

August 2012

# RAW Touchstone

## Reforming the Age Pension

*The Age Pension is an integral part of the retirement income for the majority of retirees. Australia is wealthy enough to maintain the current structure even when the baby-boomers enter retirement and push the costs higher. However, it is not well designed and integration with superannuation is poor. The Age Pension is now the largest item of expenditure in the Federal Budget each year.*

*We consider it is time to reform our social security structure in a way that will cut costs to taxpayers and which will allow scope to pay higher benefits to our poorest retirees. Simultaneously, we need to maintain superannuation incentives which continue to encourage Australians to build reasonable retirement benefits. Over time, the Age Pension should become a safety net rather than an entitlement for most retirees. Such reform would also simplify the task of superannuation funds in assisting their members to plan for retirement.*

## Background

Australia has a three pillar retirement system. The structure is:

- A mandatory contribution (made by employers) which is currently 9% of wages, increasing to 9.25% from July 2013 and then gradually to 12% from July 2019
- Voluntary contributions, many of which include tax concessions (which have been significantly reduced in recent years)
- A State means-tested Age Pension commencing at age 65 for males and (currently) 64 for females but increasing to age 67 over the next decade. Veterans (pensioners who have been in the armed services) receive identical benefits but are entitled to access them five years earlier than civilians.

All elements are subject to constant changes for fiscal reasons. Australians in accumulation funds don't know what they are going to receive at retirement – and they are even less certain about how much they need and how they should spend their benefit in the retirement years. Superannuation is complex enough but the Age Pension adds another dimension of uncertainty.

The current Labor government had a review of all social security pensions (the Harmer Review in 2008). However, while the report sets out the issues succinctly, the review had a short time-scale and missed the opportunity for genuine reform of the Age Pension.

Superannuation funds are poor at integrating the Age Pension. Few funds adapt the default investment strategy for retirees - and many appear to be indifferent to the Age Pension and don't provide information to members about it - even though most of their members will receive it.

Yet, members need to know about the integration of superannuation, taxation and the Age Pension if they want to plan properly for their retirement years. Our system is far too complicated and forces members to obtain financial advice to work out their best strategy. Simplification of the system would make it easier and cheaper for funds and members to plan for retirement.

***As these benefits are now the largest single item of expenditure for the Federal Budget, and growing rapidly, fundamental reform should now be considered by government.***

## A brief history of the Age Pension

The history of the Age Pension is informative in understanding government objectives over time. From inception, Australia has paid for Age Pensions from consolidated revenue, so it is an unfunded benefit. Effectively, each generation pays for its parents' retirement benefit. Ongoing fiscal pressure has led to many changes over time. NSW introduced a State pension in 1900 followed by Victoria and Queensland. Commonwealth legislation was passed in 1908 introducing a means-tested flat-rate Age Pension, replacing the State age pension schemes. The pension was introduced to provide income support for older people, from age 65 for men and age 60 for women.

The pension was affordable for two reasons – only 58% of 20 year old male workers would live until age 65 and the life expectancy of a 65 year old male was only 11 years. Pension design, including rates of payment, indexation and means-testing, has been modified over the years, with significant changes occurring in the 1960s and 1970s. Changes included combining the property and income tests into a single merged means test in 1961, and introducing separate rates in 1963 for single and married persons in recognition of economies in expenditure for couples.

The most notable change was the introduction of a tapered means test in 1969; partial pensions became available for the first time, a development that has persisted until the present.

***The tapered means test is the core of the complexity of the modern system.***

In the 1970's, the Whitlam government started a process for the elimination of means testing for everyone over age 70, but this was abandoned by the next government (Fraser) and has not been seriously considered since. Whitlam also raised the basic pension from 20% of average male earnings to nearly 25%.

While an income test replaced the combined means testing arrangements in 1976, an assets test was re-introduced for all persons in 1985. This arrangement, whereby assets and income are considered separately and both affect the level of pension received, has persisted until today.

The introduction of compulsory employer superannuation contributions from 1986 replaced a pay rise sought by trade unions for alleged productivity gains in the workforce. The 4% pay claim became a 3% superannuation contribution. This benefit has always been seen as deferred pay and additive to the Age Pension. However, those on a full career of 12% contributions will lose part of their Age Pension when they retire – so there is clearly substitution and a shift to private funding of pensions.

In 2000, the Howard government increased the Age Pension benefit by 4% to counter the impact of the new Goods & Service Tax (GST). This took the rate to 26% of male wages.

More recently, the Harmer reforms<sup>1</sup> led to an increase in the Age Pension for single persons by \$60 a fortnight on top of the usual indexation. This took singles from about 61% to 67% of the couple's rate. In late 2009, partly to pay for this increase, means testing was tightened; the Age Pension income-test taper was increased to 50 cents per dollar for singles and 25 cents in the dollar for couples.

