

## CHAPTER 4 : TARGETS, TIMETABLE AND LEVELS OF CONTRIBUTION

### The SGL Target

4.1 Under the SGL, the Government's retirement income target for a person on average weekly earnings (AWE) is 40 per cent of that level of income. To reach this target, the Government intends phasing in employer contributions which will total nine per cent by 2000. The final 12 per cent outcome will be achieved by an arrangement being reached with employees at a stage, yet to be determined, whereby employees will contribute the other three per cent. The schedule for the phasing-in of the employer contributions is in Table 4.1.

Table 4.1

SGL Targets	
Year	Percentage
1992-93	5
1993-94	5
1994-95	6
1995-96	6
1996-97	7
1997-98	7
1998-99	8
1999-2000	8
2000-01 and subsequent years	9
For employers where payroll in the base year did not exceed \$500 000 the schedule is:	
1992-93	3
1993-94	3
1994-95	4
1995-96	5
1996-97	6
1997-98	7
1998-99	8
1999-2000	8
2000-01 and subsequent years	9

4.2 Treasury justified these targets in supplementary material made available specifically at the Committee's request. Table 4.2 shows increases in retirement benefits potentially available to hypothetical individuals whose present income is a specified multiple of AWE. The shaded rows in the table show the SGL outcomes compared to existing outcomes under existing policy.

Table 4.2

Present Income		Increase in Retirement Benefits Potentially Available to Hypothetical Individuals*					
		Multiple of AWE					
		.5	.75	1	1.5	2	3
Assumed contribution rates (b)							
(i)	Employer						
	No SGL	0.00	0.03	0.03	0.05	0.10	0.15
	SGL	0.09	0.09	0.09	0.09	0.10	0.15
(ii)	Member						
	No SGL	0.00	0.00	0.00	0.03	0.05	0.05
	SGL	0.03	0.03	0.03	0.03	0.05	0.05
Annual retirement benefit							
	No SGL	50%	45%	35%	37%	57%	66%
	SGL	*81%	62%	52%	47%	57%	66%
	Increase	31%	17%	17%	10%	0%	0%
Age pension entitlement (Full, Part, or None)							
	No SGL	F	P	P	P	N	N
	SGL	P	P	P	N	N	N

Source: Submission no. 195, supplementary submission of 6 May 1992, p 8.

\* Assumptions:

- (i) Post-retirement benefits for single retiree assuming 40 year accumulation with retirement at age 65 and private retirement income in the form of a 5 per cent-indexed annuity, taking account of the pension income and assets tests.
- (ii) Proportion of member earnings. SGL rates assume that the measure is fully phased in.
- (iii) Per cent of pre-retirement income. This is the net present value (NPV) of annual net income in retirement expressed as a percentage of gross final salary.
- (iv) Inflation rate of 4 per cent p.a.
- (v) Fund earnings rate of 8 per cent p.a.

4.3 Treasury's explanation of the model in Table 4.2 was:

... [it] illustrates the progressive impact of the SGL on the pattern of retirement benefits. For somebody on three-quarters of AWE, for example, the SGL increases projected post-tax retirement income by 17 per cent of pre-retirement income. By comparison, somebody on twice AWE experiences no increase in retirement income; the assumed present superannuation contributions made in respect of this individual already exceed the minimums proposed under the SGL legislation.<sup>1</sup>

<sup>1</sup> Sub No. 195, Additional sub of 6 May 1992, p.8.

## The Use of Other Assumptions

4.4 At the specific request of the Committee, Treasury provided further justification for the Government's targets. The Treasury modelled the following additional assumptions:

### *Impact of Death/Disability Cover and Administration Charges*

4.5 Treasury used a total fee level of \$1.70 (\$1 insurance, 70 cents administration charges) which it submitted was 'close to an average level of combined administration fee and death and disability premium for award superannuation funds ...'<sup>2</sup>

4.6 Treasury concluded that:

... while fees have negligible impact on a person's average level of net retirement income, a higher level of fees does result in a small increase in age pension eligibility for lower income earners. This is because:

- for higher income earners, with high levels of superannuation support, the fee is insignificant relative to the assumed level of contributions and so has a negligible impact on benefits; and
- for lower income levels, where the level of superannuation support is assumed lower, the reduction in superannuation benefits arising from fees is offset by the combined effect of an increase in age pension eligibility and reduced taxation.<sup>3</sup>

### *Higher Real Earning Rates*

4.7 In additional material, Treasury incorporated a higher real earning rate for a ten year period during the accumulation period for a benefit. Treasury assumed that the higher rates of return would begin in 2002, once the SGL had been fully implemented. Having presented the data in table form, Treasury commented:

The impact of a period of higher real earning rates on a person's net retirement income depends upon when during the accumulation phase of the superannuation benefit that period of higher earnings falls. The closer the period of higher earnings is to the person's retirement date, the greater the impact on final benefits because of the impact of the higher earnings rate upon already accumulated benefits.

It should be noted that sustained real earning rates as high as ten per cent are extremely unlikely, particularly over periods as long as 10 years. In this regard the 1980s cannot be regarded as typical and followed a long period of low and often negative real earning rates. A December 1991 paper – *The Role of Superannuation in the Financial Sector and in Aggregate Saving: A Review of Recent Trends* by Messrs Edey, Foster and Macfarlane of the RBA – reports nominal average earning rates of six, seven and 15 per cent per annum for the past three decades successively. Adjusted for average inflation of around eight per cent per annum, on this basis the real earning rate for the 1980-90 decade

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<sup>2</sup> SG sub no. 48, p 2.

<sup>3</sup> *ibid.*

would have been around seven per cent – well under the ten per cent assumption of this question.<sup>4</sup>

**Shorter Working Life**

4.8 A number of witnesses questioned the fundamental assumption of a 40 year contribution period, suggesting that for many employees this was an unrealistic figure. Mr Daryl Dixon submitted that a working life of 37 years was more realistic.<sup>5</sup>

4.9 The witnesses representing welfare groups also questioned the 40 year assumption saying that it was 'quite misguided'<sup>6</sup> and that for women it would be well less than 30 [and] closer to about 20.<sup>7</sup>

4.10 Accordingly, the Committee sought Treasury advice on the outcomes that would be obtained for periods less than the 40 years in the original model using contributions of 12 per cent (that is, nine per cent employer contributions and three per cent member contributions) throughout the accrual period. Table 4.3 shows the benefits which would accrue to employees, assuming 40, 31, 20 and ten year working lives respectively.

4.11 A person on AWE, assuming a 40 year accumulation period, would receive 55 per cent of AWE on retirement. Should a 31 year period be relevant, 48 per cent would result. For 20 and ten year periods, the outcomes would be 42 per cent and 34 per cent respectively.

**Table 4.3**

Retirement Incomes Under SGL for 40, 31, 20 and 10 Year Working Life						
Present income:	Multiple of average weekly earnings					
	50%	75%	100%	150%	200%	300%
Average annual retirement income under SGL						
40 years	85%	65%	55%	49%	57%	66%
31 years	78%	58%	48%	38%	43%	50%
20 years	71%	52%	42%	31%	29%	32%
10 years	59%	43%	34%	26%	23%	19%

Source: SG submission number 48, Tables 8, 9, 11 and 13.

**\*Assumptions:**

- (i) Assumes:
  - Marital status: Single
  - Commencement in fund: 1992
  - Retirement age: 65 years

<sup>4</sup> *ibid.*

<sup>5</sup> SG evidence, p 84.

<sup>6</sup> Professor J Disney, SG evidence, p 100.

<sup>7</sup> Ms E Cox, SG evidence, p 108.

Fund earning rate in projections	8.0%
Effective tax rate on funds	7.0%
AWE growth	5.5%
Retirement benefit is 5% indexed lifetime annuity	

- (ii) For SGL cases, contribution rates assume the SGL is implemented without any phasing in period.
- (iii) Average value of annual net income in retirement as a percentage of gross final salary (measured as the NPV of expected net retirement income as a percentage of the net present value of pre-retirement earnings projected over the same period).
- (iv) Average pension entitlement as a percentage of the full age pension over the period a person is eligible for an age pension.

