6.0 Introduction

The Australian mandatory retirement income system is unusual by international standards. It is composed of an income-tested basic publicly-provided benefit, the Age Pension, and a (largely) defined contribution (DC) program of retirement saving through the Superannuation Guarantee (SG), introduced in 1992. The standard bedrock of most other countries’ programs—a universal contribution-based defined benefit component provided wholly by the government or through a ‘multi-pillar’ system of public and private providers—is noticeably absent. Other countries have features which look like the Australian program, for example, the greater emphasis on income testing of basic public pension benefits in the United Kingdom in the last decade, and the combination of basic and targeted benefits with a DC ‘pillar’ in Denmark, but no country has quite the combination of components to its mandatory pension program that is observed in Australia.

Pension programs typically evolve and add components over time rather than being established ‘in one piece’ (and the Australian program is no exception), so the aims of the program as a whole are not always easy to discern. However, a natural question is what the Australian pension program delivers, relative to other countries, given its unique format. Table 6.1, which has been compiled from OECD (2005), is therefore of some interest. This document calculates the net replacement rates derived from retirement programs in OECD countries for stylised individuals at different points in the lifetime income distribution, taking account of all mandatory components (including income-tested benefits and compulsory retirement saving components). The calculations also deduct direct taxes levied before and after retirement. The calculations in the document are more comprehensive than many stylised measures of ‘the’ replacement rate across countries which ignore tax deductions and various quirks, non-linearities and the welfare program supplements intended to augment ‘core’ social insurance programs.

What is striking therefore (at least, to me) about Table 6.1 is that, 
ex post,
several countries have net replacement rate-to-multiples of average earnings profiles that look very similar to Australia despite their very disparate program structures. Such countries include Belgium, Canada, Denmark, Japan, Switzerland, the United Kingdom and the United States. New Zealand and Ireland, which are wholly reliant on a flat public pension, stand out as having a far greater ‘taper’ of replacement rates to average earnings than these countries (although New Zealand has the intention that the ‘Kiwisaver’ plan introduced in 2007 will be taken up by a large fraction of the workforce, and Ireland has a well-established private sector). There are several other countries, of course, which exhibit much higher theoretical replacement rates at higher levels of average earnings than Australia, but these are countries with very little voluntary private provision of pensions, and indeed some of the replacement rates in such countries seem unsustainable in the long (or even short) term.

This similarity in replacement rates across a number of countries, including Australia, raises intriguing questions
both for the analyst and for the potential reform process. First, what is it that generates similar replacement rates across very disparate pension programs? Is it an outcome of deliberate policy choice or an outcome of underlying processes of political economy, as public choice theory might suggest (on which, see Galasso 2008)? Was it the intention of the unusual Australian program to deliver a distribution of replacement rates different from other countries, and if so, why has it not been successful in doing that? (We can also note from Atkinson, Creedy and Knox (1996), that alternative reforms of the Australian retirement income program seem to induce rather similar lifetime income distributions.) And finally, if different pension ‘regimes’ produce rather similar outcomes, does it matter which ‘route’ to that outcome is chosen? The answer to this last question may be that different programs might give similar outcomes, but if program A induces greater distortions to household behaviour than program B, then both social welfare and indeed output and employment may be lower in the one case than the other.

The remainder of this chapter comprises four general sections. Section 6.1 considers the design of the publicly-provided pension within the mandatory Australian program—namely, the Age Pension. It considers what would be the welfare implications of moves in two opposite directions: towards greater income testing and, in contrast, towards greater universality. Section 6.2 considers issues surrounding the second ‘pillar’ of the mandatory program: the Superannuation Guarantee (SG). It examines how international evidence can be applied to examine two potentially important issues surrounding the SG. First, the effect that mandatory provision has had on the total level of household saving, and second, whether household saving (and, by inference, the SG) is sufficient to provide an ‘appropriate’ retirement income.

The next two sections consider tax issues. Section 6.3 considers taxation of retirement benefits—both the integration of the pillars of the mandatory program through the income and asset testing of the Age Pension, and the taxation more generally of voluntary and mandatory retirement saving. In Australia, retirement saving is taxed at all stages (contributions, accumulation, disbursement) and is subject to differential treatment across very disparate pension programs. Is it an outcome of underlying processes of political economy, as public choice theory might suggest (on which, see Galasso 2008)? Was it the intention of the unusual Australian program to deliver a distribution of replacement rates different from other countries, and if so, why has it not been successful in doing that? (We can also note from Atkinson, Creedy and Knox (1996), that alternative reforms of the Australian retirement income program seem to induce rather similar lifetime income distributions.) And finally, if different pension ‘regimes’ produce rather similar outcomes, does it matter which ‘route’ to that outcome is chosen? The answer to this last question may be that different programs might give similar outcomes, but if program A induces greater distortions to household behaviour than program B, then both social welfare and indeed output and employment may be lower in the one case than the other.

The next two sections consider tax issues. Section 6.3 considers taxation of retirement benefits—both the integration of the pillars of the mandatory program through the income and asset testing of the Age Pension, and the taxation more generally of voluntary and mandatory retirement saving. In Australia, retirement saving is taxed at all stages (contributions, accumulation, disbursement) and is subject to differential treatment according to how funds are disbursed. By international standards, the treatment is fiendishly complex (although, reassuringly for Australia, most tax systems for retirement saving turn out to be more complex in practice than the simplified ‘EET’, ‘TTE’ and other models beloved in the literature). Nevertheless, this means that as an ‘outsider’ I do not claim to have fully come to grips with all this complexity. Conversely, so far as I can see, when considering the taxation of housing in section 6.4, the situation is much easier to understand. The integration of tax regimes for different forms of wealth that may be considered as providing forms of potential income streams in retirement then becomes an important issue, which is the last issue considered here.

The taxation of housing seems to be relatively under-researched in Australia, at least in the context of retirement saving. (I focus here specifically on the interaction between retirement saving and the housing market, and not on the housing market more generally.) In this specific context, it seems that accumulation of housing assets is more favourably treated than other assets. This has implications for portfolio allocation, for household-saving behaviour, and for public policy in general.

### 6.1 Pension Design: General Issues

#### 6.1.1 Means Testing: the Economics of MIGs and Tapers

The basic arguments for and against means testing of public pensions are well known and straightforward (e.g. see Knox 1995, in the Australian context). Means testing focuses payment of benefits on the poorest elderly and thus is broadly inequality-reducing over the lifetime distribution of income. Second, when taxes cannot be raised by first-best means, overall deadweight losses are minimised by targeting benefits, so minimising distortions arising from revenue-raising from second-best or indeed n-best tax structures. However, what makes the Australian program unique is that the sole public defined benefit pension is means tested and tapered; many other countries have an income-tested ‘floor’, with benefits generally withdrawn at a rate of 100 per cent against other capital or labour income, but such benefits are often not very generous and are very much secondary to the main universal program of flat or earnings-related benefits.