There has also been rationalisation of ancillary pension benefits and rebates. Consequently, the current benefit (including the Pension Supplement) for a single pensioner is about 30% of average male wages.

## Fiscal affordability

The Government provides significant tax concessions to assist Australians to save for retirement. Even after the recent budgetary changes which restricted the amounts of concessional contributions, the costs will rise steeply, putting further pressure on tax revenue.

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<sup>1</sup> Pension Review August 2008

**Table 1. Cost of providing superannuation concessions<sup>2</sup>**

Financial Year	2011-12	2012-13	2013-14	2014-15
	Estimate	Estimate	Projection	Projection
	\$m	\$m	\$m	\$m
Concessional taxation of employer contributions	14,850	15,500	16,700	18,800
Concessional taxation of superannuation entity earnings	14,000	15,100	16,750	19,550
Other concessions	1,276	1,266	1,106	1,176
<b>Superannuation Tax Concessions</b>	<b>30,126</b>	<b>31,866</b>	<b>34,556</b>	<b>39,526</b>

The cost of these concessions assumes that the revenue would otherwise be taxed at company or marginal personal income tax rates. In practice, these tax rates would be reduced if there were no concessions.

The concessions will assist in reducing future expenditure on the Age Pension, but the level of dependency projected under Treasury’s intergenerational reports does not fall significantly. That is why Treasury and others question the value of superannuation concessions.

***Age Pension costs are rising steeply and will grow significantly as the baby-boomers enter their retirement years over the next decade.***

**Table 2. Income Support for Seniors<sup>3</sup>**

Estimates			Projections		
2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
\$m	\$m	\$m	\$m	\$m	\$m
31,938	34,812	36,760	39,017	41,741	44,865

It is not just the weight of new retirees which will push costs higher; it is also the ever-improving longevity of older people. Over the past 100 years, life expectancy for 65 year old men has increased from 11 years to 21 years today; while for women, life expectancy for 65 year olds has increased by close to 10 years to more than 22 years today. Further increases of 1 to 2 years are expected every decade!

<sup>2</sup> 2011 Federal Budget – Treasury Expenditure Statement 2011 Section 3

<sup>3</sup> 2012-13 Budget paper No. 1 – Tables 9 and 9.1 & past Final Budget Outcomes

## Eligibility

### Qualification

In 1962, the minimum period of residency was reduced from 25 to 10 years. Most economic migrants have to be under age 45 so they easily qualify – and have time to become self-sufficient in retirement. However, Australia now takes on a large number of refugees and migrants under the family reunion program. We can expect these to place a heavy burden on future Budgets as the majority will become full Age Pensioners when they retire.

From 1973, Australian pensioners living abroad were able to claim the Age Pension and have it repatriated to their home. This has assisted many migrants who have retired in their place of birth after a working life in Australia. The 2012 Budget tightened this and a full pension is now only paid after a 35 year working life in Australia (previously 10 years).

### Eligibility Age

The government response to rising costs has been to increase the eligibility age for the Age Pension. Originally, it was thought that married women would retire at the same time as their husbands, who were generally 5 years older. Thus, females retired at 60 presumably so couples could retire close together. The female age is increasing from 60 to 65 over the 20 years to 2014.

The qualifying age for the Age Pension will increase to 67 progressively from 2017 in another attempt to reduce costs – but this will only work if we can curtail the number of people who retire early by moving to the Disability Support Pension!

In 2023, the government will review whether the age needs to rise further due to increased longevity.

## Participation in the Age Pension today

Currently 75% of Australians over the age of 65 rely on a full or part Age Pension for financial support.

