CRISIS OF CASH OR CRISIS OF CONFIDENCE: THE COSTS OF AGEING IN AUSTRALIA

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The retirement of the 'baby boom' generation, and the associated increase in the number of retirees has been prominent in public debate, and debate around government taxing and spending policies in particular, since the turn of the 21st century. The federal government has commissioned the Intergenerational Report (Treasury 2002), as well as the Economic Implications of an Ageing Australia (Productivity Commission 2005). Political leaders, including the Prime Minister and the Treasurer, have framed the desire to achieve other policy goals (such as reduced government expenditure) in terms of dealing with the imminent retirement of the baby boom generation.

The Prime Minister, for example, has stated:

> Gearing retirement incomes policy to encourage greater self-reliance through higher voluntary savings will reduce pressures on the age pension, while helping people to achieve a level of retirement income which will provide them with an acceptable standard of living (Howard 2002).

And the Treasurer has stated:

> An increasing aged population implies higher government expenditures. More than half of Commonwealth government spending is directed to health and aged care, social safety net payments to individuals, and to education. Over the next forty years Commonwealth expenditure on aged care and pensions will rise by around 2.7 per cent of GDP (Costello 2003).

However, as a recent international comparison of Australia's taxation system found, Australia's retirement income taxation regime is already highly concessional. The Hendy Warburton (2006) report found that:

> Australia is fifth out of 21 OECD countries in terms of the relative concessionality of the retirement savings taxation regime and third out of the OECD-10 (Hendy and Warburton 2006: 233).

Further:

> (Australia) provides above average concessions in terms of the availability and taxation treatment of lump sum payments (Hendy and Warburton 2006: 227).

The purpose of this paper is to highlight a major contradiction in the federal government's approach to the stated costs of ageing, namely, its determination to move people away from reliance on the aged pension and towards 'self funded' retirement. Apart from the rhetorical encouragement for individuals to 'take responsibility' for their retirement, the government has announced a wide range of policies designed to encourage increased investment in superannuation accounts, including the introduction of government funded co-payments for voluntary contributions to superannuation and reductions in the high income earners' surcharge on superannuation contributions. The superannuation industry is currently seeking to have the 15 per cent superannuation contributions tax abolished, despite an estimated annual cost of more than $3 billion per year (see Smith 2006).

The contradiction in question is that, for medium and high income earners in Australia, the cost of taxation concessions granted to their superannuation contributions is more expensive than the costs of providing individuals with an aged pension. A range of data is presented below to support this assertion.

Another argument to support the increasingly generous tax treatment given to investment in superannuation is that the aged pension is inadequate to support the 'lifestyle' expectations of baby boomers. This may be so, but the case for treating the baby boomers more generously in retirement than today's retirees has not been made by either the government or the superannuation industry.

This paper is structured as follows. The next section highlights the way in which the superannuation industry, and indeed the government itself, has sought to significantly raise the expectations of older Australians about the amount of income they will need in their retirement. Then comes a section that contrasts these new higher expectations with the realities of retirement incomes for Australians today, and for those set to retire over the coming decade. It shows that while the public norm for retirement income might be that of regular overseas travel and ample money to pursue active recreation, the lived experience of most retirees is, in fact, quite different.

The following section of the paper then presents data on the relative cost of providing aged pensions and of providing tax concessions for superannuation contributions. It shows that for middle and high income earners, the cost of tax concessions for superannuation is actually greater than the cost of the direct provision of an aged pension.

The paper ends with an assessment of the effectiveness of the increasing reliance on superannuation tax concessions as a mechanism for financing retirement incomes in Australia. The main conclusion is that the shift from the aged pension towards subsidies for superannuation will result in an increase in the cost to taxpayers for the provision of retirement incomes and a reduction in the equity of the distribution of retirement incomes.

How Much Does it Cost to Retire With Dignity?

There is no agreed definition of poverty in Australia. A commonly used indicator is the updated Henderson Poverty Line, which shows that in March 2006 the poverty line for a single pensioner was estimated to be \$268.21 (Melbourne Institute of Applied Economic and Social Research 2006: 2). At the time a single pensioner receiving rent assistance would receive \$294.05 on average, putting him or her just a little above the poverty line.