If the aim of the Australian program is to minimise the costs of raising revenue and to maximise the inequality-reducing aspect of the public pension program, why not simply go to the extreme of providing a guaranteed minimum income and withdraw benefits dollar for dollar as outside income increases? In contrast, Australia’s Age Pension allows an exempt ‘free area’ of other income and then withdraws benefits at 40 per cent of each extra dollar of accrued income rather than the 100 per cent rate of a pure Minimum Income Guarantee (MIG) program. The response to this rhetorical question is often rather vague and refers to the relative ‘disincentives’ of a pure MIG versus a tax credit-type program such as the Age Pension. Such a debate has arisen in the United Kingdom and is pertinent here.

A combination of the revenue-raising and equality-enhancing arguments underpinned the decision to boost significantly the system of means-tested pension benefits in the United Kingdom in the late-1990s by indexing the Minimum Income Guarantee paid to pensioners to an earnings index rather than prices (in contrast to the primary social insurance benefit—the flat universal basic state pension—which remained indexed in payment to prices). Subsequently, concern about effective tax rates of 100 per cent coupled with a vaguely expressed quest to improve ‘incentives’ led UK policy-makers in 2002 to introduce Pension Credit, which effectively reduced the taper on the income and asset-tested MIG (now rebranded as the Pension Credit Guarantee) from 100 per cent to as low as 40 per cent (depending on what other means-tested benefits were claimed). This latter reform meant that many low to
middle-income pensioners were now eligible to receive some Pension Credit in addition to their basic state pension, so that by the mid-2000s, about half of pensioners were eligible for Pension Credit, with the proportion projected to increase given the differential indexation of the two public programs. The two programs are depicted in Figure 6.1 (see Disney & Emmerson 2005 for further details). However, analysis of these programs suggests that we have to be cautious in our understanding of ‘incentives’ in the context of tapering benefit systems at less than a 100 per cent rate.

Figure 6.1 considers the effect on behaviour (in the form of acquiring additional private income whether through working or increasing income from private wealth) in the MIG versus the tapered Pension Credit in the context of a ‘static’ model of choice of non-pension income. The MIG, which is assumed (as in the United Kingdom) to be slightly more generous than the basic state pension, would have completely deterred an individual from increasing their private income throughout from point A (zero private income) to C. Introducing the reduced taper through the Pension Credit leaves individuals’ incomes on segment AB unchanged (in the context of the ‘static’ model). From B to C, introducing the Pension Credit gives a greater incentive to acquire private income via a standard substitution effect but also has an offsetting wealth effect, since the Pension Credit raises income relative to the no-Credit initial situation. From C to D, the individuals who previously had no claim to income-tested benefits are brought into the income-tested program by the introduction of the Pension Credit. For that group, therefore, both substitution and wealth effects would induce lower private income, relative to the MIG program. Focusing only on the substitution effect from the reduced taper in contrast to the full offset is only half the incentive ‘story’ and we cannot say a priori what would be the net effect on behaviour of a decision to relax the taper. This has implications for potential policy reforms in Australia, such as reducing the taper to ‘broaden’ the take-up of the pension.

The drawbacks of means-tested programs are also well known. Assume initially that all households are ‘life-cyclers’:

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Figure 6.1 Stylised Budget Constraint for a Single Individual Aged 65 under MIG Regime and Pension Credit Regime in 2005, United Kingdom

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that is, they make decisions based on current and future expected incomes taking account of current and future expected tax regimes. Means testing of assets and incomes at pension age has two effects: first it reduces retirement saving directly; second, by providing some degree of ‘cushioning’ to income volatility, it reduces precautionary saving among risk-averse households. A string of papers from the United States suggests that income-tested programs have just this adverse effect on saving rates (Hubbard, Skinner & Zeldes 1995; Hurst & Ziliak 2006; van der Klaauw & Wolpin 2008; Neumark & Powers 1998). In general, the welfare loss arising from specific income and asset tests should be analysed within the context of the household’s inter-temporal budget constraint; taxes of this type distort the inter-temporal allocation of consumption so that the consumer suffers a deadweight loss from the shifting of consumption across periods to alleviate the impact of the tax regime (Feldstein 1978). However, this analysis has to be slightly modified where there are liquidity constraints, where taxes and benefits are time-limited (Grogger & Michalopoulos 2003), and/or where there are bequest motives.

6.1.2 The Economics of Means Testing versus Universal Flat Benefits

Section 6.1.1 examined the merits or otherwise of increasing (or indeed reducing) the rate at which the Age Pension was tapered in respect of outside income from saving and any residual labour income. The alternative strategy is, of course, to reduce the taper to zero and to have a universal flat benefit as in the programs of New Zealand and Ireland. What are the economic issues that arise in considering such a transition?

Figure 6.2 illustrates the stylised case where the Age Pension is replaced by a universal flat pension, somewhat like that in New Zealand or Ireland. Given revenue-raising constraints, I have assumed that the flat pension is less generous to those with zero other income than the Age Pension. The latter is illustrated with the taper above an exempt amount of earnings. In practice, the New Zealand
In various simulations, therefore, Feldstein argues that this incentive to switch whilst maintaining a level of means-labour income for the life-cyclers, but only if it can minimise benefits for the myopic and reduces the ‘tax wedge’ on the universal program. This wealth effect might induce the individual to save more, or to work more hours, if the universal pension replaced the Age Pension. Between points B and C, the effect is also clear-cut. The individual is worse off under the universal pension, but there is also an enhanced incentive to increase his or her outside income given the abolition of the taper, with the same implication for behaviour. At point C, the individual is getting the same amount under both programs, but to the right of point C, faces a disincentive arising from the taper in the income-tested system and also has lower income than in the universal program. This has no clear-cut effect on behaviour since the wealth effect and the substitution effect work in opposite directions. Beyond point D, the individual is worse off in the income-tested program relative to the universal program and will have to increase his or her outside income to raise the standard of living. The welfare effects of such a transition to a universal pension are therefore not clear-cut from this illustration, and again it should not be assumed that the ‘incentive-improving’ consequences of moving to a universal non-means-tested program are clear-cut. As with Figure 6.1, therefore, there is no clear-cut effect on ‘incentives’ arising from changing the degree of means testing within the program.

