THE UNIVERSITY OF MELBOURNE

Melbourne Institute Working Paper Series

Working Paper No. 23/08

Australia's Retirement Income System: Historical Development and Effects of Recent Reforms

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MELBOURNE INSTITUTE of Applied Economic and Social Research

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Melbourne Institute Working Paper No. 23/08

ISSN 1328-4991 (Print)

ISSN 1447-5863 (Online)

ISBN 978-0-7340-3291-1

November 2008

* This research is supported by an Australian Research Council Linkage project (#LP0882748) grant titled "Ageing Baby Boomers in Australia: Informing Better Actions for Retirement". Chief investigators are Professor Hal Kendig, University of Sydney; Professor Mark Wooden, University of Melbourne; Professor David DeVaus, La Trobe University; Professor Yvonne Wells, La Trobe University; Dr Kate O'Loughlin, University of Sydney. Partner investigators are National Seniors Australia and the US AARP. The author also thanks Mark Wooden, Bruce Headey, Jeff Borland and Mark van Zijll de Jong for valuable comments and suggestions.

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Abstract

Over the past decade, changes to Australia's retirement income policy have been announced in almost every Federal Budget, with no signs yet that reform is coming to an end. Indeed, the *Simpler Super* reforms announced in the 2006 Federal Budget have been described as the largest overhaul of Australia's superannuation system since the introduction of compulsory superannuation.

This paper describes the current retirement system in Australia and provides a summary of the historical development of the Australian retirement system, with special emphasis placed on the recent reform initiatives designed to increase labour force participation of mature age Australians, provide higher levels of savings for retirement, and reduce reliance on the Age Pension as the main source of retirement income.

The final section of the paper contains a review of the existing research addressing the issue of whether recent changes to retirement income policy will in fact have their intended effects. At this point it is still unclear whether these reforms will increase mature age labour force participation or reduce reliance on the Age Pension. Indeed, some have argued that these policy changes create perverse incentives, and will encourage early retirement.

In Australia, as in most OECD countries, population ageing has given rise to concerns about whether there will come a time when will be insufficient people in the workforce to support the growing proportion of the population who have left the labour force. At the same time, a majority of Australian men and women retire before the statutory age for the pension. Combined with increased life expectancy, this means that the average number of years Australians are spending in retirement is increasing, potentially increasing the burden on the income support system.

The Australian retirement income system is made up of three elements. First, a publicly funded means tested Age Pension; second, mandatory employer contributions to private superannuation; and third, voluntary saving, including voluntary superannuation and other long-term saving through property, shares and managed funds. This “three pillar” system for the provision of retirement income has been endorsed by the World Bank as world’s best practice (World Bank, 1994).

This paper describes the current retirement system in Australia and provides a summary of the historical development of the Australian retirement system. Over the past decade, changes to retirement income policy have been announced in almost every Federal Budget, with no signs yet that reform is at an end. Indeed, the *Simpler Super* Reforms, which were announced in the 2006 Federal Budget and came into effect on 1 July 2007, have been described as the largest overhaul of Australia’s superannuation system since the introduction of compulsory superannuation (Borowski, 2008). Special emphasis is placed on the recent reform initiatives designed to increase labour force participation of mature age Australians, provide higher levels of savings for retirement, and reduce reliance on the Age Pension as the main source of income in retirement, thereby providing a better standard of living for older Australians. Sections I and II focus on the Age Pension and superannuation respectively, while section III discusses the expected consequences of recent policy changes and whether recent these changes have had, or will have, their intended effect of increasing mature age labour force participation and reducing reliance on the Age Pension.

I. The Age Pension

The Age Pension has been at the centre of Australia’s retirement system since its introduction in 1909. Currently, the maximum rate of Age Pension is $546.80 per fortnight for single persons and $456.80 per fortnight for each member of a couple.[1] Age Pensioners who are renting their home may also be entitled to rent assistance of up to $107.20 per fortnight. At present the Age Pension is available to men aged 65 years and over and women aged 63.5 years and over who are citizens of Australia and have been permanent residents for at least ten years.[2] Those who are eligible to receive the Age Pension may also be eligible for other payments and benefits, such as pharmaceutical allowance, telephone allowance, utilities allowance, remote area allowance and a pensioner concession card which reduces the costs of medicines under the Pharmaceutical Benefits Scheme, as well as other benefits such as reductions in property and water rates, reduced fares on public transport, and reductions on motor vehicle registration (Centrelink, 2008).

The Age Pension was originally designed as a social welfare safety net for the elderly, providing a modest benefit for those not able to fully support themselves during retirement. For this reason, eligibility is subject to means testing in the form of an income test and an assets test. In order to calculate the amount of Age Pension a single person or couple is entitled to, the pension amount is calculated using both the income test and the assets test. The test that results in the lowest rate of pension is then applied.

