Proposed Changes to Retirement Income Policy: Implications for the Labour Market with an Ageing Population

Abstract:

Australia’s retirement income system is based on three pillars: the age pension, the superannuation guarantee and voluntary savings, or voluntary superannuation contributions. The system is currently very topical, as earlier this year both the Federal Government and the Opposition released proposals to change retirement income policy. These policies have been designed to deal with a number of issues, the most important for the Government being the ageing of the population. The implication of this demographic change is that the dependency ratio will rise, with a greater share of retired seniors depending, to varying extents, on the economic product of a workforce that comprises a smaller share of the population. This has led to some concern that the current system of social expenditure will be unsustainable.

The literature generally suggests that the ageing of the population will not lead to a ‘social expenditure crisis.” One reason for this has been the introduction of the superannuation guarantee, which will limit potential increases in expenditure on the age pension. The effects of this policy on the labour market as a whole have been modelled by Freebairn (1998). In this study, Freebairn’s work on the labour market effects of the superannuation guarantee has been enhanced in two ways: i) by considering the sectoral impacts of the guarantee; and ii) by considering the impact of changes in the intergenerational transfer realised through the fiscal system on the labour market outcomes with and without the superannuation guarantee. I conclude that, from a labour market perspective, it appears that the decision to introduce the superannuation guarantee was appropriate.
Introduction

Earlier this year both the Government and the Labour Opposition released policy proposals to alter Australia’s retirement income system. These policies have been designed to deal with a number of issues, the most import for the Government being the ageing of the population. This demographic change is likely to put pressure on social expenditure, particularly through health, aged care and the age pension. This paper will discuss the labour market effects of Australia’s retirement income system. In particular, it will focus on two methods of dealing with higher age pension expenditure. The first is the superannuation guarantee, the effects of which have been modelled by Freebairn (1998). A second means of dealing with greater pension expenditure is to increase income taxes. The aim of this paper is to compare the effect of the two options on wages and employment.

Australia’s Retirement Income System

Australia’s Retirement Income System is based on three pillars – the age pension, the superannuation guarantee and voluntary savings or voluntary superannuation contributions.

The Age Pension

The qualifying age for the pension is 65 for males and 62 for females (to rise to 65 by 2014). The age pension is means tested to restrict access by wealthy individuals. Expenditure on the pension was 2.9% of GDP in 2001-02 (Commonwealth Treasury, 2002, p.10). In this year 54% of people over the qualifying age received a full pension and 28% received a part pension (Commonwealth Treasury, 2002, p.10). The Government states that the pension is a “means tested safety net”, providing a modest income for those who have has limited opportunities to save for retirement (Commonwealth Treasury, 2002, p.9). However, the fact that the proportion of those of qualifying age who receive the pension has consistently been over 50% implies that the pension acts as more that just a “safety net”.

Superannuation Guarantee

The superannuation guarantee was introduced to improve the adequacy of retirement incomes and to reduce reliance on the age pension (ASFA, 2004). Employers are required to make quarterly contributions for their employees at a minimum rate of 9% of the employee’s “notional earnings base” (Commonwealth Treasury, 2002, p.11). These contributions are fully preserved until the preservation age of 55 (60 after 2015). Contributions are currently subject to a work test.

Voluntary Private Superannuation and Other Savings

Employees may also make additional contributions above those required by the superannuation guarantee. If these contributions are made by an employer on behalf of the employee, they are taxed at the rate applying to employer contributions, rather than the employee’s marginal tax rate. All voluntary contributions also benefit from the reduced tax on earnings that superannuation funds receive. The government encourages private contributions from low income earners through its co-contribution scheme.