When would a means-tested program therefore be preferable to a universal program? The essential tradeoff is between the potential cost of the tax burden arising from universality as against the specific distortions arising from a means-tested program. In Feldstein (1987), there are two groups of people: the ‘life-cyclers’, and the ‘myopic’ who will never save enough for retirement. At the social optimum, the life-cyclers would save optimally for retirement and the government would levy taxes to provide some kind of minimum pension for the myopic group. In an ideal world, some kind of separating equilibrium with two social security regimes might be desirable (there are elements of this in the Australian program insofar as there is both a saving component through the Superannuation Guarantee as well as the Age Pension) but the concern is that, on the margin, the co-existence of the two regimes induces some life-cyclers to act like the myopic group. Targeting benefits increases welfare, insofar as it raises benefits for the myopic and reduces the ‘tax wedge’ on labour income for the life-cyclers, but only if it can minimise this incentive to switch whilst maintaining a level of means-tested benefit that is socially optimal for the myopic group. In various simulations, therefore, Feldstein argues that the case for and against means testing of benefits versus universality can go either way—but, this is really only an issue that can be settled by some robust economic research in which it is possible to evaluate welfare outcomes.

The key question at the heart of Feldstein’s analysis of alternative public pension programs is, therefore, the extent to which such programs distort life-cycle consumption choices. Changing the base on which taxes are levied, for example, will only induce welfare losses insofar as they induce changes to individual life-cycle consumption choices, and also choices relating to which assets to hold (see section 6.4.2). However, more generally, the introduction into a public pension program of features which imitate a private retirement saving program will ‘crowd out’ private saving as argued in a long literature from Feldstein (1974) onwards. Moreover, if the program is unfunded, it will in a dynamically efficient economy impose a welfare loss on generations through the ‘implicit tax’ arising from Pay-As-You-Go (PAYG) financing rather than full funding (Fenge & Werding 2004). This reasoning would tend to support the argument for a Beveridge-type ‘floor’ program (whether of the traditional social insurance form or in an income-tested form) rather than the more comprehensive forms of public program extant elsewhere in Europe.

There is, however, another dimension to this question of program design. If benefits are closely related to contributions (e.g. Sweden’s system of ‘notional accounts’), the within-generation ‘tax component’ of the pension program arising from the discrepancy between individual contributions paid and expected benefits received is low. This characteristic may reduce the distortion to labour supply by reducing the ‘tax wedge’ element of the financing of the programming, insofar as people perceive the benefit–contribution link as increasing the transparency of the ‘pension promise’.

Overall, therefore, there is a tradeoff: public programs that replicate private programs will tend to have a greater ‘saving offset’ effect with respect to ‘free’ retirement saving whereas highly redistributive pension programs will conversely tend to distort the labour market rather than savings decisions in the economy. Exploiting differences in programs, across countries and over time, provides cross-country evidence that supports these propositions (Disney 2004, 2006). The question is whether, from the perspective of household welfare, it is worse to distort the labour market or the market for retirement saving. Specifically, one study (Disney 2006) implements the counterfactual simulation (given estimated cross-country parameter values) of what would be the effect on the US household saving rate of switching from the US public pension design to the average replacement rate and average return on contributions provided by Australia’s Age Pension, and finds that this reform would increase the US saving rate by 12 per cent (not percentage points)—a result that sounds impressive but which is quite small given the radical nature of such a reform.

Nevertheless, this discussion is stacking the argument too much in favour of the Australian program. A highly redistributive program such as Australia’s Age Pension, in which tax payments are not linked explicitly in any manner
to benefits received, has two features. First, all the costs of the program are rolled up into general tax payments and are likely to be treated by workers simply as part of the ‘tax wedge’ which differentiates the real product wage from the consumption wage, as in the standard OECD analysis. If there are any adverse effects of the tax wedge on employment in Australia, either on the intensive margin (e.g. hours worked) or on the extensive margin (e.g. retirement decisions), the design of the Australian program, other than its relatively low cost, does nothing to mitigate them. And, although the Age Pension does not directly offset private saving across the population precisely because it is targeted and relatively low cost, the interaction of other components of the program—notably the Superannuation Guarantee, which can be drawn down from age 55—with the Age Pension raises additional incentive issues. In particular, there is the obvious possibility that households will increase their consumption out of superannuation between the date at which they can first draw down their fund and the age at which they can first draw the Age Pension (age 65), which has the potential to induce welfare losses arising from the distortion to life-cycle consumption smoothing.

6.2 The Superannuation Guarantee

The second key ‘pillar’ of the Australian retirement income program is the Superannuation Guarantee (SG). Introduced in 1992 in the context of a national round of pay negotiations as a form of ‘deferred pay’ and broadened from the existing base of employer-provided pension plans, the SG has taken on the form of a mandatory or ‘forced’ saving plan for private individuals (Bateman, Kingston & Piggott 2001). As those authors point out, such mandatory saving plans have been relatively unusual as a form of retirement saving (other than Australia, they are more common in Latin America and South-East Asia than elsewhere in OECD) but have received an impetus as a result of World Bank (1994). Consequently, the lessons to be learnt from countries which use largely voluntary programs—with retirement saving generally encouraged by a regime of specific tax incentives—are less clear-cut for Australia.

Two broad questions that we might consider are: first, what constitutes an ‘adequate’ level of saving for retirement in Australia so, by inference, is the SG set at the ‘right’ level and second, the counterfactual of what individuals would have saved if the SG had not existed? A difficulty in answering both these (inter-related) questions is that retirement saving is also affected by other components of the Australian retirement income system, particularly the income and asset tests for the Age Pension, but also by tax treatment; not simply of retirement saving vehicles but also the particular preference given to holding assets in the form of housing wealth afforded both by the tax treatment of housing and the exemptions applied by the Age Pension asset test.

6.2.1 Has the Superannuation Guarantee Raised Saving?

Taking the counterfactual first; a standard rationale for mandatory saving (going back to Diamond 1977, and probably before) is that individuals would not save the ‘right amount’ for retirement if left to their own devices. This is a slightly different version of the earlier argument that there are subsets of lifetime-poor or myopic individuals who would not save at all, and for which some form of public provision such as means-tested benefits, would raise social welfare. The saving adequacy argument is slightly different insofar as it refers to the inability of individuals to compute key decision variables in smoothing their lifetime consumption in the face of various risks, notably longevity risk and, (since longevity risk might be partially insured by private markets, subject to adverse selection issues) more generally cannot compute what would be their future optimal consumption path. If individuals cannot calculate what saving level would generate a given consumption path before and after retirement, and indeed do not know exactly what their consumption requirements will be later in life, then there seems to be a potential role for public intervention in the form of mandatory saving. Of course, risk adverse individuals faced with uncertainty may actually over-save as well as under-save, so mandating saving levels may be welfare-improving even for forward-looking consumers.

