Australian
Council of
**Social Service**

ACOSS Submission | September 2008

# Submission to the Minister for Families, Housing, Community Services and Indigenous Affairs

## Pension review

**ACOSS, September 2008**

Locked Bag 4777

Strawberry Hills, NSW, 2012 Australia

Ph 02 9310 4844 Fax 02 9310 4822

Email: info@acoss.org.au

Website: www.acoss.org.au

## *Contents*

## *Overview*

ACOSS appreciates the opportunity to make a submission to the Pension Review.

In this submission we recommend that a financial relief package be implemented as soon as possible after the 2009 Federal Budget for those social security recipients (including pensioners and those on other payments) who have been most affected by recent increases in the costs of basic essentials. We suggest that this contain three elements: increases in Rent Assistance, increases in and extension of eligibility for Utility Allowance, and increases in Pharmaceutical Allowance.

We propose that any wider policy changes, including adjustments to base rates of payment, be implemented as part of the broader Henry Review of the tax-transfer system and propose a policy framework for these wider reforms. This has three dimensions: reform of the social security payment structure based on an Australian Minimum Standard of Living, reform of the system of public support for retirement incomes (including payments and tax concessions), and reform of concessions.

The Henry Review, rather than the Pension Review, should recommend any specific changes to base rates of social security payments because the Henry Review has the scope to consider these broader issues. It also has the scope to take account of the circumstances of all 5 million social security recipients including 2 million Age Pensioners, 710,000 Disability Support pensioners, 540,000 Parenting Payment recipients, 420,000 Newstart Allowance recipients, 330,000 Youth Allowance recipients, 210,000 Veterans Pensioners, and 120,000 Carer Payment recipients.

### Social security payments are inadequate

Our first key message is that social security payments are inadequate to meet basic living costs:

- The maximum single rate of pension, together with cash supplements, is just $298 per week.

- The maximum level of Newstart Allowance is just $219 per week.

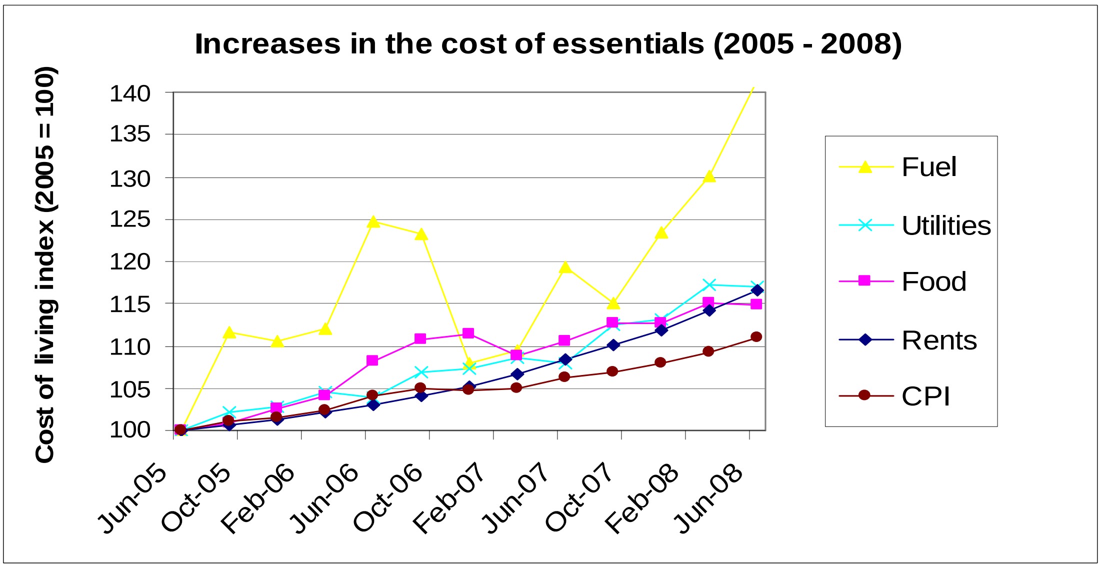
- A sole parent with two school age children has to get by on $475 per week.

- The maximum level of Rent Assistance for a single low income tenants is $54 per week ($63 for families with one or two children), which is a small fraction of the escalating rent levels across most parts of Australia.

These payments are all below, or close to, poverty lines commonly used to measure whether people can afford the essentials of life. Recent research commissioned by ACOSS found that 41% of people who mainly rely on social security for their income lived below a standard poverty line set at half median family income.[1]

People reliant on social security have struggled with sharp increases in the costs of essential items over the last two years. For example, since June 2005, the average price of food has risen by 15%, rents have risen by over 17%, household energy bills have risen by 17% and fuel has risen by 41% (see graph 1 below).

**Graph 1**




Source: ABS Consumer Price Index

Many social security payments are regularly indexed in line with movements in the Consumer Price Index, which has increased by 11% over this period, well below rises in the cost of essentials. Given the low level of all social security payments, most recipients lack a financial buffer of income or savings to cope with large increases in prices.

We therefore recommend that action be taken in the next Federal Budget to increase cash income support for those social security recipients who are likely to be most affected by these price hikes. They include:

- private tenants;
- people with chronic health conditions with regular medical and Pharmaceutical costs; and
- income support recipients generally facing higher utility bills, which are likely to increase further as a result of carbon pollution abatement measures.

[1] Social Policy Research Centre 2007, *Poverty in Australia*.

## Changes to pensions should be part of a wider reform of social security payments, superannuation, and tax concessions

Pensions are part of a wider system of social security payments for people of working age, and tax and income supports for retired people. Therefore, our second key message is that it is vital that the review strikes the right balance between:

- improvements in pensions and other social security payments;
- support for retired people through the social security, tax and superannuation systems; and
- adequacy and incentives to work and save.

Any changes to base pension levels should form part of a wider reform of the social security system that removes anomalies and inconsistencies between payments (see table below). Many social security recipients struggle on incomes well below the pension. For example, a single adult on Newstart Allowance receives $79 per week less in allowances and supplements than a single pensioner, and sole parents on income support do not receive the $500 Utilities Allowance. A Newstart Allowance recipient must cover escalating rents and other basic living expenses and search for work on a weekly income of $219 plus Rent Assistance.

Over the last decade, the gap between pension and allowance payments widened as pensions, but not allowance payments, were increased. The average annual increase in allowance payments was 0.1% in real terms (comprising compensation for the introduction of the GST in 2000) while the average real annual increase in pension rates was 2.1% for singles and 2.2% for couples.[2]

[2] FaHCSIA 2008, *Pension Review background paper*.