Under the income test, a single person can earn up to $138.00 per fortnight and a couple can have a combined income of up to $240.00 per fortnight and still receive the maximum rate of Age Pension. For those whose income is above these thresholds, the pension is reduced by 40 cents for each dollar of income above these amounts (20 cents in the dollar each for couples). As a result, single persons earning $1519.50 or more per fortnight and couples with a combined income of $2538.50 per fortnight will not be eligible for any Age Pension. For the purposes of the income test, any income from financial investments, such as bank, building society and credit union accounts, term deposits, managed investments and shares, is assessed under one set of rules, known as deeming, regardless of the income these assets actually earn. From 1 July 2008, for a single person, the first $41,000 of financial assets is deemed to earn 4% per annum and any amount over that is deemed to earn 6% per annum. For a couple, the first $68,200 of combined financial assets is deemed to earn 4% and any amount over that is deemed to earn 6%.

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[1] Rates effective 1 July 2008 (Centrelink, 2008).

[2] The age pension eligibility age for women is being gradually increased so that by 2013 it will be 65, the same as for men.

The assets test threshold depends on whether a person is single or partnered, and also whether or not they are homeowners. As of 1 July 2008, a single homeowner can have assets of up to $171,750 and still receive a full pension, and a couple who owns their own home can have combined assets of up to $243,500 before their pension is reduced. For those who are not homeowners, the thresholds are higher – a single person can have up to $296,500 and a couple can have combined assets of up to $368,000 before the pension is affected. For those who have assets above these thresholds, the pension is reduced by $1.50 per fortnight for each $1000 above the threshold, so that single homeowners with assets of $540,250 or more, couple homeowners with combined assets of $856,500 or more, single non-homeowners with assets of $664.750 or more, and couple non-homeowners with combined assets of $981,000 or more will not receive any Age Pension (Centrelink, 2008).

With the exception of the home that a person lives in, most assets, including cash, money in bank accounts, bonds, shares, managed investments, superannuation and rollover funds, properties, and the value of businesses, motor vehicles, boats and caravans, are assessable and taken into account under the assets test, with any debts secured against an asset deducted from the value of that asset. Some income streams, (i.e., investment products which allow an individual to receive regular payments, usually as a pension or annuity) are exempt from the assets test. Complying income streams purchased before 20 September 2004 are 100% exempt and those purchased between 20 September 2004 and 20 September 2007 are 50% exempt. Income from these assets is, however, included in the income test.

Introduction of the Age Pension

The first Age Pensions in Australia were introduced in New South Wales and Victoria in 1900.[3] At that time, a means tested Age Pension of 26 pounds per fortnight, subject to a 25 year residency requirement, became available to men aged 65 years and over. With the formation of the Commonwealth of Australia on 1 January 1901, Commonwealth parliament became authorized to legislate in respect of age and invalid pensions. However, it was not

[3] A summary of the historical development of Australia's retirement system is provided in an Appendix. A very useful short history of the development of Australia's pension and benefits system, provided by the former Department of Social Security, can also be found on the Australian Bureau of Statistics web site on the *Year Book of Australia, 1971* web page. (Why on this page is difficult to know given the history describes developments through to the mid-1980s). We draw heavily on this summary here.

until June 1908 that legislation providing for the introduction of means-tested 'flat-rate' age and invalid pensions was passed, and the Commonwealth Age Pension came into operation in July 1909, superseding the state Age Pension schemes. The Commonwealth Age Pension was based on the NSW Age Pension and was paid to men and women aged 65 and over, subject to a means test and a 25 year residency requirement. The residency requirement was reduced to 20 years soon after the introduction of the pension, and, in December 1910 women aged 60 and over became eligible to receive the Age Pension. From that time onwards, most changes to the Australian Age Pension were either in the form of changes to the means tests or changes to the indexation of the pension.

Means testing

When the Age Pension was first introduced, the pension was cut off completely if income and property exceeded the threshold amount. In 1912, the means test was amended so that the family home was not included. With the exception of changes in the threshold amounts, no further changes were made to means tests until 1952, when means tests on Age Pensions were largely removed for permanently blind people (FaCSIA, 1983). Then, in 1954, income from property was excluded from the income test (Australian Government, 2008a). In 1961, the separate property and income tests were combined into a merged means test, under which means were calculated by adding personal earnings to 10% of the value of property (ABS, 1971). The means test was modified further in 1969, so that only half of the amount in excess of the threshold was deducted from the annual rate of pension (FaCSIA, 1983). That is, the pension was reduced by 50 cents for every dollar over the means test threshold, rather than dollar for dollar. This amended means test became known as the 'tapered means test'.

For pensioners aged 75 years and over, means tests for the Age Pension were abolished in 1973, and in 1975 means tests were also removed for pensioners aged between 70 and 74 years (FaCSIA, 1983). In 1976 the means test for Age Pension eligibility was replaced by an income test, which took into account income alone, including income from property (Australian Government, 2008a). From October 1978, the rate of pension paid free of the income test to Age Pensioners aged 70 and over was frozen at the current rate, and subsequent increases in the rate of Age Pension became subject to the same income test applied to Age Pensioners below the age of 70. That is, as Age Pension rates increased, pensioners aged 70 and over were entitled to receive a base rate of age pension (the 1978 pension rate) regardless of income, but could receive a higher amount if they qualified under the income test (FaCSIA, 1983).[4] From 1983, the income test free component of the Age Pension available to pensioners aged 70 and over became subject to a special income test, where the previously income test free amount was reduced by 50 cents for each dollar of income earned above the thresholds of $200 per week for a single person and $333 per week for a couple (Daniels, 1999).

