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Research Insights

Can superannuation contribution matching schemes incentivise low and middle-income earners to save more?

Superannuation contribution matching schemes are falling short of expectations to reduce retirement income inequality.

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Private pension matching schemes in Australia and around the world

Faced with fiscal pressures from an aging population, many countries encourage reliance on private pensions, especially through tax-favoured treatment of private pension contributions. In Australia, on top of compulsory employer contributions, employees can receive tax concessions by asking their employer to pay (salary sacrifice) some of their salary into their superannuation fund where it attracts a flat tax rate of 15 per cent instead of the employee's marginal tax rate. However, because low and middle-income earners face lower marginal tax rates, the incentive for them to salary sacrifice voluntary contributions is relatively low or non-existent. For this reason, governments such as those in Australia, Austria, Czech Republic, Germany, Hungary, New Zealand and the United States of America (USA) have introduced incentive schemes targeted at low and middle-income earners whereby the government 'matches' individual contributions to private pensions up to an eligible maximum contribution amount (e.g. $1,000 in Australia).

However, it's unclear how effective these matching schemes are. While the lure of government matching payments may encourage some people to start contributing, it is possible that they will do so by reducing contributions to other forms of savings that are unmatched by a government contribution. This may be particularly true for low and middle-income earners who are struggling to 'make ends meet'. Also, for those who are already making contributions, especially those contributing above the eligible maximum, the government matching payment represents a windfall in retirement, which reduces the need for them to contribute as much of their own money towards their retirement.

Evidence to date from a handful of studies from the USA and Germany suggest matching schemes lead to only modest increases in people's pension contributions. However, it is possible that these modest results are because schemes in these countries are highly complex – there is also evidence of larger increases when simpler and more transparent matching schemes are offered as part of a field experiment (Duflo et al., 2007).

We examine the impacts of the Superannuation Co-contribution Scheme in Australia, introduced in 2003 as part of the Howard Government's Better Superannuation System, with the objective of, "… financial self-reliance in retirement of every Australian." The scheme's eligibility is based mainly on annual income being below a given threshold, which varies year to year, but has been generally below $60,000, or around 60 per cent of tax filers. The scheme is very simple and has high match rates that have varied over time – 50 per cent, 100 per cent and 150 per cent – for contributions made from personal bank accounts (after tax) up to $1,000. For example, at a match rate of 150 per cent, for every dollar contributed by an individual up to $1,000, the government would contribute $1.50 to a maximum of $1,500 each year.

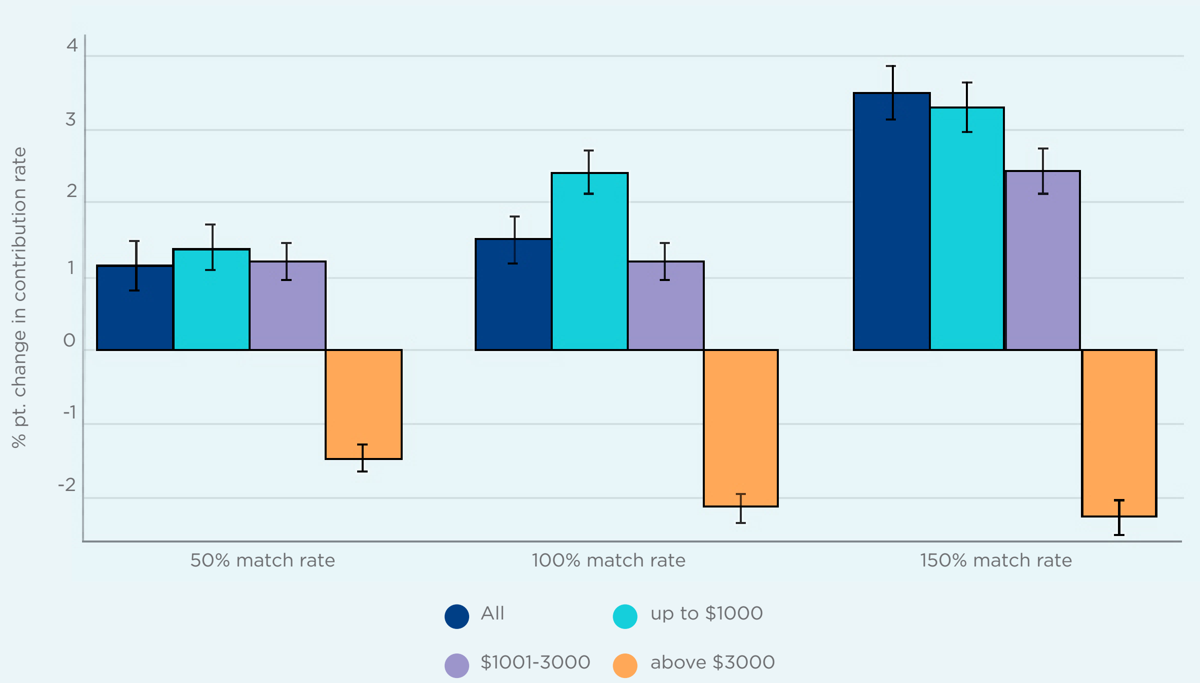
Our analysis uses data from a 10 per cent sample of superannuation statements and personal income tax returns from the Australian Taxation Office (ATO) linked at the individual level over time between 1999–2000 and 2016–2017. Our sample of analysis is restricted to low and middle-income earners, defined as those who earn less than $80,000 in at least one year between 1999-2000 and 2016-17. The impact of the Superannuation Co-contribution Scheme is estimated using econometric models that measure individual changes in contributions associated with individual changes in eligibility over time.