The difficulty with this sort of argument, apart from the standard and reasonable objection that individuals may still be their own best judges of these issues rather than the government, is that it is hard to assess the counterfactual of what private saving would have been had the government not intervened in the form of mandating the Superannuation Guarantee. At the most basic level, the existence of a mandatory saving instrument crowds out private saving; and since so few countries implement mandatory programs of retirement saving, Australia offers an interesting ‘test bed’ of this proposition. Predictably, there is little agreement on the answer to this question so far as I can see from my limited search of the Australian literature. Using time series techniques, Morling and Subbaraman (1995) argue that about three-quarters of private saving is offset by superannuation, whereas, from household panel data, Connolly (2007) argues that households who are paying into superannuation if anything increase their voluntary saving because the SG reduces the cost of access to saving accounts and thus mandatory and voluntary saving are complements rather than substitutes. This dichotomy between time series and cross-section results is rather typical of the international literature.

As an alternative means of answering the question, we might look to find groups that are not covered by the SG and examine their saving behaviour, or look at a ‘before-after’ effect of the introduction of the SG on private saving, or look at some other country, such as New Zealand, which does not have the SG, and compare levels of voluntary saving there with the level of mandatory plus voluntary saving in Australia. None of these approaches, however, is likely to yield wholly convincing results.

Taking the first criterion and according to Bateman and Piggott (2001), by 1999 over 92 per cent of employees were covered by the SG, with uncovered employees largely among the lowest paid. At the same time, self-employed people are not covered by the SG. Clearly low wage employees are
unlikely to save a great deal for retirement (unless low wages are wholly driven by life-cycle rather than lifetime differences in earnings capacity) and do not form a good counterfactual while the self-employed, even if we could match on characteristics, are likely to exhibit different preferences (especially attitudes to risk) to employed workers.

The more plausible strategy might seem to be the pre-1992 period where we have a potential treatment between those who were covered by pre-SG employer-provided pension plans relative to the behaviour of those brought into the SG having previously relied wholly on voluntary saving. The difficulty with this strategy is that saving for retirement was already affected by other components of the Australian retirement regime including the Age Pension and the preferential treatment, in terms of asset taxation and asset test exemption, of housing.

This seems to suggest that a somewhat similar economy may be the most useful ‘benchmark’ in investigating the impact of specific saving policies. Despite competition on the sports field and much else, Australia and New Zealand seem to be natural comparators. However, New Zealand has also gone through periods of major reform in pension provision and, in particular, in its tax treatment of private pensions (St John 2001). It seems very likely that the negligible levels of voluntary household saving for retirement in New Zealand in recent years have arisen from the more generous flat pension and the changed tax treatment of retirement saving. New Zealand turns out to be unusual in providing very little tax relief for retirement saving, relative to other OECD countries, in the recent past (see Yoo & de Serres 2005) and therefore turns out not to be a particularly representative ‘benchmark’ by which to examine the Australian experience.

Overall, therefore, Bateman and Piggott’s conclusion that the SG would have likely raised the Australian saving rate between 1992–93 and 2004–05 by around 1.5 percentage points may be of the right order of magnitude although I tend to the view that forms of retirement saving are highly substitutable, so that such calculations (and future projections of increasing national saving attributable to the SG, relative to the counterfactual) err on the high side.

6.2.2 Is Retirement Saving at an ‘Adequate’ Level in Australia?

If the existence of the SG indicates the need for a mandatory saving program, a related issue concerns whether individuals are saving ‘enough’ for retirement. There is a specific issue here given the structure of the Australian program. If we assume that saving would have been sub-optimal in the absence of the SG, and that the level of the SG provides a signal to individuals of what is an appropriate level of saving, then the level of the SG contribution itself should reflect a notion of ‘adequacy’. In contrast, if we view the object of the SG as being to provide at least a minimum level of retirement saving over and above entitlement to the Age Pension (or indeed its existence is simply intended to lift people off the Age Pension) whilst maintaining the maximum flexibility in voluntary additional contributions to allow for heterogeneity in saving preferences, then a higher level of SG contribution could not be justified and indeed a lower rate might even be preferable. My own answer (from a background of voluntary saving in the United Kingdom), is that the SG should be providing for the second of these two aims and should not therefore be set at what the policy-maker might regard as an appropriate level of saving for the ‘average household’. However, it is clear that some of the debate in Australia has taken the first position.

Assuming, therefore, we are defining ‘adequacy’ as the appropriate level of saving for households, then the retirement saving behaviour in what are primarily voluntary saving regimes such as New Zealand, the United Kingdom and the United States does provide a benchmark for answering the question of what constitutes this ‘adequate’ saving level. And a common feature of all these studies is the gulf between how (most) academic economists perceive notions of adequacy and the expressed definitions of policy-makers in the field.

From the point of view of the life-cycle economist, ‘adequacy’ must be defined in relation to a criterion of optimality: that is, the life-cycle path of consumption that would maximise utility given expected lifetime wealth, the nature of the capital market, the existence of a bequest motive, and preferences (time preference and risk aversion).

For consumers who are myopic or are held to exhibit ‘time inconsistent’ behaviour, it is not clear that this criterion can apply; however, to argue both the case for greater compulsion in retirement saving on the basis of such alleged traits (see UK examples: Pensions Commission 2005 and Department of Work and Pensions 2006a) and then to attempt to utilise standard life-cycle welfare measures to evaluate such interventions (Department of Work and Pensions 2006b) is attempting to have your cake and eat it, at best.

Using the standard life-cycle criterion, however, the most rigorous attempt to estimate a structured model of optimal retirement saving is that of Scholz, Seshadri and Khitatrakun (2006) who apply fully specified models of life-cycle earnings and plausible preference parameters to a sample of individual households in the United States to calculate optimal wealth at retirement and then use data to match this to actual household wealth at retirement. They report that the model accounts for 80 per cent of the cross-sectional variation in wealth and that fewer than 20 per cent of households have less wealth than their optimal targets. Moreover the ‘wealth deficits’ of those who are undersaving is small. Note that a simplest constant saving rate model that would best fit their data (and may therefore serve as a benchmark for stylised calculations of adequacy) implies a saving rate of 14.7 per cent (Scholz, Seshadri & Khitatrakun 2006, p. 633). Similar results, based on more stylised methods, which question whether there are substantial ‘saving deficits’ at retirement include Banks et al. (2005) for the United Kingdom, and Scobie, Gibson and Le (2005) for New Zealand.