The assets test on the Age Pension was reintroduced in 1985, with the family home excluded from the value of assets and non-homeowners allowed a higher assets test threshold (Australian Government, 2008a). In 1992, allocated pensions became subject to both the asset and income tests (Clare, 2007).

From 1 July 1996 'extended deeming' was applied to financial investments to discourage people from holding financial assets in such a way that low returns made them eligible for the Age Pension and also to reduce the administrative burden of the income test. Instead of using actual income from financial assets for income test calculations, deemed income from financial assets was calculated using a single set of rules.[5] A 'deeming threshold' on the total value of all financial assets of $30,000 for a single person and $50,000 for a married couple was established. Within that threshold, the first $2000 (for a single person) and $4000 (for couples) of interest on cash and financial institution deposits was assessed only on the basis of the actual interest received, up to a maximum of the lower deeming rate. The remainder of the threshold amount was deemed to be earning a return of 5% and any amount above the threshold levels was deemed to be earning 7% (FaCSIA, 2006).[6]

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[4] This special income test did not apply to age pensioners who were legally blind.

[5] Financial investments covered for deeming purposes included: deposits of any kind with banks, building societies, credit unions or other financial institutions; listed shares and securities; managed investments; shares in unlisted public companies; investments in superannuation funds, approved deposit funds and deferred annuities after Age Pension age; loans; debentures; and insurance, friendly society and other bonds. Income stream products such as superannuation pensions, allocated pensions and immediate or allocated annuities were not subject to extended deeming and so their treatment was unchanged (FaCSIA, 2006). Income streams with a term of less than five years were assessed under the social security deeming rules, while income streams with a term of greater than five years were assessed under the income test on the basis of the gross annual income from the product reduced by an annual allowance for return of capital.

[6] The deeming thresholds were subject to automatic increases on 1 July each year in line with movements in the Consumer Price Index between the previous March quarters.

In a measure designed to encourage the taking of superannuation as an income stream rather than a lump sum, from 20 September 1998 annuities that met required minimum standards became 100% exempt from the assets test. To classify as a complying income stream, a product had to provide an orderly draw down of capital over a person's lifetime or life expectancy. That is, the annuity had to be non-commutable – the capital supporting the income stream could not be accessed as a lump sum.

To compensate for the impact of the introduction of the Goods and Services Tax (GST) on the cost of living, a 4% GST supplement was added to pensions and the taper rate that applied to the Age Pension income test was lowered from 50% to 40% on 1 July 2000 (FaCSIA, 2006).

In 2004, it became clear to policymakers that a reasonable proportion of individuals with assets substantially above the assets test cut-off point were able to still receive the Age Pension by taking advantage of the rule that complying income streams were exempt from the assets test. To restrict wealthier individuals from accessing the Age Pension, while still maintaining an incentive to purchase an income stream, the assets test exemption applied to complying income streams purchased after 20 September 2004 was reduced from 100% to 50% (Australian Government, 2004).[7]

Along with the reduction in the assets test exemption, the government broadened the definition of complying income streams to include non-commutable, market-linked income stream products which required an orderly draw down of capital over a person's life expectancy, and restricted payments to a set proportion of the account balance. Unlike the existing complying income streams, these market-linked products did not provide a guaranteed income; the amount of income received was based on the return on the investments supporting the pension. This change was intended to increase choice and competition in the complying income stream market and enabled superannuation funds to provide complying income streams for the first time (Australian Government, 2004).

As part of the superannuation package introduced in the 2006 Federal Budget, it was announced that, to make the assets test fairer for those who make additional savings for their retirement, the assets test cut-out points for a partial Age Pension would be raised substantially, and the taper rate reduced so that pension recipients only lose $1.50, rather than

[7] Complying income streams purchased before that date would still receive the 100% assets test exemption.

$3, per fortnight for every $1000 over the threshold (Australian Government, 2006).[8] These changes came into effect on 20 September 2007, and, as a result, many people became eligible for the Age Pension for the first time. It is estimated that more than 165,000 current Age Pension recipients will benefit from the easing of the assets test, and up to 50,000 retirees became eligible for the Age Pension for the first time (Clare, 2007). The 50% assets test exemption applied to complying income streams was removed for all income streams purchased after 20 September 2007, as it was believed that retaining this exemption along with the reduced assets test taper rate would create greater scope for wealthier individuals to access an Age Pension (Centrelink, 2007).

