The Age Pension in the 21st Century

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for the Financial Services Forum 2018

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1. Background

1.1 Abstract

The Age Pension in the 21st Century looks at the changing role and dependency of the first *Pillar* of our retirement incomes system.

This Paper reviews the major changes to the Age Pension over the last 20 years. It shows how the benefit has evolved largely from being a safety net for many Australians to becoming a supplementary benefit to superannuation income for the majority.

It looks at changes in retirement demographics and models the future distribution of wealth to show a changing role for the government benefit over the next twenty years.

It recommends changes so that the Age Pension becomes better targeted, more certain and stable, at all phases of retirement. This requires better integration with superannuation, Aged Care and other income.

1.2 Conclusions

There should be a national objective for the Age Pension, in much the same way we will have one for superannuation.

The cost of continuing the Age Pension in its current form is projected to reduce as a percentage of GDP, from around 2.7% of GDP in 2017 to around 2.5% of GDP in 2038. This reflects recent tightening of means testing, later retirement ages and further growth in superannuation balances.

Some of the matters which could be considered for future policy initiatives:

1. **Including the family home in the Means Test at a fixed value of average earnings (threshold to be decided). Adding a multiple of six times average earnings to the asset test thresholds would shift the pension to becoming a safety net; a multiple of 10 times would provide the benefit to 40% or more of the population.**

2. **Significantly increase rental assistance for age pensioners.**

3. **Enhance incentives for part time work in retirement.**

4. **Set a target for combined Age Pension and Aged Care costs as a percentage (say, 4% to 4.5%) of GDP.**

1.3 Acknowledgements

Martin Stevenson of the Department of Treasury (not to be confused with our ex-President of the same name) has provided useful insight into income and welfare distributions. While on secondment to Rice Warner, he has managed a small team of actuaries and analysts and they produced the modelling and other numerical work for this Paper.

The *ISA Rice Warner Retirement Outcomes Model* was used to produce projections analysis in this Paper.

The Paper was peer reviewed by actuaries Michael Berg and Tim Jenkins.

1.4 The Age Pension in 1998

In 1998, I wrote a Paper for the *Institute of Actuaries of Australia, The Age Pension, Our Unstable Pillar*[i].

At the time, the superannuation system was beginning to settle down after 15 dramatic years of frequent changes to the rules and taxation of occupational benefits. However, the mandatory Superannuation Guarantee (SG) system was in its infancy and average balances at retirement were small.

The projected costs of the Age Pension benefit were then believed to be significant given the size of the baby-boomer cohort coming up to retirement. This was quantified a few years later with the government's first Inter-generational report[ii],released as part of the 2002-03 Federal Budget papers. In 2002, the annual cost of the Age Pension was 2.9% of GDP with Treasury projections showing it would become 4.6% of GDP in 40 years (2042).

Over the last twenty years, the total costs of age pensions (from DSS and DVA[1]) have grown by more than 5% a year, which is double the rate of price inflation.

Superannuation has had even more rapid change over the last two decades and these changes have impacted on the coverage and cost of the Age Pension.

1.5 Issues in 1998

The 1998 Paper made several points which remain valid today. The key observations were:

- Australia has a three-tiered retirement policy which follows many principles set out in the often-quoted World Bank 1994 research report, ***Averting the Old Age Crisis***[iii]. The 1998 Paper argued that this structure was permanent and could become sustainable. However, it required several policy changes before the system would become stable.
- Little attention had been paid to the proper financial management of the costs associated with pensioners. These included medical benefits, accommodation and nursing care. The most visible of these costs was the Age Pension, the ***safety net for those who are financially disadvantaged in retirement.***
- The Australian government applies Means Tests (against assets and income) to reduce eligibility for the Age Pension benefit, but these measures are driven largely by annual fiscal (budgetary) considerations or by short-term political objectives. The government did not have a long-term focus on eligibility criteria, so there was poor integration with privately funded superannuation and with the rapid ongoing changes in society.
- This instability was exacerbated by blaming changes in the demographic structure of the community for a looming fiscal crisis, when the ageing of the population was predictable years in advance. The Paper argued that the problems were caused by poor planning and lack of funding rather than ageing. Furthermore, changes to eligibility for social security often run contrary to the government's stated objectives.
- The Paper examined the emerging costs of retirement incomes provided by government and suggested placing the unfunded liabilities of the Age Pension in respect of those already retired onto the national balance sheet as a means of putting them into perspective - and making them transparent.
- Other needs such as accommodation, aged care and health benefits for the aged were also costly and lack proper provision.

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[1] Most pensions are paid by Centrelink on behalf of the Department of Social Security (DSS). War veterans are paid equivalent benefits from the Department of Veterans Affairs (DVA).

- The Paper looked at the changing nature of retirement and discussed appropriate levels of social security. It discussed the financial and other needs of retirees and noted that these can change significantly throughout retirement and this is not well recognised in social security or the provision of privately funded superannuation.
- The then current system (and some proposed solutions) relied on taxation to change behaviour. The validity of this was considered.

The Paper recommended that separate solutions be considered for the existing cohort of pensioners and those still in the work-force. Social security benefits in respect of the existing cohort could be partly funded using proceeds of forthcoming privatisations as a mechanism for addressing the issue of emerging costs.

Controversially, it also suggested that the first-tier of any private superannuation proceeds for future retirees could be applied to purchase the equivalent of any government benefit. This would ultimately replace part of the Age Pension with SG benefits. In practice, this is extraordinarily difficult to do with the high present value of the Age Pension and the impact of the means-testing.

1.6 2004 Paper – Retirement Income Integration

In 2004, actuary Geoff Dunsford and I prepared a Paper reviewing the provision of *Retirement Incomes in Australia*[iv]. At the time we identified the complexity of superannuation, social security and taxation arrangements and the prevalence of lump sum benefits in retirement as key concerns that would require a policy response.

We noted that, within the three-pillar structure of the retirement income system, ***there were no explicit goals or objectives of the superannuation system.***

The suggested policy changes we proposed in the Paper focused on simplifying the superannuation system, improving the transition from lump sum to retirement, and reducing Government expenditure over the long-term.

Again, as in the 1998 Paper, we recommended that any changes to retirement income policy be made for younger age cohorts and not those currently retired. These groups have the longest lead time to retirement and so implementation. Therefore, community acceptance of any policy change would be easier for the Government of the day. We suggested that transitional arrangements could always be made for older cohorts.

The then Howard Coalition Government announced significant changes to the superannuation system at the 2006-07 Budget. These changes were designed to significantly simplify the system and reduce the complexity of the taxation of superannuation. Under these changes, benefits paid to retirees aged 60 or above from a taxed fund were exempt from tax.

Reasonable benefit limits were also abolished so the amounts put into funds, particularly self-managed superannuation funds, grew to take advantage of the tax-free retirement phase (earnings and benefits were exempt from tax). Consequently, whilst these changes did simplify the tax treatment of retirement benefits, they also significantly increased the tax concessions provided to those who already had a significant amount of wealth.

Changes to the superannuation system since 2006-07 (most recently at the 2016-17 Budget) have attempted to moderate inequalities in concessions for superannuation, particularly for large balances in the pension phase. The trade-off has been more complexity.

Whilst there have been significant changes to superannuation policy since drafting the 2004 Paper, many fundamental issues are yet to be resolved. The complexity of the system has grown and the interaction with social security and tax remains unstable.

2. The Australian Retirement Income System

2.1 The three-pillars

The World Bank has argued that a national retirement incomes policy should have the following three key functions:

- **Savings** – postpone some consumption during periods of high earnings to periods of low earnings.
- **Redistribution** – from high income earners to low-income earners.
- **Insurance** – against recession, bad investments or inflation eroding savings, outliving one's savings, or the failure of public programs.

It argued that these functions should be met by the following aspects of a three-pillar design:

- A **publicly provided pension** (either flat or Means Tested) to achieve redistribution and coinsurance objectives.
- A **privately managed mandatory** savings scheme which provides for savings and coinsurance objectives.
- **Additional voluntary contributions** to provide additional savings and coinsurance.

Australia has such a three-pillar retirement structure:

- The means-tested government Age Pension provides retirees with a minimum standard of living in retirement. It is both a safety net for those who haven't saved enough for retirement and a supplementary benefit for those who have not saved enough to be comfortable in retirement. The benefit is paid from consolidated revenue and is not pre-funded.
- Compulsory saving through the SG applied to all income from personal exertion. This is currently 9.5% of wages and collected by employers which select a default fund. The SG is legislated to increase gradually to 12% by July 2025. Most employees have the right to nominate their own choice of fund.
- Voluntary contributions may be made to superannuation funds, with various tax concessions.

The 1998 Paper argued that the design of our system should also be evaluated against a range of additional objectives including social objectives, equity objectives and whether the retirement income system provides an acceptable quantum of income in retirement.

In a later publication[v], the World Bank expanded to five-pillars by splitting the first Pillar into contributory and non-contributory components, and by adding a voluntary system outside the pension system which included financial assets and non-financial assets and support.

2.2 Goal of first Pillar – Age Pension

At the time, the 1998 Paper argued that the **social objective** of Australia's retirement income policy should be to ensure that elderly people are able to live out their lives, with the support of community and family:

- in dignity and in peace
- free from worry over continuing shelter, care or economic hardship
- participating in community and family life wherever possible.