The Ageing Population

It is indisputable that Australia’s population is ageing. This demographic change is occurring due to declining fertility rates, as well as an extended life expectancy. It is predicted that the proportion of the population over 65 will rise from 12.5% in 2001-02 to 24.5% by 2041-42 (Commonwealth of Australia, 2002, p.22). As this proportion rises, the proportion of the population of labour force age will fall. As a result, the dependency ratio is expected to increase from 0.5 in 2001-02 to 0.65 in 2041-42 (Stacey, 1998, p.75). This has been taken as a serious cause of concern, as it implies there will be more people depending on a workforce that comprises a smaller share of the population (Commonwealth of Australia, 2002, p.23). However, some caution is required when interpreting these figures. By definition the dependency ratio assumes that all people over 65 years of age are dependents, and all people between 15 and 65 are independent. However, almost one quarter of those
between 15 and 65 receive some form of income support (Kinnear, 2002, p.16), whilst many over 65 can be classified as “net contributors” or independents (McDonald & Kippen, 1999, p.55). Therefore the dependency ratio may exaggerate the problems of the ageing population.

Indeed, there is an argument that ageing is not in fact a crisis, but an inevitable result of a wealthier society. The human capital argument suggests that when real incomes increase, the opportunity cost of having a child also rises. This leads to a drop in the fertility rate, causing the population to age. However, there is now greater investment per child, thus increasing the level of human capital in the economy and increasing real incomes (Dorwick, 1999, p.35). However, this argument does not allow for the fact that ageing is due to increasing longevity as well as lower fertility rates (Dorwick, 1999, p.35).

Ageing and Social Expenditure

One of the major concerns arising from the ageing population is the fact that social expenditures in the form of age pensions, aged care and health are expected to increase. Of great concern, and one of the reasons for the government’s Intergenerational Report (Commonwealth of Australia, 2002) is the fiscal sustainability of these outlays.

There is a definite relationship between the size of the aged population and a country’s expenditure on pensions (Kinnear, 2002, p.17). In Australia, the proportion of the population of pension age is expected to double by 2041-42 (Commonwealth of Australia, 2002, p.10). However, it is generally accepted that Australia’s retirement income system is relatively “well placed” to deal with the ageing population (Commonwealth of Australia, 2002, p.45, Khan, 1999 & Kinnear, 2002, p.18). Australia spends the lowest share of GDP in income transfers of any OECD country other than Japan and the USA (Khan, 1999, p.141). The means tested pension, as well as the superannuation guarantee will limit any increases in expenditure on the age pension. Pension outlays are expected to stabilise at approximately 4.6% of GDP by 2041-42 (Commonwealth Government, 2002, p.10). After accounting for a drop in disability support payments, family tax benefits and unemployment benefits, the increase in total “social safety net payments” by 2041-42 is predicted to be 0.5% of GDP (Commonwealth Government, 2002, p.44). It seems more likely that pressures on social expenditure will come from health and aged care, rather than the retirement income system (Bacon, 199, p.95 & Ingles, 2000, pp.6-7). The government predicts health expenditures to increase from 4.3% of GDP in 2001-02 to 8.1% of GDP by 2041-42. Expenditure on aged care is predicted to rise from 0.7% of GDP to 1.8% of GDP (Commonwealth of Australia, 2002, p.38). The greatest pressure on expenditure is expected to occur in around 15 years time (Commonwealth of Australia, 2002, p.66).

Proposed Policy Changes

The Government1

The main focus of the Government’s proposed adjustments to the retirement income system is to deal with the problems that will accompany the ageing of the population.

Major policy changes include an adjustment to the work tests that currently restrict who can make superannuation contributions. For example, under the current system people aged over 65 must be working 10 hours a week, otherwise their fund must pay out their benefits (Commonwealth of Australia, 2004, p.9). The government proposes to completely remove the work test for those aged 18-64, and to amend the test for those aged 65-74 so that it is “more consistent with current and future work trends”. For those over 75, benefits will be paid out as soon as is practical, unless they still receive superannuation contributions under an industrial award.

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Currently people aged over 55 but below 65 must retire to access their superannuation. There is some concern that this leads to premature retirement. The government therefore proposes to allow people who have not yet retired, but who have reached the preservation age, to access their superannuation as a non-commutable income stream. The aim of this policy is to increase the flexibility of the older workforce, allowing them to work part time and supplement their income with their superannuation.