### Women – Broken Labour Force Participation

4.12 In addition, the Committee requested that Treasury model the particular problems that women experience in participating in occupational superannuation. The material provided assumes that the age pension is payable from age 60 or the preservation age, whichever is later, and the person in the case study is assumed to either live on the proceeds of other, non-superannuation savings or be supported by another person's income. The case involves a person who works full-time for seven years at 90 per cent of Australian Weekly Ordinary Time Earnings (AWOTE), leaves the workforce for ten years, returns part-time for five years at 40 per cent of AWOTE before returning to work full-time for ten years at 90 per cent of AWOTE before retiring at age 50. During the accrual period of the benefit, fees are assumed to continue to apply annually at the same level as in contributory periods in years where no contributions are made. The outcomes for such a person are set out in Table 4.4<sup>8</sup> which shows that at 55 retirement, a retiree would receive marginally more than the single age pension benefit (25 per cent of AWE). Retirement at 60 or 65 would result in an income stream significantly greater than the age pension.

Table 4.4

Illustration of Impact of Broken Labour Force Participation on Retirement Benefits			
	Age 55 preservation	Age 60 preservation	Age 65 preservation
Gross retirement benefit (multiple of AWE)	2.03	2.22	2.34
Average value of net retirement income (as percentage of the value of AWE level payments)			
– Annuity payments	11%	13%	14%
– Age pension payments	18%	22%	21%
– less tax	1%	1%	1%
<b>Total</b>	<b>28%</b>	<b>34%</b>	<b>38%</b>
Percentage of full rate age pension payable over the period the person is eligible and a superannuation benefit is paid	96%	91%	89%

## Retirement Income Targets

### *Assumptions, Contributions and Outcomes*

4.13 The adequacy of Treasury's targets can be gauged by considering them in the context of factors identified by witnesses as being relevant in setting an appropriate retirement income target. These included:

- (i) that community expectations about the desirability of rising standards of living need to be considered in setting future retirement income targets;
- (ii) that a minimum standard can be inferred by referring to the level of age pension, in that it reflects an adequate level of income;
- (iii) that the income cut-off point for part pensions under the means test for the single age pension gives some guide as to what is a more reasonable standard of living. Under the means test the cut-off point for a part-pension is \$17 800 or 58 per cent of AWE.<sup>9</sup>
- (iv) that overseas comparative data can be a useful guide in setting targets but that any comparisons need to take account of the extent to which tax-driven incentives operate, and that some overseas retirement income policies also may include health, medical and unemployment and maternity benefits;
- (v) that established contributory superannuation schemes in the public sector provide an indication of contributions and benefits. A typical public sector scheme provides for a retirement income of around 50 per cent of final salary which is generated by five per cent member and 13-15 per cent employer contributions over approximately 40 years; and
- (vi) that in private sector contributory superannuation schemes a five per cent employee and an eight-ten per cent employer contribution would be 'average' for that sector.<sup>10</sup>

4.14 At no stage of the Committee's inquiry was a demand made for the Government to reduce the present level of pension benefit expressed as a percentage of AWE, that is, 25 per cent. Those witnesses representing the interests of welfare groups submitted that the current age pension is too low and needs to be increased.

4.15 In this regard, AFCO submitted that the aged pension should remain at least indexed to increases in inflation but that it should be elevated to 35 per cent of male average weekly earnings.<sup>11</sup> ACOSS contended that if the Treasury model had

<sup>9</sup> SG evidence, p 5.

<sup>10</sup> Mr Rob Paton, Australian Institute of Actuaries, Evidence, pp 8-9.

<sup>11</sup> Sub No. 139 p 4.

incorporated a pension set at 30 or 35 per cent of AWE, other than 40 per cent, it would have been a fairer analysis of the claimed benefits of the SGL.<sup>12</sup>

4.16 Referring to the criteria in points (i) – (iv) in paragraph 4.13, Treasury pointed to community standards regarding a reasonable retirement income which is suggested to be at around half pre-retirement income.<sup>13</sup> This position is consistent with an earlier submission to the inquiry by the same department which observed that a person on AWE making a contribution of 12 per cent for 40 years would receive a retirement income of 40 per cent of AWE, compared with 26 per cent of AWE under the pension system.<sup>14</sup>

4.17 The Institute of Actuaries provided the Committee with information on retirement benefits that assumed a contribution rate of 15 per cent of salary.

