual is likely to achieve. This could lead to sub-optimal policy decisions as it does not measure the relative efficiency of saving in retirement in advance (through the SG) vs. contributing on a PAYG basis (through the Age Pension).

Comparison of the Net Present Value (NPV) of payments in, against benefits received would allow for an improved public debate and could measure:

- The relative efficiency of the use of the Age Pension or SG to provide retirement income
- Equity considerations, including:

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[3] https://www.theaustralian.com.au/nation/age-pension-liability-will-fall-faster-than-projected/news-story/bbc2f880752988bb86592fccf3ca060e

[4] defined as the number of individuals aged 65 and over per 100 people of working age (defined as those aged between 20 and 64)

- Intergenerational equity
- Socio-economic equity
- The appropriateness of public support

## *Adequacy*

**10. What should the Panel consider when assessing the adequacy of the retirement income system?**

PwC note that the sophistication of models and available data to assess adequacy has increased substantially since the Superannuation Guarantee was implemented. We agree with the Panel that the analysis of whether an individual is likely to achieve an adequate retirement income based on a given policy setting should account for:

- Gender
- Marital status
- Longevity
- Health and aged care costs
- Accommodation costs (for non-homeowners).

We encourage the Panel to also consider when assessing adequacy:

- **Retirement age** – most of the modelling produced by Treasury and other commentators has historically assumed a retirement age of 67 even though the majority of retirees will cease work prior to pension age. We encourage the Panel to consider different groups of retirees who will likely retire before, at or after the pension eligibility age.
- **Longevity –** most modelling of adequacy assumes retirees live until life expectancy, and often drawdowns are optimised to extinguish assets at life expectancy. When considering adequacy, we encourage the Panel to explore cohorts of members who will die before and after their estimated life expectancy.
- **Aboriginal and Torres-strait islanders –** face unique challenges in retirement and deserve consideration in the measurement of adequacy.

**11. What measures should the Panel use to assess whether the retirement income system allows Australians to achieve an adequate retirement income? Should the system be measured against whether it delivers a minimum income level in retirement; reflects a Retirement Income Review Consultation Paper 28 proportion of pre-retirement income (and if so, what period of pre-retirement income); or matches a certain level of expenses?**

PwC support the use of multiple types of benchmarks for the measurement of adequacy (i.e. both budgetary standards and a proportion of pre-retirement income). We note that both definitions of adequacy have advantages and disadvantages, and there is considerable variation in the definition of adequacy within each type of benchmark.

Given actual retirement income needs will vary by individual, and consumption needs will not be uniform (often depending on health, home ownership, marital status, etc.) no single measure will be optimal. Nonetheless, measures from both categories can produce *useful rules of thumb*.

Budgetary standards are useful for:

- Assessing whether the system provides a minimum level of “acceptable” retirement income e.g. for poverty alleviation
- Communicating retirement needs to the general population in a simple to understand format
- Removing the distortive effects of broken career patterns (e.g. maternity leave, transition to retirement, unemployment) or discrimination (e.g. the gender pay gap).

The setting of the right level for a budgetary standard is difficult for an “adequate” retirement income (as opposed to poverty alleviation). Often, benchmarks are set with reference to current retiree expenditure which may suffer from cohort effects, changes in the cost of living and is constrained by the assets available to be converted into income.

Replacement rates are useful for:

- Assessing whether the system achieves lifetime “consumption smoothing”
- Setting tailored goals, personalised to an individual
- For international comparisons

There are a number of issues that arise with the use of replacement rates. Setting policy based on the achievement of replacement rates can entrench inequities as measured gaps to the “adequate” level of income are often larger for higher income workers. Replacement rates would not address poverty alleviation (if the individual is near the poverty line) and are not useful for those with incomplete working careers. The determination of the correct base income on which to calculate the replacement rate is contentious as nationally the average worker sees a reduction in income in the lead up to retirement (often working part-time).