Indexation of the Age Pension

Until 1933, increases in the rate of Age Pension occurred through changes to the *Invalid and Old-age Pensions Act*, by which the maximum Age Pension amount was increased to 30 pounds per fortnight in 1920 and 35 pounds per fortnight in 1923 (FaCSIA, 1983). In 1933, a provision for automatic increases in the rate of Age Pension on the basis of changes in the cost of living was introduced. This provision was subsequently repealed in 1937, but reintroduced in 1940 (FaCSIA, 1983). It was not until 1975 that Age Pensions became linked to average weekly earnings and indexed annually so that pensioners received 25% of average male weekly earnings, and in 1976 pensions became subject to automatic increases twice a year (Nielson and Harris, 2008).

In September 1997, the Australian Government legislated to maintain the single rate Age Pension at a minimum of 25% of male total average weekly earnings. Since retirees who are solely reliant on the Age Pension pay no income tax, this translated to a net replacement rate of 37% (Bateman and Piggot, 2001).[9] Compared to other OECD countries, this replacement rate is quite low. In 2007, Australia had the seventh lowest net replacement rate out of thirty OECD countries — higher only than that of Mexico, Ireland, Japan, the United States, New Zealand and the United Kingdom (OECD, 2007).

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[8] The assets test cut-out points were increased as follows: from $343,750 to $529,750 for a single homeowner; from $464,750 to $620,250 for a single non-homeowner; from $531,000 to $839,500 for couple homeowners (combined) and from $652,000 to $960,500 (combined) for couple non-homeowners (Centrelink, 2007).

[9] This was legislated in the *Social Security and Veterans' Affairs Legislation Amendment (Male Total Average Weekly Earnings Benchmark) Act 1997*.

A Senate inquiry into the adequacy of the Age Pension undertaken in March 2008 was presented with evidence suggesting that the maximum single rate of Age Pension may be insufficient to maintain a basic, decent, standard of living.[10] Single pensioners, particularly women, those with severe or chronic illnesses, and those living in private rental accommodation or residential aged care facilities were identified as being disproportionately affected by rises in the costs of essentials such as food, housing and utilities (Australian Government, 2008c). The Committee recommended that the Government review the adequacy of the base level of the Age Pension, particularly the single rate, and also that the Government provide older people with subsidies, rebates and concessions that are appropriately indexed to maintain their real value.

Other changes to the Age Pension

Other changes to the Age Pension during this time included: the introduction of rent assistance for single pensioners paying rent in 1958; a reduction in the residence qualification for Age Pension eligibility from 20 years to 10 years in 1962; the introduction of a single rate of pension in 1963; the phased increase of pension eligibility age for women, starting in 1995; and the introduction of the deferred pension bonus plan in 1998.

The single pension rate, when introduced in 1963, was set at 54.8% of the couple combined pension. Prior to 1963, the maximum rate of pension for a single person was the same as that of a married person. The new single rate gave single pensioners a higher pension payment in recognition of the economies of scale available to a married couple who share living expenses. Between 1963 and 1974, the single Age Pension rate was gradually increased to 60% of the couple combined pension and has been at that level ever since.

Under the *Social Security Legislation Amendment Act* of 1994, it was announced that the Age Pension eligibility age for women would be increased in a phased process commencing on 1 July 1995, so that by 1 July 2013 the pension eligibility age for women would be 65, the same as the pension eligibility age for men. The pension eligibility age for women is being increased by six months every two years, as shown in Table 1.

[10] Saunders et. al. (2007) also found that prevailing Government pension levels were not sufficient to buy what most Australians consider to be essential items.

Table 1: Changes to Age Pension Eligibility Age for Women

Date of birth	*Age Pension eligibility age*	*Eligibility age effective on:*
Before 1 July 1935	60	Before 1 July 1995
1 July 1935 to 31 December 1936	60.5	1 July 1995
1 January 1937 to 30 June 1938	61	1 July 1997
1 July 1938 to 31 December 1939	61.5	1 July 1999
1 January 1940 to 30 June 1941	62	1 July 2001
1 July 1941 to 31 December 1942	62.5	1 July 2003
1 January 1943 to 30 June 1944	63	1 July 2005
1 July 1944 to 31 December 1945	63.5	1 July 2007
1 January 1946 to 30 June 1947	64	1 July 2009
1 July 1947 to 31 December 1948	64.5	1 July 2011
On or after 1 January 1949	65	1 July 2013

Source: FaCSIA, 2006.

In July 1998, the deferred pension bonus plan was introduced. This scheme offers a once only, tax free lump sum bonus to people who continue working beyond Age Pension eligibility age rather than claiming an Age Pension or service pension. The amount received depends on the amount of basic Age Pension the individual is entitled to when they leave the workforce, the length of time they have been a member of the deferred pension bonus scheme, and whether they were single or partnered during the time they deferred the Age Pension. A maximum of five years accruing membership can be taken into account for the bonus. The entitlement is calculated by taking 9.4% of the person's annual basic pension entitlement for each year, and multiplying this figure by the number of qualifying years squared. Based on this formula, the minimum bonus payable (accumulated over one full year) was 9.4 per cent of a person's basic pension entitlement, and the maximum bonus payable (accumulated over five full years) was 235% ($9.4\% \times 5 \times 5$) of a person's basic pension entitlement (FaCSIA, 2006). As of 1 July 2008, the maximum amount of pension bonus payable to a single person who would be entitled to a full pension but deferred retirement for one year was $1336.40 ($1116.40 each for couples). For those who would have been eligible for a full Age Pension but defer their retirement by five years, the deferred pension bonus increases to $33,409.50 for singles and $27,910.50 each for couples.