**Table 1: Anomalies in levels of payment and supplements**

| **Payments** | Eligible groups | Maximum rates including supplements (single)[3] ($pw) | Maximum rates including supplements (couple)[4] ($pw) | Ratio of single: couple base rates (%)[5] | Supplements and concessions |
|---|---|---|---|---|---|
| **Pensions** | Retirees, people with disabilities, carers, sole parents | $298 | $481 | 60% | Pensioner Concession Card, Senior's Bonus (if over 65), Utility Allowance (not for sole parents), Pharmaceutical Allowance, Telephone Allowance, Carer Allowance, Mobility Allowance |
| **Newstart Allowance** | Unemployed people, including many people with disabilities, carers and sole parents | $219 | $394 | 56% | Health Care Card, Pharmaceutical Allowance (in some cases), Carer Allowance, Mobility Allowance |
| **Austudy Payment/ Youth Allowance** | Students 18-65 yrs, living independently, unemployed young people | $178 | $355 | 50% | Health Care Card, Carer Allowance, Mobility Allowance |

One of the historical reasons for paying unemployed people less than pensioners was that most unemployed people only needed income support for a short time. However, since overall unemployment levels have fallen the profile of those still out of work has become more disadvantaged. For example over 60% of Newstart Allowance recipients have lacked substantial employment for over a year and over 60% of this group has a Year 10 education or less. Further, as a result of the Welfare to Work policy changes introduced in 2006 many sole parents and people with disabilities now receive Newstart Allowance rather than a pension. As well as creating hardship, the gap between pensions and allowance payments discourages work. For example, many Disability Support Pensioners are discouraged from seeking employment because they then risk being transferred from the pension to lower allowance payments.[6]

The Review should also strike the right balance between support provided to retirees through the pensions, tax and superannuation systems. Together, these income supports will become more costly as the population ages. There are currently five people of working age for every mature age person, but in 40 years time this will fall to two for every mature

[3] Including widely available supplements – Utility Allowance, Senior's Bonus, Pharmaceutical Allowance, Telephone Allowance but not Rent Assistance, Mobility Allowance or Carer Allowance.
[4] Including widely available supplements as above.
[5] Does not include supplements.
[6] ACOSS 2006, *Welfare to work policy, effects and solutions*; We welcome recent initiatives to defer pension reviews when DSP recipients obtain work or apply for employment assistance. However, deferral of reviews does not fully address the lack of income security for people with disabilities who transition from the pension system to allowance payments.

age person. The latest official estimates suggest that in the absence of policy changes, by 2046 Budget expenditure will rise by 4.8% and the Federal Budget will be in deficit by 3.5% of GDP due to higher health, aged care and social security spending mainly caused by population ageing.[7]

Australia's expenditure on pensions is modest by OECD standards and most of the projected increase in costs is in health expenses rather than social security. Nevertheless, it will be difficult for future Governments to sustain improvements in Age Pensions unless more retirees pay income tax. Currently, only one in five do so. The effective tax free threshold for a mature age couple is almost $50,000 compared with approximately $30,000 to $35,000 for a typical dual income couple of working age (taking account of tax offsets such as the Low Income Tax Offset and Senior Australians Tax Offset). Tax concessions for superannuation cost $25 billion in 2006-07, more than the cost of Age Pensions ($23 billion) and superannuation benefits paid after age 60 are generally tax free. Retired people are also eligible for a raft of special tax concessions such as the Senior Australians Tax Offset.[8]

Finally, the Review should strike the right balance between adequacy and incentives to work and save. Although pensions are close to the poverty line, they extend to more than three quarters of retired people. This means that in the absence of changes to income and assets tests, any substantial increase in maximum rates of payment will be costly. The cost of such increases will also rise as the population ages.

As a result of substantial easing of income and assets test in recent years, a retired couple can receive up to $66,000 in annual income and $857,000 in assets (other than their home) and still be eligible for a part pension and the related pensioner concessions. If the pension was the only form of public income support available to retired people this might be considered fair and sustainable. However as referred to above, retirees with substantial income and assets are also eligible for tax concessions that are not available to people of working age, and superannuation payments for those over 60 years of age are no longer taxed.

Age pensioners now fall into two groups - a majority who live at or close to poverty levels and a growing minority who, though not wealthy have enough income and assets to live comfortably if they own their home outright and have no dependents:

- Although most Age Pensioners have assets worth less than $300,000 (and less than $50,000 in assets apart from their homes) the top 20% of pensioners have total assets worth over $500,000.

- Although 42% of Age Pensioners have private incomes below $20 per week, 25% have private income of $100 to $1,300 per week in addition to the pension.[9]

Over the past decade, the gap in the disposable incomes between these two groups has widened as a result of increases in tax concessions and direct payments for retirees with significant private income. The average real increase in disposable incomes for a pensioner couple on half average earnings was 2.7% compared with 2.1% for a pensioner couple with

---

[7] Treasurer 2007, *Intergenerational Report*.
[8] Estimates for proportion paying tax are for 2005-06, see Australian Taxation Office, *Taxation Statistics* 05-06; Treasury 2008, *Architecture of Australia's tax and transfer system*.
[9] FaHCSIA 2008, *Pension Review background paper*.

no private income.[10]

If pensions are increased to assist those with limited private income and assets, then under the present system the benefits would flow to couples with private incomes up to $66,000. The recent easing of income and assets tests was argued on the grounds of improving incentives to work and save. However, it also makes increases in maximum levels of pensions more costly. If payments are increased, a better balance would need to be struck between improving income adequacy for those with the lowest incomes and maintaining incentives to work and save, taking account of the tax concessions available to higher-income retirees.

Decisions made within the next few years on levels of social security payments will have a lasting impact on the living standards of people on low fixed incomes for years to come. In order to properly take into account the links between pensions and other payments and between age pensions and other forms of government support for retirement, we recommend that decisions regarding base rates of payment or other structural changes to the social security system should be made by the Henry Review into taxes and transfers. The Henry Review has both the time and the scope to consider these issues comprehensively since its terms of reference include the entire social security system, as well as income tax and superannuation. It is due to report by December 2009.

## Reform principles

Fundamental reform of pensions and other social security payments should proceed from first principles, rather than a 'quick fix'. We outline below 10 principles that we believe should guide the work of the Henry Review as it examines options for reform of the social security system as a whole:

1. Maximum levels of income support should at least be sufficient to prevent poverty (that is, an inability to obtain the necessities of life according to standards commonly accepted in the community) for each household type (for example singles, couples, and families).

2. Rates of payment should therefore reflect the relative needs of different types of households, with priority for any increases going to the most disadvantaged.

3. Benchmarks for the adequacy of payments should be developed using independent research on absolute and relative living standards. The Government should consult widely over their development.

4. Payments should be indexed to take account of both average changes in living costs and movements in broader community living standards.

5. The income support system should be as simple and understandable as possible.

6. Incentives to work and invest should be maintained.

[10] FaHCSIA 2008, ibid.

7. Payment reforms should consider the income support system as a whole, including the relationship between payments for retirees and people of working age, and those between pension and allowance payments.

8. Reforms to retirement payments should take account of the broader package of supports including the superannuation system and tax concessions, as well as the adequacy, fairness and sustainability of retirement income supports as the population ages.

9. Payment reforms should also take account of the wider system of subsidies and concessions for specific expenses such as public utilities.

10. The proposed reforms should provide a strong and fair foundation for timely and adequate compensation for low income households for the effects of climate change abatement policies.

## Recommendations

Our first two recommendations comprise a financial relief package for implementation following the 2009 Federal Budget. ACOSS is also developing detailed options for broader social security and tax reform to submit to the Henry review as it progresses. Recommendations 3 to 5 below offer a framework for these reforms.

### Financial relief package

R1. A financial relief package should be included in the 2009 Federal Budget to assist social security recipients cope with rising cost of essential items.

Increases in the following supplements should be implemented from 1 July 2009, and eligibility for the Utilities Allowance should extend to recipients of income support payments that do not presently attract eligibility for this supplement:

- The maximum rates of Rent Assistance - increase by 30%

  Cost: approx $500 million in 2009-10

  Note: This would benefit approximately 290,000 low income families, 100,000 Age Pensioners, 60,000 Disability Support Pensioners, 60,000 Newstart Allowance recipients, 30,000 Youth Allowance recipients, 6,000 Veteran's Pensioners, and 7,000 Carer Payment recipients, with an average gain of $15 per week.

- Utilities Allowance – increase by 30% or $150 per year and extend the Allowance to Parenting Payment, Newstart Allowance and other social security recipients who currently miss out.

