

# A LESS THAN SUPER FUTURE

Lifestyle spending by Generation X and Y may leave them short in retirement, unless action is taken now to boost savings, warns superannuation expert Ross Clare.

**O**ne of the hardy perennials of public policy debate is what to do about baby boomers. There are an awful lot of them about, and accordingly their needs, expectations and what they are able to contribute to society and the economy forms a crucial part of public debate. Many policy makers and policy commentators are also baby boomers, also heightening the interest in that group.

However, quite refreshingly, the House of Representatives Economics Committee, in its inquiry into improving the superannuation savings of people under 40, is taking a long hard look at a demographic group who up until now may have been somewhat neglected by policy makers. The committee has received 46 submissions so far, has held one public hearing and is due to report to the parliament by late 2006.



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Those aged under 40 are generally tagged as Generation X and Generation Y. While definitions differ between various pop-demographers (as do some of their other sweeping generalisations), Generation X are usually regarded as the group currently aged between 30 and 40, while Generation Y is the group currently aged between 20 and 30. Beyond that the alphabet starts to run out, with Generation Z sometimes being regarded as those currently aged under 20.

The House Economics Committee inquiry is interesting and very relevant, not least because the demise of the Senate Select Committee on Superannuation raised the question of how the parliament would deal with the big picture issues in retirement income provision. Clearly, this committee has put its hand up to deal with at least part of the issue, if not sketching all of the picture.

What do we know about Australians aged under 40? Obviously they have some differences from those over 40. As we know from the words of the song *Father and Son* by Cat Stevens (known as Yusuf Islam to the under 40s), being young is their fault but it is something they will overcome. However, settling down, marrying (or not) and procreating is part of a repeating pattern of society, and those under 40 will become increasingly like those over 40.

So while many of the characteristics of the under 40s come from being at a different stage of the life course than the rest of the population, some differences will remain, and others will undoubtedly emerge as this group ages.

Among the differences from the previous generation that are already evident is that household formation and purchasing a home has not happened for a significant proportion of the adult population aged under 40. There are indicators that the average age of first marriage and average age for purchasing the first home have increased over the last decade or more. Significant proportions of both Generation X and particularly Generation Y are still in the family home. However, this is more likely to indicate delay in achieving these stages of the life course, rather than any evidence of a decline in the eventual rates of family formation and house purchase.

Are Gen X and Y taking the opportunity to save while they live at home? Perhaps at least some are, but there is not much evidence they are saving for retirement. A large majority of males and females aged under 25 have a current superannuation balance of less than \$5,000, with over 40 per cent having no superannuation at all.



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Clearly this is because many are still studying and not yet in the workforce. For those aged between 25 and 34, around half of men have balances between \$10,000 and \$50,000, while around half of women have a superannuation balance between \$1,000 and \$20,000. For those aged 35 to 44, around half of men have balances between \$20,000 and \$100,000, while for women around half have balances between \$5,000 and \$50,000.

Women tend to have lower superannuation balances than men due to segmentation of the workforce, with women tending to be clustered in low paying occupations, and women also tending to have more breaks from the paid workforce due to family responsibilities. For example, women in full-time jobs on average earn 92 per cent of the average hourly rate earned by men, and women on average are in the paid labour force for the equivalent of around 20 full-time

working years, compared to around 37 years for men.

The superannuation accumulations are not big amounts for any of the groups described. A charitable assumption might be that they are pumping any extra cash into home purchase or paying off HECS debts. Anecdotally, the money seems to disappear into lifestyle for a good many.

The submission from the Association of Superannuation Funds of Australia (ASFA) to the House Economics Committee inquiry provides projections of lump sum superannuation benefits based on current age and past receipt of the Superannuation Guarantee. These indicate that an individual needs a substantial number of years of contributions together with a substantial annual salary in order to generate retirement savings of the order of \$500,000 or more, which a major Westpac-ASFA research project showed is the amount needed to generate sufficient income in retirement to support a couple in the comfortable lifestyle they expect.

These research results are based on detailed budgets of what singles and couples would need to spend to be able to have a comfortable lifestyle in retirement. More specifically, the budgets show what spending is needed to enable an older, healthy retiree to be involved in a broad range of leisure and recreational activities and to have a good standard of living through purchase of such things as household goods, private health insurance, a reasonable car, good clothes, a range of electronic equipment, and domestic, and occasionally international, holiday travel.

If anything the lifestyle budgeted for is relatively modest in comparison to the aspirations of many of those aged under 40. Market research conducted by ASFA indicates that Generation X and Y types aspire to a lifestyle in retirement involving a level of comfort well in excess of what their granny might be used to.