Like the deferred pension bonus scheme, the Senior Australian Tax Offset (SATO), introduced in 2000, aims to provide a further incentive for older people to continue working past age pension eligibility age. This tax offset reduces the amount of tax payable by men and women who have reached age pension eligibility age. As of 1 July 2008, single people who meet the eligibility criteria for the SATO can earn up to $25,867 per year ($43,360 combined for couples) before having to pay any income tax.

II. Superannuation

Although superannuation has existed in Australia since the mid-1800's, it was not until the Superannuation Guarantee was introduced in 1992 that it became a major component of Australia's retirement system. Today, almost all workers are entitled to superannuation, a form of compulsory saving for retirement.[11] As part of the Superannuation Guarantee, employers are required to contribute a minimum of 9% of an employee's earnings to a superannuation fund, and these savings cannot be accessed by the employee until they reach the superannuation preservation age. Superannuation benefits may be accessed in the form of a lump sum or income stream upon reaching the preservation age, which is currently 55 but being gradually increased to 60 by 2025. There appears to be a strong preference for taking superannuation as a lump sum payment, even though until recently income streams have been treated more favourably by the Age Pension assets test (Mitchell and Piggott, 2000).

The Superannuation Guarantee has increased superannuation coverage to almost all employees, and recent policy initiatives such as the superannuation co-contribution, choice of super fund, transition to retirement pensions, and the removal of tax on superannuation taken after the age of 60, have increased both awareness of superannuation and the popularity of superannuation as a long term investment.

Introduction of superannuation in Australia

Before the introduction of the Superannuation Guarantee in 1992, superannuation coverage in Australia was low, and mainly limited to white collar workers. From the mid-1880's until the

[11] There are some exceptions to superannuation entitlement. For example, employees who earn less than $450 per month before tax, employees aged 70 years or over, and employees under 18 years of age who work less than 30 hours per week may not be entitled to superannuation (APRA, 2007).

1970's, superannuation provided a select group of salaried employees with an independent retirement income.[12]

Tax concessions for voluntary superannuation were introduced in the *Income Tax Assessment Act* of 1915, allowing tax deductibility of employer contributions made on behalf of employees and the exemption of superannuation fund earnings from taxation (Nielson and Harris, 2008). Superannuation coverage increased in 1922, when the Commonwealth Employees Superannuation Fund – the first superannuation scheme for Commonwealth employees – was established to provide superannuation products to employees of the Australian Government (Bateman, Kingston, and Piggott, 2001). In 1936, tax concessions for lump sum superannuation benefits were introduced, providing a further incentive for making voluntary superannuation contributions. However, the superannuation industry was still largely unregulated and benefit standards were poor (Bateman and Piggott, 2001).

It was not until the 1970s that superannuation started to become more common, through the negotiation of its inclusion in industrial awards. By 1974, 32.2% of wage and salary earners (40.8% of male wage and salary earners and only 16.5% of females) were covered by superannuation (Treasury, 2001). However, superannuation was still concentrated among a minority of employees; generally higher paid professionals, managers and administrators in large corporations, public servants, employees in the financial sector, and members of the Defence Force (Gunasekera and Powlay, 1987; APRA, 2007).

In 1973, the Whitlam Government argued the case for a national superannuation scheme as a way to improve equity and broaden superannuation coverage and established the National Superannuation Committee of Enquiry, led by Keith Hancock. The Hancock report, released in 1976, contained a recommendation for a 'partially contributory, universal pension system with an earnings-related supplement that would raise pension rates to a minimum of 30 per cent of average weekly earnings' and 'a broadening of existing arrangements through a scheme encompassing a non-contributory flat rate universal pension, a means tested supplement and greater encouragement of voluntary savings through an expansion of occupational superannuation' (Treasury, 2001). The Fraser government rejected the findings of the Hancock Report in 1979, primarily on the grounds that the proposed scheme would

[12] The first formal superannuation scheme was established in 1862 by the Bank of New South Wales, 13 years before private pension plans were first established in the United States by the American Express company (Borowski and Olsberg, 2007).

place too great a burden of contributions on low to middle income earners (Social Welfare Policy Secretariat, 1983). However, the work of the Hancock Committee led to other suggestions for reform of the Age Pension and a shift in emphasis for retirement income policy away from poverty alleviation through the Age Pension towards income maintenance through contributory superannuation (Treasury, 2001).