While there has been little public debate on the adequacy of the aged pension, there appears to be a growing community consensus that the children of today's retirees deserve a much higher standard of living than that of their retired parents. The then Minister for Ageing, Julie Bishop, for example, stated that:

> We are moving towards a future where older Australians will have different needs and expectations. With the advent of the Baby Boomers as the next generation of older people, old age will be characterised by different values and aspirations, needs, services, cultures and recreational activity (Bishop 2005).

Interestingly, it is not just the government and the superannuation industry that support this view, with progressive commentators such as Clive Hamilton stating in a paper that refers to baby boomers as the 'not so lucky generation':

> ...all boomers share a disadvantage as a generation. At a time when individuals are increasingly expected to self-fund in retirement, baby boomers have become the 'bunnies', caught in a situation in which they are being asked to do something they do not have the capacity to do. Because compulsory superannuation was introduced late in their working lives, the boomers have become subject to the new expectations of self-provision without having had the opportunities to save enough to provide fully for retirement. Of course, in this situation, lower income earners are disadvantaged in two ways - as against other generations and against wealthier members of their own generation (Hamilton and Hamilton 2006: ix).

The fact that a retiree with any superannuation will retire on an income in excess of the aged pension that today's retirees are expected to live on is typically ignored in analyses of the likely living conditions of future retirees[1]. According to Hamilton and the government alike, the absolute increase in retirement incomes of baby boomers, as compared to today's retirees, is of less concern than the perception of baby boomers that they

1 That is, retirees with only modest incomes from superannuation are still entitled to receive the full aged pension. The aged pension therefore acts as a floor for retirement incomes, with all superannuants receiving incomes in excess of this floor due to the way that superannuation incomes are a supplement to, rather than a substitute for, the aged pension.

will not have nearly as much as they would like.

This perception that happiness in retirement is a direct function of retirement income has been heavily promoted by the superannuation industry, which often uses the word 'dignity' when it is extolling the benefits of higher retirement incomes. For example, in the words of one advertisement for a financial planner:

> The objective is to help clients plan to achieve financial independence without delay and a retirement with dignity (Fusion Planning Group 2005).

Similarly, the 'story' told in the following advertisement reveals not just the desire for well funded dignity among baby boomers, but explicit recognition of the fact that today's retirees are not well provided for.

> Sally and Paul want to have sufficient money in retirement to live in dignity. They know they have to save for their retirement but they don't know how much.
>
> Sally and Paul want to retire at age 60 and estimate they need $25,000 pa before tax in today's dollars to accommodate their planned retirement lifestyle.
>
> Ideally, they would like to take an extended holiday around Australia when they first retire, upgrade their car in five years and renovate their kitchen within the next two years. However, Sally and Paul's overriding goal is to remain financially independent in retirement ...
>
> Sally and Paul have watched their parents struggle to live on the Age Pension and they don't want to face the same challenge in retirement. They consider they have worked hard and they are looking forward to a comfortable retirement. They feel strongly that it is important to balance today's wants with their future retirement needs (Count Financial Limited 2006).

The policy problem, however, is not the difficulties faced by today's retirees, but how to ensure that future generations of retirees fare better. As the Treasury states:

> Retirement income policy should encourage people to achieve a higher standard of living in retirement than would be possible from the age pension alone, while ensuring that all Australians have security and dignity in retirement (Treasury 2006).

The Association of Superannuation Funds of Australia (ASFA) plays an active role in promoting the need for significantly higher retirement incomes than those received by today's retirees. ASFA has commissioned and published a range of materials designed to ensure that most Australians are aware of the need to have 'more' in their retirement. For example, in one of their publications under the heading 'How much do you need to spend to have a comfortable standard of living in retirement?' ASFA informs its readers:

> The level of the Age Pension tells you what people can survive on, but most Australians want and need more than the Age pension. The Westpac/ASFA Retirement Living Standard provides detailed budgets of what singles and couples would need to spend to be able to either have:
>
> - A modest lifestyle in retirement, better than just survival on just the Age Pension but still only being able to afford fairly basic activities; or
>
> - A more comfortable lifestyle in retirement, enabling an older, healthy retiree to be involved in a broad range of leisure and recreational activities and to have a good standard of living through purchase of such things as household goods, private health insurance, a reasonable car, good clothes, a range of electronic equipment, and domestic and occasional international holiday travel (ASFA 2004a:1)

The report concludes that, in 2004, to retire with a modest lifestyle would require $17,756 p.a. for a single person and $24,919 for a couple. To retire 'comfortably' a single retiree would require $34,563 p.a. while a couple would 'need' $46,297. These figures are up to twice the aged pension at that time, and, it is important to note, ASFA provide an update every three months to inform people about how much more expensive comfort is becoming.