The Government does not plan to change the taxation of superannuation. In Australia, superannuation is currently taxed at each of the following stages: contributions, earnings and benefits. For example, employer contributions, and payments made under salary sacrifice arrangements are taxed at 15% for low and middle income earners, plus a 15% (soon to be 12.5%) surcharge for higher income earners (Commonwealth Treasury, 2002, p.14). Treasury estimates that the concessionary tax treatment of superannuation funds will cost the government a total of $10,490 million in 2003-04 (Commonwealth Treasury, 2004, p.161). This figure is based on departures from a benchmark situation where contributions are taxed like any other income, earnings are taxed like any other investments and benefits from superannuation funds are untaxed (Commonwealth Treasury, 2004, p.155). This cost is expected to fall in the future, as the superannuation system matures and more people begin to withdraw their benefits (Sampson, 2004).

The Labor Opposition

The focus of Labor’s policy is to increase retirement incomes above the age pension. One of the key measures in their policy was the goal of “65 at 65”. That is, a person’s retirement income should be 65% of what they were receiving on retirement (i.e. at 65). Labor demonstrated that this was possible for those on an income of less than $30,000 from the age pension and superannuation guarantee alone. Those with higher incomes would need to make additional private savings to reach this goal.

Like the government, Labor proposes to change the superannuation rules to allow a “phase down into retirement”, by permitting people to work part time after reaching the preservation age, and receive their superannuation benefits at the same time.

Labor’s policy also includes a reduction in the contributions tax from 15% to 13% over a four year period, with the long term goal of eliminating this tax completely. Labour states that this tax cut should automatically increase superannuation savings, as well as act as an incentive to increase voluntary contributions.

Current Impacts of the Superannuation Guarantee on the Labour Market

Superannuation, Employment and Wages

For employers, superannuation is a non-wage cost of employment, with “an equivalent dollar for dollar production cost value as wages” (Freebairn, 2004, p.191). For employees it is a form of deferred or future income (Freebairn, 1998, p.58). Because superannuation is compulsory, and results in greater retirement savings than would occur otherwise, it may be viewed as a net tax on the labour market (Freebairn, 1998, p.59). Freebairn defines the effective tax burden of compulsory superannuation as the difference between the lower of the marginal payoff from income spent on consumption, or the marginal payoff from income used for savings, and the marginal payoff from superannuation contributions. Before the introduction of the superannuation guarantee, employees would voluntarily choose superannuation contributions up to the point where the marginal payoffs were equal. However, the need for compulsion implies that the marginal payoff from superannuation is now less than that from one or both of consumption or personal savings (Freebairn, 1998, p.60).

Freebairn (1998) considers a demand and supply model of the labour market, using a comparative static approach to determine the effects of the superannuation guarantee. He considers both a flexible

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and a rigid wage model, and examines three situations: when the employer pays the levy; when the employee pays; and when the government pays the contribution. The situation where the employer pays the levy is most applicable to Australia, and is discussed below.

**Employer Pays the Levy**

When the employer is responsible for the contributions, superannuation is a direct addition to labour costs, and thus the labour demand curve shifts down by the amount of the levy (Freebairn, 1998, p.61). The superannuation payment is an additional benefit to the employee, and therefore the labour supply curve also shifts down, by the present value of the contributions \( R(S) \) (Freebairn, 1998, p.61). Due to compulsion, liquidity constraints, lower flexibility and interactions with eligibility for the age pension, the present value of the contribution to the employee may be less than the levy itself (Freebairn, 2004, p.194). In such a situation, the supply curve will fall by less than the demand curve (Freebairn, 2004, p.194).