The first significant initiative of the Hawke government in the area of superannuation was to address concerns that a small proportion of high income individuals who received part of their remuneration as superannuation were benefiting from significantly lower effective marginal tax rates than lower income individuals who received all of their remuneration as a wage or salary (Treasury, 2001).[13] These concerns were addressed in May 1983, when it was announced that lump sum superannuation payouts taken before the age of 55 would be taxed at 30%, and for those aged 55 years and over, the first $50,000 of a lump sum would be taxed at 15% and the remainder at 30% (Treasury, 2001)[14],[15]. Also in 1983, the Hawke Government initiated discussions with the Australian Council of Trade Unions (ACTU) on the possibility of broadening access to superannuation throughout the workforce as part of the Government's negotiated Accord with the trade unions (Treasury, 2001).

[13] Prior to 1983, superannuation contributions by employers were exempt from tax, employee contributions (as contributions from wages and salary) were taxed at the employee's marginal rate and not taxed again when withdrawn from the fund and investment earnings of superannuation funds were not taxed when earned, but taxed when withdrawn from the fund. Superannuation benefits paid as a pension were treated the same as other types of income and taxed at the individual's marginal tax rate. For superannuation benefits paid as a lump sum, 5% of the total lump sum benefit was included as assessable income and taxed at the individual's marginal taxation rate, which in effect meant that the maximum rate of tax that applied to lump sums was 3% – the 60% top marginal rate applied to 5% of the lump sum (Treasury, 2001).

[14] These arrangements applied only to lump sum amounts relating to service after 1 July 1983. The existing taxation arrangements were preserved for benefits that related to service prior to this date (Treasury, 2001).

[15] Prior to this date the tax provision for most employer superannuation funds were as follows: employee contributions may qualify for a rebate; employer contributions were generally deductible; the investment income of the fund was generally not taxed if the fund was approved and maintained in accordance with taxation legislation; the entire amount of pension benefit was treated as assessable income, and an amount equal to five per cent of a lump sum was included as assessable income (APRA, 2007).

Superannuation in industrial awards

The process of institutionalising employee superannuation began in September 1985 when, as part of its National Wage Case claim with the Conciliation and Arbitration Commission, the ACTU sought a 3% superannuation contribution by employers to be paid into an industry fund (APRA, 2007). When Accord Mark II was finalised, it stipulated that total compensation to employees who were covered by awards should be 6% to keep pace with inflation, and this compensation should be in the form of a 3% employer superannuation contribution to be paid into an industry fund, a 2% wage rise, and tax cuts to take effect from 1 September 1986 (Bateman and Piggott, 1996). This produced an immediate jump in superannuation coverage in the public sector to over 90% (ABS, 1995), while coverage in the private sector increased progressively from 32% in 1987 to 68% in 1991 (APRA, 2007).

The Hawke Government statement of 1988, *Reform of the Taxation of Superannuation*, contained measures to bring forward payment of superannuation taxation liabilities by introducing a tax on contributions and reducing the tax on benefits. From 1 July 1988, a 15% tax was applied to all employer contributions and deductible member contributions received by superannuation funds, and the tax on end benefits was correspondingly reduced (APRA, 2007). A 15% tax also applied to investment income of superannuation funds derived from 1 July 1988.[16] Reasonable Benefit Limits (RBL's) were also introduced on 1 July 1988, with the aim of limiting the taxation concessions available to high income earners by subjecting superannuation benefits above these thresholds to marginal rates of tax. To encourage people to take their superannuation as a pension rather than a lump sum, the reasonable benefit limits applied to income streams were double the reasonable benefit limits applied to benefits taken as a lump sum.

The Superannuation Guarantee

While the introduction of award superannuation caused rapid growth in the number of employees with superannuation, not all employees who were entitled to superannuation were paid their entitlements and by 1991, nearly one-third of private sector employees still had no superannuation (APRA, 2007). In some cases employees were confused about the nature of

[16] To avoid the imposition of a new tax on a retrospective basis, the taxation treatment of the pre-1983 component and amounts accumulated between 1 July 1983 and 30 June 1988 remained unchanged, further adding to the complexity of superannuation taxation arrangements (APRA, 2007).

their entitlements; for others, unions had not established industry funds into which employer contributions could be paid, and compliance with superannuation requirements in awards could only be enforced through a case mounted with the Conciliation and Arbitration Commission, which was a very laborious process (Treasury, 2001). Furthermore, the 3% employer contribution was too small to provide any significant improvement in retirement incomes for all but the highest paid workers (Borowski, 1991). Because of these shortcomings, the Conciliation and Arbitration Commission rejected a claim for a further 3% superannuation increment in 1991 and instead recommended that the Government convene a national conference on superannuation to consider the issues of non-compliance and the extension of superannuation to all awards, and to casual and part-time employees (Treasury, 2001). These recommendations were not acted upon, and instead, it was announced in the 1991-92 Federal Budget that from 1 July 1992, under a new system to be known as the Superannuation Guarantee, employers would be required to make superannuation contributions into an approved fund on behalf of their employees.