## *Equity*

**13. What should the Panel consider when assessing the equity of the retirement income system?**

Consistent with the response to question 5, we encourage Treasury to undertake modelling that examines the equity of the retirement income system from an individual’s perspective on a wholistic basis.

Figure 4 of the Retirement Income Review consultation paper shows the distribution of Lifetime Government Support that the Government is expected to provide to individuals of different income percentiles to support retirement incomes. However, the analysis only makes allowance for payments from Government (in the form of the Age Pension) or tax not-collected (in the form of concessions).

It would be informative for Treasury to undertake new analysis showing the contribution (a percentage of total tax paid) each income percentile is likely to make towards supporting the payment of the Age

Pension to pensioners over their lifetime. This would allow commentators to better appreciate the net redistributive effect of the retirement incomes system as a supplement to where support is provided.

This analysis could also be used to model any intergenerational transfer of wealth, as it is the current working population on provide taxes to pay for current Age Pensioners.

## *Sustainability*

**19. What factors should be considered in assessing how the current settings of the retirement income system (e.g. tax concessions, superannuation contribution caps, and Age Pension means testing) affect its fiscal sustainability? Which elements of the system have the greatest impact on its long-term sustainability?**

When measuring the cost to public finances of the retirement incomes system we would recommend the Panel have Treasury undertake modelling on a budget costing basis rather than the "revenue foregone" basis as assumed in the Tax Benchmarks and Variations Statement[5]. We note that the "revenue foregone" estimates in this statement of $19.6b and $17.8b for concessional treatment of earnings and employer contributions are often quoted as the cost to the Government budget of compulsory superannuation and are often compared to projected future savings on the Age Pension.

We note however, that the savings would not be realised in the budget bottom line where compulsory superannuation abolished as taxpayers would adjust their behaviour. Without the SG the existing stock of superannuation assets would not exist to the level it does today, and Government would additionally miss out on the potential tax payments from the investment earnings on these savings.

We further note that although treasury provides an additional "revenue gain" metric which allows for some behavioural change, in the case of superannuation the estimate assumes that compulsory superannuation would continue, and preservation rules would remain in place. As such, the "revenue gain" estimate does not constitute a costing of the impact on the budget if compulsory superannuation were abolished, only the allowing for the behavioural impact if the tax preferred nature of super were removed.

## *Cohesion*

**24. What is the evidence that the outcomes the retirement income system delivers and its interactions with other areas (such as aged care) are well understood?**

The Royal Commission into Aged Care Quality and Safety provides some background for the complexity of the Aged Care system and its poor integration with the Age Pension.

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[5] https://treasury.gov.au/publication/p2019-357183

Background Paper 1 to the Royal Commission[6] "Navigating the Maze", outlines the difficulty that older people and their families face in accessing and finding information on Aged Care.

At the heart of the issue on integration with retirement incomes is the means test. Age Pensioners who need to access Aged Care face a dual means test, the first which is applied to the level of Age Pension that they are eligible to receive and the second which is applied to the Aged Care fees.

We note that budget projections show that the cost of Aged Care is projected to increase at a faster rate than the Age Pension[7], consequently, the integration of Aged Care in the retirement incomes system is also of utmost importance for the sustainability of Government finances.

To assist the Panel in its assessment of the integration of Aged Care in the retirement incomes system, we refer you to research previously undertaken by the Centre of Excellence in Population Ageing Research (CEPAR)[8].

Kind regards,

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[6] https://agedcare.royalcommission.gov.au/publications/Documents/background-paper-1.pdf
[7] See Budget Paper 1, 2019-20 Table 9.1, Trends in the major components of assistance to the aged sub-function expenses. https://budget.gov.au/2019-20/content/bp1/download/bp1.pdf
[8] http://cepar.edu.au/sites/default/files/Aged_care_in_Australia_Part_I.pdf
https://cepar.edu.au/sites/default/files/Aged_care_in_Australia_Part_II_0.pdf