Some pop demographers and other commentators who have been doing some research either in magazines in airport lounges or on the internet argue that prospects for coping in retirement are even more

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alarming on the financial front because of increasing life expectancy. There are some interesting projections bandied about from time to time. For instance, some commentators have suggested that a baby girl born this year can expect to live into her nineties, and hence will have at least 40 or so years in retirement. This statistic or projection is certainly interesting, but it would be news to most demographers.

In Australia, life expectancy at birth (as traditionally calculated) currently is 76 years for men and 82 years for women. Average life expectancy could increase to something in the nineties, but it would require yet-to-be-discovered medical breakthroughs and/or the passage of a lot of time. Whether life expectancy will continue to increase and at what rate is essentially unknowable. Policies should be designed to cope with uncertainty, rather than assuming one possibility is a certainty.

However, even without any increase in life expectancy, many individuals will spend decades in retirement. For those retiring over the next few decades who necessarily have a life expectancy that is already more or less determined, it is likely that around 40 per cent of the population will spend up to 25 years in retirement, around 40 per cent will spend up to 35 years in retirement and around 10 per cent will spend more than 35 years in retirement. A significant minority of individuals will spend more time in retirement than they did in the labour force.

**S**o what does ASFA suggest to help those savings-challenged 20 and 30-somethings? The recommendations in our submission to the inquiry focus on measures that would help the whole adult population, with those under 40 particularly benefiting from still having quite a few years to take advantage of what we propose. Being young has a number of advantages, including having more time to reduce a savings shortfall compared to someone on the cusp of retirement. For instance, 30 or



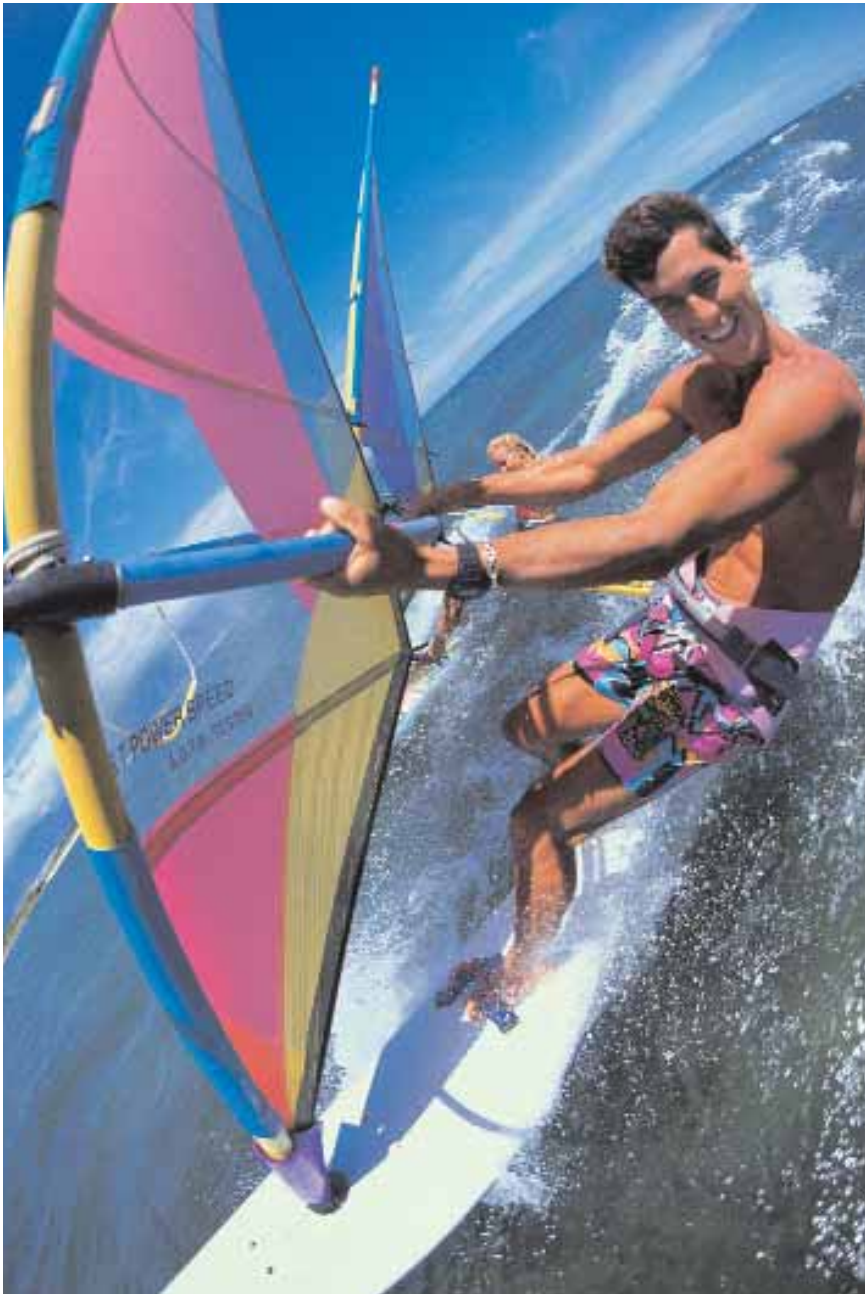
40 years out from retirement an individual might be able to reach retirement savings sufficient for a comfortable lifestyle by making additional contributions equivalent to 2 per cent to 3 per cent of wages. But just 10 to 20 years out they might have to contribute up to an additional 20 per cent of wages a year to get to the target.