Cost: approx $1,200 million in 2009-10

Note: This would benefit approximately 2,090,000 Age Pensioners, 690,000 Disability Support Pensioners, 490,000 Parenting Payment recipients, 390,000 Newstart Allowance recipients, 180,000 Veterans pensioners, 15,000 Youth Allowance recipients and 160,000 Carer Payment recipients; with an average gain of $3 per week for those already getting Utilities Allowance and $13 per week for those not currently eligible.

- Pharmaceutical Allowance – increase by 100% or $2.90 per week.

Cost: approx $500 million in 2009-10

Note: This would benefit approximately 2,080,000 Age Pensioners, 690,000 Disability Support Pensioners, 360,000 Parenting Payment recipients, 180,000 Veterans pensioners, 70,000 Youth Allowance recipients and 160,000 Carer Payment recipients, and a significant number of Newstart Allowance recipients, with an average gain of $3 per week.

R2. From January 2010, income support recipients should be given a choice to receive supplements including Utilities Allowance, Pharmaceutical Allowance and Telephone Allowance as add-ons to their fortnightly payments or as regular lump sum payments.

Cost: administrative expense only

Table 2 below shows the typical weekly increases in social security payments that different groups of recipients would receive under the financial relief package. The vast majority of Australia's 5 million social security recipients would benefit from this package.

**Table 2: Financial relief package – typical increases in payments for different groups**

| | Age, Veterans, Disability & Carer Pensioners ($pw) | Parenting Payment Single recipients ($pw) | Newstart, Youth Allowance and other payments ($pw) |
|---|---|---|---|
| Rent Assistance (for private tenants with rents over $50pw only) | $0-$15 | $0-$15 | $0-$15 |
| Utilities Allowance | $3[11] | $13 | $13 |
| Pharmaceutical Allowance | $3 | $3 | $0 - $3[12] |
| Total | $6-$21 (depending whether they rent privately) | $16-$31 (depending whether they rent privately) | $13-$31 (depending whether they rent privately and receive Pharmaceutical Allowance) |

## Framework for fundamental reform of social security and income tax

R3. The Henry review should develop detailed options and costings for fundamental reform of the social security payment structure for adults based on:

- an Australian Minimum Standard of Living - minimum income levels required by a single adult or a couple to avoid poverty
- supplements for rent, the extra costs of disability and caring, sole parenthood, and the costs of workforce participation or training
- for recipients of working age payments, a common platform of eligibility and

[11] The increase in Utility Allowance is lower for these recipients ($3pw) because they are already entitled to $500 per year ($10pw) in lump sum Utility Allowance payments. Most of the $13pw increase for the other groups is to extend this existing payment to them because they currently miss out altogether.

[12] These recipients are only entitled to Pharmaceutical Allowance if they have chronic illness, have only a partial capacity to work, or are the sole principal carer of a child under 16 years.

entitlements (including residence requirements, assets tests, and access to supplements), apart from activity requirements (if any) which would continue to vary between categories of payment.

R4. Consistent with Recommendation 3 above, the Henry review should develop detailed options and costings for fundamental reform of the system of retirement income supports including pensions, tax concessions and superannuation in order to:

- reduce financial hardship and future inequality of retirement incomes
- more efficiently encourage and support saving for retirement
- encourage workforce participation
- ensure that these supports are sustainable as the population ages
- encourage retirees to draw down their superannuation savings to improve their living standards and reduce their need to rely on pensions, rather than for estate planning purposes
- simplify these systems and their interaction – for example by treating income and assets more consistently across the pensions and tax systems.

R5. The Henry Review should develop detailed options and costings for reform of concessions, including consideration of the following options:

- establish national minimum standards for Commonwealth and State and Territory concessions based on a percentage of costs incurred up to a ceiling
- extend Commonwealth responsibility for concessions linked to markets supervised by the Commonwealth (for example energy)
- offer income support recipients the option of cashing out their concessions
- consider how concessions can be better targeted to those who need financial support.

## 1. The effects of recent increases in the cost of essentials

Over the last three years, the cost of key essential goods and services has risen sharply, putting pressure on the living standards of social security recipients. Although payments are generally indexed to either the CPI or average earnings, the cost of some essentials has increased at a faster rate. This has particularly affected those recipients with little or no savings whose spending is concentrated on essential items – that is, the poorest social security recipients.

### Rents

Rents have risen by over 17% since June 2005, and are likely to continue to increase faster than the CPI. These rent increases are caused by a decline in investment in rental housing in recent years and as a consequence a sharp reduction in vacancy rates in many parts of the country, especially in larger capital cities and rural areas affected by the mining boom. It is common for applicants for rental properties in these places to be asked to bid for properties against dozens of other applicants.

Around a third of social security recipients rent privately including:

- 18% of single Age Pensioners and 8% of couples[13]
- 47% of single Disability Support Pensioners and 21% of couples
- 39% of single Carer Payment recipients and 21% of couples
- 60% of single Newstart Allowance recipients and 44% of couples
- 56% of single Parenting Payment (single) recipients and 44% of couples
- 92% of single Youth Allowance recipients and 72% of couples.[14]

Most private tenants in the social security system receive Rent Assistance, which is generally paid to those with the highest rents. Among Rent Assistance recipients, almost one third (31%) paid more than 30% of their income in rent in 2006, a standard definition of housing stress.[15] That proportion is likely to be higher today given recent rent increases.

Research suggests that although the overall level of financial stress is relatively low among mature age people, housing stress (high housing costs relative to income) has a greater impact on overall financial stress among this group. This indicates that among mature age people, the minority who rent privately are particularly vulnerable to financial stress. The majority of mature age private tenants live on their own.[16]

Sole parent families have both high levels of overall financial stress and high levels of housing stress. Around half of sole parent families rent privately and they lack the

[13] Single women, people in non metropolitan areas, and those on the lowest incomes are over-represented among mature age private tenants. See Jones et al 2007, *Rental housing for lower income older Australians*, AHURI.
[14] FaHCSIA 2008, op cit.
[15] AIHW 2007, *Australia's welfare*.
[16] Yates 2007, *Housing affordability and financial stress*, AHURI.

economies of scale enjoyed by couples in regard to housing costs.[17]

The maximum level of Rent Assistance is set at well below typical market rents. For example the maximum level for a single adult is $54 per week and for a family with two children it is $63. Rent Assistance is indexed to the CPI but rents have grown much faster in recent years.

A substantial increase in the maximum rates of Rent Assistance, along with greater investment in social housing and the introduction of the National Rental Affordability Scheme to encourage private investment in low cost housing, would help ease the hardship experienced by private tenants on social security payments.[18]

## Health related costs

People with disabilities and chronic illness, including many Age Pensioners, have been adversely affected by the steady shift of costs for primary health care and related services from Governments towards patients. Out of pocket payments by individuals accounted for $16.5 billion or 20% of health care funding from all sources in 2004-05, compared to $6.7 billion or 13% (current prices) in 1994-05.[19]

In 2004–05, of the estimated $16.9 billion in out-of-pocket recurrent expenditure by individuals on health goods and services:

- 27.8% was spent on medications
- 21.0% was spent on medications not listed on the Pharmaceutical Benefits Scheme (PBS)
- 6.8% was spent on PBS patient contributions
- 20.1% was spent on dental services
- 17.8% was spent on aids and appliances
- 9.6% was spent on medical services.[20]

Patient co-payments are lower for pensioners than for other low income people because they are entitled to the Pensioner Concession Card. However, pensioners and other low income earners with disabilities and chronic illnesses still have difficulty meeting the cost of health care for the following reasons:

- Many medications have been de-listed from the PBS in recent years in order to achieve budget savings.
- PBS co-payments for concession card holders jumped from $3.80 to $4.60 (an increase of over 20%) on 1 January 2005. The impact of this increase on the use of

[17] Yates 2007, ibid.
[18] National Housing Affordability Summit 2004, *A call for action*.
[19] AIHW 2005, *Health Expenditure Australia 2004-5*, Canberra, 2006, p31, p38
[20] AIHW 2005, ibid, p41

medicines by low income groups, including older people who are the heaviest users of medicines, has not been investigated.