Nevertheless, and notwithstanding this research, it appears to be self-evident to many policy-makers in countries where voluntary retirement saving is an important component of retirement income that households do not
save ‘enough’ for retirement, partly through fairly arbitrary definitions of what constitutes an appropriate saving rate and partly from qualitative data indicating that many households lack a complete and comprehensive understanding of pension programs and incentives (see Pensions Commission 2004). It seems to me more useful to look at what households actually do rather than qualitative surveys of opinions; moreover, sub-optimal outcomes in terms of retirement saving may arise from inconsistent policy rather than from inconsistent behaviour—a finding pretty well demonstrated to my satisfaction in the UK context by Chung et al. (2008).

However, it is true that in several countries, including the United Kingdom and the United States, the trend in retirement saving has been downward. It seems likely that it arises in large part in recent times from a strong period of accumulating capital gains in existing households assets, from the relative performance of the housing market and the equity market in recent years (with pension portfolios typically allocated to the latter) and from various disadvantageous changes to the regulatory and tax regimes governing defined benefit employer-provided pension plans, rather than to any overall failure of individual household rationality. However, it is noticeable that the academic studies cited above that cast doubt of the ‘saving adequacy’ argument also tend to incorporate some or all of accumulated housing wealth at retirement into the measure of potential available wealth at retirement, whereas studies that focus on the ‘inadequacy’ of wealth at retirement tend to utilise data only on private pensions and financial wealth. Thus the twin questions of whether housing wealth should be treated as potentially disposable wealth, and as to whether the tax system encourages savers to invest in housing wealth rather than in the more fungible pension and financial wealth, are key issues in discussing saving adequacy.

Given the importance of mandatory saving in the Australian program, these debates may not seem of great interest. But they are relevant both in defining the appropriate level of the SG and what the SG is for. Most of the existing analyses of other countries’ ‘optimal’ saving rates leave me sceptical as to whether there is a case for increasing the rate of SG, but do pose the issue of whether households are investing in the right assets, and the extent to which tax policies divert portfolios down particular channels. And this is the question to which I next turn.

### 6.3 Tax Treatment of Retirement Saving

There are three broad issues to consider in relation to the taxation of retirement saving in Australia. First, there is the interaction between the income and capital tests and the Age Pension. Second, there is the generosity of the tax treatment of retirement saving (relative to, say, the benchmark of standard OECD tax treatments of retirement saving). Third, there is the issue of how superannuation disbursements are taxed, since superannuation can be taken in various forms of annuity, such as a life annuity or a fixed-term annuity, or as a lump sum. It will be apparent that these three questions are inter-related and that much of the complexity of the tax treatment of retirement saving arises from this fact.

#### 6.3.1 Interaction of Superannuation Guarantee and the Age Pension

The means-tested Age Pension does not differentiate between voluntary and mandatory saving arrangements, but does distinguish between whether the Superannuation Guarantee is taken as a lump sum or as an income. If the SG is taken as a lump sum, and is not spent before the retiree is eligible for Age Pension (since SG can be taken at an earlier age of 55, and it is currently proposed gradually to align this with the age at which the Age Pension can first be taken, see Australia’s Future Tax System 2009), then it is assessed under the assets test. If it is taken as an annuity, then the rules governing income in the form of annuities apply, and it would broadly be assessed under the income test. It appears, however, from evidence cited in Bateman and Piggott (2001) that lump sums have so far been primarily invested, rolled-over or used to pay off mortgages.

As suggested in section 6.1.1 above, this combination of means-tested pension and defined contribution funded ‘pillars’ in the mandatory pension program is fairly unusual by international standards. The international evidence suggests that households which face asset or income tests adopt different saving strategies from those that do not; for mandatory saving arrangements, therefore, this finding would also suggest that program participants would adopt investment strategies to minimise their tax burden. However, whilst much of the Australian debate seems to have focused on the iniquities of ‘double dipping’, by which individuals dissipate lump sums in order to maximise entitlement to the Age Pension, it should not be forgotten that almost all optimal life-cycle behaviour would be informed by a desire to minimise the lifetime tax burden so as to maximise disposable income. From the limited data that I have seen for Australia, for example, they seem consistent with the view that it would be rational to utilise the SG lump sums to maximise the household’s housing wealth rather than some ‘spending bonanza’, since housing receives the most beneficial tax treatment under the Australian program for older homeowners (in particular, exemption from the assets test). Whether this restructuring of wealth portfolios by older households would be sensible as cumulated SG sums increase with successive cohorts of retirees is open to question, since we would thereby have the phenomenon of ‘asset rich-income poor’ older households noted in the United Kingdom and the United States (Banks et al. 2007; Disney, Henley & Stears 2002; Venti & Wise 1989, 1990). This in turn raises the issue of whether the Australian market for housing equity-downsizing functions efficiently, to which I return later.

Aligning the date at which the Superannuation Guarantee can be accessed and the date at which the Age Pension can first be received also seems entirely to be driven by concern about the use of lump sums obtained from superannuation before age 65. Does this imply that all voluntary saving arrangements would also be aligned with...
If this were to become the case then, by international standards, retirement options in Australia would become rather inflexible, driven wholly by the age of entitlement to the Age Pension. In most multi-pillar pension programs, there is much more flexibility in terms of separating dates at which retirement benefits can be accessed from dates at which ‘retirement tests’ operate. Individuals may thereby be able to access benefits from voluntary retirement saving programs earlier than from the state pension, or indeed to postpone annuitising or cashing in their retirement saving beyond state pension age, depending on the performance of their investments. This seems desirable since, in the standard model of consumption-smoothing, it may not be optimal for all pensions to be available at a single age; scope for flexibility in receipt of annuities, in retirement date and in type of retirement (e.g. gradual or partial transitions from the workforce) might be more desirable.

