Pensions at a Glance 2019

How does AUSTRALIA compare?

27 November 2019

Key findings

- While contributing to superannuation funds is nearly universal among employees, only 27% of the self-employed made contributions in 2016-17.
- Full career self-employed workers will have a pension equivalent to 90% of that of full career employees despite not having made any pension contributions.
- Relative incomes of those aged over 65 to the total population are low at 72% compared to the average of 87%, while poverty rates for the elderly are very high in Australia at 23%, ten percentage points above the average. As Superannuation funds can be taken as a lump sum, this might skew these figures.
- Replacement rates in Australia are lower than the OECD average. The future net replacement rate for a full-career male (female) average-wage earner is 41% (37%) compared to 59% (58%) for the OECD. With the relatively high value of the Age Pension this improves to 76% (72%) or low earners compared to the average of 68% (68%).
- Five-year breaks in the career for childcare or unemployment lower future replacement rates by 12%, much higher than the OECD average of 4% and 6%, respectively.

Overview – The self-employed need to be better served for pensions

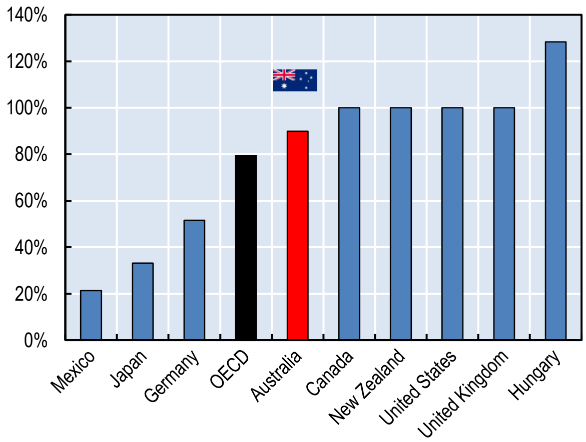
Employees are automatically enrolled in the Superannuation system, although they are not compelled to make any contributions as the base scheme is entirely financed from employer contributions, whilst additional voluntary contributions can be made by employees. The self-employed are thus only covered by voluntary contributions and there is no requirement for them to contribute to the Superannuation scheme. With near universal coverage of employees the Superannuation scheme has shown its effectiveness in providing a savings mechanism but with no compulsion for the self-employed to enrol their participation rate is much lower, at only 27% in 2016-17.

As a result, the self-employed tend to be solely reliant on the Age Pension, giving them a lower replacement rate at retirement compared to employees. For a self-employed worker at the same net earnings as an average-wage employee their future pension (from the Age Pension) will be 90% of the employee from mandatory schemes despite not having made any pension contributions. As the Age Pension is funded from general taxation this places an unnecessary extra burden on public finances. Pension systems should be designed to mitigate disparities between standard and non-standard workers in terms of coverage, contributions and entitlements so as to protect against old-age poverty, smooth the living standards upon retirement, ensure fair treatment, pool risks as broadly as possible and facilitate labour mobility across job types.

The average income of current retirees is only 72% of the population figure for the over 65s. There is also considerable variation by age with the 66-75 years age group at 78% compared to only 64% for those aged 76 and over. This age profile partly reflects the building-up of the impact of the Superannuation system, which was only introduced in 1992: those aged over 75 today would have had only limited opportunities to contribute.

The self-employed have lower pensions than employees

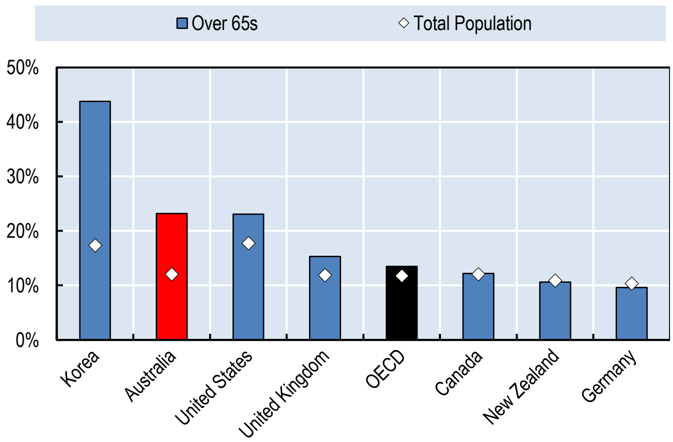
Theoretical pensions of a self-employed worker relative to an employee both with income at average net wage



Source: [Figure 2.13].

Old-age poverty rates are still high but they have been declining

Percentage with income lower than 50% of median equivalised household disposable income, 2016



Source: [Figure 7.2].

The old-age relative income poverty rate is high at 23% compared to 14% across the OECD in 2016. Women had a slightly higher prevalence to be in poverty than men but the group at most risk was the over 75s, with poverty levels at 29%. However, the poverty rate for the over 65s has been declining steadily over the last few years, from 39% in 2007, whilst the total population figure has gone from 15% to 12% over the same time. Also the poverty depth (which measures how far below the relative poverty line the average income of the poor falls) is relatively low in Australia as the Age Pension, which provides a floor for pensions, is close to the poverty line.