In another paper, ASFA explains in greater detail the differences between their definition of a 'modest' and a 'comfortable' retirement. Its analysis does not even attempt to describe the living conditions of those enduring an aged pension:

> The modest budget allows for the basics but very little else. For example, both eating out and entertaining at home is very restricted, and no overseas travel is possible. The extra expenditure associated with a shift from a modest lifestyle to a comfortable lifestyle in retirement adds a lot to enjoyment, comfort, style, holiday travel, health insurance cover, and the ability to more fully participate in modern Australian society. At the modest budget level many retirees would not be able to participate in a range of sport and social activities that involved out of pocket expenses of various sorts (ASFA 2004b:1).

Under the heading 'Enjoyment' the ASFA report goes on to highlight a number of recreational activities costed into their comfortable budget:

> The comfortable budget also allows another $20 a week or so per person in total for expenditure on items such as drinks at the club, some gambling on lottery tickets or the like, tobacco purchases (if a smoker), or gifts to family or organisations if this is the preferred form of enjoyment (ASFA 2004b:1).

It is interesting to note that the Commonwealth government is providing income tax subsidies to people during their working life to ensure that they have sufficient disposable income in retirement to consume a range of highly taxed activities that government policy is aimed at reducing. Further, whenever younger welfare recipients are seen to have sufficient income to 'enjoy' smoking, drinking and gambling, such consumption is often depicted by critics of the provision of income assistance as evidence of the undue generosity of those payments.

Under the heading of 'Holidays' ASFA states that:

> The modest budget only allows for an annual holiday in cheap accommodation not far from home, costing no more than $450 for a single person. The more comfortable budget allows for a budget overseas trip every five years, and up to 10 domestic trips each year to visit family, friends or to holiday (ASFA:1).

While there is no doubt that the capacity to travel frequently would be of benefit to retirees, the inability to make 10 domestic trips per year seems like an unlikely problem for government's to be concerned with solving.

The final ASFA publication that it is necessary to describe is a research report commissioned from the University of New South Wales' Social Policy Research Centre (SPRC). In 2004 the SPRC produced a major report for ASFA entitled *Updating and extending indicative budget standards for older Australians* (SPRC 2004).

The SPRC had previously been involved in a long running research project to help determine the cost of living for low income earners. The purpose of SPRC (2004) was to apply the same method to help the superannuation industry convince the Australian population of just how expensive retirement living could be.

It is interesting to note that the purpose of the SPRC paper was to:

> Undertake, on a provisional basis, a revision of the existing modest but adequate standard so that it represents a more affluent standard of living for older households who are substantially reliant on superannuation rather than the pension SPRC (2004: 2).

The report goes on to describe its new budget standard for retirement income as comfortably affluent and sustainable (SPRC 2004: 3).

It is interesting that, while the SPRC uses the word 'affluent' twice in its description of the research it was undertaking, ASFA refers to the budget for 'comfortably affluent and sustainable' only as 'comfortable'. The word affluent does not appear in the ASFA reports on the costs of retirement.

Finally, it is important to note some specific details on the costs that ASFA considers are required to experience a comfortable retirement. These costs are shown in Table 1 on the following page.

Table 1: Selected Expenditure Items for a 'Comfortable' Retirement

Item	Life Time (years)	Unit Price
home security system	20	$1,606
Stove	20	$2,299
Refrigerator	15	$3,999
Air conditioning unit	15	$2,999
Personal Computer	6	$2,999
Private health insurance	Each year	$1,618
10 domestic trips per year	Each year	$1,957
1 international trip every 5 years	5	$1,015
Kitchen renovation		Unstated
Bathroom renovation		Unstated

Source: SPRC (2004)

According to SPRC (2004), it is important for the government to provide generous tax concessions to wage earners to ensure that, in retirement, their superannuation income is sufficient to purchase a 619 litre double door fridge for $3,999, to travel domestically ten times each year and to renovate both a kitchen and bathroom.

Pages 46 to 51 of SPRC (2004) provide an extensive list of other 'must haves' for retirees, including a new summer nightie every 18 months for women, a new winter cardigan each four years for men, and three meals per week at the RSL club.