It argued that the encouragement of self-funding through tax concessions is sensible. It is debateable at what level these concessions should be struck particularly as they apply on mandatory contributions as well as voluntary ones. The upper bound of the concessions could be measured against the cost of the Government providing universal pensions as an alternative.

We agreed with the **equity criteria** provided by Knox and Cornish[vi], namely that a national retirement income system should provide:

- an adequate minimum income for all retirees
- outputs (benefits) should be related to inputs (lifetime contributions and taxes)
- progressive redistribution (from high income earners to low income earners)
- similar benefits should be provided to individuals with similar circumstances.

At the time, there was no clear criteria for the **absolute quantum of retirement income** that should be provided via the Age Pension. It could fall somewhere between the following boundaries:

- Subsistence – retirement income should be at a level to ward off poverty, that is to house and feed the person, but not provide discretionary income.
- Dignity – provide a small level of disposable income.
- Comfort – all people able to save some income and having sufficient for some discretionary expenditure.

The 1998 Paper recommended the Age Pension be set at some level between *dignity and comfort*. Obviously, this will depend on affordability and community expectations.

It is fair to say that there is no clear objective for the Age Pension. Its quantum and eligibility have changed many times

2.3 Other retirement support

There are other elements supporting retirement adequacy including:

- The family home, which removes the need for income to pay for rental accommodation, and can act as an asset of last resort to fund Aged Care or emergency medical costs.
- Part time work usually in the early years of retirement which can help defer consumption of private superannuation.
- Government support for:
  - Aged Care
  - Health benefits.

These additional Pillars are important in formulating public policy, but it is questionable whether they have been integrated efficiently with the retirement income system.

2.4 The second-pillar – Superannuation Guarantee

Occupational superannuation has been encouraged by tax incentives ever since the *Income Tax Act 1915,* exempted taxation of the investment income of superannuation funds and allowed the deductibility of member and employer contributions. These concessions have been changed frequently over the last 35 years and have been substantially reduced by a series of measures over the last decade. Nonetheless, superannuation still receives favourable tax treatment relative to other forms of investment.

Occupational superannuation was usually established to attract people to employment with the company (or government). Defined benefits were structured to favour long-serving and senior employees. However, even in the early 1980's under a regime of extraordinarily generous tax deductions (by current standards), only about 40% of Australians belonged to occupational funds and many of these dissipated their potential retirement benefits by requiring members to take (and even spend) lump sums whenever terminating employment or at retirement. Most private sector arrangements were designed to provide a lump sum at retirement and there were few private sector pension arrangements.

Given that most people won't save for retirement unless forced to, this meant that most Australians received the Age Pension when they retired. It is not uncommon to hear people over age 70 complain that they paid taxes all their working life to receive a pension, so there has been a sense of entitlement, even though the benefit is unfunded and none of their taxes were set aside for this benefit on their behalf.

Conversely, most Australians have been prepared to save for a family home and about 80% of retirees above age 65 have owned their own home for much of the last 50 years. In fact, for the whole of the twentieth century, a significant majority of retirees received a full Age Pension.

The growth of occupational superannuation means that there is increased self-sufficiency of new retirees and this will continue to improve as the SG system matures.

2.5 The Superannuation Guarantee Charge (SGC/SG)

In the mid-1980's, Labor introduced compulsory employer-sponsored superannuation through industrial agreements. Under centralised bargaining, a fully vested 3% superannuation contribution was given in lieu of an alleged 4% increase in workers' productivity. This *award superannuation* was introduced progressively by each industry and caused a shift from defined benefit to defined-contribution schemes. It was sold to workers as deferred pay and ***as being additive to the Age Pension.***

Many small businesses did not comply with award superannuation even though the contributions were only 3% of wages. The number of additional people beginning to fund their retirement benefits, though an improvement, was still insufficient. Worse, the 3% contribution was clearly woefully inadequate to fund a decent retirement income.

In its *Economic Statement May 1988*, issued as part of the 1988 Budget Papers, Labor stated that the main objective of its retirement incomes policy was to ensure that all members of the population have an adequate and secure level of income in retirement. It also stated that the main means of providing this was through the Age Pension (and service pensions) and support for housing, health care and other welfare support.

Labor realised that most retirees would remain on the Age Pension. However, a secondary objective was to encourage self-provision for retirement. It was also intended that self-funded people would accrue benefits greater than that provided by the Age Pension. Thus, Labor justified encouraging self-provision through tax concessions since this would reduce the future cost of social security benefits.

Labor introduced the SG from July 1992. This required employers to pay contributions on salaries (capped variously at between two and three times average weekly earnings). The legislation allowed for a rise over ten years to 9% by July 2002. Importantly, the benefits were portable (able to be transferred between funds on changing jobs), fully vested, and preserved until retirement age. The Preservation Age was then 55 but was legislated to increase to age 60 by 2024.

The SGC legislation from 1992 was intended to force larger numbers onto self-provision, though the impact would not be realised for a very long time. The policy recognised that it was going to be politically difficult to change the eligibility for Age Pensions too quickly without upsetting the electorate.

The full employer contribution of 9% was phased in over ten years to moderate the pain for employers of this new payroll tax. However, most employers began to count the SG contributions as part of their employees' salary packages, thus reinforcing the view that occupational superannuation is deferred pay. Until quite recently, there was a widespread community expectation that occupational superannuation benefits should be paid in addition to the Age Pension. Politicians were reluctant to contradict this view as they did not wish to alienate voters, particularly while the impact of the SGC on final benefits was small.

The *Henry Tax Review 2009* considered the treatment of superannuation. It favoured some form of annuitisation so that all benefits would be used within retirement with no *leakage* left as bequests. It did not recommend increasing the SG rate beyond 9%. The panel considered that, for most employees on low to middle incomes, a 9% SG rate would provide a reasonable level of income in retirement (coupled with a part Age Pension).

Despite this recommendation, the then Labor Government proposed gradually increasing the SG rate from 9% to 12% from 2013-14 to 2019-20. The Liberal Government has since delayed the increase, with the SG rate frozen at 9.5% and currently due to reach 12% in July 2025.

It is now clear that a career of contributions at 12% of wages will lead to a comfortable retirement for many Australians, with much of the superannuation benefit substituting for some (or all) of the Age Pension benefit. The extent of this substitution has never been quantified and this is one of the reasons why saving for retirement remains uncertain for most Australians.

2.6 The third-pillar – voluntary savings

The third-pillar, voluntary savings, allows members to pay contributions before or after tax up to specified limits. We lack a target measure of adequacy, so the limits are structured around the short-term fiscal costs. Consequently, they have been reduced in recent years to curb the cost of moving more money into a tax-privileged vehicle.

Not surprisingly, wealthy Australians (those in the top two deciles of income) receive most tax concessions The 2016 Budget changes addressed this by reducing limits significantly, but still allowing the build-up of generous retirement benefits.

It could now be argued that the middle tier of income earners receive lower value from the system. They do not receive full Age Pensions nor do they have the disposable income to build large retirement benefits.

2.7 Objectives of superannuation

The *Financial System Inquiry 2014* recommended that the primary objective of superannuation would be:

To provide income in retirement to substitute or supplement the Age Pension

After much consultation with industry, the Government has accepted this recommendation without amendment. However, this objective is still being reviewed by the Senate so has yet to be legislated.

There have been frequent changes to taxation and superannuation legislation over the last 35 years. This has caused much uncertainty for the Australian lay person. Gradually, the population has begun to realise that the benefits of the SG system are not additive to the Age Pension but are in line with the modern objective of superannuation.

Further, the strong earnings growth of superannuation funds over the past 25 years, major tightening to the means-test from January 2017 and the maturation of the superannuation system mean that the projected cost to Government of the Age Pension is no longer increasing (despite an ageing population and better longevity). Over time, the cost will fall substantially as a percentage of GDP!

Against this fiscal change, it is important to evaluate the nature and purpose of the Age Pension and broader ongoing needs of retirees (for example the increasing demand for Aged Care services). **We should note there is no specific objective for the Age Pension itself.**

3. Changes to the retirement income system

3.1 The structure of superannuation

The superannuation structure has undergone annual changes every year since the previous Paper was published in 1998. Table 1 shows the tax arrangements, contributions limits, mandatory contributions rates and benefit limits in 1998 and in 2018.