- While the current PBS co-payment for concession card holders may appear modest, this is a significant proportion of their low weekly incomes, especially for those who regularly need more than one medication.

- Despite incentives for GPs to bulk bill concession card holders, there is no guarantee that GPs will bulk bill these patients.

- The Medicare Safety Net annual threshold for concessional patients cuts in at $519.50 and the PBS Safety Net threshold at $274.40, meaning that pensioners potentially face annual out of pocket costs of at least $794 before they are entitled to further relief. This represents 6% of total annual income for a single pensioner.

- There are no concessions for low income people to reduce the very high out of pocket costs for private dental care, which can amount to $300 a year for a course of basic preventative treatment (for example oral exam, x-rays, scale and clean and fluoride treatment). Pension Card holders are eligible for public dental care through State public dental services, but there is a waiting list of over 500,000 people for general dental care nationally and an average waiting time of 27 months or up to ten years for less urgent services such as dentures.[21]

The only regular cash entitlement that assists social security recipients with these health related costs is Pharmaceutical Allowance. This is worth $2.90 per week for a single person and is paid fortnightly along with pensions and some other social security payments. However, Pharmaceutical Allowance only covers about half the maximum annual payments a recipient must make before their costs are capped under the PBS Safety Net.

## Household energy costs

Household energy bills have increased by an average of 17% over the past three years. These increases have fallen particularly heavily on low income households. Household energy bills are likely to rise further once the proposed Carbon Pollution Trading Scheme is introduced. Among households in the lowest income group (the bottom 20%) the proportion of expenditure on domestic fuel and power is, at nearly 5%, almost double that of households with the highest level of income. In 2003-04, 38% of low income households could not pay electricity, gas or telephone bills on time and 9% were unable to heat their home.[22]

In response to these concerns, this year the Government increased the Utilities Allowances for retired pensioners to $500 per year and extended it to recipients of Disability Support Pension and Carer Payment. However, sole parents on Parenting Payment still miss out on this payment despite their pension status, and recipients of Newstart and Youth Allowances also do not receive it. Unless this is resolved, this means that the Utility Allowance cannot be used as a compensation mechanism the proposed Carbon Pollution Trading Scheme. Moreover, household power bills continue to rise. For example, it is likely that the price of

[21] ACOSS, *Fair Dental Care for Low Income Earners*, Info Paper 389, p13, p21
[22] ABS 2007, *Australian Social Trends*, Canberra; ABS 2006, ABS *Household Expenditure Survey*.

natural gas for domestic heating will soon rise substantially in response to international market conditions.

## Recommendations

R1. A financial relief package should be announced in the 2009 Federal Budget to assist social security recipients to cope with rising cost of essential items.

Increases in the following supplements should be implemented from 1 July 2009, and eligibility for the Utilities Allowance should extend to recipients of income support payments that do not presently attract eligibility for this supplement:

- The maximum rates of Rent Assistance - increase by 30% for all payments attracting Rent Assistance.

  Cost: approx $500 million in 2009-10

  Note: This would benefit approximately 290,000 low income families, 100,000 Age Pensioners, 60,000 Disability Support Pensioners, 60,000 Newstart Allowance recipients, 30,000 Youth Allowance recipients, 6,000 Veteran's Pensioners and 7,000 Carer Payment recipients, with an average gain of $15 per week.

- Utilities Allowance – increase by 30% or $150 per year and extend the Allowance to Parenting Payment, Newstart Allowance and other social security recipients who currently miss out.

  Cost: approx $1,200 million in 2009-10

  Note: This would benefit approximately 2,090,000 Age Pensioners, 690,000 Disability Support Pensioners, 490,000 Parenting Payment recipients, 390,000 Newstart Allowance recipients, 180,000 Veterans pensioners, 15,000 Youth Allowance recipients and 160,000 Carer Payment recipients; with an average gain of $3 per week for those already getting Utilities Allowance and $13 per week for those not currently eligible.

- Pharmaceutical Allowance – increase by 100% or $2.90 per week.

  Cost: approx $500 million in 2009-10

  Note: This would benefit approximately 2,080,000 Age Pensioners, 690,000 Disability Support Pensioners, 360,000 Parenting Payment recipients, 180,000 Veterans pensioners, 70,000 Youth Allowance recipients and 160,000 Carer Payment recipients, and a significant number of Newstart Allowance recipients, with an average gain of $3 per week.

R2. From January 2010, income support recipients should be given a choice to receive supplements including Utilities Allowance, Pharmaceutical Allowance and Telephone Allowance as add-ons to their fortnightly payments or as regular lump sum payments.

Cost: administrative expense only

## *2. The adequacy of income support*

The main purpose of income support payments in Australia is to prevent poverty. Unlike many OECD countries, Australia does not have a national social insurance scheme funded jointly by employers, employees and Government which pays pensions and unemployment benefits to replace lost earnings on retirement or unemployment. Our closest equivalent to these payments is compulsory superannuation, which does not guarantee a minimum level of retirement income as in most social insurance schemes. As a result, Australian pensions are much lower than those paid in most OECD countries. Their role is to provide a minimum income floor or safety net, which is supplemented by superannuation and other forms of private income.

Income support payments are not benchmarked to a measure of poverty or a basic standard of living. Instead, the maximum single rate of pension is pegged to 25% of Male Total Average Weekly Earnings in the Social Security Act. Since the single rate is equal to 60% of the partnered rate, the rate for couples is also linked to average earnings. There is no benchmark for Allowances such as Newstart Allowance. Moreover, the relativities between single and married rates of Allowance payments are different to those for pensioners, with single allowees faring relatively poorly (see table 1 above).

The present social security rates structure developed by historical accident as much as conscious planning. In the past, allowances were paid at pension rates, but a failure to index unemployment payments to inflation, and the subsequent indexation of pensions (but not allowances) to wages led to a widening gap between these two classes of payments. Official projections suggest that by 2038, the maximum single rate of Newstart Allowance will be worth just half that of the pension.[23] The married couple rate of Allowances was linked to that for pensions for longer than the single rate of payment, so as a result, married Allowance recipients have not fared quite as poorly as singles.

### An Australian Minimum Standard of Living

Social security payments, including pensions for mature age people and payments for adults of working age (see part 3 of this submission) should be benchmarked to an Australian Minimum Standard of Living, that is, the minimum income typically needed by a single adult and a couple respectively to avoid poverty and live decently in accord with general community standards. This would ultimately replace the separate pension and allowance levels of payment.

The Australian Minimum Standard of Living should be based on the best available research on the living costs and financial circumstances of low income Australians, including:

- poverty lines
- Budgets developed by experts to reflect the minimum expenditures required to achieve a decent standard of living (Budget Standards)
- research on the actual living standards of recipients of the different payments, including access to socially defined ‘essentials of life’ and financial stress indicators.

[23] FaHCSIA 2008, *Pension Review background paper*.