**Table 3. Number of Pensioners over age 65 in 2011**

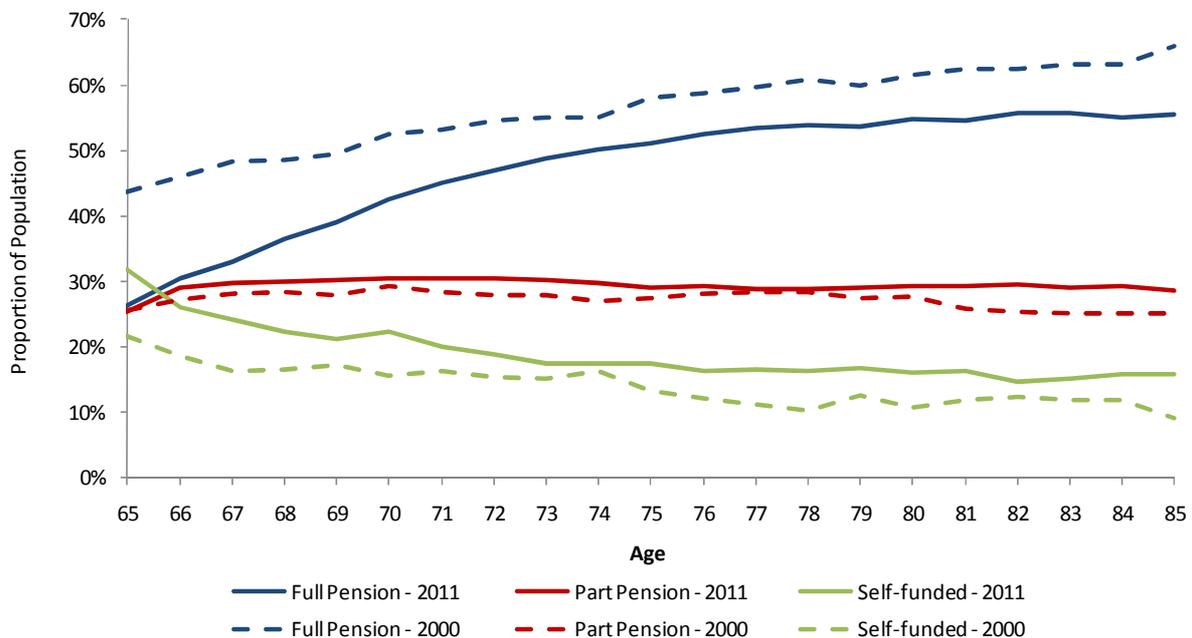
Age Pensioners		Number of people	Payments <sup>4</sup> \$m
Full	Individual	622,846	\$12,126
Full	Couple	671,010	\$9,841
Part	Individual	308,462	\$4,804
Part	Couple	556,669	\$6,534
<b>Total</b>		<b>2,158,987</b>	<b>\$33,305</b>
DVA Pensioners over age 65		228,510	\$4,112
Still Working		166,029	
Self Funded		629,901	
<b>Population over age 65</b>		<b>3,183,427</b>	
<b>Retirees aged 55 to 64</b>		<b>1,361,689</b>	
<b>Disability support pensioner</b>		<b>800,000+</b>	<b>\$ 13,800</b>

<sup>4</sup> Rice Warner estimates

Figure 1 illustrates that over the last 10 years, the proportion of the Australian population receiving the full Age Pension has decreased, most markedly between age 65 and 70 as these cohorts have benefited from the Superannuation Guarantee for a longer period of their working lives than those who retired ten years earlier (and the cohort is wealthier than the one for the previous decade).

While the proportion on the partial Age Pension has risen only marginally, the proportion of self-funded retirees has increased to a greater extent. Despite this encouraging trend, the proportion on the Age Pension remains high, reaching over 80% of the population by age 75.

**Figure 1. Proportion of the population receiving the Age Pension and self-funded retirees – 2000 and 2011**



While the number of persons of eligible age for the Age Pension will increase markedly in the future due to our ageing demographics, the Superannuation Guarantee will limit the outlays. This is supported by Treasury projections to 2049-50, which show that those on the part pension will increase significantly with a commensurate fall in those entitled to the full pension. However, despite growing superannuation balances, Treasury projects that the proportion of the population not receiving any Age Pension will rise relatively slightly to no more than about 25% of retirees.<sup>5</sup>

## Goals of the Age Pension

Before proposing any reform, we should first consider how the Age Pension is structured, the principles that ideally should be satisfied by a successful pension scheme, and whether or not the Age Pension satisfies these principles. A useful guide for these purposes is the Pension Review Background Paper of the Harmer Review, which lists five key principles underpinning a successful social security system:

<sup>5</sup> Treasury 2010 Intergenerational Report

- Support should be at a basic acceptable standard of living
- Payments should be equitable between people in similar circumstances
- Payments are targeted to those not able to fully support themselves
- It promotes workforce participation and self-provision
- It is sustainable.

### Acceptable standard of living

The first purpose of the Age Pension is to establish a suitable standard for a retiree without any other resources which should be supported by taxpayers. As a bare minimum, it must meet a minimum subsistence level to ward off poverty.

After the latest indexation from March 2012, the full Age Pension is \$695.30 a fortnight for a single person and \$1,048.20 a fortnight for a married couple. There is also a pension supplement for singles of \$60.20 a fortnight (\$90.80 for couples). A minimum pension supplement of \$32.40 per fortnight for singles and \$48.80 for couples (combined) is payable to those eligible for a partial Age Pension under the means test.