6.3.2 Tax Treatment in Australia

The taxation of Australian superannuation is complicated, since all stages of the superannuation program—contributions, accumulation and disbursement—are potentially subject to tax but are then at all levels given concessional treatment relative to a ‘standard’ saving vehicle such as saving in a bank account. The OECD (Yoo & de Serres 2005) therefore, using the standard three stage T (tax) and E (exempt) classification, describe the Australian system as ‘TTT’ (Table 6.2 below) and suggest that the Australian program is very much an outlier in international terms. This classification has irked some, not least the Australian Treasury, and it might be more accurate to describe the Australian regime as ‘ttt’ since notional rates of tax at each stage are 15 per cent or less, compared to higher rates on other saving instruments. In fact, this problem of classification applies to most regimes when the E/T method is used. The UK program is, for example, normally classified as EET (a standard ‘expenditure tax’ treatment) but in practice is also ‘ttt’; lump sum disbursements are exempt from tax to a ceiling, lifetime tax relief limit for contributions is applicable (which is indeed binding for some higher-paid workers), and various concessional tax reliefs to pension funds in the accumulation phase have been cut back in the last decade. Indeed, some analysts suggest the effective outcomes in terms of ‘tax expenditures’ between the United Kingdom and Australia are much closer than might be suggested by a standard comparison. One suspects that other countries’ programs also have more complex tax treatments in practice than these simple classificatory schema suggest. I also have formed the impression that the amount of ‘tax expenditure’ levied on the Australian program has somewhat increased in recent years with the abolition of the SG surcharge, measures to allow couples to split contributions and other concessional measures on payouts.

At first sight, taxing contributions, wealth and income at a roughly equivalent rate sounds as if it provides a form of ‘neutral’ taxation but it seems to the outsider to be a somewhat cumbersome administrative method, insofar as a simpler tax base should be able to generate the same ex post rate of return to contributions. Consequently, as described by Horne (2002), for example, there have been several suggestions for rationalising the system of taxation of retirement saving in Australia. One set of proposals suggests switching to explicit EET or TEE treatments of the program. Note that these are not equivalent if there is not a flat rate of tax on income—which there is not in Australia—and therefore EET will tend to be more favourable to high earners than TEE unless tax reliefs are only allowable at the ‘standard rate’. Other proposals

| Abbreviations: E (exempt), pT (partially taxed: only in the EET system), T (taxed). Notes: (a) The employee’s contributions are partially exempt or receive tax credits in Austria, Belgium and Portugal. (b) Mexico and the Czech Republic provide a state subsidy to contributions. Source: Yoo and de Serres (2005, Table 1). |

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<th>Table 6.2 Country Grouping According to the Tax Treatment of Private Pensions</th>
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<td>Australia</td>
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1 Most benefits taken since 1 July 2007 are tax free from age 60 although they are subject to social security means tests.
(perhaps influenced by the New Zealand experience) suggest something akin to a comprehensive income tax treatment—either ETT or TTE, with a ‘tax credit’ aspect bolted on to a standard tax regime in order to encourage retirement saving. There are two further substantive points that should be made, in my view. First, the Australian retirement saving program appears to offer a high degree of tax concession relative to the standard tax regime for assets in Australia since the revenue raised by taxation of capital in Australia is the highest among OECD countries (Australian Treasury 2008, Chart 6.5). Thus it is perfectly possible for Australia both to have one of the highest rates of effective tax on retirement saving in the OECD and at the same time to offer one of the most concessionary rates of taxation of retirement saving relative to other assets. This is illustrated in Figure 6.3 (Yoo & de Serres 2005). Second, however, it is also apparent that these twin features (significant taxes on some forms of capital; significant tax concessions to retirement saving) induce various distortions in the overall program at the household or company level: for example, the differential treatment of the self-employed and the employed, those who are working and those who are inactive, employers relative to employees, and so on. Whatever the tax base, these differences will still distort work-leisure decisions and investment decisions.

Although it is fashionable to question whether behaviour of agents can be fully understood using standard models of life-cycle optimisation without the inclusion of various behavioural theories to explain procrastination, time-inconsistency in behaviour, responses to framing of saving regimes and so forth (and indeed the Australian degree of mandating of retirement saving suggests that policy-makers do not entirely believe in the ‘rational saver’ model either), it is also the case that there is plenty of evidence from studies elsewhere that individual households respond to tax regimes and in particular to differential tax treatments of assets just as economic orthodoxy would suggest, irrespective of the complexity and difficulties experienced in understanding the regime to which they are subject. Milligan (2003) showed how changes in contribution limits affected saving behaviour not just within a single period but in terms of the inter-temporal pattern of saving. Disney, Emmerson and Wakefield (2009) also showed that changes in tax reliefs had a significant impact on ‘treated’ households during the Stakeholder Pension reform in the United Kingdom in 2001, even though the consensus was that the reform had had no effect and in addition a quite different group of households had been ‘targeted’ in the announcements surrounding the reform. The lively discussion in Australia as to the reform of the retirement saving tax regime bears testament to these points. An inevitable consequence of complex tax regimes is that there will be a good deal of asset-shifting in response to disparate and changing tax treatments, which has in turn sparked a debate (most notably in the United States) as to whether tax incentives for retirement saving have generated a substantial degree of net ‘new’ saving. All in all, analysis of such regimes requires a degree of hard graft in modelling incentives and in working out the consequences of tax regimes (and proposed changes in the tax regime) on household and firm behaviour.

6.3.3 The Disbursement Phase

The tax treatment phase of superannuation is, of course, heavily influenced by the structure of income testing of the Age Pension. Whereas the Age Pension reduces the demand for annuities and the need for precautionary saving against adverse income shocks later in life, the capital test induces individuals to divert assets into those most immune from assets tests and/or drawdown before retirement in order to obtain tax exemption.

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**Figure 6.3 Effective Tax Rates on Private Pension and Benchmark Saving: Age Group Average**

![Figure 6.3](image_url)

Source: Yoo and de Serres (2005, Figure 3).
Given the incentive to disburse superannuation wealth before the income and assets tests ‘bite’ at age 65, and to maximise holdings of exempt assets, the disbursement tax regime appears intended to offset these incentives by encouraging participants to annuitise. By so doing, individuals avoid the asset test and are given a preferential income test insofar as the full purchase price of the annuity is deducted from the tax liability (Bateman & Piggott 2001). In other words, one ‘distortion’ to the tax regime (preferential treatment of annuities) is structured to offset the other (the income test in the Age Pension). It seems unlikely, however, that asset drawdown unlike asset diversion (primarily into housing) is a big issue in Australia as most simulations suggest that the income test ‘binds’ rather than the asset test (Creedy & Disney 1989; OECD 2005).

International experience does not give a good guide to outcomes here given that the interaction between income tests and various disbursement strategies is an experience that is pretty unique to Australia. How relative preferences for disbursement strategies over time will change is therefore something of an unknown for several reasons. First, the tax regime has been subject to several changes and these reforms are likely to continue. In particular, the proposal to bring into line the first date at which superannuation funds can be accessed relative to the date at which the Age Pension can be drawn will have implications for the willingness of individuals to take superannuation funds as lump sums.