Over three-quarters of the older Australian population (65+) benefits from the safety net (Age Pension) compared to roughly one-quarter on average for OECD countries. However, almost 38% of all recipients in Australia have their Age Pension benefit reduced by the means test. The maturing of the system combined with the increasing take-up of annuities or phased withdrawals rather than lump-sums is likely to reduce poverty rates.

Australia is ageing more slowly than the OECD average. Given the relatively limited involvement of the government in pensions and the slower ageing process, there is less of an issue of public finance pressure than in many other OECD countries. Public expenditure on pensions is projected to remain well below half of that of the OECD average. The Superannuation system being defined contribution is not subject to financial sustainability issues and as it will reach full maturity fewer individuals will be reliant on the Age Pension safety-net.

Future net replacement rates for average-wage earners in Australia are low at 41% compared to 59% for the OECD on average. The situation is however much better for lower earners with a net replacement rate of 76%, compared to 68% on average for the OECD, as the Age Pension provides an effective safety-net for this group. However, individuals who are taking the Superannuation component as a lump sum are then able to spend it as they wish. Once the funds start to deplete they can also then become eligible for at least a partial payment from the Age Pension.

Recently fairer and more equitable means-test rules for lifetime income stream products have taken effect. The rules support the development of new retirement-income products that may help people manage the risk of outliving their savings in retirement and will hopefully therefore encourage more retirees to use these products rather than taking lump sums.

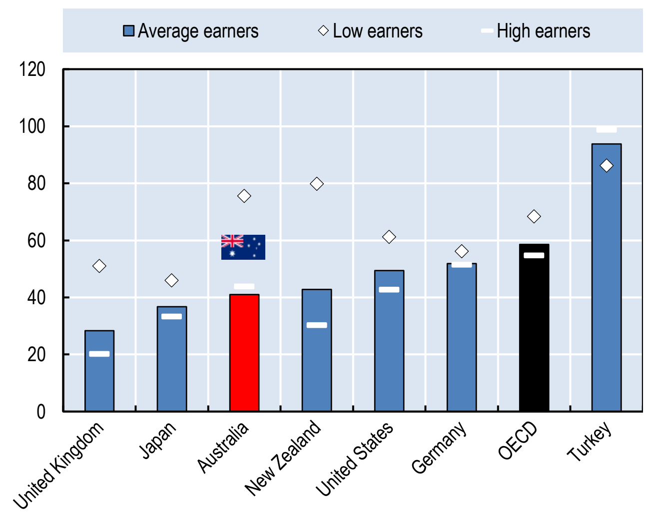
In Australia, the impact on pension entitlement of interrupted careers is mixed depending on the absence period. There are no credits for either unemployment or childcare absence within the Superannuation system, unlike most other OECD countries, where in addition childcare absences usually have a lower impact on future pension entitlements than unemployment. For five years out of the labour market the pension entitlement in Australia for an average-wage earner is reduced by 12% compared to 6% on average in the OECD for unemployment and only 4% for childcare.

With 10 years out of the labour market for childcare absence the reduction in Australia is actually lower than for five years at only 7%, compared to 12% across the OECD. This discrepancy is because of the dual calculation process of the Age Pension where both income and assets are taken separately to calculate the entitlement. Even with five years of unemployment for an average-wage earner the asset of their Superannuation eliminates entitlement to any Age Pension at the immediate point of retirement, though this would change in later years as the asset diminishes.

However, for 10 years of unemployment after starting the career five years later the pension entitlement is only reduced by 3% compared to the full-career case whilst it is 24% across the OECD. Under the assumed economic parameters there is little difference in the level of a full-career Superannuation annuity payment and the Age Pension.

Australia has low projected replacement rates

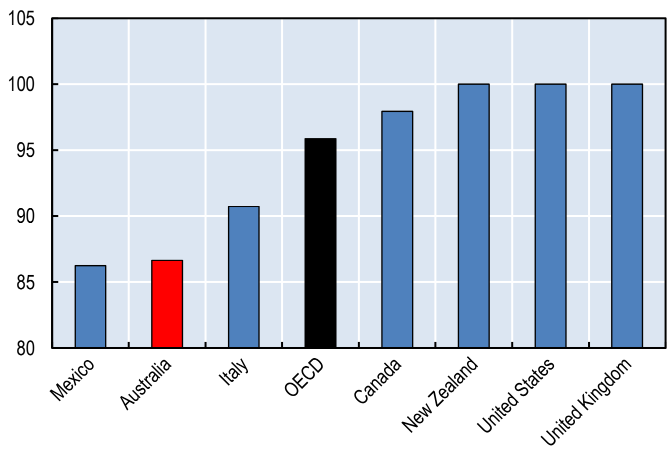
Net pension replacement rates by earnings level



Source: [Table 5.5].

Short career breaks can have a big impact on entitlements

Gross pension entitlements of average earners with a 5-year childcare break versus worker with an uninterrupted career



Source: [Figure 5.10].

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