The Superannuation Guarantee provided for a major extension of superannuation coverage to employees not already covered by superannuation, as well as a more efficient method for ensuring employers comply with their superannuation obligations.[17] Under the *Superannuation Guarantee (Administration) Act 1992*, a prescribed level of superannuation support must be provided by employers to all of their employees, with employers failing to meet this level being subject to a superannuation levy. At the time of the 1991-92 Budget, the initial level of prescribed superannuation contributions was 5% of ordinary time earnings for employees of employers whose annual payrolls exceed $500,000 and, to ease the transition for small business, 3% for other employees. Higher levels of contributions were to be phased in, so that by the year 2000 the prescribed level of employer superannuation contributions was 9% (Kerin, 1992).[18] By 1993, 81% of employed persons (86% of full-time workers and

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[17] This new superannuation scheme provided very few exemptions, the most prominent being employees earning less than $450 per month, part time employees under 18 years of age, and employees aged 65 years and over (APRA, 2007).

[18] This timetable was subsequently amended so that the Superannuation Guarantee phase-in began at 3% contributions for employers with a payroll of $1 million or less, and at 4% contributions for employers with a payroll greater than $1 million. In addition, the phase-in period was extended so that mandated contributions would reach a maximum of 9 per cent in 2002-03 (Treasury, 2001). For the larger employers, contributions increased to 5% from 1992-93 to 1994-95, then to 6% for the next three years, to 7% for two years, to 8% for

61% of part-time workers) in Australia were covered by superannuation. The gender gap in superannuation coverage had also narrowed, with 82% of employed men and 78% of employed women covered by superannuation (ABS, 1995).

With the introduction of the Superannuation Guarantee scheme, the proportion of superannuation accounts with small balances increased, and the effects of fees and charges on small accounts became more noticeable. To prevent small amounts of superannuation being eroded by fund fees and charges, new member protection standards came into force from 1 July 1995 under the *Superannuation Industry Standards Regulations Act*. These rules prevented fees and charges on accounts with balances of less than $1000 from exceeding investment gains on those accounts. (APRA, 2007).

In his 1995 budget speech, Treasurer Ralph Willis outlined plans to pay previously announced tax cuts into employee's superannuation funds, so that by 2002, minimum superannuation contributions would be 15%. It was also proposed that the government should match additional superannuation contributions made by employees dollar-for-dollar (Willis, 1995). While these proposals were not adopted at the time, the principle of a government superannuation co-contribution was established.

The first budget of the Howard Government, in August 1996, included the introduction of the Superannuation Surcharge, as well as proposals to introduce Retirement Savings Accounts (RSA's) as an alternative to trustee controlled superannuation funds, an opt-out from the Superannuation Guarantee for low income earners, and the ability to make superannuation contributions on behalf of a spouse.

The Superannuation Surcharge was introduced in an attempt to reduce the bias in favour of high income earners, who were able to benefit much more than lower income earners from the tax concessions available on superannuation and the added advantage from salary sacrifice. From 20 August 1996, a surcharge of 15% was applied to superannuation contributions for those whose annual income (including deductible superannuation contributions) was $85,000 or more. This surcharge was also to be gradually phased in for those with annual incomes above $70,000 (Costello, 1996).

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two years, and to 9% from 2002-03. For employers with a payroll of $1 million or less, contributions remained at 3% in 1992-93 and 1993-94, then increased to 4% in 1995-96, to 5% in 1995-96, to 6% in 1996-97, and from 1997-98 became the same as for employers with payrolls of $1 million or more (Drew and Stanford, 2003).

In June 1997, an alternative to trustee controlled superannuation funds was introduced under the *Retirement Savings Accounts Act 1997*. Under this new legislation, taking effect from 1 July 1997, it became possible for banks, credit unions and building societies to offer retirement savings accounts (RSA's). The aim of RSA's was to provide a simple, low cost, capital protected alternative to superannuation accounts for small balances that could be rolled over into traditional funds after savings had been built up, and also serve risk averse retirees seeking cash investments (APRA, 2007).

Other proposed reforms in the 1996-97 Budget included an 18% rebate for up to $3000 of contributions made by a person on behalf of their low income spouse, and the extension of the age limit for voluntary superannuation contributions from 65 to 70 years, on the condition that the individual is still in the workforce. These changes, designed to enhance the fairness of superannuation and encourage older workers to remain in the labour force, took effect from 1 July 1997.

In the 1997-98 Budget, it was announced that from 1 July 1999 all future superannuation contributions, including personal contributions and earnings, would be preserved until preservation age and the superannuation preservation age would be gradually increased from 55 to 60 years by 2025.[19] Persons born before 1 July 1960 would continue to have a preservation age of 55, but for those born after that date, the preservation age would be increased by one year for those born between 1 July 1960 and 30 June 1961, by two years for those born between 1 July 1961 and 30 June 1962, and so on, so that for individuals born after 30 June 1964, the superannuation preservation age will be 60 (Costello, 1997). The phase in schedule for the change in superannuation preservation age is shown in Table 2.

[19] Benefits which were unpreserved at that date would remain so.

