

## INSIGHTS BLOG

**The lead up to last night's federal Budget carried industry expectations of a government delivering a far-sighted pension policy barricade against the turbulence of short-termism. However, hopes for a comprehensive package to stabilise Australia's pension system were not met.**

**What we got instead was a small step in the right direction.**

**Michael Rice was in Canberra, and filed this blog.**

### Budget 2015 does little to quell age pension uncertainty

#### Addressing the Deficit

Last year's 2014/15 Federal Budget, the first by Treasurer Hockey, attempted to curb Australia's ballooning deficit. However, many of the changes were unpopular and were prevented by a hostile Senate. Consequently, the deficit continues to grow.

One item under attack was the Age Pension. This is an expensive welfare benefit, worth more than \$800,000 to a 65 year old couple who draw a full pension throughout their lives. The costs are growing as more of the baby boomers retire.

The significant change set out in last year's Budget was a change in the indexation on the Age Pension. Currently, this benefit is linked to wages which allows pensioners to share in the growth of the economy. The proposal was to change indexation to prices which grow at a lower rate than wages over time. That would only have saved \$449 million over five years, but much more in later years.

A change to CPI indexing would lead to a significant reduction in value for the Age Pension. This may not be a big issue for those already retired, as their income will tend to keep up with their expenditure. But it will have a significant effect on new retirees in the future who will be faced with a pension significantly lower than their earnings prior to retirement. Indexation also hurts poorer pensioners more as they have few other assets.

The Senate blocked this proposed indexation change so Scott Morrison, the Minister for Social Services, last week announced changes to the tapering of assets on the means test. This change, saving \$2.4 billion over four years, has curbed growth in Age Pension payments which remain at \$41 billion growing to \$50 billion over four years.

The changes will reduce Age Pensions for about 235,000 retirees and a further 91,000 will no longer qualify for any pension. Conversely, about 170,000 poorer pensioners will receive an increase averaging \$30 a week and a further 50,000 part pensioners will move to a full pension.

In order to minimise an adverse electoral outcome from the 326,000 retirees losing income, the changes have been deferred until January 2017, a few months after the next election. Further, the 91,000 who lose a benefit will keep their subsidised Health Cards which introduces another area of inequity!

## Part Pensioners

As members build larger superannuation accounts, they retire with higher benefits and more will become subject to the means tests. For those aged 65 to 75, the active period of retirement, the number of part pensioners has grown from 28.6% to 30.2% over the seven years since the generous Costello changes to superannuation.

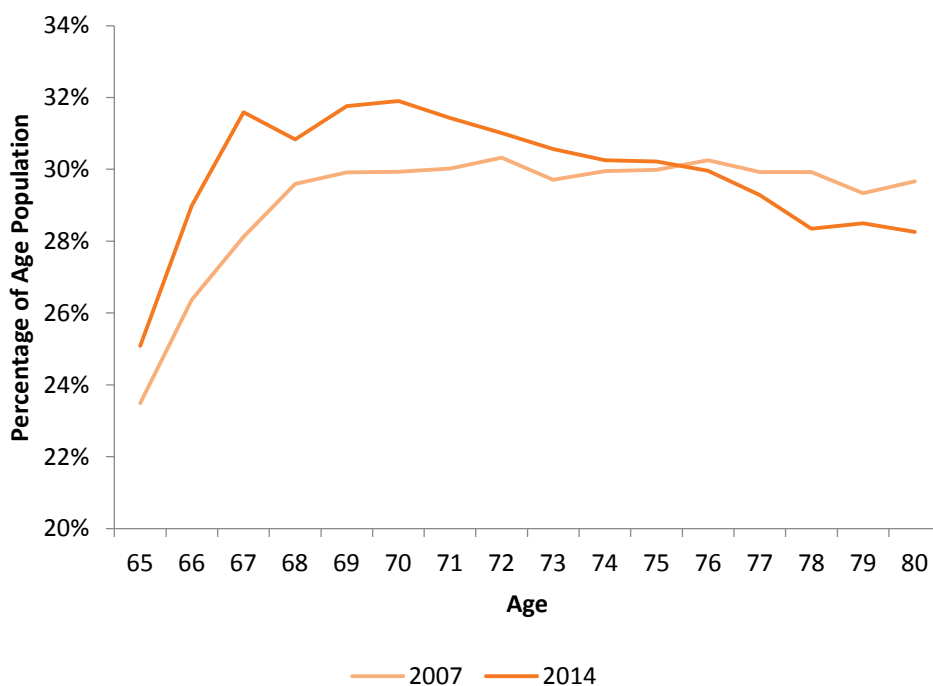
Some of this change comes from people now receiving part pensions rather than full pensions due to higher super balances of recent retirees. The change in the composition of pensions since the Costello tax changes is shown in table 1.

Table 1. Age Pensioners 2007 vs. 2014

Age Bands	2007			2014		
	Full Pension	Part Pension	No Pension	Full Pension	Part Pension	No Pension
60-64	6.4%	4.8%	88.8%	0.9%	0.5%	98.7%
65-69	35.8%	27.4%	36.8%	30.3%	29.6%	40.1%
70-74	45.1%	30.0%	24.9%	42.7%	31.1%	26.2%
75-79	50.1%	29.9%	20.0%	52.2%	29.3%	18.5%
<b>Total</b>	<b>30.4%</b>	<b>20.7%</b>	<b>48.9%</b>	<b>27.0%</b>	<b>20.4%</b>	<b>52.7%</b>

The graph below shows the growth in part pensioners, which will lead to a growing cohort of disillusioned retirees in time.

Graph 1. Population receiving part pensions 2007 vs 2014



## Impact of change

This change is progressive as we need to encourage self-sufficiency in retirement. It only appears to be unfair compared to the previous regime which was too generous. However, the timing is poor. We know that there are areas of inequity in superannuation but the government will not address these in this term. So, these pensioners are the only people in the retirement system being asked to make a sacrifice at this time.

They do so when the rates on term deposits have more than halved in the last four years. A single retiree with assets of \$547,000 could now move from a part pension of \$10,000 to nothing. If they earned 5% on their term deposit last year and 3% now, their total income will have fallen from \$37,350 to \$16,410. This will force them to use the capital on their pension account – so, eventually they will get a part pension again. However, the sudden shock on income will be difficult to stomach.

## Radical change

We have a major problem with our unique means-tested Age Pension.

Three years ago, Rice Warner proposed a solution which included abolition of the part Age Pension. We believe retirees should spend their own money first and then receive a full Age Pension. We would allow an exempt amount of assets (say \$400,000 for a couple) and would also count the value of the family home above a threshold (say, \$1.5 million today).

People would then apply for a pension when they had insufficient funds to be self-reliant. Of course, this approach would show that the Age Pension is welfare and not an entitlement – and that may not be the view of the broader population.