Second, however, it seems likely that disbursement strategies will change as superannuation funds grow. When funds are relatively small in value, given the fixed costs of purchasing annuities, it may be simplest to take funds as lump sums (even if, say, income and asset tests didn’t exist) simply to minimise transaction costs. As accumulated funds grow, the attraction of using those funds to invest in other assets, or to take as annuities, increases. Whilst there may be tax incentives to utilise funds to increase housing wealth (such as paying-off residual mortgages or increasing house spaces) there are obvious limits to this in parts of the country where land and materials are cheap, and from a desire to avoid the ‘asset rich-income poor’ outcome described previously. Finally, one of the adverse impacts of asset tests—a reduction in the aggregate level of private saving—is diminished to the extent that the SG ‘model’ is one of.compulsion rather than voluntarism. In other words, whilst in the UK context, it is doubtful whether, for low-to-middle income households, there is any strong incentive to save greater amounts given the implications of the taper on the Pension Credit, Australia has bypassed the problem by enforcing a mandatory program of saving for most households.

### 6.4 Tax Treatment of Housing

The tax treatment of housing is an important issue in its own right. Which aspect of housing is being taxed? How do we treat rented versus owned property? What are the implications for asset prices including buildings and land, and so on? Here, for reasons of space, I focus primarily on the interaction between taxation of retirement saving and pensions, on the one hand, and housing assets on the other. For the purposes of this issue, therefore, we can consider that the majority of older households will be homeowners with, possibly, some residual mortgage debt, who face active decisions as to how to invest their superannuation. Issues such as whether the tax system may or may not distort the housing market by its treatment of renters and owners, and of first-time buyers, may be indirectly related to these issues but are not considered in great detail here.

From this point of view, the key features of the tax treatment of housing in Australia are as follows. First, imputed rent and capital gains from owner-occupied housing are exempt from income tax. Second, the principal place of residence is given concessional treatment under the income test and is exempt from the asset test of the Age Pension (although the asset test threshold for other assets is lower for homeowners than renters). Third, stamp duty is levied on house transactions although one can argue whether the incidence of this falls on the buyer and seller. Finally, as in the United Kingdom, residential property is a primary source of revenue for levies of tax by municipal authorities. In contrast, rental properties are subject to income tax and moving to rental accommodation by pensioners may render them subject to the income test (though raising the threshold at which their other assets are liable to the asset test).

It seems apparent from this list that the combination of the tax treatment of housing and of retirement saving assets gives a strong incentive for older taxpayers to invest the maximum in their primary residence and then to defer ‘downsizing’ for as long as possible (although some states offer tax concessions to pensioners who move to smaller homes).

In thinking about the issues of the taxation of housing, it is usual to consider the services provided by ownership of housing assets before focusing on the specifics of the interaction with the taxation of other assets. So this strategy is followed here.

#### 6.4.1 General Principles of Taxation of Owner-Occupied Housing

The essential dichotomy in considering owner-occupied housing is that, on the one hand, ownership of housing yields a consumption stream over time which may in principle be measured by its opportunity cost (the imputed rent), and on the other hand home ownership functions as an investment with the prospect of capital gain (or loss). Furthermore, being a durable good, the cost of purchase and the stream of consumption over time are temporally distinct; taxes on purchase (such as expenditure taxes or various types of transaction taxes such as stamp duty) have the merit of ease of collection but little else to commend them in terms of tax theory.

Studies have often focused on the ‘investment decision’ aspect of the acquisition of housing assets, and therefore on whether the tax system provides preferential treatment of housing, which it normally does. In a standard model, this preferential treatment will lead to over-investment in housing and a reduction in investment in other assets (Hendershott & Hu 1983; Gervais 2002). In a ‘steady state’
model, where the focus is not primarily on capital gains and where house prices reflect the capitalised stream of housing consumption benefits, it is the failure to tax imputed rent which is at the heart of the preferential treatment. This is especially the case where mortgage interest is allowed tax relief, although this treatment will be offset by downpayment restrictions. Bourassa and Hendershott (1992) make the important point in the Australian context that, since mortgage interest relief is not allowed, the net return on home ownership in Australia is greater when the loan-to-value ratio of the household is relatively low and as the effective marginal rate of tax facing that household increases. Under both these criteria, older households obtain a greater net return relative to younger households. Finally, since Bourassa and Hendershott measure the incentive to ‘over-invest’ in housing by the net ‘user cost’ (i.e. the net-of tax and depreciation cost of purchasing additional housing assets relative to other forms of investment), these factors imply that older Australian households would tend to over-invest in housing relative to other forms of investment.

This is by no means a desirable outcome for policy-maker and homeowner alike. In a standard optimising framework, we can envisage that households’ desired consumption of housing relative to consumption of non-housing goods and services over and above ‘subsistence’ needs depends on total wealth, preferences and asset returns, and changing consumption needs over the life-cycle (Disney, Gathergood & Henley 2009). If the tax system distorts these choices, and encourages over-investment in housing, there will be disparity between the (pre-tax) marginal utility of consumption of housing relative to non-housing goods and services. This will be reflected in lower levels of consumption of non-housing goods and services among older households, given housing maintenance and servicing costs, than would otherwise be optimal (Bank et al. 2007). This is reflected in the phenomenon of ‘asset rich-income poor’ households, as described briefly earlier. In this case, policy-makers will wish to take a special interest in the functioning of ‘reverse mortgage’ or ‘equity release’ schemes to convert housing assets into income flows among the oldest segment of the population, since standard means of downsizing (selling housing assets and possibly moving into rented accommodation) will fall foul of the income tests associated with the Age Pension. But given standard problems of adverse selection in such ‘equity release’ markets, it is not clear that private provision of such financial instruments will be very effective.

The other aspect of potential over-investment in housing among older households is that they are thereby disproportionately exposed to market volatility. Although in fact younger households in Australia tend to have higher ratios of housing wealth to total wealth, roughly two-thirds of housing wealth at the fifth decile of the 65 and over age group in Australia is held in the form of housing (Wood 1999). Whilst this group have therefore benefited from the general above-trend increase in house prices over and above the values of other assets in recent years (such as equity returns), this high proportion of wealth held in the form of housing exposes such households to house price volatility and other natural and environmental risks to property, as recent events have illustrated on both fronts.

