OECD
BETTER POLICIES FOR BETTER LIVES

AUSTRALIA

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- **Reduce the taper rate for the Age Pension asset test and increase contribution rates to Superannuation beyond what is currently planned**
- **Simplify the eligibility tests for Age Pension and improve incentives to annuitise Superannuation**

The mandatory pension system generates low replacement rates at the average wage. The first-tier pension scheme, Age Pension, provides a means-tested safety net at 28% of the gross average wage for people with insufficient assets or income who cannot fully support themselves. It is financed from general revenue. The earnings-related component, Superannuation, is a mandatory defined contribution pension financed through employer contributions, with only voluntary payments from employees. The combination of these two mandatory schemes generates long-term replacement rates that are high for low-wage earners, but fall much below the OECD average for those above average earnings because of the fast withdrawal of the Age Pension. Overall, the average income of people aged over 65 relative to that of the whole population is among the lowest within OECD countries. Moreover, the relative old-age poverty rate is the among the highest in the OECD. However, income poverty figures should be interpreted with care as most pensions are not annuitised and therefore do not generate a regular income flow throughout retirement. Moreover, as Superannuation is still maturing, reaching full maturity from 2042, pension income should steadily increase, as reflected in these long-term replacement rates.

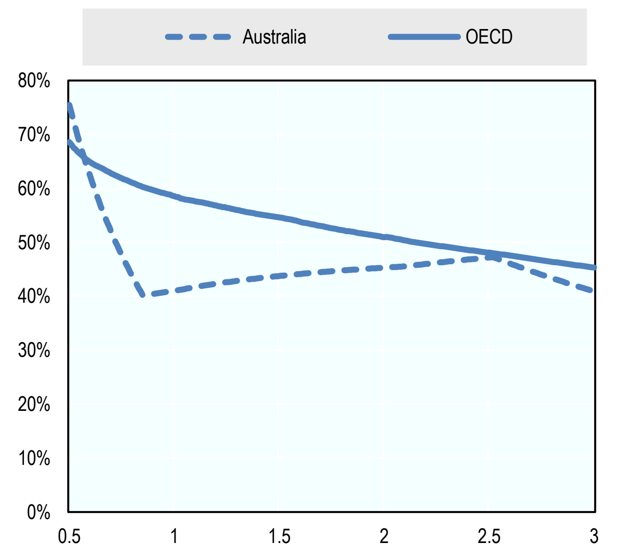
Key indicators: Australia and OECD average

	Mid-1980s	Mid-1990s	Mid-2000s	latest available	latest OECD	long-term	long-term OECD
Normal retirement age for a full-time career starting at the age of 22	65 (60)	65 (60)	65 (62.5)	65.0	64.2 (63.5)	67.0	66.1 (65.7)
Statutory retirement age	65 (60)	65 (60)	65 (62.5)	65.0	64.5 (63.8)	67.0	66.5 (66)
Net replacement rate, average earner						41.0 (37.3)	58.6 (57.6)
Effective contribution rate (average earner)				9.5	18.4		
Total pension spending, % of GDP	3.5	6.7	6.8	10.0	10.0		
Public pension spending, % of GDP	3.5	4.8	4.9	5.3	8.5		
Public debt, % of GDP	..	39	15	44	80		
Employment rate 55-64, %	57.1 (19.5)	55.7 (27.3)	63.8 (43.1)	69.7 (58.2)	68.5 (54.8)		
Labour-market exit age	62.5 (58.9)	62.3 (59.4)	63.7 (61.3)	65.3 (64.3)	65.4 (63.7)		
Old-age poverty rate, %		22.3	30.2	23.2	13.5		
Life expectancy at 65, years	14.7 (18.6)	16.4 (20.1)	18.6 (21.6)	20.0 (22.7)	18.1 (21.3)	23.8 (26.5)	22.5 (25.2)
Old-age to working-age ratio	0.18	0.20	0.21	0.28	0.31	3.00	0.58
Fertility rate	1.9	1.8	2.0	1.8	1.7	1.7	1.7

Note. The figures for women appear in parenthesis where they differ from those for men.
Long term: Around 2060 based on all legislated reforms up to mid-2019.