Table 4 shows the most recent budget standards for a modest and comfortable lifestyle from ASFA<sup>6</sup>. While these values do not reflect the situation of every retiree, they allow us to gauge the average needs for different lifestyle expectations given costs of living in Australia. These are compared with the maximum annual rate of Age Pension<sup>7</sup> as at July 2012.

**Table 4. ASFA Retirement Standards**

	Modest lifestyle	Modest lifestyle	Comfortable lifestyle	Comfortable lifestyle
	– single	– couple	– single	– couple
Yearly Total	\$21,970	\$31,675	\$40,412	\$55,316
Age Pension	\$19,643	\$29,614	\$19,643	\$29,614
Difference from Age Pension	\$2,327	\$2,061	\$20,769	\$25,702

It is clear that the Age Pension is close to meeting the modest lifestyle needs of retirees. As the benefit is linked to wages and the modest lifestyle is linked to prices, the Age Pension will gradually close in on the modest lifestyle.

For a comfortable lifestyle, retirees need to build their own superannuation as the Age Pension will be inadequate.

It should be noted that the Age Pension is far more generous than the Newstart Allowance paid to Australia’s unemployed. The Age Pension exceeds the amount paid under Newstart by between \$6,000 and \$7,000 per annum for singles and couples, and any increase in the Age Pension would widen this discrepancy.

<sup>6</sup> ASFA (March Quarter 2012). The budget standards assume that the home is owned outright.

<sup>7</sup> Including pension supplements.

## Equity

The Age Pension is equitable insofar that payments are the same for all eligible persons. However, financial needs will vary according to each person's circumstances and it is difficult to compensate adequately for this. In general, government attempts to address this through means testing, and through supplementary payments which are targeted to those with specific needs (e.g., renters or those with dependants).

Despite these methods, it is difficult to achieve full equity. For example, the pension does not take into account geographical differences in living costs between regions. Another anomaly is the definition of a couple. This is now out of date as family structures have changed. For example, two people living together (friends or siblings) receive two single benefits whereas a married couple receives a smaller combined benefit; yet their financial needs may be very similar.

As shown above, the Age Pension is more generous than other social welfare payments, such as the Newstart Allowance. This is in part due to the Age Pension being benchmarked to Male Total Average Weekly Earnings (MTAWE), as compared to Newstart which is indexed with CPI.

***The largest inequity is the exclusion of the family home from the assets test irrespective of its value.***

## Targeting benefits

The means testing that is applied to the Age Pension consists of an income test and an asset test. The payment received is the lower amount determined by the two tests. The family home is exempt from the assets test.

As an example of the means tests, a single homeowner with assessable income less than \$152 per fortnight, and assets outside the family home that are less than \$192,500, is entitled to receive the full pension of \$695 per fortnight plus a pension supplement of \$60.20 per fortnight. Every dollar of income above the income test threshold reduces the pension entitled by 50 cents per fortnight, and every \$1000 of assets above the asset test threshold reduces the amount of pension by \$1.50 per fortnight.

This is illustrated in the following tables, which show the Age Pension entitlement for 65 year old pensioners (the Age Pension payments include the Pension Supplement). The cells are shaded to show recipients of a full Age Pension.

Table 5 shows the annual Age Pension payments for pensioners with different asset levels (assuming assessable income is below the income test threshold of \$152 per fortnight).

**Table 5. Assets test**

Category	Assets	\$0	\$100,000	\$200,000	\$300,000	\$400,000	\$500,000	\$750,000	\$1,000,000
Home Owner	Individual	19,643	19,643	19,351	15,451	11,551	7,651	-	-
	Couple	29,614	29,614	29,614	28,561	24,661	20,761	11,011	1,261
Non Home Owner	Individual	19,643	19,643	19,643	19,643	16,991	13,091	3,341	-
	Couple	29,614	29,614	29,614	29,614	29,614	26,202	16,452	6,702

Table 6 shows the impact of different incomes in retirement. The values are the same for home owners and renters.

**Table 6. Income Test<sup>8</sup>**

Category	Assets	\$0	\$100,000	\$200,000	\$300,000	\$400,000	\$500,000	\$750,000	\$1,000,000
	Income	\$0	\$6,000	\$12,000	\$18,000	\$24,000	\$30,000	\$45,000	\$60,000
Pensioner	Individual	19,643	18,619	15,619	12,619	9,619	6,619	-	-
	Couple	29,614	29,614	27,046	24,046	21,046	18,046	10,546	3,046

The implication of the means testing rules is that an individual home owner can earn over \$1,600 per fortnight and have non-housing assets of close to \$700,000 before eligibility for the partial Age Pension cuts out.

### Poor targeting of Means-testing

A partial Age Pension is payable for home owning couples with earnings up to close to \$2,500 per fortnight and with over \$1,000,000 in non-housing assets.