ACOSS is preparing a separate research report on hardship among social security recipients that will examine each of these measures in more depth. In this submission we briefly compare the levels of income support payments with poverty lines and budget standards.

## Poverty lines

There is a well established research tradition of measuring poverty using poverty lines. These are set at the minimum income levels considered necessary to finance a decent standard of living. They are generally based on a single 'benchmark' poverty line for a particular family type, which is then adjusted to take account of variations in household size. The three most commonly used poverty lines in Australia are:

- 50% of median income, which is based on a poverty line for a single adult equal to half the median (middle) income of all Australians – this is the main poverty line used by the OECD

- 60% of median income, which is based on a poverty line for a single adult equal to 60% of the median (middle) income of all Australians – this is the main poverty line used by the UK and European Union

- the Henderson Poverty Line, which was developed by the Melbourne Institute for the National Poverty Inquiry that was conducted in the 1970s. It was based on the 'basic wage' plus child endowment for two dependent children and has been updated since by the Melbourne Institute.

Research commissioned by ACOSS and conducted by the Social Policy Research Centre estimated the extent of poverty among different groups in the community in 2005-06, using all three of the above poverty lines.

Table 3 below compares these poverty lines with maximum rates of social security payments at that time. Note that these figures are for 2005, since the last available data on poverty lines is for that year.

**Table 3: Income support payments and poverty lines (2005-06 in dollars per week)**

| | Income support | 50% of median poverty line | Henderson Poverty Line | 60% of median poverty line |
|---|---|---|---|---|
| Single, Newstart Allowance | $202 | $281 | $331 | $337 |
| Single, pension | $244 | $281 | $268 | $337 |
| Couple, Newstart Allowance | $365 | $421 | $442 | $506 |
| Couple, pension | $408 | $421 | $380 | $506 |
| Sole parent, 2 children (on Parenting Payment) | $423 | $449 | $514 | $539 |
| Couple, 2 children (job seeker, on Allowances) | $528 | $590 | $621 | $708 |

Sources: Australia Fair 2007, *Update on those missing out* (www.australiafair.org.au); Melbourne Institute 2006, *Poverty Lines*, Australia. Income support does not include Rent Assistance of up to $60pw that is paid to a significant minority of recipients. Note that many sole parents now receive the lower Allowance rates of payment (not shown here), and that Henderson Poverty Lines are higher for unemployed people to take account of the costs of seeking work.

These figures indicate that income support payments are generally set below the three commonly used poverty lines, with the greatest gaps between income support and poverty lines being found among single people.

They suggest that people whose main source of income is social security face a high risk of poverty. The researchers found that at least 40% of Australians who mainly relied on social security for their income lived below the poverty line and that around three quarters of poor Australians were mainly reliant on social security.[24]

Caution should be used in interpreting these figures. Although they show that income support payments are very low, and well below typical household incomes, not all people living below poverty lines experience hardship and not all people with incomes above them are comfortably off. This depends on the other resources at people's disposal. For example, the above estimates of poverty in the community do not take account of whether a household owns or rents their home. This can make a major difference to living standards, especially among mature age people since 80% own their homes outright.

It is therefore important to compare the results obtained from poverty research with other

[24] Saunders 2007, *Poverty in Australia*, SPRC.

indicators of living standards.

## Budget standards

An alternative approach to assessing the adequacy of payments is to use Budget Standards. These are household budgets developed by researchers to meet basic needs. Although they rely heavily on expert judgement, one advantage of Budget Standards is that they are transparent and readily understood by the community. Minimum wages were originally set in Australia using a similar method.

A set of Budget Standards was developed by the Social Policy Research Centre for the former Department of Social Security in the mid 1990s, and it would be possible to update these to present values. One set of budgets, the ‘Low Cost’ Budgets, were developed to inform policy discussion around the adequacy of income support payments. These budgets were restricted to the essentials of life, so they only allow for a very austere standard of living.

Two caveats made by the researchers should be kept in mind: the original research did not produce viable estimates for sole parent family budgets, and after about 10 years it is necessary to fully revise the budgets as they will have fallen out of date. It is likely that such a revision would increase the budgets overall due to growth in community living standards and expectations, so the updated budgets shown below should be regarded as conservative.[25]

Table 4 below compares estimated values for the Low Cost Budgets for mature aged home owners and workforce age households without children with base rates of pensions and allowances. It also compares the relative costs for singles and couples with the relative value of payments for singles compared with couples. Note that these figures are for December 2007, based on the availability of CPI data to update the Budget Standards. To keep the comparisons simple, the costs of children (if any) have not been included.

[25] Further, we have used the Consumer Price Index to update the Budget Standards from 2004. Although this approach is regarded as acceptable by the original researchers, the outcomes would be slightly different if we indexed each of the detailed expenditure items in the Consumer Price Index in accordance with their weightings in the Budget Standards.

**Table 4:**

**Income support payments and Low Cost Budget Standards (December 2007 in $pw)**

| | Budget Standard | Income support (base rates) | Gap |
|---|---|---|---|
| Single, mature age home owner (Age pension) | $285 | $269 | $16 |
| Couple, mature age home owner (Age Pension) | $390 | $449 | -$59* |
| Single, mature age as a % of couple | 73% | 60% | |
| Single, working age renter (Newstart Allowance) | $399 | $215 | $184 |
| Couple, working age renter (Newstart Allowance) | $523 | $388 | $135 |
| Single, working age as a % of couple | 76% | 55% | |

Sources: Saunders 2004, *Updating and extending indicative budget standards for older Australians*, SPRC; Saunders 2004, *Updating budget standards for Australia*; Note: Budget Standards indexed to Dec 2007 using CPI, 'Income support' is base rate of Age Pension and Newstart Allowance respectively and does not include Supplements (such as Rent Assistance of up to $53pw that is paid to a significant minority of recipients). *In this case, income support is higher than the Budget Standard.

The comparisons in the table above suggest that:

- In all cases except pensioner couples, income support payments are well below the relevant Budget Standard.

- The gaps between payments and Budget Standards are much greater for singles than for couples. This suggests that the income support system does not give sufficient weight to the extra costs of living alone.

- The gaps between payments and Budget Standards are much greater for those on allowance payments than pensions. This partly reflects the lower level of allowance payments and partly the higher costs typically facing households of working age.

- The main reasons that low income singles and couples of working age typically face higher costs are that they are less likely to own their homes outright (the Low Cost Budget Standards assume that they rent, whereas in this case the Budgets for mature people assume home ownership), and they face higher transport costs due to employment or job search.

## *3. Reform of the social security payment structure for people of working age*

Any changes to base pension levels should form part of a wider reform of the social security system that removes anomalies and inconsistencies between payments. On the other hand, any changes to Age Pension rates that do not extend to other pensioners and allowance recipients could exacerbate the unfairness and inefficiency of the present system. This section of the submission deals with options to reform the system of social security payments for adults of working age.

The present income support system for people of working age is based on an historical distinction between one group of payments (pensions) for people who are deemed unable to work and another (allowances) for people who are considered work ready. Levels of payment reflect this distinction. Thus, the Newstart Allowance for a single adult is $219 per week, $55 less than the pension (or $79 less taking account of cash supplements). The gap in payments between pensions and allowances for a sole parent is $38 per week. In addition, those on Allowance payments miss out on many of the supplements and concessions received by pensioners, including Utility Allowance and discounts on energy bills in a number of States and Territories. Young people aged 18 years and over, and full time students aged up to 65 years receive lower payment again, for example $178 for a single person.