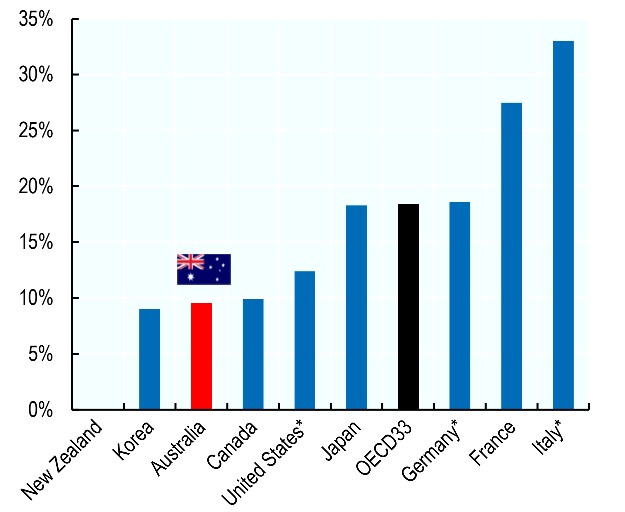
Recent measures have improved pension finances. While the Age Pension is in principle indexed to inflation, the combined benefit for couples cannot fall below 41.8% of the national pre-tax Male Total Average Weekly Earnings level. Given that it is already at that level this portion of retirement income cannot decrease in relative terms. To deal with the impact of population ageing on financial sustainability, the eligibility age to Age Pension has been increasing from 65 in 2016 to 67 years in 2023. If career lengths are effectively extended, the increased years of coverage under Superannuation will reduce reliance on Age Pension. In 2017, the asset threshold of the Age Pension asset test was increased, thereby assisting those with still relatively modest assets. Beyond this new threshold, although the initial withdrawal rate was already high, the benefit is now being reduced twice as quickly as before. The overall objective is to cover more people while reducing the total financial cost. To improve pension levels, contribution rates to Superannuation will be gradually raised, starting in June 2021, instead of 2019 as initially planned, from 9.5% currently to 12% in 2025.

Long-term net replacement rates (%), mandatory schemes, by earnings level



Source: OECD pension models.

Effective mandatory pension contribution rate for an average earner, % of average earnings



*Contribution rate also finances disability or invalidity benefits
Source: OECD Pensions at a Glance 2019.

The reformed asset test has extreme implications for middle- and high-income earners. There is a dual income and asset test to Age Pension eligibility, which complicates a lot the expectations people can make of their retirement income. The asset test is typically more binding even for relatively short careers with low earnings. The doubling of the taper (withdrawal) rate for assets effectively leads to withdrawals of the Age Pension at over 100% beyond the threshold, which does not occur in any other OECD country. For example, assuming annuitisation, those with low earnings (50% of average) will have a higher total pension for several years into retirement than average earners'. Moreover, having the dual test can lead to discrepancies in Age Pension payments among those with the same effective wealth as not all assets and income are treated equally. Taking annuities is also not a popular option as more pensions are either taken as lump sums or more regularly as account-based pensions. Whilst these account-based products can provide an income with great flexibility there is no longevity protection, potentially leading many retirees to have insufficient incomes later in retirement, therefore relying more on income from the Aged Pension.

Policies should focus on increasing contribution rates and simplifying the eligibility tests. Current mandatory contributions to the Superannuation Guarantee are amongst the lowest among OECD countries at 9.5%, all paid by employers, compared to an OECD average of18.4% - 10.9% by employers and 7.5% by employees. The asset-test Age Pension taper rate needs to be reduced to ensure that contributing to Superannuation increases retirement income. Actually, combining the asset and income tests into one simplified testing scheme would make it easier for individuals to calculate and predict their future retirement incomes. Making annuitisation mandatory, at least for half of the pension pot would provide long-term income security in retirement. Developing an effective annuity market should remain a priority, with for example the government acting as a (default) provider to discipline the market as in Sweden or the United Kingdom. The remaining portion of the pot could be taken as lump sums or through account-based pensions as is the case now.

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