4.18 This reflects the Institute's beliefs that contribution targets higher than 12 per cent are desirable. The Institute submitted that a ten per cent employer and five per cent employee contribution would produce an adequate income given current tax arrangements.<sup>15</sup> Table 4.5 shows lump sum benefits from this level of contributions.

**Table 4.5**

LUMP SUMS	
Institute of Actuaries Lump Sum Projections	
Years of Contribution	After tax lump sum benefit from contribution equal to of 15 per cent of salary
25	4.1 years of salary
30	5.1 years of salary
35	6.2 years of salary
40	7.4 years of salary

Assume: real rates of return of two per cent and current tax arrangements.

Source: Submission no. 108.

4.19 Should the member purchase an annuity with the above mentioned lump sums, Table 4.6 shows the following net income streams, based on a retirement salary of \$35 000, would be generated.

4.20 The Institute's data is useful because it demonstrates the relationship between lump sum benefits and subsequent income streams following the purchase of an annuity. Also, it takes into account the fact that many employees do not experience a 40 year period in the workforce, for example, a person who spends 25 years only in the workforce

<sup>12</sup> SG evidence, p 111.

<sup>13</sup> *ibid*, p 92.

<sup>14</sup> Sub No. 195, p 15.

<sup>15</sup> SG evidence, p 7.

would receive an income stream of 31 per cent of final salary as opposed to 56 per cent should the 40 year assumption be appropriate.

Table 4.6

PENSIONS	
Institute of Actuaries Annuity Projections*	
Years of Contribution	Gross of Tax Indexed Annual Annuity resulting from Above Lump Sums
25	31% of Salary
30	39% of Salary
35	47% of Salary
40	56% of Salary

Source: Sub No. 108.

*\* Assumptions*

- (i) life-time annuity indexed to the CPI;
- (ii) male age 65 with a spouse age 62 (this is not substantially different to a female age 65 with a spouse age 68);
- (iii) 50 per cent reversion of annuity to spouse;
- (iv) no guaranteed minimum payment period; and
- (v) purchase price of \$13,200 per \$1,000 per annum of annuity (expenses have been ignored).

4.21 The Association of Superannuation Funds of Australia used the Government's projected increase in compulsory superannuation contributions as per the SGL (final projection 9 per cent employer and 3 per cent employee contribution in lieu of a wage increase) and submitted that the benefits shown in Table 4.7 would accrue to members.

4.22 ASFA considered that whilst a target of 12 per cent should be pursued via compulsory funding, additional contributions are 'desirable' and should be encouraged with tax concessions.<sup>16</sup>

4.23 This was a theme taken up by a number of witnesses who argued that a retirement income which approximates 70-80 per cent of pre-retirement earnings would be sufficient to maintain a standard of living consistent with that experienced when a retiree was a member of the workforce. The AMP<sup>17</sup> and Mercer Campbell Cook & Knight (Mercers)<sup>18</sup> and a number of other witnesses submitted that this level of retirement income would be a suitable target.<sup>19</sup>

<sup>16</sup> Sub no. 89, p 130.

<sup>17</sup> Sub no. 120, p 54.

<sup>18</sup> SG sub no. 9.

<sup>19</sup> Evidence, p 43.



Table 4.7

ASFA Lump Sum and Pension Benefits Table*		
Age (as at 1991)	Benefit at 65 (before benefits tax)	
	Lump Sum (multiple of final salary)	Pension – per cent of final salary
Assuming a real rate of investment return of 4 per cent:		
25	9.03	60.2 per cent
35	5.44	36.3 per cent
45	2.94	19.6 per cent
55	1.21	8.4 per cent
Assuming a real rate of investment return of 2 per cent:		
25	5.91	39.4 per cent
35	4.00	26.7 per cent
45	2.42	16.1 per cent
55	1.10	7.3 per cent

Source: Submission no. 89, p 28.