![Figure 1: Employer Pays Compulsory Levy - Flexible Wage](image)


In a flexible wage, or long run situation, shown in Figure 1, the introduction of superannuation results in both a drop in wages, to \( W_1 \), and a fall in employment, to \( E_1 \). Employer labour costs rise from \( W \) to \( C \), but this increase is less than the full cost of the levy. Effective employee income falls from \( W \) to \( Y \). (Freebairn, 1998, p.61)

In the short run, rigid wage model, shown in Figure 2, there is no change in wages. However, employer labour costs rise by the full amount of the levy, to \( C \). There is also a larger decrease in employment than in the flexible wage case, with employment falling to \( E_1 \). Unemployment rises from \( EF \) to \( E_1F_1 \) (Freebairn, 1998, p.67).
Freebairn constructs a numerical example of the flexible wage model. He assumes labour demand has an elasticity of -0.7 and labour supply has an elasticity of 0.2 (Freebairn 1998, p.64). The more elastic either curve is, the greater the fall in employment resulting from the superannuation guarantee (Freebairn, 1998, p.64). Freebairn considers four situations, in which the present value of the superannuation contributions to the employees are 0%, 33%, 67% and 100% of the levy. The extreme valuation of 100% means that superannuation is a perfect substitute for wages, whilst a valuation of 0% implies superannuation has no present value (Freebairn, 1998, p.64). The results for each valuation in the case where the employer pays the levy are presented in Table 1. The effects of the superannuation levy on the labour market may be significant, particularly when employees have a low valuation of the levy.

### Table 1: Employer Pays the 9% Levy

<table>
<thead>
<tr>
<th>Present value of superannuation as a percentage of levy</th>
<th>Percentage change of:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Market wage</td>
</tr>
<tr>
<td>0</td>
<td>-7.0</td>
</tr>
<tr>
<td>33</td>
<td>-7.7</td>
</tr>
<tr>
<td>67</td>
<td>-8.3</td>
</tr>
<tr>
<td>100</td>
<td>-9.0</td>
</tr>
</tbody>
</table>


Guest and McDonald (2002) also consider the superannuation guarantee as a tax on employment, focusing on its effect on living standards. Citing Freebairn’s (1998) model they focus on the situation where the contribution is paid by the employer (Guest & McDonald, 2002, p.25). They use a simulation model to examine the impacts of a 3% and 6% increase in the superannuation guarantee on the average standard of living.
Demand for labour is assumed to be infinitely elastic, whilst the elasticity of labour supply is 0.2 (Guest & McDonald, 2002, p.30). The effective tax burden of the superannuation guarantee is the difference between the benefit to the employee and the cost to the employer (Guest & McDonald, 2002, p.30). Guest and McDonald take this to be 50% of the levy. They therefore estimate employment in year j, after the increase in the levy, to be:

\[ L_j^* = L_j \left[ 1 - (\text{change in SGL})*0.5*0.2 \right] \]

where \( L_j \) is employment before the increase in the superannuation guarantee (Guest and McDonald, 2002, p.31). They find that the size of the employment tax effect on living standards increases over time (Guest & McDonald, 2002, p.32). Whilst the tax itself is constant over all years, the loss in living standards increases as people adjust their consumption behaviour (Guest & McDonald, 2002, p.32). However, as technological progress improves living standards over time, the discounted value of the employment effect is very close to zero (Guest & McDonald, 2002, p.32). Guest & McDonald conclude “the impact of the employment tax on the utility value of living standards is negligible both in the present and the future” (Guest & McDonald, 2002, p.32).

**Sectoral Analysis**

Freebairn uses a figure of 0.2 for the elasticity of labour supply and -0.7 for the elasticity of labour demand (Freebairn, 1998, p.64). These figures are for the labour market as a whole. However it is likely that the elasticity of labour demand will vary across each sector of the economy. Phipps (1983) estimated the elasticity of demand for labour in 8 sectors. His estimates were significantly different from zero in four sectors: mining; manufacturing; construction; and electricity, gas and water. His results are displayed in Table 2.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Phipps' Elasticity Estimate</th>
<th>Scaled Elasticity Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mining</td>
<td>-0.312</td>
<td>-0.542</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>-0.521</td>
<td>-0.905</td>
</tr>
<tr>
<td>Electricity, Gas and Water</td>
<td>-0.217</td>
<td>-0.377</td>
</tr>
<tr>
<td>Construction</td>
<td>-0.562</td>
<td>-0.976</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td></td>
<td><strong>-0.7</strong></td>
</tr>
</tbody>
</table>