Table 1. 1998 and 2018 Superannuation Structures[vii]

Policy	Measure	1998	2018
Tax	on contribution	15% plus surcharge of 15% for those with adjusted taxable income above $73,220. Superannuation contributions were deductible for income tax purposes in that year, up to certain amounts (see employer superannuation below).	15% for those with income (including superannuation contributions) below $250,000. 30% on contribution amount above this threshold (div 293 tax).
	on earnings	15% on earnings and CGT if held for less than 12 months. 10% CGT rate in the accumulation phase if asset held for at least 12 months. 0% in the pension phase.	15% on earnings and CGT if held for less than 12 months. 10% CGT rate in the accumulation phase if asset held for at least 12 months. 0% in the pension phase.
	on lump sum benefit	tax-free if under $90,916, the remaining is taxed at 15% up to RBL, the amount above the Reasonable Benefit Limit RBL ($454,718 in year 1997-98) is taxed at the highest income tax rate.	Tax-free if retirement age is reached.
	on pension account withdrawal	Taxed as ordinary income if benefit was taken as a pension. A 15% tax rebate is applied to the amount below RBL ($909,435 in year 1997-98). Undeducted purchase price (UPP) is not taxed. UPP refers to that part of the purchase price of a pension or annuity which has not been claimed as tax deduction.	Tax-free if retirement age is reached.
Contribution concessions and limits	on personal superannuation	Contributions made by self-employed or someone with no employer superannuation contribution, which is typical made from after-tax income, is entitled to the annual tax deduction. The tax-deductible contribution is up to $3,000 plus 75% of contributions more than $3,000 up to the age-based employer contribution limits mentioned below. No limit on non-deductible contribution.	$25,000 per year (concessional) $100,000 every three years (non-concessional)
	on employer superannuation	In 1997 -1998, superannuation contributions were deductible for income tax purposes in that year, up to certain amounts. For age under 35, the limit was $10,332 For ages 35-49, it was $28,420 For ages 50 -70, it was $70,482 No limit on non-deductible contribution.	$25,000 per year (concessional) $100,000 per year(non-concessional)
Mandatory employer contribution	SG contributions	6% (1997-1998) and 7% (1998-1999)	9.5%
Benefit limits	lump sum	$454,718, above which maximum personal income tax rate is applied.	No limit
	pension	$909,435, above which maximum personal income tax rate is applied.	Transfer balance cap limits the total amount that can be transferred into the pension phase at $1.6 million. The balance above this remains in the accumulation account and is taxed accordingly.

Source: Australian Taxation Office

3.2 Impact of changes

As can be seen from Table 1, there have been several tax changes over the last twenty years, with several intermediate changes. All the changes have been made to meet short-term fiscal goals rather than any long-term modification to policy settings.

Collectively, they have had the effect of curbing the amounts that can be built within superannuation accounts. This shows that there is a continual battle between encouraging self-sufficiency (with less reliance on the Age Pension) and the fiscal costs of providing tax concessions.

Some points for reflection:

- Concessional contributions are deductible for employers and have a base tax rate of 15% within the fund. In 1998, higher income people paid a *surcharge* of 15% and today, there is a similar surcharge for salary packages above $250,000. In 2006, there was no surcharge.
- Concessional contributions have been curbed. They were $100,000 a year in 2008-09, but have reduced gradually to $25,000 a year today.
- The tax rates on investment earnings have not changes. However, the value of franking credits has led to a surge in tax refunds to SMSFs which invest heavily in listed Australian equities.
- There is now no distinction between lump sum and pension benefits. Retirees above age 60 can draw a full or partial benefit tax-free at any time.
- From 2007-08, *Reasonable Benefit Limits* were abolished and there was no limit to the amount that could be held in a pension. From 2017-18, the amount which can be transferred into a pension account has been limited to $1.6 million. Amounts above $1.6 million in pension phase at 1 July 2017 were transferred back into accumulation phase (or taken from the fund as a benefit). The pension account can grow with fund earnings, but will also be reduced by pension payments. Members and retirees can still hold unlimited amounts in accumulation accounts.

4. The Age Pension

4.1 History

In Australia, NSW introduced the first State pensions in 1900, followed by Victoria and Queensland. After the normal vigorous State and Commonwealth debate, the Commonwealth took over the responsibility for pensions and introduced a (non-contributory) Age Pension in 1909.

Table 2 outlines some of the major changes to Government-funded Age Pension entitlements since 1900. Apart from frequent adjustments to means-testing, the basic concept has remained to this day.

Table 2. Age Pension and superannuation changes over time[viii]

Year/Date	Change
1900	New South Wales introduced a Means Tested age pension of $26 a year, funded out of general revenue. Victoria and Queensland followed suit.
1908	Commonwealth acts to take over State pensions.
1910	**Pension age for eligible women reduced to 60.**
1912	**1908 Act amended to completely remove the family home from the Means Test.** Since then, it has always been an exempt asset.
By late 1960s	Means assessed on basis of income plus a proportion of countable assets except for the family home. About 70% of people qualifying on grounds of age received the pension.
1973	Means Test for pensioners 75 years of age and over abolished.
1975	Means Test removed for persons aged 70 to 74 inclusive.
1975	Pensions linked to 25% of average weekly earnings, to be indexed annually.
1976	Pensions became subject to automatic increases twice yearly. Age pension assets test abolished.
1978	Pension increases to be adjusted only once a year (in November). Future increases in the Age Pension for those aged 70 or over made subject to an income test.
May 1983	Base pension for those aged 70 and over subject to an incomes test.
1984	Age Pension assets test reintroduced. Family home excluded.
1994	Female Eligibility Age gradually increased to 60 over the 20 years to 2014
1997	Age pension to be formally maintained at 25% MTAWE. Maximum age for SG contributions increased from 65 to 70.
1998	Age Pension Means Test for retirement income streams revised. Pension Bonus scheme introduced. A person could accrue a pension bonus payment by deferring claiming the pension while still working.
2000	Age Pension raised by 4% (to 26% of MTAWE) to allow for introduction of GST.
July 2005	Transition to Retirement Pensions available. Older workers could then have a pension account and use their pension payments to top-up concessional contributions in their accumulation account.
Sept 2007	Social Security assets test threshold was raised. It is estimated that more than 300,000 extra people will be eligible for the Age Pension.
Sept 2009	Following the Harmer review, the 25% of MTAWE adequacy benchmark was adjusted to 27.7% for single people and 41.76% for couples. The pension income test taper rate was increased from 40% to 50%. A work bonus was introduced, and the Pension Bonus Scheme was abolished.
Jan 2017	Pension payment reduces by $3.00 per fortnight for every $1,000 of assets above the lower assets test threshold. Previously the taper rate was $1.50 per fortnight.

Year/Date	Change
July 2017	The qualifying age for the Age Pension will increase by six months every two years until it reaches 67 years of age on 1 January 2024.
Future	Government policy is to increase the qualifying age to 70 by 2035.

4.2 Benefit and indexation

The Age Pension is paid fortnightly by the Department of Social Security (DSS) through its agency Centrelink. Various pensioners who are eligible through past military service receive a similar benefit from the Department of Veterans Affairs (DVA).

It has been observed that the payment every second Thursday does causes a spike in spending on shopping and gambling over the next 24 hours. Conversely, about one-third of people on a full Age Pension are savers, showing there is a wide range of expenditure patterns for retirees.

The benefit is indexed each half year, in March and September, to the wages of males in full-time employment (Male Total Average Weekly Earnings (MTAWE)). In the 2014-15 Budget, the government foreshadowed changing indexation to prices rather than wages as a means of reducing the cost of the benefit. There was public outrage and, consequently, it tightened the thresholds for the means-test instead.

The indexation was subsequently changed to reflect the higher of CPI and a Pensioner and Beneficiary Living Cost Index. This is complicated as there is a minimum combined couples rate of 41.67% of MTAWE (with the singles benefit set at two-thirds of the couple's rate). Effectively, the benefit is still linked to wages.

4.3 Historical rates of pension

The Age Pension hovered around 20% of male wages (average weekly earnings) until 1975 when it was raised to nearly 25%. It remained between 23% and 25% of male earnings until 1997 when it was set at 25% of MTAWE, and it moved to 26% following the introduction of GST in 2000.

In 2009, the *Harmer Review* found out that the rate of payment to single pensioners was too low. In response, the Government increased the total value of the pension for singles by up to $1,689 per annum — an increase of $32.49 per week.

Under the new arrangements, the total value of the package of payments (pension plus various supplements) for single pensioners would increase to two-thirds of the couple combined package and achieve a new pension benchmark for singles of 27.7% of Male Total Average Weekly Earnings — an increase of over 10 per cent from the previous 25%.

There are two additional payments, a Pension Supplement (only paid to pensioners residing in Australia), and an Energy Supplement (unindexed).

The current rates of pension (March 2018) are set out in Table 3.

The current rate of annual benefit is compared to ASFA's standards for a modest and comfortable lifestyle for retirees who own their homes outright.

ASFA has recently raised its Modest Standard, which was becoming very close to the value of the Age Pension.

From this, we can state that the Age Pension fulfils its role of being an appropriate safety net for retirees who are home owners. From this, it follows that it falls short of funding even a modest standard of living for the growing number of Australians who rent in retirement.