For example, a couple who are homeowners with non-housing assessable assets of \$750,000 and assessable income of \$45,000, are eligible for a considerable part Age Pension payment of over \$10,000 per annum, and those with even higher income and \$1 million in non-housing assets are *still* eligible for a partial pension. This suggests that the benefit is poorly targeted under the current means testing system.

Currently, many wealthier Australians who have a valuable home and/or contact with a knowledgeable financial planner can access the Age Pension. Yet, when these retirees later pass on a substantial asset tax-free to their estate, the Australian tax payer has effectively subsidised the inheritance<sup>9</sup>.

### Complexity and inconsistency

Apart from the overly generous exemptions for home ownership, the means testing provisions generally ensure that those who are relatively well off do not receive a full Age Pension. However, means-testing has become a complex and inconsistent system.

The example we give is for a single male homeowner retiring at age 65. We assume he has assets of \$400,000 invested in an account-based pension, and draws a pension payment of \$40,000 each year (adjusted annually for inflation).

Figure 2 shows how his superannuation balance reduces over time and expires within 20 years. Figure 3 shows the annual retirement income sourced from his superannuation and the Age Pension. He is able to maintain his desired income (including indexation) for 18 years.

<sup>8</sup> We assume the retiree's assessable income equals 6% of the value of their assets.

<sup>9</sup> Australia has no death duties – apart from the tax on superannuation death benefits paid to non-dependants

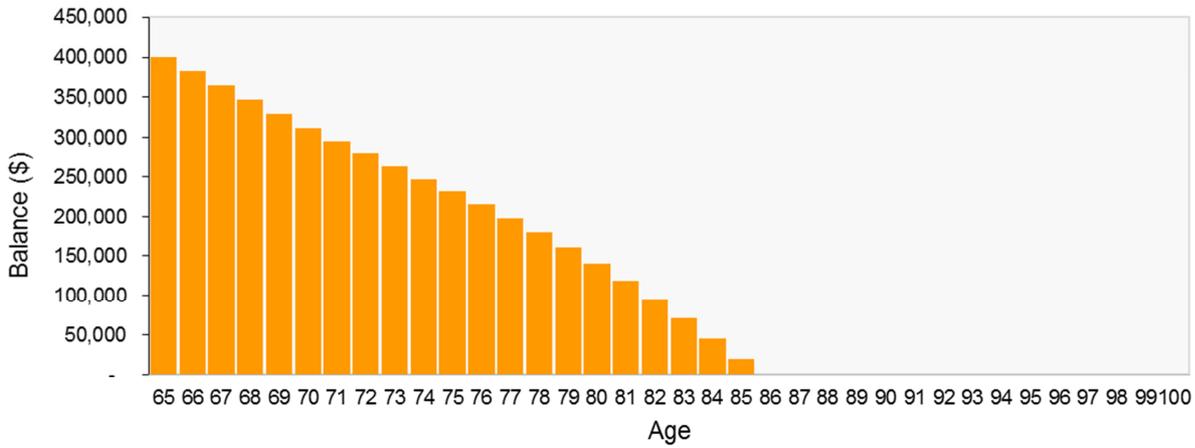


Figure 3 shows the average life expectancy (50<sup>th</sup> percentile) as well as the points at which 25% and 10% of his cohort will survive.