Phipps' estimates are significantly lower than that used by Freebairn, who took his figures from a survey of the literature. In order to compare estimates of the labour market effects of superannuation in different sectors to Freebairn’s results for the economy as a whole, Phipps’ estimates have been scaled up such that the four significant values have an average of -0.7. These figures are therefore approximations, and the results of the sectoral analysis must be treated with some caution. In addition, the elasticity of labour demand in the agricultural sector has been estimated as a range between −0.5 and −1.3 (Freebairn, 1998a, p.121, citing Lewis 1987). This range can be used as a form of sensitivity analysis.
Table 3: Wages and Employment by Sector

<table>
<thead>
<tr>
<th>Sector</th>
<th>Percentage Change in Wages</th>
<th>Percentage Change in Employment</th>
<th>Present Value of Superannuation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Elasticity 0</td>
<td>Elasticity 0.33</td>
<td>Elasticity 0.67</td>
</tr>
<tr>
<td>Mining</td>
<td>-0.542</td>
<td>-6.57</td>
<td>-7.37</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>-0.905</td>
<td>-7.37</td>
<td>-7.91</td>
</tr>
<tr>
<td>Electricity, Gas and Water</td>
<td>-0.377</td>
<td>-5.88</td>
<td>-6.91</td>
</tr>
<tr>
<td>Construction</td>
<td>-0.976</td>
<td>-7.47</td>
<td>-7.97</td>
</tr>
<tr>
<td>Agriculture</td>
<td>-0.5</td>
<td>-6.43</td>
<td>-7.28</td>
</tr>
<tr>
<td>- upper bound</td>
<td>-1.3</td>
<td>-7.80</td>
<td>-8.20</td>
</tr>
</tbody>
</table>

Table 3 shows the changes in wages and employment by sector due to the 9% superannuation guarantee. For each estimation the elasticity of labour supply was assumed to be 0.2, in accordance with Freebairn’s estimations. The results show that the industries with a greater elasticity of labour demand (Manufacturing, Construction) are more affected by the introduction of the superannuation guarantee. The estimates for the agricultural sector indicate that the effect of the superannuation guarantee on employment does not change dramatically with a reasonably wide range of elasticity estimates (-0.5 – -1.3). The difference in the effect on wages is slightly more pronounced.

Future Impacts of the Superannuation Guarantee - Comparative Statics

Freebairn’s analysis considers the current labour market effects of the superannuation guarantee. In effect, the intergenerational transfer of resources from the working generation to the retired generation through the fiscal system is implicitly assumed to be a constant influence. However, one policy relevant feature of an ageing population is that the intergenerational fiscal transfer increases with time – and the superannuation guarantee is, to some extent, the policy instrument designed to reduce these transfers. Consequently, the insight of Freebairn’s model should be complemented by a comparative static analysis of the labour market effects of the current policy, when the superannuation guarantee applies, and an alternative policy regime where there is no superannuation guarantee, but higher taxes to fund the higher cost of pensions.

In the interests of carrying out comparative static exercises, it is necessary to determine when the economy will reach its new equilibrium (ceteris paribus). Kippen and McDonald argue that the ageing of the population is a “once only phenomenon” (Kippen & McDonald, 1999, p.54). Under the Australian Bureau of Statistics (ABS) mortality assumption that life expectations at birth will increase by 10 years over the next century, almost all of the growth in the 65-74 age group will occur between 2008 and 2028, whilst the growth in the size of the over 75 age group will occur from 2018 and 2038 (Kippen & McDonald, 1999, p.54). After this time, increments to the number of people over 75 will be small to moderate (Kippen & McDonald, 1999, p.54). Therefore, by around 2040, the economy should be back in an equilibrium state.

