The ADEQUACY OF AUSTRALIAN RETIREMENT INCOMES
- NEW ESTIMATES
Incorporating the Better Super reforms

George P Rothman
Retirement and Income Modelling Unit

Department of the Treasury
Coverage of Presentation

- Update on Super policies and facts
- Measuring adequacy
- A few hypothetical results
- The RIMGROUP model
- Aggregate adequacy results
- Resolving the apparent conflict with IFSA’s Saving’s gap
- Conclusions
Australia’s evolving superannuation system

- By almost any measure superannuation in Australia has been an ongoing success story.
- From humble beginnings we have:
  - Coverage over 92% of employees
  - Assets about $1050 billion, growing rapidly
  - Super funds now owning around a third of the Australian stock market
  - Sensible regulation and minimal failure rates
- Very strong government support
  - Through tax concessions, co-contributions, transition to retirement and Better Super
- Income in retirement for most Australian will be funded by super saving, other private savings and a full or part age pension.
Adequacy- Replacement Rates

- Basic idea is that a person’s standard of living in retirement should be a reasonable proportion of their standard of living during working life.
- RIM uses and strongly prefers an expenditure or spending concept for replacement rate calculations.
  - This is not ‘income’ because it involves a drawdown of capital and because it is after tax and saving.
  - It is not also not ‘consumption’.
- Senate Committee and the Institute of Actuaries accept spending replacement rates and suggest a target range from 70-80 per cent.
- Government has no preferred range.
  - Individual circumstances vary.
Definition of Replacement rate is not unique

![Graph showing Income, Benefits and Tax for Whole-of-life Hypothetical](image)

- **Private Income**
- **Government Benefits**
- **Tax**
- **Net Expenditure**

<table>
<thead>
<tr>
<th>Age</th>
<th>Private Income</th>
<th>Government Benefits</th>
<th>Tax</th>
<th>Net Expenditure</th>
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### Updated Hypothetical analysis

Table 1: Various replacement measures for a single male with a working life of 35 years, retiring at age 65 in 2042[1]

<table>
<thead>
<tr>
<th>Salary (multiple of AWOTE)</th>
<th>Private benefit taken as:</th>
<th>Average over retirement / last year work</th>
<th>First 10 years retired / last 10 years work</th>
<th>First 5 years retired / last 5 years work</th>
<th>First year retired / last year work</th>
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<tr>
<td>0.75</td>
<td>Allocated pension*</td>
<td>80%</td>
<td>80%</td>
<td>75%</td>
<td>71%</td>
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<td>Lump Sum</td>
<td>78%</td>
<td>72%</td>
<td>67%</td>
<td>63%</td>
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<td>1.00</td>
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<td>70%</td>
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<td>64%</td>
<td>60%</td>
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<tr>
<td></td>
<td>Lump Sum</td>
<td>67%</td>
<td>61%</td>
<td>56%</td>
<td>52%</td>
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<tr>
<td>1.50</td>
<td>Allocated pension*</td>
<td>60%</td>
<td>57%</td>
<td>53%</td>
<td>49%</td>
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<tr>
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<td>Lump Sum</td>
<td>56%</td>
<td>49%</td>
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<tr>
<td>2.50</td>
<td>Allocated pension*</td>
<td>52%</td>
<td>49%</td>
<td>45%</td>
<td>44%</td>
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<tr>
<td></td>
<td>Lump Sum</td>
<td>46%</td>
<td>38%</td>
<td>34%</td>
<td>32%</td>
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</table>
The RIMGROUP Model

Cohorts represent the full Australian population from beginning work to death

- age 18 to 100 in single years
- male, female
- 10 income groups
- modelled for up to 68 financial years from July 1992 to June 2060

- Labour force composition of each group (FT/PT/ob/U/NILF * Sector) and earnings for those working
The RIMGROUP Model(2)

- Superannuation accumulations by seven main account types
  - private: defined benefit, established defined contribution, SG/Award,
  - public: Defined benefit, Defined contribution including SG/Award
  - self employed, rollover/ personal;
The RIMGROUP Model (3)

- Increments to super from contributions from employers, employees and personal
- Decrements to super from death, job change, hardship, disability and retirement
- Other savings
- Social security allowances and income tax
- Retirement benefit taxation and investment choice
- Retirement incomes and government pensions and taxation
FEATURES of the AGGREGATE MODELLING