**Figure 3. Annual retirement income**

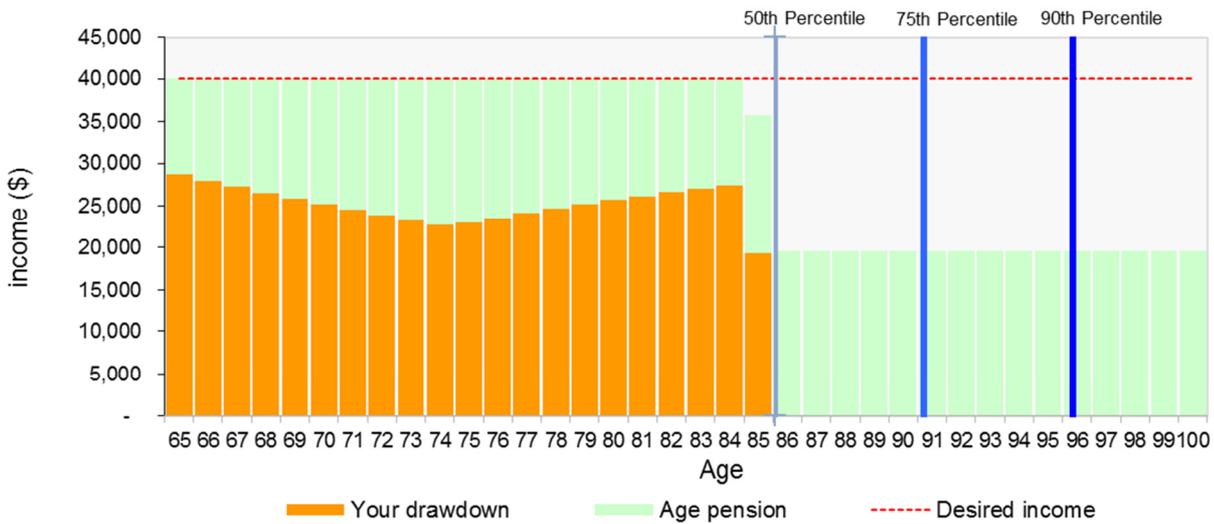


Table 7 gives the amount of Age Pension for this example under the income and asset tests at different ages.

**Table 7. The effect of the means testing<sup>10</sup>:**

		Age			
		65	70	75	80
Individual Home Owner	Income test pension	19,643	19,643	17,076	14,332
	Asset test pension	11,326	14,783	17,930	19,643

<sup>10</sup> The shaded cells show the actual pension received, being the lesser of the amounts receivable under the income and assets tests.

It does appear counter-intuitive that, as the pensioner gets older and his assets decline, his Age Pension entitlement declines as well.

The explanation lies in the assessment rules for income derived from an account-based pension. In this case, the retiree's accessible income equals his withdrawal from the account-based pension minus a deductible amount, the calculation of which is complex but roughly equals the value of assets at the time of the purchase of the account-based pension divided by life expectancy at that time. This deductible amount is not indexed.

Hence, as the retiree ages, the pension eligible under the assets test increases, however the pension eligible under the income test decreases!

In short, when a retiree is attempting to target a fixed expenditure amount, the result of current means testing is an Age Pension rate with a humped shape.

While the likely intention of the income test is to prevent retirees from drawing their savings too quickly, the current arrangements are complex to administer and difficult for retirees to understand. Under current arrangements, working out one's optimal drawdown of wealth and Age Pension entitlement is complicated and requires professional assistance. Moreover, this income test disadvantages females, as their longer life expectancy implies a lower deductible amount, meaning they are entitled to a lower pension than males in the same situation.

Means testing is also expensive to administer, as it requires continuous monitoring of each pensioner's financial circumstances. Pensioners are required to report their income and assets twice yearly, and additionally whenever their financial circumstances change. This administrative burden costs both retirees and Centrelink. We estimate that the cost of administering the Age Pension by Centrelink could be as high as \$1 billion a year<sup>11</sup>.

### *Participation and self-provision*

Ideally the Age Pension should encourage individuals to continue to participate in the workforce, and should not act as a discouragement to self-provision in retirement. The current pension arrangements fail these principles.

First, existing means testing discourages part-time work; the income test implies a high effective marginal tax rate for those who would sacrifice a higher Age Pension rate in favour of increased hours of work.

Second, although the eligibility for the Age Pension is 65 and increasing to 67, retirees can access their superannuation at age 60. This allows early retirees to spend some or all of their superannuation and fall back on the Age Pension at a relatively young age.

Third, the exemption of the family home from means testing discourages many retirees from downsizing their home to release capital, and may encourage some to upsize in order to lock away capital as retirement approaches. Retaining the exempt status of the family home in effect discourages self-provision, unless the capital in the home is released to meet expenditure needs.

The government does have some mechanisms to encourage participation. An example was the Pension Bonus Scheme which was designed to encourage retirees to defer their claims for the Age Pension.

However, the take-up rate was poor and this scheme was replaced with an initiative to allow single retirees to earn up to \$150 a fortnight and married couples up to \$264.

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<sup>11</sup> 2012-13 Government budget paper estimated the total administration cost of Centrelink to be \$3.8 billion in 2011-12, and Age Pension outlays equal 27.4% of total social security and welfare payments.

## *Sustainability*

The Age Pension is not pre-funded but is paid from consolidated tax revenue each year. As the population continues to age, more retirees will require funding from a shrinking tax base.

The 2010 Treasury Intergenerational Report puts the cost to the taxpayer of the Age Pension to be about 2.7% of GDP, costing Australian tax payers around \$32 billion a year in 2010 dollars. This is projected to rise to 4.6% of GDP over the next forty years, costing around \$140 billion (in 2010 dollars) per year in 2050.

The expected increase in pension costs over 40 years to 4.6% of GDP is generally considered to be sustainable. The question to be asked is whether better targeting or encouragement for private superannuation could reduce the cost increase over the period and/or provide higher benefits for those in real need.