Most advocates of the reform of the tax treatment of housing seem to suggest that some form of tax on imputed rent provides part of the answer. Insofar as residential property taxes are levied on the value of the house (such as council tax in the United Kingdom and residential property taxes in Australia), then there is some loose form of imputed tax already in existence. But typically, existing property taxes are banded. They do not deal with changes in house prices since valuations only take place infrequently, and assume that house prices do indeed reflect capitalised streams of imputed rents. The Institute for Fiscal Studies in London, as part of the Mirrlees Review into taxation in the United Kingdom, is therefore considering reforms to the taxation of housing which include a ‘housing services tax’ (which is a form of tax on imputed rent) as well as taxes on land values and on capital gains (with, presumably, tax credits for capital losses) (Institute for Fiscal Studies 2009).

6.4.2 The Interaction of Housing Taxation and Retirement Saving

A key question in considering the interaction of the tax treatment of housing with the issue of retirement saving is whether the overall structure in Australia encourages households to enter retirement with the ‘right’ level of retirement saving and asset portfolio structure. The first part of the question has already been considered in section 6.2.2 above, so I focus on the second part here.

Standard models of life-cycle consumption suggest that, in the absence of a bequest motive, households will primarily want to annuitise at retirement in order to protect themselves against longevity risk. Other motives, such as saving for down-payments, or as a precaution against earnings or employment loss, would seem to be of less importance at this stage of the life-cycle. Households will therefore hold housing wealth for two main reasons, because: first, they have a bequest motive and wish particularly to bequeath property and, second, they gain some intrinsic utility from owning property (and presumably, a specific property at a particular location) which would not be gained simply by renting housing services. The question is whether a residual motive for holding housing wealth is sufficient to justify the fact, mentioned previously, that roughly two-thirds of wealth of the median older household in Australia is held in the form of housing.

A comparison with other countries is, perhaps, illuminating. For example, evidence from the United Kingdom suggests that, in the mid-1990s, the median household age in their 60s or early 70s held just under half their wealth in the form of housing (Disney, Johnson & Stears 1998). However, if social security wealth was excluded from the calculation, the proportion held in the form of housing wealth was comparable to Australia. A rationale for including social security wealth in the calculations for the United Kingdom is that pensions are universal and contribution-based and in many other European countries would indeed be the dominant form of retirement wealth other than housing, given the lack of development of private pensions and other private retirement saving instruments in those
countries. Nevertheless, including the Age Pension in calculations for Australia is problematic because payment of the benefit is conditional on other income and assets (although the United Kingdom, too, has an important means-tested component to its social security program). Moreover, the structure of the Australian Age Pension, which has a strong insurance aspect against income loss, also gives a strong incentive to households to hold their other assets in relatively liquid and high-earning forms, even leaving aside the preferential treatment afforded to housing by the income and asset tests. Therefore it is hardly surprising that older Australians’ household portfolios are dominated by housing wealth, and such assets would probably remain a major component of the portfolio even if they were given less favourable tax treatment.

This does not resolve the potential problem of ‘asset rich–income poor’ households, however. Thoughts have already turned in Australia to encouraging the ‘reverse equity mortgage’ market. According to data provided by the Australian Treasury (2008), the number of individual households availing themselves of such arrangements can be numbered in the tens of thousands, or around 1.4 per cent of potential households aged 60 and over. Although a small fraction of households, this may be a comparable fraction to other comparable countries such as the United Kingdom and the United States. Moreover, the income stream from such an instrument is not counted in the income test and even lump sums can be exempt from the asset test up to a ceiling for a 90-day period. Whether these relative tax incentives outweigh the problem that, in a thin market, such products will tend to be far from ‘actuarially fair’, requires further analysis.

6.5 Conclusion

This chapter has covered a good deal of ground, sometimes perhaps too sketchily. It started by describing the Australian retirement income program and showing that the mandatory program, despite its unique features, gave an ex post distribution of replacement rates by income level that was not so different from other countries. Whether this is an intended or, indeed, a predictable outcome is not clear.

I then examined the Age Pension and the cases for and against tighter means testing or indeed greater universality. Simple static models demonstrated that the impact of such reforms on overall behaviour—for example, whether households subject to these reforms changed their voluntary retirement saving behaviour—could not be predicted a priori, despite the rather loose discussions of ‘incentives’ that are sometimes presented to policy-makers. Ultimately, the question is whether the distortions to optimal life-cycle consumption patterns arising from such tax structures for individual affected households outweighed arguments for redistribution and for minimising the overall tax burden.

I then considered the second pillar of the program, the Superannuation Guarantee. Standard issues that have arisen in terms of voluntary retirement saving programs concern whether individuals would have saved ‘enough’ in the absence of government intervention (the counterfactual) and, second, what constituted ‘adequacy’. An important question for Australian tax reform is to consider whether the level of the SG represents a benchmark of what should be an ‘adequate’ saving level or exists simply to bring people up to a minimum level of retirement income and also to lift them out of the income-tested program. My own instinct is that private and mandatory retirement saving are highly substitutable and that this fact alone should provide a ceiling to the SG contribution rate given preference heterogeneity, but other people no doubt have a different view.

Next, I considered issues concerning the tax treatment of pensions. There has been a good deal of focus on the behavioural implications of the different dates at which the SG can be claimed and the Age Pension first received, but I am uncertain as to whether this is going to be the primary issue as SG funds accumulate and the optimal form of disbursement comes to dominate the debate. It is clear that the differential treatment of disbursements, and of assets under the asset test, are important issues, and also that the tax treatment (in particular, levying preferential rates of tax at all stages of the process; contribution, accumulation and disbursement) is over-complicated. The international evidence also suggests that there is a high degree of preferential treatment to retirement saving in Australia, but not least because (by international standards) Australia obtains a high fraction of its tax revenues from taxing capital.

Finally, I sketched out some issues concerning the tax treatment of housing. As Australia has local property taxes and does not have mortgage interest tax relief, its tax preferences in favour of housing are not large by international standards for the average working household. However, the progressive structure of direct tax rates combined with the fact that most older homeowners are outright owners or have low mortgages to pay off, and the interaction of forms of retirement asset holding with the income and asset tests, shift the tax equation towards over-investment in housing wealth for older households. Most of the wealth of older homeowners therefore takes the form of housing wealth, and this may be unhealthy where such households are exposed to asset price volatility and to other environmental risks such as loss of property due to natural causes. Given the structure of asset and income tests, thought must be given to the evolution of the reverse equity mortgage market in Australia. This appears to have taken place, and there needs to be further evaluation of whether tax preference is sufficient to offset the well-known adverse selection problems that seem to have limited the development of this market in several countries.

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