The system is inequitable because levels of payment are based on historical views about which groups are more or less deserving of support rather than on people's actual living costs. For example, a person with a disability on Newstart Allowance who faces high medical costs due to their disability receives less than a Disability Support Pensioner who does not face such costs. Unemployed people required to search for a job receive less than pensioners without such requirements, despite the extra costs of seeking work.

Apart from Mobility Allowance, there is no supplementary payment that recognises the extra costs associated with a disability. Research commissioned by the Department of Family and Community Services in 1998 found that 91% of DSP recipients faced additional costs due to their disability. These included travel costs, prescriptions, consumables (e.g. ointments and pads), medical and related treatments, housing modifications, furniture, assistance with home tasks, aids and appliances, and care costs. The costs faced by individuals with different impairments and circumstances are diverse.[26] Other countries including the UK and New Zealand have comprehensive payments to assist with the costs of disability.

One justification used in the past for separate rates of payment for pensions and allowances was that people on Allowances typically only needed short term income support, but as the profile of Allowance recipients has become more disadvantaged, that assumption no longer holds. As overall unemployment levels have fallen those still out of work are drawn from severely disadvantaged groups in the community. For example over 60% of Newstart Allowance recipients have lacked substantial employment for over a year and over 60% of this group have a Year 10 education or less.

Further, the boundaries between pension and allowance payments are not clear cut. Many

[26] FACS 1999, *Cost of disability survey.* See also Tibble 2005, *Review of existing research on the extra costs of disability*. UK Department for Work and Pensions.

social security recipients move between the two systems. For example, a sole parent leaves the pension system if she re-partners even though she may still be the main carer of her children. It is estimated that half of new Age Pension recipients were previously on another social security payment (including Newstart Allowance) at the time of their pension claim. Similarly, one third of new Disability Support Pensioners were on Newstart Allowance when they claimed the pension.[27] Separate levels of payment for pensions and allowances make these transitions between payments difficult for people.

As a result of the Welfare to Work policy changes introduced in 2006, many sole parents and people with disabilities now receive Newstart Allowance rather than a pension. Although one of the policy objectives of Welfare to Work was to improve employment outcomes by engaging more people with employment assistance services, the outcome for many was simply a lower level of payment. In the new system of payments for parents, an unemployed sole parent whose youngest child is over 8 years old receives at least $37 per week less than a sole parent in the same circumstances whose youngest child is 7 years of age although the family's living costs are unchanged (and usually rise as a child grows older). Similarly, a jobless single adult with a disability who is able to work part time and applied for social security before July 2006 is likely to receive at least $55 per week less (on Newstart Allowance) than a person in the same circumstances who applied two years previously (on Disability Support Pension).

This two tier system of income support blocks transitions to employment among people with disabilities and sole parents. This occurs because those who test the labour market face the risk of transfer to a lower payment. It is likely that this feature of the social security system has a much greater impact on work incentives than the high effective tax rates arising from income tests that have attracted more policy attention. The reason for this is that pensioners put their income security at risk if they seek employment, as well as losing some of their income support. Pensions are widely regarded as more secure payments than allowances. This is a key reason that Australia has one of the lowest employment rates among disability pensioners in the OECD (only around 12% have a job). For this reason, it is unlikely that many Disability Support Pensioners will participate in employment programs in spite of the welcome Government initiatives to defer reviews of pension eligibility when a recipient obtains work or applies for employment programs.

The social security system also discourages participation by jobless people in further education and training. Since Austudy Payment for full time adult students is $41 per week less than Newstart Allowance, and there is no supplement (like the Pensioner Education Supplement) to assist with the costs of books and fees, unemployed people who enrol in educational courses to improve their future job prospects are financially disadvantaged. This is contrary to the spirit of the Government's Skills Agenda.

To complicate matters further, a range of conditions of payment including residency requirements and assets tests are different for working-age pensioners and those on allowance payments. There is no logical basis for these distinctions. They make the system harder for recipients to understand and sharply increase the costs of administration. They also increase the difficulty of transitions between the pension and allowance systems, for example when a sole parent's youngest child reaches the age of 8 years.

[27] FaHCSIA 2008, op cit; FaCSIA 2004, *Characteristics of DSP customers*.

It makes more sense for activity requirements to vary between different categories of payment. People with disabilities and caring responsibilities are more constrained in their ability to participate in the labour market, and activity requirements should reflect this. This gives the recipients a degree of certainty about the range of requirements that will (or will not) apply to them. It also brings an element of equity into the system by ensuring that people in similar circumstances in different parts of the country face similar requirements.

However, the present system of activity requirements is too inflexible. People on pension payments generally have no requirements at all, whereas many people with barriers to work on the Newstart Allowance (for example a mental health problem) often face the same requirements as those with none. A more graduated system of activity requirements that takes account of individual circumstances is needed. For example, the system should take into account the circumstances of people who have a disability in addition to caring responsibilities. There is also a case for broad-banding activity requirements to enhance flexibility. For example, it would be easier for income support recipients to combine job search with education and training if Newstart Allowance and Austudy Payment were merged, rather than being administered as two separate payments.

The social security system also has two different sets of income tests for pensioners and those on allowance payments. The pension income test is less stringent, with a higher free area that takes account of the number of dependents in a family and a lower taper rate (40%). This is designed to encourage part time work. The Allowance income test has a much lower free area that takes no account of the number of dependents and higher taper rates of 50% and 60%. The effect of this income test is to discourage part time work and instead encourage recipients to seek a full time job. The problem with this set of incentives is that most of the growth in low skilled jobs in the last two decades has been in part time work. Over half of all low skilled jobs in Australia are now part time.[28] The Allowance income test is particularly inappropriate for those sole parents and people with disabilities affected by the Welfare to Work policy, who are required to seek part time rather than full time jobs.

Two countries with broadly similar social security systems to Australia's - the UK and New Zealand - are now considering reforms to simplify their social security systems to remove distinctions between 'pension' and 'allowance' payments. A key motive for these reforms is to encourage employment participation among people with disabilities. The OECD has also recommended payment simplification in Australia for this reason. [29]

Options for reform of the social security payment structure for people of working age include:

- Rates of social security payments for adults of working age (as for age pensioners) to be based on an Australian Minimum Standard of Living - the minimum income needed by a single adult and a couple respectively to avoid poverty and live decently in accord with general community standards. This would replace the separate pension and allowance levels of payment.

- Supplements for specific costs that vary substantially among different groups of

[28] ACOSS 2008, *Submission to Fair Pay Commission on minimum wages*.
[29] Vanstone & Abbott 2002, *A simpler system*; Freud 2007, *Reducing dependency, increasing opportunity*, Department for Work and Pensions; Minister for Social Development and Employment 2005, *Extending Opportunities to Work*, New Zealand Cabinet submission; OECD 2007, *Sickness, Disability and work*.

recipients including housing costs, the costs of disability, the additional costs of sole parenthood, the costs of caring, and the costs of participation in employment education or training.

- Care should be taken to ensure that no group is worse off, and that those with the greatest gaps between their income support needs and levels of payment are better off.

- A single 'platform' of core eligibility requirements and entitlements should apply to people of working age, including residency requirements, assets tests and concessions but not activity requirements.

- Separate categories of payment such as Disability, Parenting and Carer Payments would still be needed for the purpose of setting activity requirements (where appropriate), and possibly for income testing (for example, if some groups are required to seek part time work while others are required to seek full time jobs). The levels of payment received by recipients of these payments would not vary between categories of payments. Instead, it would be based on the Australian Minimum Standard of Living together with any supplements to which individuals are entitled.