In the 2010 Federal Budget, the government projected that the Age Pension (and service pensions from veterans) would reduce by \$3.8 billion by the 2036FY with a cumulative saving to that time of \$41 billion. Ironically, this reduction is based on the increase in the SG from 9% to 12%. Treasury expects that the increased contributions will be taken from employee wages via lower pay increases. As the Age Pension is indexed to wages, these benefits will also be reduced!

## **Reforming the Age Pension**

It appears incongruous that people cannot claim a Newstart allowance until they have used up their own money first, while there is a generous asset test for the Age Pension. Further, Newstart has no partial payment – you either qualify or you don't.

Could this be considered for the Age Pension too? Why shouldn't people use their own resources first and then fall back on social security as a safety net later in life?

Our proposed reform suggests a way in which this can be done. Obviously, the implementation would need to be introduced over a lengthy period, perhaps 20 years so that existing pensioners are not affected.

The objective of our proposed reform is to direct taxpayer funds towards retirees in need, rather than funding a perceived entitlement. By reforming the Age Pension, Australia will be in a position to deal more equitably and more effectively with the ageing population.

### *Use Superannuation and other assets first*

We would retain a threshold of assets which would be exempt from the Age Pension means-test.

We propose a threshold amount, to be held in superannuation, of \$250,000 for singles and \$350,000 for couples. This benefit would be a tax-free account-based pension with no limit on withdrawals or investment strategy. Let's call this an 'exempt pension amount' (EPA).

We have selected an amount of \$250,000 as the income from this, combined with the Age Pension, should provide a comfortable income in retirement.

The EPA could be held indefinitely whether the individual is eligible for an Age Pension or not.



### *Qualifying for Age Pension*

The Age Pension would be restricted to those who have first spent their superannuation and non-superannuation savings. Exempt assets would include the first \$1 million value of the family home and the EPA.

The tapering of the means test and part Age Pensions would be abolished. That is, a full Age Pension would be provided to eligible persons with assets below the EPA, but no pension would be payable to those with assets exceeding this limit. Retirement income would consist of the investment earnings on the EPA plus the Age Pension.

### *Early Access*

After the Preservation Age (currently 60), all social security benefits (including the DSP and Newstart) would be subject to the same rules.

Most people would not be affected as they would be able to shift assets into their EPA. However, wealthier Australians would need to spend their higher savings (above the EPA) first if they wished to qualify for the Age Pension. An advantage of spending savings first is that the money would not disappear to their estate if they die young.

### *Retiring Later*

If people retire above the eligibility age for the Age Pension, they will be able to accumulate additional contributions into their EPA. This will provide a higher exempt threshold which will lead to higher income later in life even when eligible for the Age Pension.

### *The family home*

The Age Pension would not be available to homeowners if the value of their homes (together with the EPA) exceeded a particular limit. We could set the limit for the home at \$1m which would give an individual the opportunity to have a house worth \$1m and an EPA of \$250,000.

In order to access the Age Pension, those with homes that exceeded the threshold amount could either:

- Downsize their property to be less than this limit, thereby freeing up capital – some of which could be directed towards the EPA. The retiree would then be eligible for the Age Pension if the freed capital and other liquid assets did not exceed the EPA. If the liquid assets did exceed this amount, the excess would first need to be consumed before being eligible for the Age Pension
- Choose to keep their home but be required to borrow against the property. Once net equity reduced to \$1 million, the retiree would become eligible for the Age Pension.

### **Complications**

While the approach outlined above has a single asset test, we have not described the treatment of those with existing income streams, such as defined benefit pensions, lifetime annuities or guaranteed lifetime pensions. Although these are a minority of retirement benefits, separate rules would need to be used to cope with these pensioners.

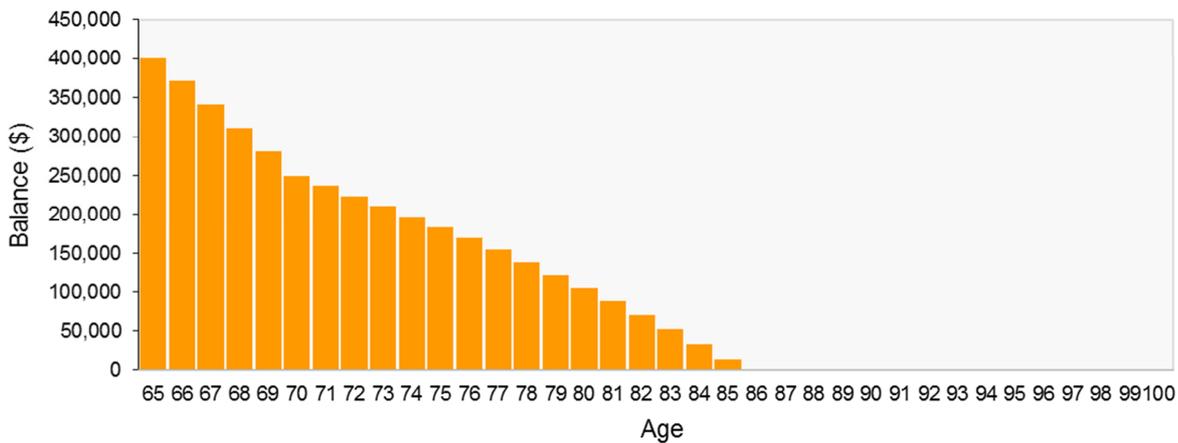
Another complication comes from transitional arrangements. While the change to a new structure could take place relatively quickly and could apply fairly early to all individuals currently under the age of 50, transition arrangements for existing pensioners would need to be carefully considered. We would suggest reviewing transitional arrangements for each 5 year cohort approaching and in retirement.