There is, of course, nothing wrong with individuals wishing to make such purchases. However, there is no doubt that the lifestyle, described by ASFA and based on the SPRC (2004) research, is well beyond the living standard of today's retirees as well as many full time employees.

It is also unclear why the 'wants' of baby boomers in retirement should take precedence over the needs of those who are already retired, or others in the community who currently go without.

What Do Most Retirees Currently Live On?

The aged pension in Australia in 2006 is $244.45 per week for a single pensioner with an additional $49.60 available as rent assistance (Melbourne Institute of Applied Economic and Social Research 2006: 2). Pensioners in receipt of income from other sources receive a declining level of pension support as their non-pension income rises. According to the 2001 Australian Census, more than half of those 2.7 million Australians of aged pension age were in receipt of the full aged pension. A further 765,000 individuals receive a part pension. Only around 400,000, or less than one sixth, of those of pensionable age were living independently of the age pension. This data is summarised in Table 2.

Table 2: Source of Income For Those of Pension Age, 2001

Self Funded Retirees	400,000
Full-time employed	85,000
People with only DVA compensation payments	60,000
Part-rate pensioners	765,000
Full-rate pensioners	1,370,000

Source: ABS census (2001)

As the following quotation shows, The Commonwealth Treasury is aware of both the current reliance on the aged pension, and the likelihood that large numbers of Australians will continue that reliance over the coming decades.

> The Superannuation Guarantee and other retirement savings will allow Australians to retire with higher living standards than previously. The age or service pension will still remain an important part of these higher living standards. However the number of people receiving a full rate pension will fall. Around 54 per cent of people of age pension age currently receive a full rate pension; another 28 per cent receive a part-rate pension; and 18 per cent do not receive a pension. By 2050, all employees will retire after having received the full 9 per cent Superannuation Guarantee over their working life. This is expected to result in the proportion of people aged 65 and over receiving a full rate

> pension falling to around one third, and the proportion of people not receiving the pension to rise to around 25 per cent. The proportion of people receiving a part-rate pension is expected to increase to around 40 per cent (Treasury 2006).

Put another way, the above quotation says that, despite the enormous cost of superannuation tax concessions, it is estimated that by 2050 three quarters of retirees will still be reliant, in whole or in part, on government aged pensions.

Table 3 shows that, for those who contribute the compulsory nine per cent of their wages towards superannuation throughout their working life, retirement incomes are likely to be in excess of, or at least on parity with, the incomes they earned over their working life. The figures are based on the assumption of a 45 year working life, 18 years in retirement, a real rate of return of 3.5 per cent and, importantly, constant earnings over the working life. Those whose income rises in real terms over the course of their working life would receive lower percentages of their income at the time of their retirement but, under the assumptions outlined above, no individual who worked throughout their life would receive an income derived from their superannuation that was less than twice the current age pension. Those on middle and high incomes are likely to retire on between five and ten times the current age pension.

Table 3: Projected Annual Retirement Incomes For Selected Working Life Incomes ($ per annum)

Annual income during working life	25,000	35,000	50,000	75,000	100,000	130,000	200,000
After tax income during working life	21,640	28,640	39,140	56,040	70,540	87,690	124,791
After tax retirement income	31,625	38,980	50,013	63,589	80,906	94,765	123,324
After tax retirement income as a % of after tax working life income	146%	136%	128%	113%	115%	108%	99%

Source: Authors estimates based on an individual making contributing 9 per cent of their wages to superannuation for 45 years, living for 18 years post retirement and receiving a real rate of return of 3.5 per cent. The retirement incomes for low income earners include income from both superannuation and the relevant part pension to which they are entitled.

The Costs to Government of Superannuation Tax Concessions and the Aged Pension

The following exchange during an ABC radio interview is indicative of how the costs of the aged pension are used to justify a wide range of fiscal austerity measures, along with tax concessions to help fund 'self funded' retirement:

