

## IN BRIEF: OLD-AGE INCOME SECURITY-- AUSTRALIA TRIES A DIFFERENT WAY

### Introduction

The Australian approach to retirement, with no earnings-related Social Security old-age benefit program, is unlike that in most other countries in the world. In *Old-Age Income Security: Australia Tries a Different Way*, James Schulz explains the Australian system, discusses the issues surrounding it, and points out its potential relevance to the on-going debate in the United States.

Australia's safety net program that provides support to the elderly poor is the means-tested "age pension," which has a liberal income test and a very liberal asset test. Originally, however, requirements for the age pension were quite stringent, but over the years there has been a steady and seemingly inexorable process of age pension liberalization.

### The Superannuation Guarantee

The superannuation guarantee charge (SG) is a *mandatory* pension system that requires employers to make pension contributions for almost all employees based on the earnings level of the employee. Today, close to 90 percent of Australian workers—almost all full-time workers and three-quarters of part-time workers—have superannuation coverage.

### Integration Problems

Probably the most important issue related to retirement income policy that Australia currently faces is how to successfully integrate the age pension with the newer SG mandate, given that the superannuation system is designed to encourage retirement saving, while the age pension discourages it. Thus,

these major retirement programs are rather competitive with one another.

In the past, individuals have sought to avoid the loss of age pension benefits by:

- Taking their superannuation benefits as a lump sum and using the money to fund voluntary early retirement living expenses until reaching the age pension eligibility age.
- Reducing assets by putting pension payouts and savings into home improvements (since the value of the home one lives in is not counted in the asset test).
- Purchasing specially designed investment instruments that produce little income or sheltered income, and thereby help their owners qualify for the maximum age pension.
- Not working after reaching the age pension eligibility age, so that earned income does not offset age pension benefits.

Another important retirement policy issue currently confronting Australia is whether the 9 percent SG contribution rate will produce adequate income in retirement. There is particular concern regarding the special situation of women and how they will fare economically under SG. Faced with broken work histories, typically lower earnings, disadvantages resulting from divorce, and longer life expectancies, there is a fear that there will be problems for older women in the future.

Source: James Schulz, *Old-Age Income Security: Australia Tries a Different Way*, prepared for the AARP Public Policy Institute, December 2005. © AARP. A copy of the full report can be obtained at [www.aarp.org/ppi](http://www.aarp.org/ppi), or write for PPI Issue Paper 2005-21, Public Policy Institute, AARP, 601 E Street, NW, Washington, DC 20049.

Another area of concern (especially regarding small funds) is the administrative costs charged for managing the funds. In Australia, small funds can have very high fees and charges, significantly reducing the ultimate pension received.

When the superannuation guarantee was originally established, the law allowed the employer to determine an investment vehicle into which the money would go. Since July 1, 2005, most Australian workers have been able to choose among competing superannuation funds to manage their individual accounts' assets.

Research shows that Australian workers typically have a relatively low understanding of many basic financial investment concepts, which calls into question their ability to make informed choices among various financial institutions and investments. Aware of this issue, the government has launched a Consumer and Financial Literacy Taskforce charged with developing plans to improve levels of consumer knowledge.

### **Conclusion: What Lessons for the United States?**

Australia's history with the age pension warns the United States to be very cautious about shifting to greater reliance on means-testing. In Australia, it has been difficult to keep benefit levels low. Moreover, integration problems have generated huge complexities and perverse labor force and financial behavior.

As in other countries, the administrative costs of operating private pensions in Australia vary greatly from plan to plan and can be very high (especially in small and/or retail plans). This experience reminds us that projections of likely future rates of return must be scrutinized closely. Rates of return are often advertised without deducting a realistic amount for marketing, administrative costs, and investment management fees.

The Australian approach shifts retirement income protection from collective to individual responsibility and thereby shifts the burden of providing income for retirement (the "national pension bill") away from government budgets onto the budgets of employers or households. Although politicians can declare that government benefit programs are now fiscally "sustainable," there remains the important question of benefit adequacy.

In addition, the Australian experience indicates that countries should give great attention to the realities of consumer financial literacy.

Finally, in Australia as in the United States, statements have been made by Australian politicians and the media about the "crisis" resulting from population aging and the unsustainability of public expenditures. The aim has been to "wake up" voters regarding old-age financing issues and to enlarge support for pension reform. However, issues related to pension reform and privatization are extremely complex and confusing to the ordinary citizen. Great efforts must be made, therefore, to insure that there is an informed political debate.