These reforms require careful consultation with organisations representing income support recipients, the community sector more broadly, and policy experts. They should not be rushed. ACOSS plans to consult with its members to further consider and develop these ideas.

## Recommendation

R3. The Henry Review should develop detailed options and costings for fundamental reform of the social security payment structure for adults based on:

- an Australian Minimum Standard of Living - minimum income levels required by single adults and couples generally to avoid poverty

- supplements for rent, the extra costs of disability and caring, sole parenthood, and the costs of workforce participation or training

- for recipients of working age payments, a common platform of eligibility and entitlements (including residence requirements, assets tests, and access to supplements), apart from activity requirements (if any) which would continue to vary between categories of payment.

## *4. Reform of the overall package of income supports for mature age people*

The Age Pension is one component of the overall system of public support of retirement incomes. The Pension Review should take into account the other elements of that system, which are also being examined by the Henry Review. The three components of public support for retirement incomes are:

- The Age Pension, which provides a minimum income 'floor'.
- Compulsory superannuation, which replaces previous earnings up to a higher standard of income adequacy.
- Tax concessions for voluntary saving through superannuation and for other forms of retirement income.

Together, these components support higher levels of retirement income than the pension alone. The relationship between the pension and these other components should be taken into account when reviewing the pension for the following reasons:

- As the population ages, the cost of all of these components will increase considerably, along with the costs of providing health and aged care services. Policy makers need to consider whether, as a package, they are fiscally sustainable. If improvements in the pension raise the future cost of the overall package, it is reasonable for the Government to consider whether all or part of this extra cost can be offset by adjustments to other components.
- The overall package of retirement income support allows many people to achieve a higher level of income adequacy than is possible through the Age Pension alone.
- The overall package of retirement income support should be equitable as well as each component (such as superannuation tax concessions).
- Changes to one component of the package have effects on the other parts. For example, as compulsory superannuation contributions grow, more retirees will rely on part-rate rather than full-rate Age Pensions.
- The overall system is very complex and should be simplified. For example, the treatment of private income for tax purposes is different to that for pension purposes.

We briefly discuss some of these issues below. The Henry Review needs to consider them in more depth.

### Fiscal sustainability

There are currently five people of working age for every mature age person, but in 40 years this will fall to two. The latest official estimates suggest that in the absence of policy changes, by 2046 Budget expenditure will rise by 4.8% and the Federal Budget will be in deficit by 3.5% of GDP due to higher health, aged care and social security spending mainly caused by population ageing.[30]

Australia's expenditure on pensions is modest by OECD standards and most of the projected increase in costs is in health expenses rather than social security. Nevertheless, it will be difficult for future Governments to sustain improvements in Age Pensions unless more retirees pay income tax. Currently, only one in five do so. On the face of it, tax revenue from retirees should increase in proportion to Gross Domestic Product as the population ages and superannuation account balances increase. However, for the following reasons, this is not guaranteed[31]:

- For retirees over 60 years old, superannuation benefits are no longer taxed in most cases.

- Retirees can substantially reduce the income tax they pay on their other income (earnings and investments) by churning that income through superannuation, for example through salary sacrifice arrangements.

- Special tax offsets applying to retirement incomes raise the effective tax free thresholds of retired people. The effective tax free threshold for a mature age couple is almost $50,000 compared with approximately $30,000 to $35,000 for a typical dual income couple of working age.

If pensions were increased to improve the income support available to retired Australians, consideration could be given to reducing the scope for retirees to use these concessions to reduce their tax. This would improve the sustainability of the overall system of retirement income support. For example, superannuation tax concessions are estimated by the Treasury to cost $25 billion in 2006-07, which already exceeds the cost of the Age Pension.

Another option that is being discussed in a number of overseas countries to improve the sustainability of pension systems is to raise the age of eligibility for pensions. However, this policy debate in other OECD countries does not readily translate to Australian circumstances. The key difference is that the international debate is about social insurance payments, not safety net payments such as our Age Pension. Social insurance systems are usually much more expensive for Governments than Australia's social security system because payments are usually based on previous earnings and they are not often income tested. For these reasons, public expenditure the Australian Age Pension is much more sustainable over the next 40 years than in most other OECD countries.

Another factor that should be carefully weighed up before considering any increase in the pension age is the profile of those individuals whose pension eligibility would be deferred. It is likely that many people who retire before age 65 have done so for reasons beyond their immediate control such as redundancy, illness or disability, or caring responsibilities.[32] Since people in these circumstances are likely to have low private incomes and assets, they would be particularly disadvantaged by having to wait longer to receive the Age Pension. Currently, around half of all new Age Pension recipients were previously on another income support payments, including Disability Support Pension, Carer Payment, and Newstart

[30] Treasurer 2007, *Intergenerational Report*.
[31] Unfortunately, the *Intergenerational Report* does not model the implications of an ageing population for tax revenue. The modelling assumes that it remains constant as a proportion of GDP.
[32] AMP-NATSEM 2004, *The lump sum, here today gone tomorrow*.

Allowance.[33] These payments are less secure than the Age Pension. Further, as indicated above, those on Newstart Allowance receive much lower payments than pensioners.

Superannuation is Australia's equivalent to social insurance. The preservation age for superannuation assets is still 55 years, although the Age Pension is only available at 63 or 65 years (depending on the person's gender). Consideration could be given to increasing the preservation age more rapidly than currently legislated. To the extent that this discourages early retirement it would significantly improve retirement incomes and reduce the cost to Government of supporting them. Those who have little option but to retire early are less likely to be adversely affected by this change because their superannuation assets are typically low. In 2003, 60% of those who retired before 55 years and 50% of those who retired between 55 and 59 years had an average superannuation account balance of less than $10,000.[34]

## A higher standard of income adequacy

One of the main purposes of compulsory superannuation is to improve the adequacy of retirement incomes beyond the level achievable through the Age Pension alone. For example as outlined below, in future most retired people are likely to achieve a living standard equivalent to at least the 'Modest But Adequate' Budget Standard – a benchmark equivalent to a living standard of 'modest comfort' that is well above the 'Low Cost' Budget Standard we discussed previously. [35]

Compulsory superannuation also allows wage earners to replace a much higher proportion of their previous incomes in retirement. This is a different way of measuring the adequacy of incomes from applying a single minimum standard to all.

Research by NATSEM indicates that, when account is taken of Age Pension entitlements, taxation, and some of the extra costs facing working households (including paying off a mortgage), the Superannuation Guarantee enables most wage earners employed for 40 years to achieve a living standard after retirement at least equal to 70-80% of their average living standard while they were working. Those who raised children during working life would generally achieve a higher living standard in retirement than they had while working. Treasury research using a different methodology arrives at broadly similar conclusions.[36]

Further, the NATSEM research also suggests that most retired people who have worked for 40 years and receive superannuation contributions equal to 9% of their earnings will attain a living standard equal to or better than the Modest But Adequate Budget Standard.[37]

The main problem with reliance on the Superannuation Guarantee alone is that many people, especially women, are not employed for 40 years or more. Further, few of the present cohort of people in their 50s and 60s have benefited from employer superannuation contributions equal to 9% or more of their earnings throughout their working lives. However, increasing the level of superannuation contributions is unlikely to substantially boost their retirement incomes. The most effective way for them to improve their retirement incomes

[33] FaHCSIA 2008, *Pension Review background paper*.
[34] AMP-NATSEM 2004, op cit.
[35] Saunders 2004, op cit.
[36] CPA Australia 2007, *The right balance?* Rothman 2007, *The adequacy of Australian retirement incomes*.
[37] CPA 2004, op cit.

through superannuation is to retire later (where possible) because this increases their superannuation contributions and reduces the number of years they have to rely on superannuation benefits. An adequate Age Pension is especially important for these groups. This reflects its role is to provide a safety net for those with inadequate private income.[38]

## Equity in public support for retirement incomes

By 2031, it is estimated that people aged 65 years or more will hold 47% of Australia's household wealth compared with around 22% today. The expansion of superannuation and other retirement assets should greatly improve the overall living standards of future retirees. However, wealth and income will be more unequally distributed in retirement. Graph 2 below compares the estimated distribution of wealth among retired people in 2001 and 2031.