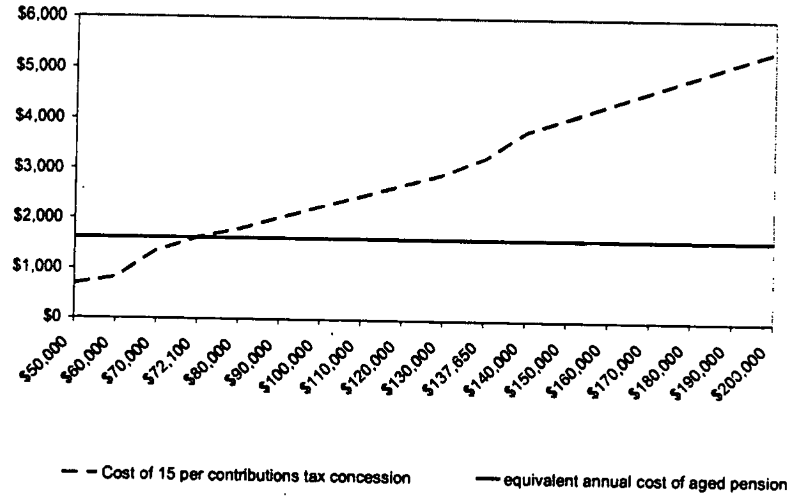
> ALEXANDRA KIRK: Firstly, the Productivity Commission has put the cost of Australia's ageing population even higher than your intergenerational report of two years ago, and it's predicting a looming fiscal gap of as much as $2,000 billion. It says that you need to make some tough decisions on tax and health. Are you ready to act now?
>
> PETER COSTELLO: Well, we raised this issue two years ago because we thought the important thing was to take the Australian public with us in understanding, first of all, the dimensions of the problem. And this independent report has confirmed what we said in our intergenerational report. And the point that I've been making all along is: Australia will have to deal with the ageing of the population, and it will have to deal with the major costs that that will bring. We'll either deal with it in small licks early on, or be forced be deal with it in large dislocation later on. But we will have to deal with it. Demography is destiny. Our destiny has been set by the changing fertility rates since the 1960's. It's set in stone – we can't walk away from it, we can't change it (Costello 2004).

Furthermore, the Treasury has stated that:

> More generally, the current tax concessions will help to reduce budgetary expenses in future years, particularly age pension payments, through encouraging private provision for retirement (Treasury 2006: 158).

However, as Figure 1 shows, the costs of providing tax concessions to middle and high income earners for their superannuation contributions are, in fact, greater than the costs of providing the aged pension. For individuals earning more than $137,6500 the cost of providing concessional tax treatment on income contributed to superannuation is more than twice the cost of providing a retiree with an aged pension.

Figure 1: Comparison of the Annual cost of Providing and Aged Pension and Superannuation Contributions Tax



Source: Author's estimates: calculations based on a 3.5 per cent real rate of return, a working life of 45 years and 18 years in retirement.

Figure 1 was derived as follows. First, the cost of providing an aged pension was annualised by estimating the annual cost of purchasing an annuity, over a 45 year working life, which would pay the real equivalent of the aged pension for 18 years in retirement. Assuming a real rate of return of 3.5 per cent, the annual cost of such an annuity was estimated to be $1604.

Second, the cost of the current contributions tax concessions was then calculated. As income tax rates vary from 0 per cent for those earning up to $6,000 *p.a.* to 46.5 per cent for those earning over $150,000 *p.a.* the cost of tax concessions rises with income.

It is important to note that those earning up to \$25,000 receive no tax concessions on their superannuation contributions (as the superannuation contributions tax of 15 per cent is equal to their marginal income tax rate), while tax concessions given to high income earners are the most expensive to provide.

Figure 1 compares the relative cost of buying an annuity to purchase the equivalent of an aged pension with the cost of current superannuation tax concessions for a range of different incomes. It shows that, for an individual earning less than \$72,100 *p.a.*, the costs of providing an aged pension are higher than the costs of superannuation tax concessions.

It also shows that, for an individual earning \$137,650 *p.a.* the cost of tax concessions for superannuation contributions is more than twice the cost of funding an aged pension. For an individual earning \$180,000 p.a. the costs of tax concessions for superannuation contributions are more than three times the cost of providing an aged pension.

Table 4 (on the next page) shows the Treasury's forward estimates for the cost of superannuation tax concessions. In 2008-09 it is estimated that tax concessions for superannuation will cost more than \$19 billion compared to an estimated \$24.6 billion for the aged pension. While these numbers are not strictly comparable (as the costs of the superannuation tax concessions refer to the costs for those currently in the workplace and the costs for aged pensions refer to the cost of providing the aged pension to those who have already left the workforce), they indicate the high cost to the government of assisting 'self funded' retirees.