Key Insights

1 Becoming eligible for the scheme induces small increases in voluntary after-tax contribution rates

Eligibility for the Superannuation Co-contribution Scheme with matching rates of 50–150 per cent is associated with 1 to 3.5 percentage point increases in the proportion of low and middle-income earners who make voluntary contributions (Figure 1). These responses are comparable to those found in studies of national matching schemes in Germany and the USA, but are much smaller than those found in the Duflo et al. (2007) field experiment. Given the generosity and simplicity of the Australian scheme and the high public awareness (80% from two independent surveys), these results are disappointing.

Figure 1: Impacts of the Superannuation Co-contribution Scheme on the rates of voluntary after-tax contributions by contribution range and match rate



2 Average individual contributions to superannuation fall due to the scheme

Despite small increases in the number of people making contributions in response to eligibility for the matching scheme, the average after-tax voluntary contribution across all low and middle-income earners is estimated to fall by between $20 and $50 depending on the match rate. This is because people already contributing above the eligible maximum of $1,000 a year respond by reducing their voluntary contributions. This is especially true among ‘high contributors’ of above $3,000 (Figure 1). For them, the unexpected matching payment from the government reduces their need to contribute as much of their own income to their savings plan.

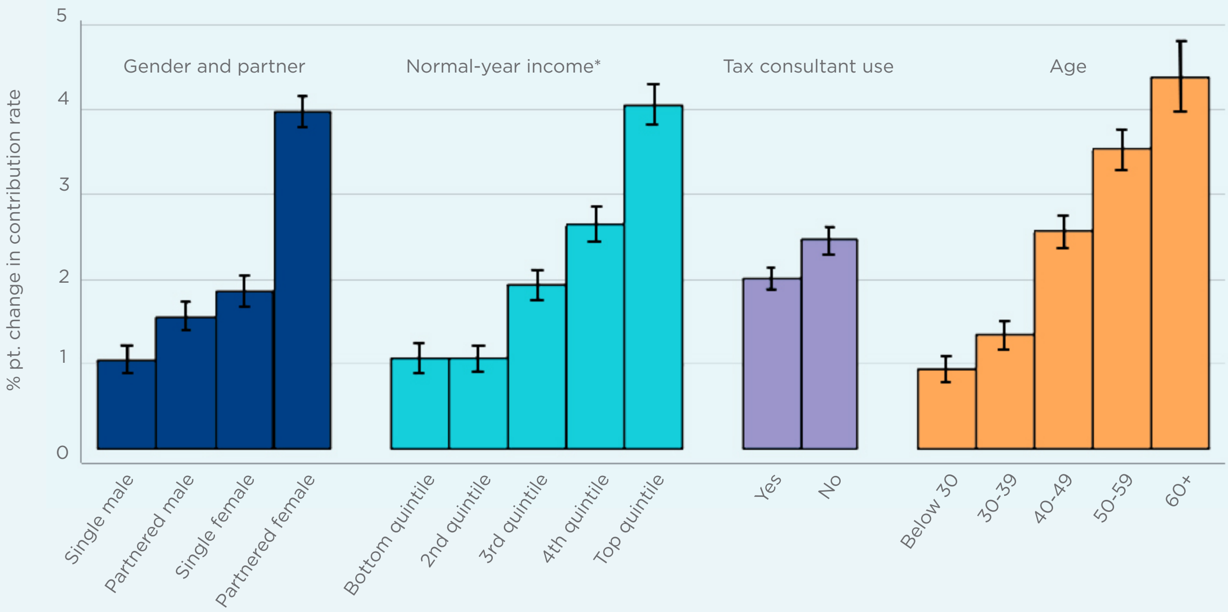
3 Many low and middle-income earners do not respond because they may have more pressing immediate financial needs