*\*Assumptions*

- (i) Employer contributions 9% of salary;
- (ii) Member contributions 3% of salary;
- (iii) Tax on employer contributions 15%;
- (iv) Expenses and insurances 10% of contributions;
- (v) Pension annually CPI indexed 85% pension reversion to spouse upon retiree's death
- (vi) Commutation factor is 15 – i.e. if a lump sum benefit were convertible to a pension/annuity, the first annual payment would be equal to one fifteenth of that lump sum.

## Overseas Practices

4.24 A number of witnesses referred to overseas practices in setting compulsory levels of contributions for both employees and employers. The Committee, in its research prior to the public hearings, compiled a survey on *Retirement Incomes Arrangements in Twenty-One Countries - Super System Survey* which showed that in 20 of those countries compulsion for either the employer or employee was a feature in providing retirement benefits. In only three of the countries was it not compulsory for the employer to contribute. There were only two countries which did not compel an employee contribution. Table 4.8 shows the levels of compulsory contributions and the retirement income benefits which are generated through a combination of social security and private provisions.

4.25 It should be noted that this information is summary data only and that the particular provisions of each system should be examined before making comparisons. For example, one of the prime considerations is the extent to which tax concessions are used to drive any system which compels or encourages superannuation and what is the opportunity cost of providing such incentives *vis a vis* the long term savings that are made

against pension outlays. Also, a number of the countries in the survey operate an integrated social insurance system which includes retirement income, health, aged care and maternity provisions.

Table 4.8

Retirement Incomes System in Twenty-One Countries Contributions & Benefits			
	Data from <i>Super System Survey</i> Compulsory Contributions for Retirement		Retirement Income Stream
Austria	Employer	12.55%	40-73% of actual final earnings
	Employee	10.25%	
Belgium	Employer	8.86%	60% of career average earnings for single person
	Employee	7.50%	
Chile	Employer	Nil	Government guarantees minimum pension
	Employee	20.6%	
Denmark	Employer	A\$314	Minimum social security pension
	Employee	A\$157	
Finland	Employer	19.3%	Up to maximum of 60% of earnings
	Employee	1.55%	
	(includes social security (sickness, medical etc) cover as well)		
France	Employer	8.20% min	40-75% of career earnings
	Employee	7.60% min	
Germany	Employer	9.35%	40-45% of final earnings
	Employee	9.35%	
Greece	Employer	10.5%	30-70% of final earnings
	Employee	5.25%	
Ireland	Employer	11.3%	Flat social security benefit
	Employee	Nil	
Italy	Employer	14.80% to 30.43%	80% of final career earnings
	Employee	6.1% to 10.79%	
Japan	Employer	7.25%	Flat social security benefit plus an earnings related benefit
	Employee	7.25%	
Luxembourg	Employer	8%	60-70% of final pay
	Employee	8%	
Netherlands	Employer	Nil	60% of national average earnings
	Employee	16.95% (subject to ceiling)	
New Zealand	Employer	Nil	Flat rate pension
	Employee	Nil	

Portugal	Employer	24.5%	50-60% of final year salary
	Employee	11.0%	
Singapore	Employer	17.5%	Privately funded end benefits a function of contributions
	Employee	22.5%	
Spain	Employer	24.0%	76-85% of final earnings
	Employee	21.8% (including sickness, medical and family allowances etc)	
Sweden	Employer	20.45-8% (including mandatory private plan)	66% of final pay
Switzerland	Employer	4.8% plus (mandatory supplement 7- 18% depending on age and sex)	60% of final salary
	Employee	4.80%	
United Kingdom	Employer	10.45% (average)	20% of revalued earnings with effect from 2000
	Employee	2%-9% depending on level of earnings	
USA	Employer	6.2%	25-60% of assessable earnings
	Employee	6.2%	

### Compulsory or Voluntary Superannuation

4.26 In discussing retirement income targets and time tables with a range of witnesses representing the various superannuation interest groups, the Committee endeavoured to gain an enhanced understanding of the principles which underpin both voluntary and compulsory retirement incomes policies. A number of witnesses signalled their support for the general principle of a compulsory national pensions scheme but were not prepared to support the SGL because they disagreed with its particular provisions. Two of the supporters of compulsion, Professors Knox and Piggott, outlined in greater detail the reasons for compulsion. Professor Piggott cited overseas experience and reservations about the effectiveness of using tax concessions to promote voluntary savings as his reasons for compulsion. He went on to say:

The biggest lesson to be drawn from international experience is that unfunded schemes – such as those operating in the US or the UK – can have alarming implications for fiscal burden and therefore national saving, in the face of an ageing population.<sup>20</sup>

4.27 On being asked whether he saw any potential problems arising from paying pensions in the future if compulsory funding were not pursued, Professor Knox remarked:

I think, given the ageing population, the demographic situation if you like, then my answer is yes. We could argue that we do not need to do anything because we are going to have enormous increases in productivity and we are going to be able to fund the age

<sup>20</sup> SG evidence, p 167.

pension in the year 2020. I do not buy that argument. I think if you do have significant productivity and it all goes to the age pension, then the workers are going to get a bit uptight about it. So I believe we do need to do something compulsory.<sup>21</sup>

4.28 He went on to add that:

we need a compulsory core and an optional extra ... we need individuals to have the option, with some tax support.<sup>22</sup>

4.29 He suggested that a core contribution for employers should be between seven and 12 per cent but added that employee contributions would need to be encouraged by tax concessions.<sup>23</sup>

4.30 The BCA informed the Committee that '... there is an emerging sort of consensus across the industry and employer groups that some form of compulsory payment is necessary.'<sup>24</sup>

4.31 The MTIA in its original submission also supported the general principle of compulsion submitting that: '... government, employers, employees and self employed would all contribute to the retirement income package'.<sup>25</sup> However, it stressed that such a policy including the planned contribution levels would need to be:

... compatible with economic capacity, form part of approved aggregate labour cost increases and not detract from industry competitiveness. This would include the need to ensure that resultant savings in government outlays were reflected in reduced taxes and charges to Australian industry.<sup>26</sup>

4.32 The Woman's Action Alliance (Australia) upheld the general principles of the existing tax-driven occupational superannuation retirement incomes system and argued that tax incentives should be more finely tuned to encourage spouses who are not in the paid workforce to receive superannuation coverage through payments made by the spouse in paid employment.<sup>27</sup>

4.33 The Hon I B Wilson, MP also supported a voluntary approach to superannuation coverage in recommending a choice between either retirement savings tax rebates or a pension at age 65 or a combination of these rebates and pension.<sup>28</sup>

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<sup>21</sup> *ibid.*

<sup>22</sup> *ibid.*

<sup>23</sup> *ibid.*

<sup>24</sup> SG evidence, p 183.

<sup>25</sup> Sub no. 55, p 6.

<sup>26</sup> *ibid.*

<sup>27</sup> Sub no. 64, p 6.

<sup>28</sup> Sub no. 71, p 1.

4.34 Another facet of the compulsory/voluntary debate is the matter of the incidence of contributions. Most witnesses discussed compulsion from a holistic viewpoint and did not venture into the matter of apportioning employee/employer contributions. The following witnesses who advocated compulsion submitted that there be an apportioning of employee/employer contributions:

Mr O'Sullivan, Noble Lowndes	Minimum of ten per cent including member contributions <sup>29</sup>
Mercer Campbell Cook & Knight	Maximum employer and employee compulsory contribution of five per cent <sup>30</sup>
Mr Davis, Australian Small Business Association (NSW Branch)	Mandatory employer and employee contributions totalling at least ten percent.
Mr Mansfield	Compulsory employer contribution of five per cent and employee contribution of between five and ten per cent <sup>31</sup>

4.35 The Committee observes that most of the witnesses advocating a compulsory system of retirement incomes suggested contributions of nine to 12 per cent of income which for persons on AWE would mean a retirement income of between 40 and 50 per cent of final salary. The Committee further observed strong support for a compulsory system of contribution for retirement incomes but notes that a significant number of witnesses, whilst supporting compulsion, did not believe that the SGL was the appropriate means of achieving this objective at this particular point in time.

<sup>29</sup> Evidence, p 209-10.

<sup>30</sup> *ibid*, pp 39-41.

<sup>31</sup> *ibid* p 1327.