**Graph 2: Estimates of wealth of individuals aged 65 years and over (2001)**


Source: Kelly 2004, *Self provision in retirement?* NATSEM

In both years, a substantial proportion of retirees have little or no wealth. Most would rely fully on the age pension. Currently, there is also a large group of retirees with assets valued at around $100,000. This mostly consists of family homes. In 2031, wealth is much more widely dispersed among those retirees with significant assets, with a substantial minority holding assets valued at over a $1 million in today's dollars.

To a large extent this more unequal distribution of wealth is due to higher superannuation benefits, and the unequal distribution of retirees' previous earnings on which superannuation contributions are based. People on higher wages generally work longer on a full time basis, receive higher compulsory contributions from their employers, and can afford to make higher voluntary contributions.

[38] CPA Australia, op cit.

The tax concessions for superannuation contributions and investment income will also exacerbate future inequality of wealth and incomes. Superannuation contributions made by employers, and the investment income of the funds, attract a flat tax rate of 15% instead of the marginal rates of tax that would normally apply. This provides a greater reduction in tax for every dollar invested on behalf of a high wage earner than for a low or middle wage earner. For example, the tax saving for an individual on the top marginal tax rate is 31.5 cents per dollar invested compared with just 1.5 cents per dollar invested on behalf of an individual on the lowest marginal tax rate. Of the estimated $27 billion annual cost of tax concessions for superannuation in 2008-09, $11 billion is due to the 15% tax rate on employer contributions and $14 billion is due to the 15% tax rate on fund earnings. This dwarfs the annual cost of other superannuation tax concessions and the co-contribution for low and middle income earners.[39]

There is no policy logic to the system of tax concessions for superannuation. Before the reforms of the 1980s, superannuation was virtually untaxed and it was widely used by high income earners as a tax shelter. To reduce the cost of this tax shelter to the Federal Budget, contributions, fund earnings and large lump sum benefits were taxed at 15% from the 1980s. In 2006, the tax on lump sums was removed for most individuals over 60 years old.

An efficient system of tax concessions to encourage long term saving would target low and middle income earners rather than high income earners, because high income earners are more likely to save for retirement regardless of the taxation benefits. Generous tax concessions for one form of retirement saving (superannuation) encourage high income earners to switch their investments from other savings vehicles (such as direct investment in shares and property), rather than substantially boosting their overall level of saving. Tax concessions should also be capped at a level of contributions or benefits that is sufficient to fund a comfortable retirement income. There is no public benefit in supporting luxurious living standards or estate planning through the tax system.

The Government co-contribution for employees is more consistent with this approach. However, because it is confined to voluntary employee contributions it is of limited benefit to the majority of low and middle income earners who can only afford to rely on compulsory employer contributions. It is likely that the co-contribution mainly supports the superannuation contributions of the partners of high income earners rather than the intended target group of low wage earners from low to middle income families.

Other tax concessions for retirees also contribute to inequality of retirement incomes. For example, the Senior Australians Tax Offset, which currently costs around $1 billion per year, is targeted towards a minority of retirees with incomes well in excess of the Age Pension. When combined with other widely available tax concessions, it raises the effective tax free threshold for a retired couple to almost $50,000.[40]

---

[39] Treasury 2007, *Tax Expenditure Statement*.
[40] $49,700 in 2008-09 - See Treasury 2008, *Architecture of Australia's tax and transfer system*.

## Recommendation

R4. Consistent with Recommendation 3 above, the Henry review should develop detailed options and costings for fundamental reform of the system of retirement income supports including pensions, tax concessions and superannuation in order to:

- reduce financial hardship and future inequality of retirement incomes
- more efficiently encourage and support saving for retirement
- encourage workforce participation
- ensure that these supports are sustainable as the population ages
- encourage retirees to use tax preferred retirement income savings to improve their living standards and reduce their need to rely on pensions, rather than for estate planning purposes
- simplify these systems and their interaction – for example by treating income and assets more consistently across the pensions and tax systems.

## *5. Reform of concessions*

Social security recipients rely heavily on the system of Federal, State and Territory concessions (discounts on the cost of specific goods and services) to meet essential needs such as medical expenses, transport and home heating. The main advantage of concessions is that support can be targeted towards those with the highest expenses on targeted necessities. The main disadvantages are that concessions are not as flexible as cash income support for households that have difficulty balancing their budgets and the service that is subsidised may not be available. Concessions will be an important part of the broader compensation package for low income households affected by the proposed Carbon Pollution Trading Scheme.

The present system of concessions is complex and inequitable:

- Three different kinds of concession cards entitle the holders to a range of different concessions: the Pensioner Concession Card has the most generous benefits, the Health Care Cards for recipients of Allowance payments has more limited benefits, and Commonwealth and State Seniors Cards provide medical and pharmaceutical benefits and a range of other assistance that varies from State to State.
- The same Commonwealth card entitles the holder to different benefits depending on the State or Territory in which they live. For example, unemployed people receive public transport concessions in Victoria but not in Queensland. This is because most of the cost of these concessions is met by State and Territory Governments.
- Within each State and Territory, access to the services that are subsidised through concessions is inconsistent. For example, transport concessions in some States and

Territories are only available for public transport, which is not provided in many country areas.

These inequities could be partly addressed by replacing the separate cards for different categories of social security recipients and low income earners with a single low income concession card. Further, the Commonwealth could negotiate minimum standards of concessions with the States and Territories.

Another problem with the present system of concessions is that the value of the subsidy is not always indexed in accordance with increases in the cost of the service. As a result the real value of concessions is often eroded over time. If, on the other hand, the system covers most or all of the cost of a good or service there is a risk that providers will shift the cost to Governments. One way to address these problems is to subsidise a fixed proportion of the cost up a ceiling (the value of which should be indexed). Another solution is to ensure that the level of Government that provides the subsidy also supervises the market in which the good or service is provided (for example, household energy).

The cost of concessions has increased substantially as income tests for social security payments are eased, and the States and Territories have established their own Seniors Cards for those whose income or assets are too high to qualify them for a pension. The improvements referred to above are unlikely to be fiscally sustainable as long as concessions extend to middle and high income households. A related problem is that suppliers such as cinemas are more reluctant to extend their own concessions to card holders if they know that middle and high income households will benefit. While there may be a case for extending some health related concessions to mature age people regardless of income and asset levels, concessions should generally be targeted towards financially disadvantaged households.

A further option for reform is to allow recipients to cash out the average value of their concessions. Careful consideration would need to be given to whether it is more equitable to allow individuals to exercise this choice or to replace concessions generally with cash payments.

## Recommendation

R5. The Henry Review should develop detailed options and costings for reform of concessions, including consideration of the following options:

- establish national minimum standards for Commonwealth and State and Territory concessions based on a percentage of costs incurred up to a ceiling
- extend Commonwealth responsibility to concessions linked to markets supervised by the Commonwealth (for example energy)
- offer income support recipients the option of cashing out their concessions
- consider how concessions can be better targeted to those who need financial support.