Graph 1. Historical rate/percentage of Age Pension payment rates

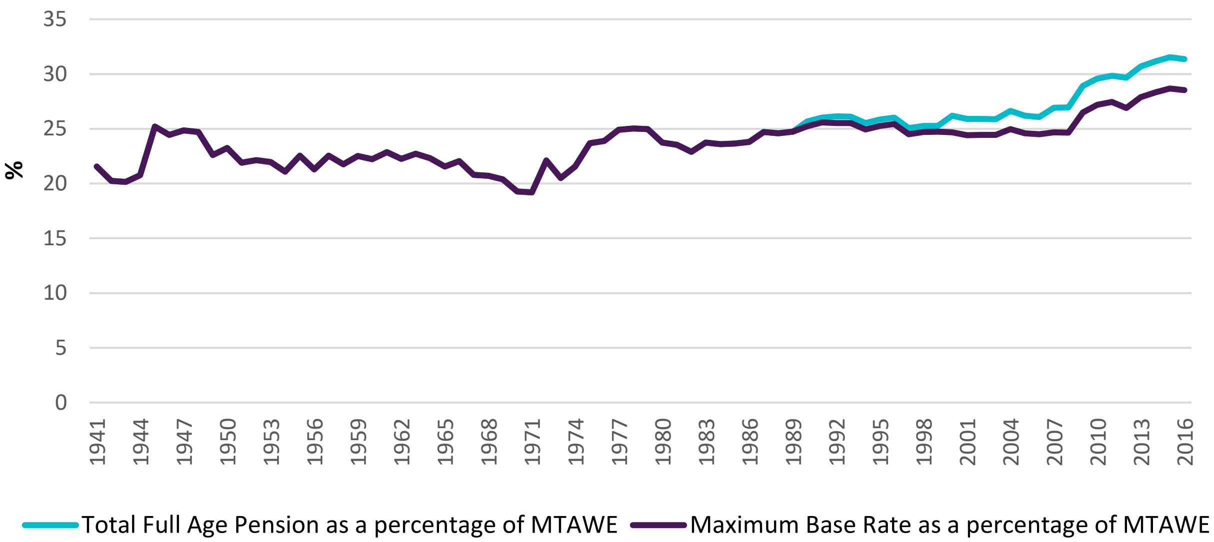


Table 3. Current fortnightly rate of Age Pension

Per fortnight	Single	Couple each
	($)	
Maximum basic rate	826.20	622.80
Maximum Pension Supplement	67.30	50.70
Energy Supplement	14.10	10.60
Total	**907.60**	**684.1**

Table 4. Adequacy of benefit

Annual Amount	Modest Lifestyle		Comfortable Lifestyle	
	Single	Couple	Single	Couple
	($)			
ASFA value	27,368	39,353	42,764	60,264
Age Pension	23,598	35,573	23,598	35,573
Difference	**3,770**	**3,780**	**19,166**	**24,691**

4.4 The number of people receiving the Age Pension

The number of people eligible to receive the Age Pension at any time has fluctuated over the years. Nearly 90% of people of retirement age received the full benefit in 1978, yet this reduced to 64% in 1982 due to a re-introduction of a means-test for those over 70 (previously removed by the Whitlam Labor government).

Today, analysing data from DSS on Australian resident pensioners, about 39% of those of pensionable age receive a full pension and a further 24% receive a part-pension.

A significant number of pensioners receive separate benefits from the Department of Veterans' Affairs (DVA). When their benefits are considered, the proportion of the eligible population receiving either a DSS or DVA age related pension will increase from 63% to 68% in 2017.

Some people of Eligibility Age are still working and will draw a pension later in retirement; others spend their super and become more dependant later. Graph 4 later in this Paper shows dependency by age.

Table 5. Number of DSS pensioners (1997)

Rate of Pension	Males (≥ 65 years)	Females (≥ 60.5 years)	TOTAL
Full Pension	38%	48%	44%
Part Pension	21%	21%	21%
No Pension/DVA Pension	41%	31%	35%
Total (no. people)	**980,628**	**1,590,941**	**2,571,569**

Table 6. Numbers of DSS and DVA pensioners (2017)

Rate of Pension	Males (≥ 65 years)	Females (≥ 65 years)	TOTAL
Full Pension	36%	42%	39%
Part Pension	24%	24%	24%
DVA Pension	5%	5%	5%
No Age Pension	35%	29%	32%
Total (no. people)	**1,778,734**	**2,027,418**	**3,806,152**

4.5 Living outside Australia

Portability rules introduced in the 1970s allowed for Australian pensions to be received while living overseas. These rules included requirements regarding residency, with a requirement of only 10 years of residency in Australia. In the year to 30 June 1997, there were 35,821 recipients of Age Pension payments outside of Australia.

Interestingly, over 13,000 of these foreign recipients were living in Italy at the time of payment, reflecting previous patterns of migration (and clusters of those who returned to their original homelands).

In the decades since, on top of changes to simplify the rules, the residency requirement has been increased to 25 years (in 2000), and again to 35 years between the age of 16 and Age Pension age (in 2014). An individual retiring today who resided in Australia for 10 years would only receive 10/35ths of the maximum means-tested rate of payment.

In the year to 30 June 2017, foreign-resident DSS and DVA pensioners grew to over 110,000, despite the stricter residency requirements.

4.6 Value of the Age Pension

The Age Pension is a material benefit for most Australians. The value received depends on the extent of the means-testing (and the discount rate applied to future payments). However, for a single person retiring at age 65 and entitled to a full Age Pension for life, the present value of the pension payments exceeds $500,000.

The present value of the maximum age pension for a couple who retires at 65 today exceeds $800,000.

The value of these benefits is much greater than the median retirement benefit paid from superannuation, which is less than $200,000 due to the relative immaturity of the SG system.

It is likely that a lay person would believe their superannuation would be more important than any pension benefit. However, this simple calculation shows the continued high relative importance of the Age Pension.

5. Retirement Ages

5.1 Age Pension Eligibility Age

The Eligibility Age for the Age Pension was set at 65 for males and 60 for females more than 100 years ago. However, the Eligibility Age and average life expectancy for retirees dictate the length of time the Government will need to aid the retired population. As life expectancy generally increases over time, it is realistically necessary that the eligibility for the Age Pension should be deferred.

Until 1994, the Eligible Age was set at 65 for males and 60 for females. The female age was gradually raised to 65 over the 20 years to 2014. The slow pace of the increase and the fact that it did not affect existing pensioners meant it was introduced without complaint.

The Eligibility Age is now being increased in six monthly increments to age 67 by 2023 as shown in Table 7.

Table 7. Current Eligibility Age

Date of birth	Eligibility Age
Prior to 1 July 1952	65 years
1 July 1952 to 31 December 1953	65 years and 6 months
1 January 1954 to 30 June 1955	66 years
1 July 1955 to 31 December 1956	66 years and 6 months
From 1 January 1957	67 years

The Department of Veteran Affairs (DVA) pays out pensions to former service personnel and their partners. The age at which a veteran and their partner is eligible for the Age Service Pension is five years earlier than DSS pensioners. For non-veterans, the Eligibility Age is the same as the one for Age Pension.

The government has indicated that it intends to legislate for further increases to be introduced with a target Eligibility Age of age 70 by 2035.

5.2 Longevity in Retirement

Table 8 shows how the expected time spent on the Age Pension has changed over time. The average duration for a male has grown by nine years since the benefit was established – and much of this improved longevity has occurred in the last 40 years. The average duration on pension for females has grown by only six years, but only due to an increase in the Eligibility Age.

This shows that raising the Eligibility Age is a significant way of reducing government costs.

In addition, the numbers reaching the retirement age have grown significantly. When the benefit was introduced, only 49% of men were expected to reach age 65. Today, it is expected that 90% of the male population will reach this age. For women, 56% were expected to reach age 65 at birth, compared to 94% today.

The average age of retirement is much younger than the Eligibility Age, so retirees can expect to live even longer in retirement, though without receiving government retirement benefits for the whole period. Many older workers (particularly those in blue collar jobs) shift to a Disability Support Pension to supplement their income until they attain the Eligibility Age. This suggests that raising the Eligibility Age will place these workers in limbo for longer periods as they will be unable to return to work.

While Table 9 utilises retirement data from the ABS, a person's decision to retire is very complex and often fluid. For example, many people officially retire and then take-up part time work. Accurate data around the average retirement age is therefore often difficult to collect.

Analysis undertaken on Rice Warner's Superannuation Insights database suggests that the average age at retirement from work in 2017 was around 64 years of age for both males and females. For males, life expectancy at 64 is 85.2, while for females, life expectancy is 87.8. These ages are more realistic than some government statistics which don't allow for re-entry to the workforce.

Table 10 and Table 11 show significant numbers of people apparently retiring from the workforce relatively early. However, many people, particularly at younger ages, don't retire permanently, but return to work later. This particularly impacts females. Some older workers take transitional pensions whilst still working, and this distorts the numbers retiring.

Table 8. Life expectancy at Age Pension Eligibility Age

Year	Males			Female		
	Age Pension eligibility age	Life expectancy at Age Pension Eligibility Age (age)	Expected time on Age Pension	Age Pension eligibility age	Life expectancy at Age Pension Eligibility Age (age)	Expected time on Age Pension
2016-17	65.0	85.3	20.3	65.0	87.9	22.9
2012-13	65.0	84.7	19.7	65.0	87.4	22.4
2008-09	65.0	84.2	19.2	64.0	87.0	23.0
2004-05	65.0	83.5	18.5	63.0	85.9	22.9
1996-97	65.0	81.2	16.2	61.0	84.3	23.3
1980-82	65.0	78.8	13.8	60.0	82.0	22.0
1901-10	65.0	76.3	11.3	60.0	76.2	16.2

Source: ABS and Australian Government Actuary (AGA)

Table 9. Life expectancy at actual retirement

Year	Males			Female		
	Age at Retirement	Life expectancy at retirement (age)	Expected time in Retirement	Age at Retirement	Life expectancy at retirement (age)	Expected time in Retirement
2016-17	58.8	83.6	24.8	52.3	86.0	33.7
2012-13	58.5	83.4	24.9	50.0	85.8	35.8
2008-09	57.8	82.6	24.8	49.3	84.9	35.6
2004-05	58.1	82.0	23.9	47.4	84.6	37.2
1996-97	58.0	79.7	21.7	41.0	82.6	41.6

Source: ABS and Australian Government Actuary (AGA)

Table 10. Proportion of population retiring at various ages for males

Age at retirement- males	1/11/1997	1/06/2005	1/06/2009	1/06/2013	1/06/2017
Less than 55	24.4	25.6	26.8	24.9	25.2
55–59	22.3	22.6	22.0	23.0	19.3
60–64	31.0	32.6	30.5	26.9	26.4
65–69	19.5	15.6	15.7	17.3	21.0
70 and over	2.8	3.8	4.9	8.0	8.1
Total number of retired (thousand)	**1,296.9**	**1,302.2**	**1,332.5**	**1,452.7**	**1,654.9**
Average age at retirement	**58.0**	**58.1**	**57.8**	**58.5**	**58.8**

Source: ABS

Table 11. Proportion of population retiring at various ages for females

Age at retirement-females	01/11/1997	1/06/2005	1/06/2009	1/06/2013	1/06/2017
Less than 55	76.0	61.9	57.8	54.7	46.2
55–59	11.5	18.9	17.9	18.5	19.1
60–64	9.5	13.2	16.4	17.4	20.1
65–69	2.6	4.2	5.3	6.8	11.4
70 and over	0.3	1.8	2.6	2.5	3.5
Total number of retired (thousand)	**1,918.4**	**1,683.5**	**1,694.9**	**1,850.8**	**1,943.8**
Average age at retirement	**41.0**	**47.4**	**49.3**	**50.0**	**52.3**

Source: ABS

5.3 The cost of the Age Pension

Table 12 and Table 13 shows that the number of people receiving the Age Pension increased considerably between 1998 and 2018. This was driven by a combination of a growing (and ageing) population, as well as an increase in the proportion of eligible members receiving a pension.