A potential limitation of the proposed system is that it might encourage retirees to spend their non-exempt assets more quickly than they would otherwise in order to gain access to the Age Pension. This could be curbed through either limits or incentives. For example, annual drawdown limits could be imposed on superannuation balances.

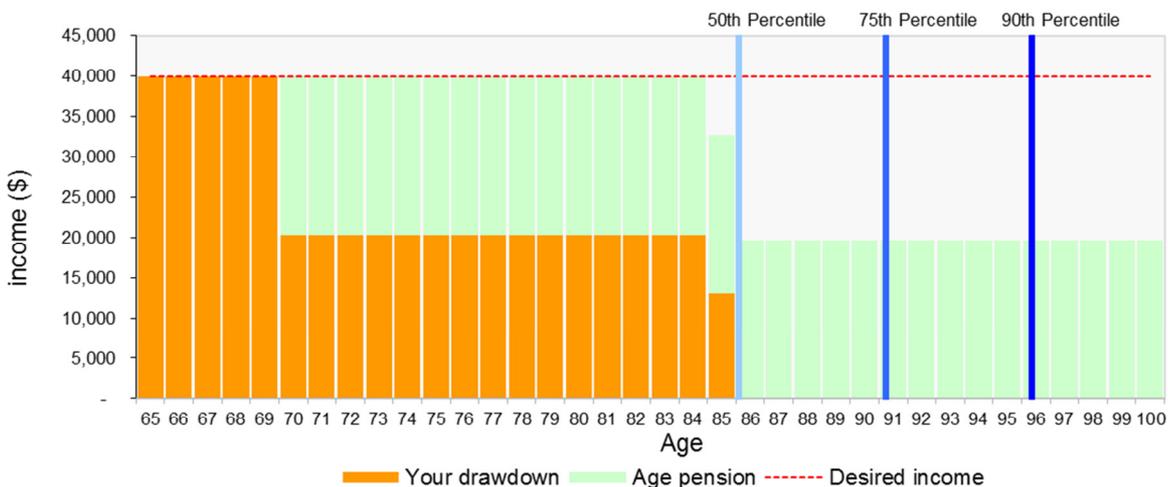
### Impact on the individual

The following Figures illustrate the Age Pension payments under the proposed system for the case set out in Figures 2 and 3.

**Figure 4. Superannuation Balance under Reform**



**Figure 5. Annual Retirement Income under Reform.**



Compared to the current system in Figures 2 and 3, we see that:

1. The benefit structure is much simpler
2. Superannuation assets reduce faster in the earlier years
3. Age Pension payments have been delayed, but once available, remain constant at the full amount
4. A similar retirement income profile is achieved under the existing and proposed Age Pension systems.

The figures clearly illustrate the reduced complexity of the proposed system.

## Value of Reform

The proposed system would require members to use their superannuation and non-superannuation assets (including investment properties), subject to a quarantined amount (EPA) before they become eligible for any Age Pension benefit.

A consequence of this arrangement is that means testing takes the form of a simple assets test rather than a dual income/assets test, and (generally) would only be applied when someone has reduced their assets and becomes eligible for social security for the first time.

The implication is that the age at which a retiree becomes eligible for the Age Pension would be older on average than it is today. This would save between 5% and 10% of Age Pension costs over time. Further, there could be significant savings in administration costs. These savings could be applied to provide support for older Australians in areas such as Aged Care.

Any changes to the Age Pension are highly sensitive. Given 2.8 million Australians currently receive some payment from the Age Pension, any reform would need to be carefully structured to avoid any claim that the proposed system is a loss of entitlements.

In conclusion, we consider changes to the Age Pension structure are required in order to improve the efficiency of retirement income policy while maintaining equity and alleviating poverty for those with real needs.



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