Kippen and McDonald also examine the patterns of ageing under a mortality assumption that life expectancy will increase by 20 years over the next century. The impact for the 65-74 year old age group is similar to that discussed above. However, the size of 75 and over age group will show large increments between 2018 and 2038, and these increments are likely to continue at a high level throughout the century (Kippen & McDonald, 1999, p.55). Therefore the time at which the economy will reach its new equilibrium is dependent on the mortality assumptions used. However, as the IGR only forecasts expenditure up to 2041-42, it is best for this purpose to continue with the ABS mortality assumption, which predicts that by this time the economy will be in equilibrium.
To undertake this analysis it is necessary to compare the current situation, with the 9% superannuation guarantee, to one without compulsory superannuation. The changes in expenditure on health and aged care, as well as those on all social security payments except the age pension, will occur regardless of the retirement income system in place. As such, it is reasonable to put these payments aside when carrying out this comparison. It should also be noted that the 9% superannuation guarantee will not remove all increases in age pension expenditure. As stated above, even with the superannuation guarantee in place, expenditure on the age pension is still predicted to increase from 2.9% of GDP in 2001-02 to 4.6% of GDP by 2041-42. When comparing the labour market effects of the superannuation guarantee to those from a fiscal adjustment, we should only consider the social expenditures that will be avoided through the creation of the guarantee, not those that will occur regardless of its introduction.

Superannuation was first introduced as award superannuation in 1986. In 1985, 1,334,300 people received the age pension, which amounted to 67.2% of people of pension age (Winter, 2000). In the same year expenditure on the age pension was 2.7% of GDP (Whiteford & Bond, 1999, p.188). In order to estimate age pension expenditure in 2041-42 in a situation without the superannuation guarantee, it is assumed that both the pension rate (i.e., an individual pension as a share of GDP) and the share of the aged population receiving the pension will remain constant, at their 1985 levels. In 2041-42, it is estimated that there will be 6.2 million people over 65 in Australia (Commonwealth of Australia, 2002, p.22). Under the above assumption, roughly 4,166,400 people would receive the pension if there were no compulsory superannuation. Age pension expenditure in 2041-42 would therefore be expected to reach 8.43% of GDP. This is 3.83% of GDP above that predicted by the Intergenerational Report. It is this amount that needs to be considered in a comparison with the superannuation guarantee.

In order to cover this increase in expenditure, Commonwealth revenue would need to rise by 3.83% of GDP. In 2001-02, revenue from income taxation was 11.23% of GDP (ABS, 2004). Assuming the entire fiscal adjustment were to come from an increase in income taxes, this would need to rise to 15.06% of GDP by 2041-42, an increase of 34.10%. This would increase the average tax rate of 23.43% in 2001-02 to 31.42%.

Figure 3: Increase in Income Taxes

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3 In 2001-02, net income tax collected was 23.43% of total taxable income (ATO, 2004)
To estimate the impact of this increase in the average tax rate on the labour market, a demand and supply model similar to that in Freebairn (1998) will be used. Only the flexible wage model is considered, as the adjustment is over the long run. This model is seen in Figure 3. As it is assumed the entire tax increase comes from personal income tax, the labour demand curve is unaffected. However, the labour supply curve shifts up by the amount of the additional tax. As a result, wages increase to W1, and employment falls to E1. This works out to be approximately a 1.78% increase in wages, and 1.24% fall in employment\(^4\). Effective employee income falls by approximately 6.20%, to \(Y\).

The effects of the superannuation guarantee and the “equivalent” increase in taxes are shown in Table 4. Whilst the superannuation guarantee and the tax change have opposing effects on the market wage, their effect on both employment and effective employee income is in the same direction. The distortional effect on employment of the tax change falls somewhere between that from the superannuation guarantee, where the present value of the levy is between 0 and 33%.