This is a driver of the growth in the annual cost of the Age Pension over the period. This has been compounded with the increasing rate of Age Pension payment (see Graph 3).

The annual cost of Age Pension in 1997 is shown in today's dollars.

Table 12. Annual Cost of Age Pension (1997)

		Number of People			Cost ($ million)		
		Full Pension	Part Pension	No Age Pension	Cost Full Pension	Cost Part Pension	Total
Male	Single	124,580	52,599	402,730	1,865	574	2,439
	Partnered	248,601	152,118		3,103	1,332	4,435
Female	Single	477,563	159,689	491,571	7,147	1,706	8,853
	Partnered	289,730	172,388		3,616	1,479	5,095
Total		**1,140,474**	**536,794**	**894,301**	**15,730**	**5,092**	**20,821**

Source: Data provided by DSS
Note:
The numbers do not include supplementary payments.
Numbers include only domestic DSS pension recipients.

Table 13. Annual Cost of Age Pension (2017)

		Number of People			Cost ($ million)		
		Full Pension	Part Pension	No Age Pension	Cost Full Pension	Cost Part Pension	Total
Male	Single	243,976	103,898	709,859	5,772	1,840	7,611
	Partnered	399,383	321,618		7,122	4,292	11,414
Female	Single	507,877	222,821	699,969	12,015	3,945	15,960
	Partnered	338,449	258,302		6,035	3,447	9,483
Total		**1,489,685**	**906,639**	**1,409,828**	**30,943**	**13,525**	**44,468**

Source: Data provided by DSS
Note:
The numbers include supplementary payments.
Numbers include only domestic DSS pension recipients.

5.4 DVA benefits

Table 14 and Table 15 show that the numbers of people receiving Department of Veterans Affairs Pensions has decreased significantly since 1997. This reflects the declining number of war veterans.

Table 14. Annual Cost of Department of Veterans Affairs' Pension (1997)

	Disability Pensioners	War Widow(er) Pensioners	Service Pensioners	Total
Number of People	159,107	93,456	337,823	590,386
Annual Cost ($m)	1,438	1,496	4,451	7,385

Table 15. Annual Cost of Department of Veterans Affairs' Pension (2018)

	Disability Pensioners	War Widow(er) Pensioners	Service Pensioners	Total
Number of People	88,974	51,329	106,970	247,273
Annual Cost ($m)	1,576	1,475	2,242	5,293

Source: Data provided by DVA

Note that Table 14 and Table 15 do not include all programs of DVA pension. These programs account for the gap in the total in Table 15, and the Budget Estimates provided in Table 16.

5.5 2018-2019 Budget

The most recent costs of services for the aged are set out in Table 16. As expected, DVA pensions are reducing and the DSS Age Pension costs are growing at about 4.5% a year.

Age Care costs are growing at a much higher rate.

Table 16. 2018-19 Budget Estimates of assistance to the Aged and Veterans

Expense	2017-18	2018-19	2019-20	2020-21	2021-22
Age Pension	45,095	46,838	49,120	51,560	53,797
DVA Pensions	6,504	6,213	6,011	5,914	5,857
Aged Care Services	16,584	18,006	19,474	20,589	22,080
Other aged assistance	2,186	1,927	1,791	1,688	1,545
Total ($ million)	**70,369**	**72,984**	**76,396**	**79,751**	**83,279**

6. Age Pension Means Testing arrangements

6.1 Broad principles

There are some key principles for setting the rules for the Means Tests:

- The Age Pension recognises that a couple living together have lower unit costs than a single person. The single person's pension is set at about two-thirds of the combined couples rate.
- The family home is an exempt asset, but renters receive higher thresholds on the income and asset tests. There is also an additional payment for rental assistance.
- There are different rules for those in retirement villages or aged care facilities.
- Blind people are exempt from the means-test (unless they claim rent assistance!)

The family home has always been an exempt asset for means-testing. Until 40 years ago, the average price of a family home was less than 2.5 times average earnings. Since then, property prices have soared, and the ratio today is more than 10 times in our larger capital cities! **At this level, much of the value within the family home could be considered an investment asset.**

6.2 Means Testing arrangements in 1998

As people continue to accumulate superannuation assets over their life, Age Pension Means Testing arrangements (particularly asset testing arrangements) will have a significant impact on the proportion of the population receiving the Age Pension.

At August 1998, a single Australian male over the age of 65 or a female over 60.5 was entitled to a fortnightly pension of $354.60. A married person was entitled to $295.80 per fortnight, each partner receiving some 16.6% less than the benefit paid to a single person.

DVA pensions commenced from age 60 for males and age 55 for females. The latter age is being increased gradually to age 60, so male and female veterans will still retire five years earlier than the rest of the population.

Recent changes to the Means Testing arrangements have simultaneously:

- increased the threshold at which people can still receive the maximum rate of Age Pension
- increased the rate at which people lose Age Pension as their assets increase.

The Age Pension was subject to the following Means Tests in 1998.

Table 17. 1998 Means Tests

	Maximum Payment	No Payment
Single	Fortnight income <$100	Fortnight income >$820
Couple combined	Fortnight income <$176	Fortnight income >$1,370
Single, homeowner	Assets< $125,750	Assets> $245,750
Single, non-homeowner	Assets< $215,750	Assets> $335,750
Couple, homeowner, combined	Assets< $178,500	Assets> $377,500
Couple, non-homeowner, combined	Assets< $268,500	Assets> $467,500

6.3 Current Means Test

Table 18 shows the current income and assets Means Testing arrangements.

Table 18. Current Means Test

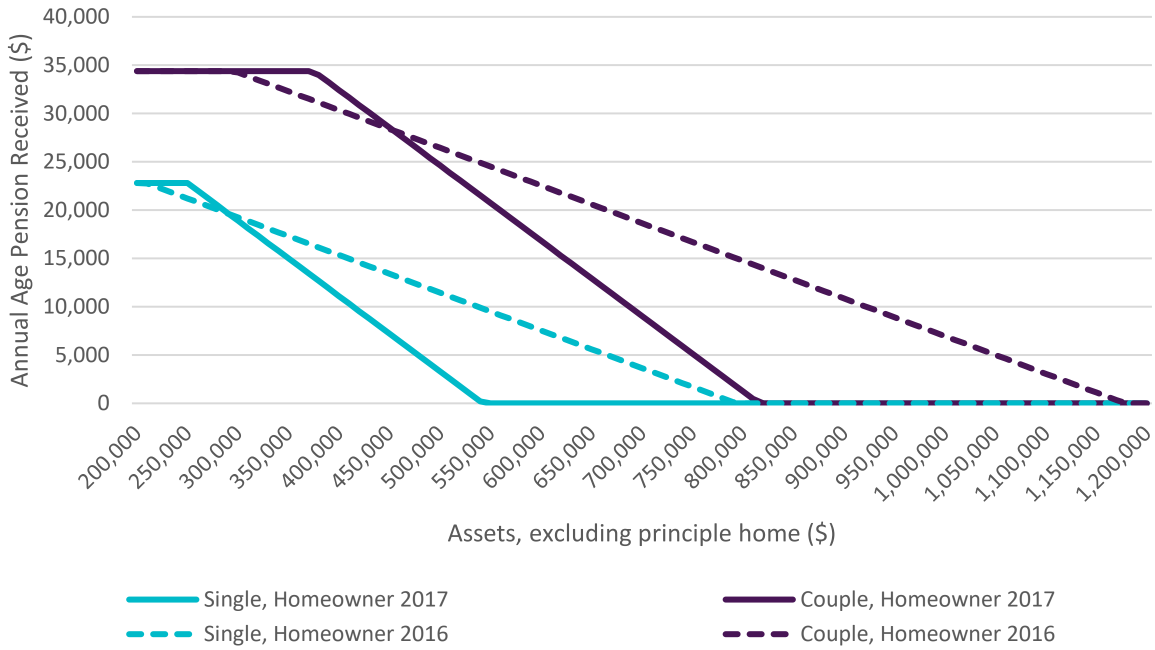
	Maximum Payment	No Payment
Single	Fortnight income <$168	Fortnight income >$1,956.80
Couple, living together, combined	Fortnight income <$300	Fortnight income >$2,996.80
Single, Homeowner	Assets< $253,750	Assets> $552,000
Single, non-homeowner	Assets< $456,750	Assets> $755,000
Couple, living together, homeowner, combined	Assets< $380,500	Assets> $830,000
Couple, living together, non-homeowner, combined	Assets< $583,500	Assets> $1,033,000