Modelling of individual outcomes has clearly confirmed what is technically described by researchers as “the bleeding obvious”. Higher contributions for more years, lower or no contribution taxes, and higher fund earning rates all contribute to greater adequacy of retirement income. ASFA recommendations are aimed at achieving such outcomes.

First we say that, in order to better meet retirement income needs and expectations, contributions need to be increased in effect to an amount equivalent to 15 per cent of wages

through a combination of compulsory contributions, voluntary contributions and tax relief.

More specifically, we recommend that for contributions made from 2006-07 the maximum co-contribution remain at \$1,500, but this be available for persons with assessable income and reportable fringe benefits of less than \$40,000 a year. The maximum co-contribution could phase down as income exceeds \$40,000 a year, at a rate of 7.5 cents in the dollar, cutting out at \$60,000. The co-contribution is a particularly useful measure introduced in 2003-04 which currently provides for a \$1.50 payment from the government for each \$1 of personal contributions, up to a capped amount and subject to an income test. As at 1 June 2005, the Australian Taxation Office had paid out \$291 million in co-contribution payments to the superannuation accounts of around 550,000 individuals.



The money seems to disappear into lifestyle for a good many.

We also recommend that the current standard 15 per cent rate of tax applying to contributions be abolished, either in one year or progressively over five years, with effect from 2006-07 onwards. This is a relatively big-ticket budget item—but make no mistake, it is one that is affordable given the current budgetary and economic outlook.

With compulsory superannuation standing at 9 per cent and the

introduction of choice of fund, ASFA also argues that there is no reason to continue the \$450 a month earnings threshold for Superannuation Guarantee payments. Many individuals rely on a number of casual or part-time jobs, and the current threshold discriminates against them relative to others with the same total employment income. Similarly there doesn't seem to be a good case to continue the current age based contribution limits currently applying to those aged under 40.

Finally, to assist the under 40s with a reality check on their savings pattern, ASFA recommends that the government examine successful overseas experience

and permit superannuation funds to provide benefit projections to individual members on a standardised basis as part of their annual reporting to members. Currently ASIC (the Australian Securities and Investments Commission) places strong restrictions on the use of prospective financial information. The regulator is concerned that fund members may view such information as a guarantee.

Nevertheless we believe it would be beneficial to consumers—especially the under 40s who at least have chronological capacity for building up considerable savings for their retirement—to receive projections of their superannuation balance at their statutory retirement date. Accordingly, we recommend that the government consider enabling superannuation funds, if they so choose, to provide projected future benefits to members on a standardised basis.

The beauty of a standardised projection is of course that consistent information would be provided across all types of funds. Also essential to this process would be the illustration of a number of scenarios, to assuage the government's and the regulator's fear that consumers would view these projections as an implicit promise.

The analysis and recommendations by ASFA are broadly supported by a number of other submissions the committee has received. However, at the time of writing we were still to see the submission from the Commonwealth Treasury. Once this and other outstanding submissions have been received and considered, it will be interesting to see what the committee recommends. Equally absorbing will be the government's reaction to the recommendations. Hopefully both will be supportive of future adequacy of retirement savings. ■

*Ross Clare is policy officer for the Association of Superannuation Funds of Australia (ASFA). The ASFA submission to the House Economics Committee inquiry into improving the superannuation savings of people under 40, along with other submissions and transcripts of evidence, is available at [www.apf.gov.au/house/committee/efpa](http://www.apf.gov.au/house/committee/efpa) or email [efpa.reps@apf.gov.au](mailto:efpa.reps@apf.gov.au) or phone (02) 6277 4587.*