<table>
<thead>
<tr>
<th>Percentage Change in:</th>
<th>Superannuation Levy of 9%</th>
<th>No Superannuation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Present value of superannuation as a percentage of levy:</td>
<td>100</td>
<td>67</td>
</tr>
<tr>
<td>Employment</td>
<td>0</td>
<td>-0.5</td>
</tr>
<tr>
<td>Market Wage</td>
<td>-9</td>
<td>-8.3</td>
</tr>
<tr>
<td>Effective Income</td>
<td>0</td>
<td>-2.3</td>
</tr>
</tbody>
</table>

Freebairn argues that for some high income people with large voluntary superannuation or large private savings, compulsory superannuation is non-binding, as they are able to substitute some of their private savings for the compulsory superannuation payments (Freebairn, 1998, p.60). For these people the present value of the superannuation levy is close to 100% (Freebairn, 1998, p.64). On the other hand, for people with low incomes, or people with part time jobs or broken careers, superannuation is likely to have a present value closer to 0% of the levy (Freebairn, 1998, p.64). These households are likely to find the lack of liquidity of superannuation constraining and may lose part of the means tested age pension due to their superannuation savings (Freebairn, 1998, p.60). Guest and McDonald (2002) assume the difference between the “cost to the employer and the benefit to the employee” of the superannuation guarantee is 50% of the levy (Guest & McDonald, 2002, p.30). They state that this is not based on empirical estimates, but that it would seem to be a “ball-park” figure (Guest & McDonald, 2002, p.30).

From a policy perspective two options to deal with greater pension expenditures have been considered: introducing the superannuation guarantee now; or increasing taxes in the future. If the present value of superannuation payments to the employee is roughly 50% of the levy, as suggested by Guest and McDonald, it appears that the superannuation guarantee has a slightly less distortional effect on employment than increasing taxes. Therefore, from a labour market perspective, the decision to introduce the superannuation guarantee appears to have been appropriate.

**Conclusion and Further Research**

It is undeniable that Australia’s population is ageing. The issue ahead is to determine the policy response to this fact. There has been some concern that the increases in social expenditure that will accompany this demographic change will be unsustainable. However, whilst it is undeniable that there will be pressures on social expenditure, it does not seem that this will lead to a “social expenditure

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\(^4\) The formula used to calculate these changes were an adjustment of those used by Freebairn (1998), which were provided in private correspondence with the author. The elasticity values used were 0.2 for labour supply and –0.7 for labour demand, as in Freebairn (1998).

\(^5\) This figure is somewhat misleading as it includes the additional taxes. The effective income figure of –6.20 shows the percentage change in wages net of the new tax.
crisis,” as has been suggested by some sources. In fact, Australia’s retirement income system is considered to be “well placed” to deal with the ageing population. In particular the superannuation guarantee will limit expenditure on the age pension.

This paper has compared the labour market effects of the superannuation guarantee with the effect of the tax increase that would have been required if the guarantee had not been introduced. Although the actual result does depend on the valuation that employees place on their superannuation payments, it seems likely that the superannuation guarantee has a less distortional effect on employment than the equivalent tax increase. From a labour market perspective it appears that the decision to introduce the superannuation guarantee was appropriate.

Further Research
One of the reasons superannuation was introduced in Australia was to encourage a higher level of saving. Indeed, it is expected that superannuation will increase savings, simply due to its compulsory nature. However, superannuation also receives tax concessions above those received by other forms of saving. There is a fundamental question of whether this is appropriate. There is some suggestion amongst the literature that such concessions may not increase the savings level, but instead simply cause people to reshuffle existing savings. Engel, Gale and Scholz (1996) and Attanasio and DeLeire (2002) examined the tax concessions of American savings plans, specifically the Individual Retirement Accounts (IRAs). Both studies found a strong substitution, or reshuffle, effect from the tax concessions, but little or no increase on the overall level of savings. Attanasio and DeLeire conclude that at most 9% of IRA contributions represented new savings (Attanasio & DeLeire, 2002, p.530).

In the rest of my dissertation I propose to evaluate whether the tax concessions received by superannuation are appropriate, and if so whether the level of concession should change. The fact that the Labor Opposition’s policy amendments include a further increase in the tax concessions received by superannuation implies they believe this is the case.

Finally, the Government’s and the Opposition’s proposed policies will be considered. It has already been established that retirement income policy does have a large impact on the labour market, primarily through labour supply and the retirement age. Any policy that alters savings and spending behaviour is also likely to have further consequences on labour supply. These labour market effects will be the primary focus of the policy evaluation.
Reference List