6.3.1 1 January 2017 changes

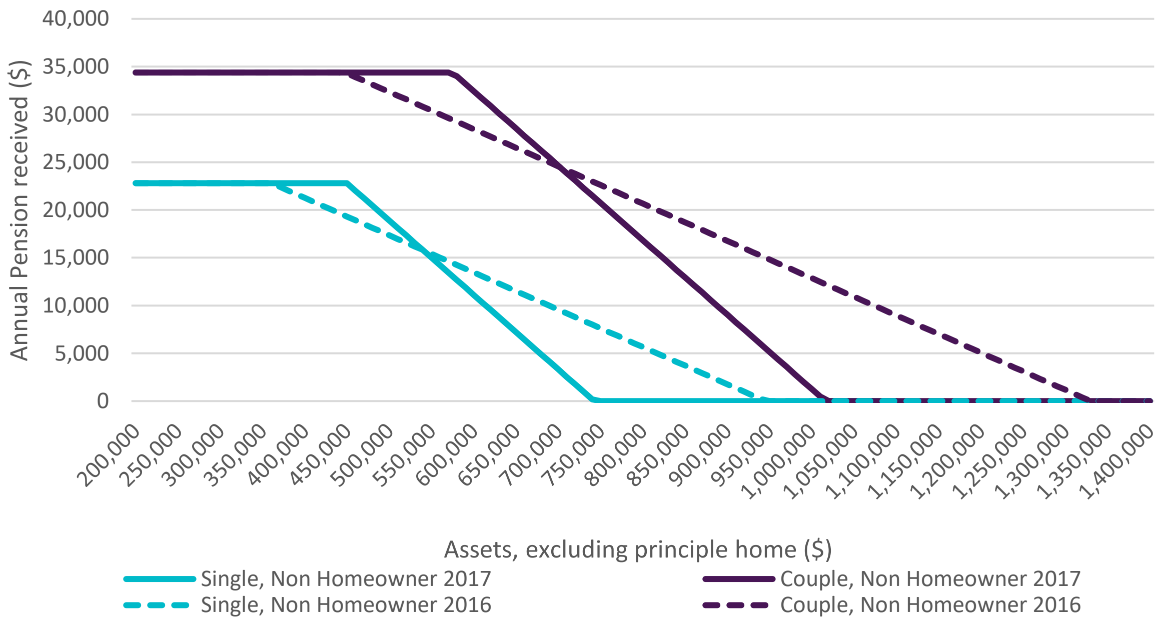
At the 2015-16 Budget the Government announced changes in the asset test free areas and taper rates that came into force on 1 January 2017. Under the new arrangements, the assets test free areas were increased, whilst the asset test taper rate increased from $1.50 for every $1,000 of assets over the assets test free area to $3 for every $1,000 of assets of the assets test free area.

The following graphs illustrate the impact on the amount of annual pension received at every asset level because of these changes. Note these payment figures are before any reduction in payments from application of the Income Test.

Graph 2. **1 January 2017 changes to assets test taper rates, Homeowners**



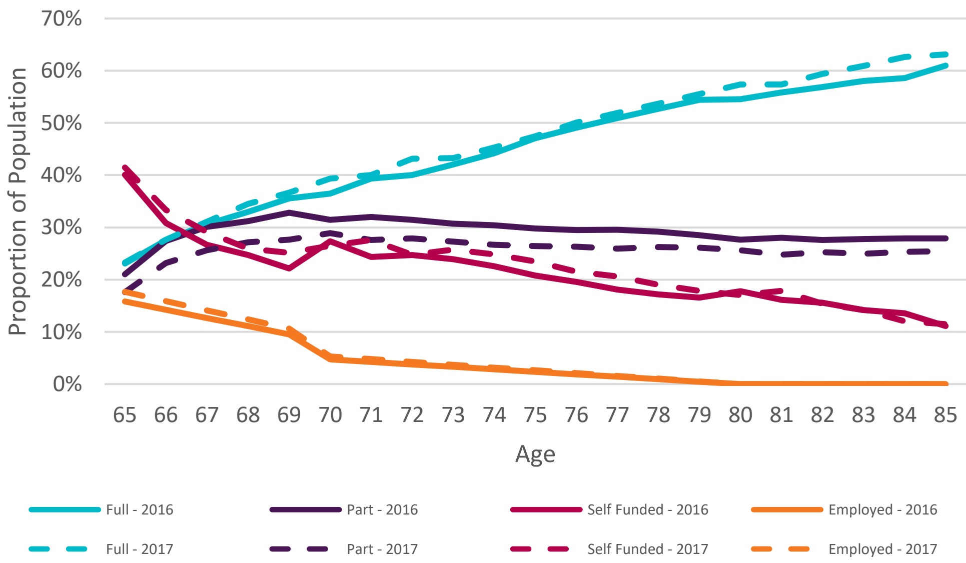
Graph 3. **1 January 2017 changes to assets test taper rates, Non-Homeowners**



Graph 4 compares the proportion of each age cohort receiving each type of pension at 30 June 2016 (before the change to the asset test arrangements) to the proportions at 30 June 2017 (after the change asset test arrangements). The tightening of the Means Testing taper rate resulted in a decrease in the proportion of people receiving a part-rate pension and an increase in the proportion who are self-funded across a broad range of age cohorts.

Increasing the lower asset threshold increased the proportion of the population receiving a full rate Age Pension for some age cohorts, although the effect of this was moderated by complex interactions with the Income Test for those whose retirement income streams commenced on or after 1 January 2015.

Graph 4. Impact of January 2017 changes on proportion of population receiving the Age Pension, by pension type and age



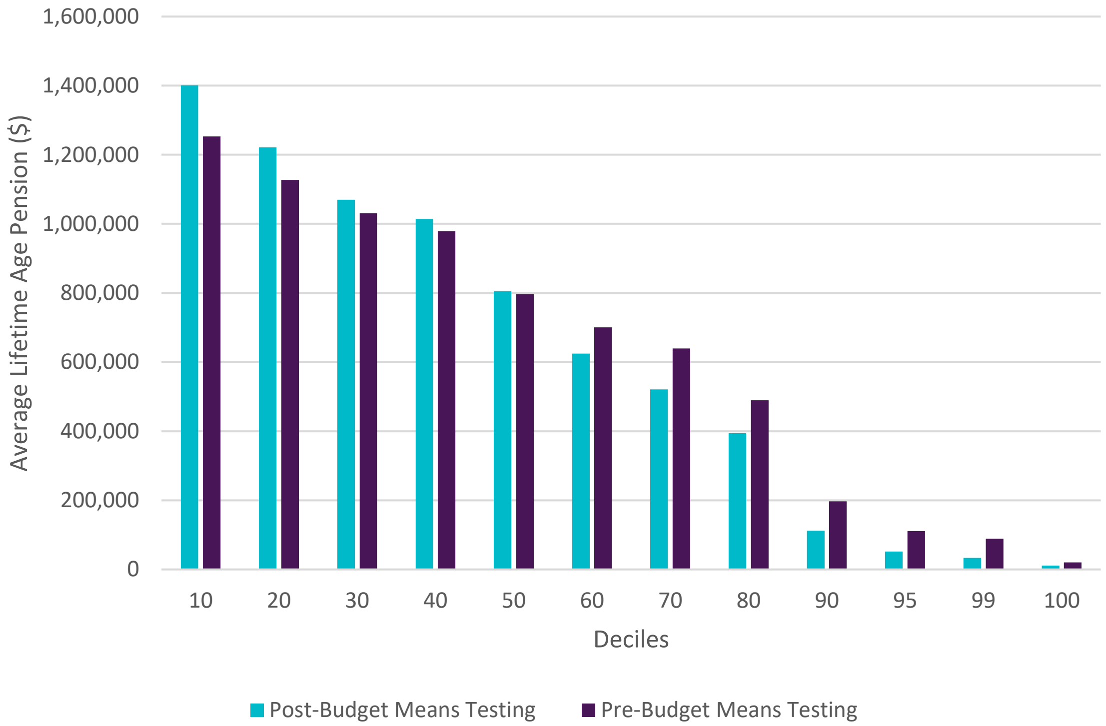
These changes to asset test thresholds and taper rates made at the 2015-16 Budget replaced changes to indexation of the Age Pension announced at the 2014-15 Budget. At the 2014-15 Budget the Government had announced it would index the Age Pension (and a range of other payments) by CPI from 1 September, 2017.

For this modelling, we have assumed that the Age Pension was indexed to CPI to 2027-28, consistent with the approach taken in the *Intergenerational Report 2015*. After this point, the Age Pension is indexed in line with long-term wage growth.

The reversal of this indexation measure and introduction of the new assets test should (in future) increase the total value of the Age Pension for those in lower income and wealth deciles and decrease the total value of the Age Pension for those in the middle income and wealth deciles.