- Full coverage of Australian population covering the range of:
  - labour force experience
  - age at retirement
  - types of superannuation
  - contribution rates, varying by gender, age and income

- Other Savings outside superannuation

- Complex pattern of Retirement investments
  - Following the Better Super reforms, allocated pensions are assumed to become the largest private source of retirement income
More about the AGGREGATE MODELLING

- Important time dimension as SG system matures

- Slightly different definition of replacement rate
  - potential expenditure of retired in 5 year range after age pension age compared with potential expenditure of not retired for 5 year range before age pension age

- Annuity pattern drawdown for fixed interest investments
  - but not all investments
  - Targeting low inheritances but realistically not zero.
Replacement rates, total all deciles
Women and Men, decile 5

Comparison of men and women, Decile 5

- women workers
- women all
- men workers
- men all

Year: 2005 to 2049
Replacement ratio: 0.00 to 1.20
Replacement rates, selected deciles
Sensitivity to parameters and policies

- In the projections many assumptions/judgements were required on future participation and retirement patterns, future investment returns, future voluntary contributions, saving outside superannuation, future tax scales, drawdown patterns of retirees ...

- Some are more important than others:
  - Changing drawdown rate by plausible amounts changes replacement rates by around 5%
  - Government policies (including tax scales) can be very important and can have immediate effect]

- Long term investment returns are important
  - 30 years of 1 percentage point higher investment returns increases replacement rate by about 13% (and vice versa)
IFSA savings gap

- Defined as gap between amount required to fund adequate retirement and projected superannuation savings (for group considered)
- Based on work by Rice Walker in 2003
- Gap was stated to be $600 billion.
- In 2006 IFSA revised gap downwards to around $450 b.
IFSA saving gap (2)

- IFSA /R-W differ from the current study by:
  - Using a gross measure of adequacy equivalent to very high net adequacy
  - Excluding saving outside super
  - Using a lower earning rate (about 1 percentage point lower)
  - But assuming higher contributions 11 per cent employer, 4 per cent member
  - Importantly, treating the age pension as a peripheral rather than an integral part of the retirement income system.
The age pension will continue to be an important part of retirement incomes
IFSA saving gap (3)

- R-W estimates private super accumulation for those between 0.5 and 2 times AWOTE at $1200 m; age pension at $100 to $200 m
  - Ratio of over 6:1
  - Can be re-estimated at 4.5 to 1
- But hypothetical analysis for a worker around AWOTE shows that retirement income is made up around 1 to 1, private income to age pension
- Suggests R-W age pension estimate is far too low
  - Better estimate would be around $700 m higher
- Changing the age pension estimate to this removes saving gap
Conclusions

- Aggregate analyses add value by covering
  - the range of labour force experiences
  - differing retirement ages,
  - differing total superannuation contribution rates by age, gender and income; and
  - the contribution of savings outside superannuation

- Replacement rates are higher than in the author’s 1999 paper reflecting strong super earnings and helpful government policies offset by some factors, notably increased longevity
Conclusions (2)

- Starting from moderate levels for workers of just over 50% currently, replacement rates will be lifted by the Better Super reforms.
  - Replacement rates are projected to continue to rise strongly reaching levels of 70% or more in the medium term (ten years or so), levels that are usually judged adequate by most observers.
- Initially the replacement rates for women is similar to that of men. However the maturing of the SG arrangements and other factors leads to higher long term ratios for decile 5 women compared with men.
- Higher decile cohorts, where the SG alone would not be enough, are seen to be making sufficient saving voluntarily, to provide similar (sometimes higher) replacement rates to those of lower deciles.
Conclusions (3)

- In considering why the findings of this paper appear at odds with the IFSA saving gap, the author has argued that the difference primarily reflects a major understatement in the Rice-Walker /IFSA projections of the significance and value of the government age pension - by around $700 billion dollars.
- If such an adjustment is made the analysis suggests there is no aggregate savings gap.
- But complacency is not appropriate.
  - The analyses aggregate various groups and individual circumstances vary considerably.
- Recent government policies, particularly the co-cont and Better Super reforms provide strong incentives to save more and to delay retirement.