While there is no doubt that tax concessions for superannuation improve the retirement incomes of some Australians, there is also no doubt that the major beneficiaries of those tax concessions are high income earners. If retirement income assistance were distributed in the form of cash payments to recipients rather than as tax concessions, then the largest payments would go to the highest income earners. The smallest payments would be given to those earning between \$25,000 and \$75,000, and those earning less than \$25,000 would receive nothing.

Table 4. Comparison of Current Costs of Superannuation Tax Concessions and the Provision of the Aged Pension ($M)

Costs	2004-05	2008-09
Under taxation of employer contributions	7,800	10,300
Deduction for non-employer sponsored contributions	430	510
Undertaxation of fund earnings	5,750	7,750
Measures for low income earners	75	280
Spouse contributions and rebates	14	14
Capital gains tax discounts for funds	110	250
Total cost of superannuation tax concessions	14,180	19,105
Cost of age pension	19,900	24,600

Source: *Treasury Tax Expenditure Statement*, 2005: 163 and *FaCS Portfolio Budget Statement* 2005: 26.

Despite the significant inequities in the way that current and future retirees are treated, the superannuation industry continues to seek further improvements to the retirement living standards of those who are yet to retire.

For example, ASFA is currently calling on the federal government to abolish the 15 per cent contributions tax, arguing that 'The beauty of removing the contributions tax is that it would boost the superannuation of lower and middle income groups, who too often tend to have low, or no other savings' (Smith 2006).

Despite the focus on the alleged benefits for low and middle income earners, ASFA published a table in the same press release which clearly shows that high income earners are the major beneficiaries. Reproduced here as Table 5, this shows that the abolition of the superannuation contributions tax would deliver an extra $400 to an individual earning

$30,000 *p.a.*, while the gain to an individual earning $100,000 *p.a.* would be nearly six times as high at $2,300.

Table 5. ASFA Research Centre Projections of Lump Sum Superannuation Benefits with and without Contributions Tax ($)

Salary	1 year	5 years	10 years	20 years	30 years
$30,000 (with contributions tax)	2,300	12,200	26,500	62,500	111,600
(with no contributions tax)	2,700	14,400	31,100	73,500	131,300
Gain	*400*	*2,200*	*4,600*	*11,000*	*19,700*
$45,000 (with contributions tax)	3,400	18,300	39,700	93,800	167,300
(with no contributions tax)	4,100	21,600	46,700	110,300	196,900
Gain	*700*	*3,300*	*7,000*	*16,500*	*29,600*
$60,000 (with contributions tax)	4,600	24,400	52,900	125,000	223,100
(with no contributions tax)	5,400	28,800	62,300	147,100	262,500
Gain	*800*	*4,400*	*9,400*	*22,100*	*39,400*
$100,000 (with contributions tax)	7,700	40,700	88,200	208,400	371,900
(with no contributions tax)	$9,000	$47,900	$103,800	$245,100	$437,500
Gain	*2,300*	*7,200*	*15,600*	*36,700*	*65,600*

Source: Smith (2006)

It is important to highlight the fact that superannuation is concessionally taxed at both the contribution and accumulation stages. The superannuation industry regularly comments on the fact that superannuation is 'taxed three times', but it typically seeks to conceal the fact that the overall impact of this taxation is highly concessional.

Conclusions

Tax concessions for superannuation are an inefficient and inequitable way to fund retirement incomes. If the problem is defined in terms of the fiscal impact of an ageing Australia then the provision of uncapped superannuation tax concessions that vary directly with the amount of income received is an unnecessarily expensive, and regressive, policy response.

In advocating the abolition of the 15 per cent tax on superannuation contributions the Finance Minister, Nick Minchin, stated:

> Anything we can do to augment individual Australians' capacity to provide for their own retirement has got to be good (Minchin 2006).

This is *not* the case when the costs to the budget of providing tax concessions to deliver increased private income in retirement are greater than the costs to the budget of providing publicly funded retirement income. The argument should be about equity, not fiscal necessity. However, neither the government nor the superannuation industry has made the case for why future retirees deserve a significantly higher standard of living than contemporary retirees.

It may be self evident to some that having more retirement income is superior to having less, but the public policy issue is whether baby boomers' desire to spend more in retirement is a public policy problem or simply a private life cycle spending choice. If it is accepted that improving the living standards of those in retirement is a public priority then it remains unclear why funding is not diverted into increasing the aged pension paid to those currently in their retirement, along with providing better and more affordable services to today's retirees.

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