Graph 5 compares the lifetime value of the Age Pension across income and wealth deciles under both policy settings described above. As expected, indexing the Age Pension to wages (and not CPI) and tightening Asset Test taper rate results in increased Age Pension payments for those in the lower deciles. However, under these policy settings, the total value of the Age Pension is reduced for those in the middle of the distribution, as they are subject to these tighter Means Testing arrangements over their life.

Graph 5. Impact of recent government changes to the lifetime value of the Age Pension by income and wealth decile



The lifetime value of the Age Pension presented in Graph 5 is higher than the net present value of the Age Pension quoted earlier in this Paper. The lifetime value of the Age Pension modelled here is the value of the pension for a person who is 20 years old today over an 80-year projection period (rather than a person retiring at 65 today). As the maximum basic rate of pension is indexed by wage growth, and we have deflated by CPI, the present value of the pension will be larger for a person retiring in the future (compared to a person retiring today).

7. The Future of the Age Pension

The Age Pension and the superannuation system has clearly undergone significant changes since 1998. Looking forward, the projected costs of the Age Pension depends on demographics, income and wealth of the future Australian population. As the Age Pension is a significant proportion of government expenditure, projected Age Pension expenditure is key to the Government long-term fiscal sustainability.

This section of the Paper includes long-term analysis of the retirement income system, focusing on the projected population receiving the Age Pension and the aggregate government expenditure on the Age Pension. These projections provide useful insights into what the Age Pension and superannuation system may look like in future.

7.1 2018-19 Budget changes to the Age Pension

The Government announced several changes to the Age Pension at the 2018-19 Budget in May 2018.

7.1.1 Pension Work Bonus

The Government increased the Pension Work Bonus to $300 a fortnight (previously $250) and extended eligibility to the self-employed. The Pension Work Bonus is an income test concession for those receiving either the Age Pension from DSS or DVA.

The value of the Pension Work Bonus is that it allows retirees to continue part time work and defer consumption of their superannuation benefit. For those with no superannuation, it allows them to top-up their income during the early years of retirement when they are still active.

However, there is still a disincentive against part time work beyond a modest level. For example, a retired couple with income of $5,000 per year from financial assets would experience a marginal rate of benefit withdrawal (which has the same effect as a marginal tax rate) of 50% on income from employment exceeding $10,600 per year.

7.1.2 Pension Loans Scheme

The Pension Loans Scheme currently offers a reverse mortgage to part and some nil-rate pensioners to increase their Age Pension income to the maximum rate of Age Pension. The government has announced that the scheme will expand to all Australians of Age Pension age, including self-funded retirees, from July 2019. It will also extend the eligibility for the Pension Loans Scheme to all retirees of Age Pension age.

The change to the policy will allow all current and future retirees of Age Pension age to participate in the scheme. The maximum allowable combined Age Pension and Pension Loan Scheme income stream is set at 150% of the maximum rate of Age Pension.

If an Australian of Age Pension age owns real estate in Australia and does not receive the full pension amount (due to income or assets test), they can apply for the Pension Loan Schemes which gives them an amount each fortnight up to the maximum qualified rate of income support payment.

The pension loan scheme is effectively a reverse mortgage provided by the government. Currently the interest rate is 5.25% compounding each year. This rate has been unchanged for 20 years, unlike private sector loans which have variable interest rate movements in line with market changes.

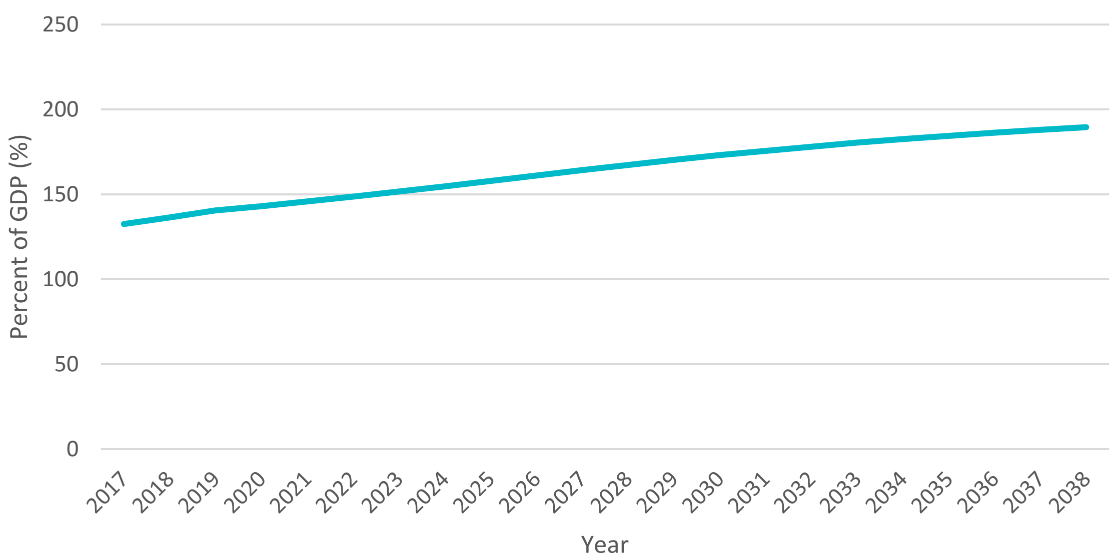
The total loan the pensioners gets depends on their age, their partner's age (whoever is younger) and the equity in the real estate.

The loan accrues until repaid or the house is sold. This means that retirees can access equity from their home without having to move out.

7.2 Projected size of the Age Pension and Superannuation Assets

Graph 6 shows that Superannuation Funds Under Management are projected to increase as a percent of GPD over the next 20 years. FUM will rise from 133% of GDP in 2017 to around 190% of GPD by 2038.

Graph 6. Projected Superannuation Funds Under Management (percent of GDP)



As the superannuation system matures and people accumulate more superannuation assets over their life, the projected proportion of the eligible population receiving the Age Pension will fall.

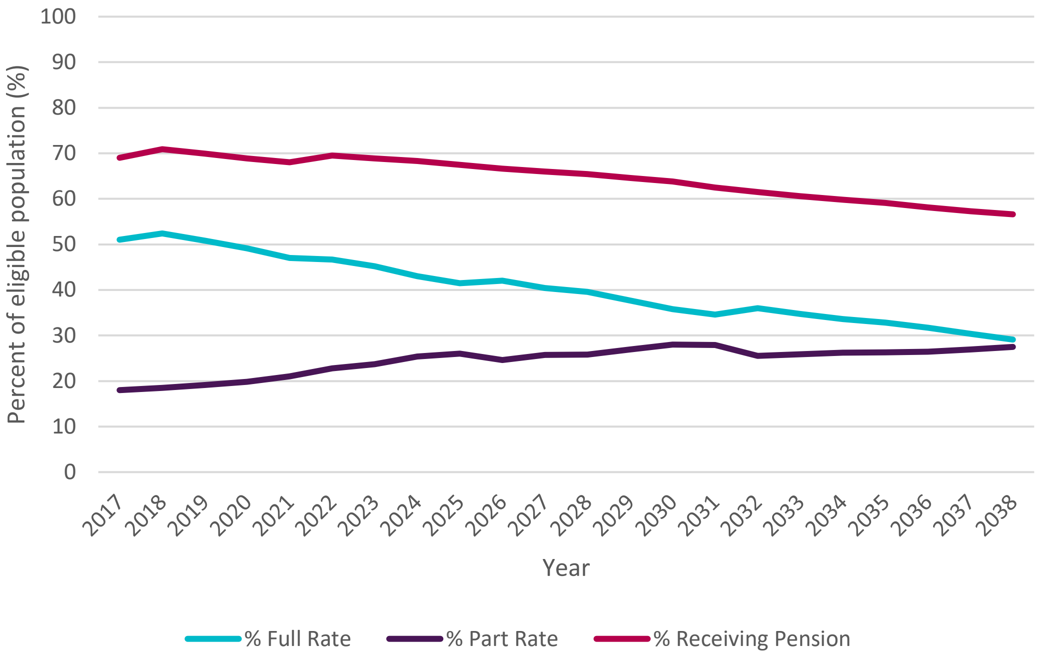
Graph 7 shows that the proportion of the eligible population receiving the Age Pension will fall from around 69% in 2017 to around 56.6% in 2038. This fall is comprised of a significant fall in the proportion of the eligible population receiving the full rate of Age Pension (from 51.0% in 2017 to 27.5% in 2038) and a relatively smaller increase in the proportion of the population receiving a part-rate Age Pension (from around 18.0% in 2017 to 27.5% in 2037).

The numbers not receiving a pension include all self-funded retirees and a small number of people still employed.