We find that people's ability to take advantage of the scheme is limited by their financial capacity to make contributions. Increases in contributions are much stronger among low and middle-income earners who have money available to make them. These groups (from Figure 2) include those with normally high income over the period, but who are eligible because of a lean year; partnered females who are often secondary earners in the household; and people close to retirement who are less likely to have dependent children or be paying off a mortgage.

For many low and middle-income earners, after paying bills and meeting mortgage repayments, there is little left over for extra contributions to superannuation.

The fact that we find no significant difference in the responses of people who do and do not use a tax consultant underlines our conclusion that the small effects of the scheme are unrelated to ignorance and/or misunderstanding (Figure 2).

Figure 2: Impacts of the Superannuation Co-contribution Scheme on sub-group voluntary after-tax contribution rates, average across match rates



*Annual income that is estimated in a normal year (volatility removed) 1999-20 to 2016-17 within the sample.

4 Small increases in voluntary contributions 'crowd-out' other forms of retirement savings

We also see that those eligible for the scheme who do increase their voluntary after-tax contributions also 'compensate' by lowering their voluntary 'unmatched' contributions made through employers (salary sacrifice). This further erodes the scheme's effectiveness in lifting savings and underlines the limited capacity of low and middle-income earners to increase voluntary contributions.

Our analysis of changes in income sources from bank deposits and investments, suggests that the money saved from reduced contributions was not used to 'save for a rainy day'. This suggests that the matching payments for these people was used to increase their consumption.

Still a role for the Age Pension as a social safety net

Our findings cast serious doubt on the effectiveness of matching schemes to lift the retirement savings of low and middle-income Australians, despite the relative simplicity, generosity, and high public awareness of the scheme. For many low and middle-income earners, making ends meet is a higher priority than saving for retirement.

Launched in July 2003 by the Howard Government under the Better Superannuation System reforms, the Superannuation Co-contribution Scheme has not lived up to its objective of lifting financial self-reliance in retirement for all Australians. Today, only 15 per cent of low and middle-income earners (who earn less than $80,000 per year) stand to benefit from the scheme that cost $127 million in 2020–2021 (Australian Treasury 2021).

Given the inevitable need to rein in public debt in a post-pandemic world, discontinuing the Superannuation Co-contribution Scheme might be ‘low-hanging fruit’. While this may be politically sensitive, legislated increases in the minimum superannuation guarantee as well as a government commitment to maintain the Age Pension as a social safety net could help desensitise the issue.

Further Information

This research is supported by an Australian Research Council Linkage Project grant (LP170101045). Analysis is based on annual curated tax and superannuation records, known as the Australian Taxation Office (ATO) Longitudinal Information Files (ALife), which is produced by the ATO. All findings, opinions and conclusions are those of the authors and do not represent the views of the Australian government or any of its agencies.

Datasets:

We use data from the Australian Longitudinal Information File (ALife), a 10% random sample of all registered tax filers (since 1980) linked to annual tax and superannuation records produced by the Australian Taxation Office.

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Further reading

Chan, M., Polidano, C., Vu, H., Wilkins, R., Carter, A. and To, H. *How effective are matching schemes in enticing low-income earners to save more for retirement? Evidence from a National Scheme.* Melbourne Institute Working Paper 27/20. https://melbourneinstitute.unimelb.edu.au/publications/working-papers/search/result?paper=3559160

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