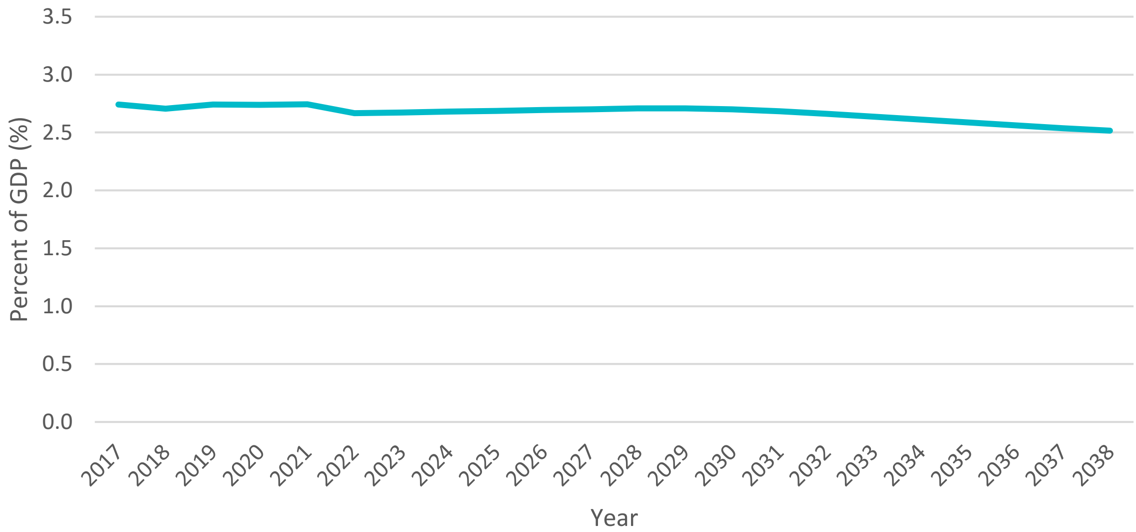
The decreasing reliance on the Age Pension results in a moderate fall in projected Age Pension expenditure as a percent of GDP. Age Pension expenditure as a percent of GDP falls from around 2.7% of GDP in 2017 to around 2.5% of GDP in 2038.

The initial *Intergenerational Report* of 2002 projected that Age Pension costs would rise from 2.9% of GDP at that time to 4.6% over 40 years. Higher superannuation balances, tighter Means Tests and the deferral of the Age Pension Eligibility Age from 65 to 67 have reduced the expected cost. This cost would reduce further should the Eligibility Age be increased to 70 in line with government policy.

Graph 7. Projected proportion of the eligible population receiving the Age Pension, by rate of Age Pension



Graph 8. Projected Age Pension expenditure percent of GDP)



The *Intergenerational Report 2015* projected Age Pension expenditure to remain stable (at just under 3.0% of GDP) over the 40-year projection period, so the trend above will free up government expenditure in due course.

Age Pension expenditure will also continue to fall over the 20 years following the end of the projection period. We project that Age Pension expenditure could fall to around 2.1% of GPD by 2060, though it is likely there will be further changes before then.

Given estimates now suggest that Age Pension expenditure will fall as a percent of GDP over the coming decades, it is important to consider the purpose of the Age Pension, the nature of the Age Pension and what the Government should reasonably provide to the retired population.

8. Reform of the Age Pension

This section of this Paper draws various conclusions about nature and size the future of the Age Pension and the retirement income system. Possible areas for reform are also canvassed to ensure an adequate income is provided for retirees and the Government maintains fiscal sustainability.

Given the projected size of Government expenditure on the Age Pension, it is important to consider the purpose of the Age Pension and whether it meets its objective. The 1998 Paper argued that Age Pension policy settings should be set to meet certain social and equity objectives and provide for a sufficient level of income in retirement.

In addition to these objectives, it is important to consider whether any further complexity in the interaction between the Age Pension, superannuation and the tax system could be sensibly reduced.

8.1 The nature of the Age Pension

Many younger members of the community may be concerned that the Age Pension may not exist in future. Our projections modelling clearly shows that, whilst the proportion of the eligible population receiving the Age Pension will fall over the coming decades, a reasonably significant proportion will still receive the benefit.

As stated earlier in this report, the proportion of the eligible population receiving the Age Pension will fall from around 69% in 2017 to around 56.6% in 2038. By 2060, the proportion of the eligible population receiving the Age Pension will fall to 45.1%. At these levels, it will remain a supplementary benefit as well as a safety net, in line with the *Objective of Superannuation*.

Given the overall wealth of retirees when including the family home, it is valid to question whether we should be targeting higher superannuation balances with a goal of the Age Pension becoming a safety net in time.

8.2 Unlocking equity in the family home

8.2.1 Current distortion between homeowners and renters

Currently, the exclusion of the family home from the assets test creates distortions in savings patters and favours home owners over renters. In addition, it discourages downsizing, as the proceeds of downsizing would become subject to Means Testing.

It also creates anomalies between different home owners. For example, a couple with a home worth $500,000 and $1.25 million of financial assets would receive no Age Pension. In contrast, a couple with a home of $3 million and minimal financial assets would receive a full Age Pension, at the expense of taxpayers in much less fortunate situations.

The treatment of renters is largely historical. Up until about 30 year ago, the value of a family home in a capital city was about 2.5 times average annual earnings. It is now between 8 and 12 times earnings varying by State. Consequently, the home is a valuable investment, far beyond what was originally envisaged for social welfare benefits.

The Asset Test effectively has a $200,000 threshold difference between renters and home owners, which appears to be too narrow, and does not provide any additional support to those pensioners who are below the threshold on any basis.

The overall difference between means testing for renters and home owners is narrower than implied by the above difference between Asset Test thresholds. This is caused by complex interactions with the Income Test.

For example, a retired single renter with assets of up to $456,750 might expect to receive a full Age Pension based on the relevant Asset Test threshold. However, the Income Test reduces the annual pension by 50c for every dollar by which income exceeds an income threshold, which for most single retirees is $168 per fortnight. **Critically, this income threshold does not depend on whether the pensioner is a home owner or a renter.**

Income from financial assets is calculated based on deeming rules, with assets underlying account based pensions subject to the deeming rules unless an income stream was commenced before 1 January 2015. As a result:

- Someone with relevant assets at the threshold for the asset test for a single renter would have deemed income of $14,091 per year and their Age Pension would be reduced by $4,862 per year.
- The actual level of assets which the renter can hold before the Age Pension starts reducing is $157,569, just 35% of the headline figure from the asset test.

The lack of differentiation between home owners and renters in the Income Test over-rides much of the Government's intended differentiation in the Asset Test, especially for recent and future retirees.

Further, rental assistance is a maximum of $3,505 for a single person and $6,604 for a couple. This is also too low relative to the current rental market.

8.2.2 Utilising equity in the family home

The Government's recent announcement to extend the Pension Loan Scheme will provide additional, non-Means Tested income to Age Pensioners and self-funded retirees who may have significant housing wealth.

If the value of the family home above a certain threshold was included in the Assets Test, retirees would be encouraged to downsize and unlock some of the value of their current home to provide for their retirement income. This approach may result in a more appropriate allocation of housing supply, as retirees no longer reside in unnecessarily large homes.

Alternately, they could use the Pension Loan Scheme to supplement their income and unlock equity in the home without needing to downsize.

8.3 Encouraging part time work

Incentives to continue working part time could be improved. For example, the Pension Work Bonus could be increased further and/or there could be a band where (for example) only half of income from employment counts towards the Means Test.

8.4 The cost of Aged Care

At the time of the last *Intergenerational Report*, Government Expenditure on Aged Care was projected to increase from 0.9% of GDP in 2014-15 to 1.7% of GDP by 2054-55.

At the 2018-19 Budget, the Government announced that it would invest $1.6 billion to provide 14,000 additional home care Aged Care packages. As longevity and the costs of providing care to the elderly continue to increase, perhaps the fiscal space provided by a reduction in Age Pension expenditure should be used to fund the provision of Aged Care services.

In the 1998 Paper, it was we argued that the absolute level of Age Pension should be set to provide retirees with dignity and comfort in their retirement. The adequate provision of Aged Care for retirees will certainly ensure that retirees are afforded dignity in the later stages of their life.

It is worthwhile considering whether there should be a fiscal target for combined Age Pension and Age Care costs. If there was a goal of paying (say) 4.0% of GDP for these benefits, it would then be the role of government to ensure that the payments were made equitably.

8.5 Targeting future costs

The modelling included in this Paper shows that Government expenditure on the Age Pension will fall over coming decades. At the same time, Treasury projects increases in Aged Care costs.

As superannuation balances increase, it is worth considering whether the total income provided in retirement is sufficient for future retirees.

Some of the matters which could be considered for future policy initiatives:

1. **Including more valuable homes in the Means Test**

   This could be done by including the value of the home above a threshold within the assets test. The level of the threshold is a matter for debate. If we wanted the Age Pension to be a safety net, based on current average earnings, that would exclude the first $500,000 of a home (based on approximately 6 times average annual earnings). The excess would be included in the assets test. Many retirees would receive lower pensions from this change (though the thresholds for the asset test would be increased).

   If we wanted (say) 40% of the population to receive a part Age Pension, we would set the multiple higher, perhaps at 10 times average earnings and add this to the thresholds.

   Any reduction in income from including the family home this way could be met by spending superannuation benefits and/or by using the Pension Loans Scheme.

   This initiative could be introduced over a ten-year period to give people an opportunity to get their affairs in order.

2. **Significantly increase rent assistance for age pensioners**

   The rental assistance is inadequate and there would be scope to increase it given the other changes to overall pension costs.

3. **Enhance incentives for part time work in retirement**

   The higher Eligibility Ages will mean that people will have to work longer. This is an issue for those in manual, unskilled or boring jobs. Part time work helps fill the gap between work and retirement and allows for deferment of superannuation benefits.

4. **Set a target for combined Age Pension and Age Care costs as a percentage of GDP**

   Aged Care and pension costs are about 4% of GDP today. We know that pension costs will decline, and Aged Care costs will increase. We should set a future target for the cost of both combined – perhaps at 4% to 4.5% of GDP.

   This will provide governments with a financial budget. Any change to thresholds or benefits can then be done within the financial constraints.

9. References

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