Table 2: Changes in Superannuation Preservation Age

Date of Birth	*Preservation Age (years)*	*Preservation Age Effective*
Before 1 July 1960	55	1987
1/7/60 to 30/6/61	56	July 2016
1/7/61 to 30/6/62	57	July 2018
1/7/62 to 30/6/63	58	July 2020
1/7/63 to 30/6/64	59	July 2022
After 30 June 1964	60	July 2024

Source: Costello (1997).

Other announcements in the 1997-98 Budget included the introduction of the deferred pension bonus plan (described in the previous section) and an opt-out option for superannuation contributions for low income employees, both to take effect from 1 July 1998. In order to alleviate the problem of people on very low incomes being forced into superannuation when their pressing need is to maintain current living standards, employees with incomes between $450 and $900 a month would, with the agreement of their employer, be able to choose between receiving Superannuation Guarantee contributions or the equivalent as wages and salary (Costello, 1997).[20]

The 1997-98 Budget also included a proposal to replace the previous Government's proposed increased mandatory contribution rate with a 15% tax rebate for voluntary superannuation contributions and a call for greater choice for employees as to which superannuation fund their Superannuation Guarantee contributions were made into. From 1 July 1998, a tax rebate of 7.5% was available for undeducted superannuation contributions (voluntary contributions from after-tax income), up to an annual cap of $3000. The rate of this rebate increased to 15% from 1 July 1999 (Adams, 1998).

The original Superannuation Guarantee legislation did not specify any rules regarding which particular superannuation fund employers should make mandatory contributions into, apart from the requirement that it was a 'complying fund' as described in the *Superannuation Industry Supervision Act 1993* (APRA, 2007). The legislation necessary to allow employees

[20] For employees under the age of 18, the $900 threshold is replaced by an $1800 threshold over two months.

to choose which fund received their Superannuation Guarantee contributions was first introduced into Parliament in December 1997. However, it was not until 2003 that agreement was reached about the way in which choice of superannuation funds would operate, and amending legislation was passed allowing employees to choose from five superannuation funds nominated by their employer (APRA, 2007).

Several changes to superannuation were announced in the 2002-03 Budget, most notable of which was the introduction of the superannuation co-contribution scheme. In order to encourage individuals to increase their retirement incomes by making greater contributions to superannuation, from 1 July 2002, the Government would make a matching superannuation co-contribution of up to $1000 per year for qualifying low income earners who made personal undeducted superannuation contributions. Individuals with assessable incomes and reportable fringe benefits up to $20,000 per annum would be eligible for the maximum $1000 co-contribution, and those with annual incomes of up to $32,500 would be eligible for a reduced co-contribution (Costello, 2002).

It was also announced in the 2002-03 Budget that: the Government would reduce the superannuation surcharge rates by one-tenth of their current levels each year, so that by the 2004-05 financial year, the superannuation surcharge would be 10.5%; the thresholds for tax deductible superannuation contributions for the self employed were to be increased from $3000 to $5000 from 1 July 2002; the maximum age to be eligible to make personal superannuation contributions would be increased from 70 to 75 years for those who were working at least ten hours per week; and non-mandated employer contributions would be allowed for those under the age of 75 (Costello, 2002). To reduce potential loss of superannuation benefits in the event of an employer going bankrupt or becoming insolvent, from 1 July 2003, employers would be required to make Superannuation Guarantee contributions on at least a quarterly basis. For those who separated or divorced after 28 December 2002, superannuation assets would be able to be split between spouses by agreement or by court order, and, in order to make superannuation contribution arrangements more family friendly, members of accumulation funds were to be allowed to split future superannuation contributions with their spouse from 1 July 2003 (Costello, 2002).

In the 2004-05 Budget speech, Treasurer Costello announced yet more changes. First, in order to boost retirement savings, the superannuation surcharge would be further reduced to a maximum rate of 7.5% from 2006-07. Second, restrictions on who could contribute to superannuation would be reduced and options for those in the transition to retirement would be improved, allowing those who had reached their superannuation preservation age to access some of their superannuation in the form of an income stream without having to completely retire from the labour force. It was also announced that the superannuation co-contribution scheme would be extended to cover those with incomes of up to $58,000 (up from $40,000), the maximum annual co-contribution available would be increased from $1000 to $1500, and the matching rate would be increased to $1.50 for every dollar contributed. Furthermore, eligibility for the co-contribution was extended to those who earned less than $450 per month and were not eligible for Superannuation Guarantee contributions.

The Government's statement, *A More Flexible and Adaptable Retirement Income system*, released in February 2004, outlined measures to further broaden the availability of superannuation, provide more choice in financing retirement income, and make superannuation more adaptable to changing work arrangements. In order to encourage older people to make additional contributions to superannuation regardless of whether they were employed, the work test on who was able contribute to superannuation was removed for those under the age of 65 in July 2004. Furthermore, from 1 July 2005, the work test for men and women aged between 65 and 74 was simplified to require only that a person had worked 40 hours within a 30 day period of the financial year in which contributions were paid, so that people aged between 65 and 74 who were doing irregular part-time or short term contract work were able to make additional superannuation contributions if they chose to (Australian Government, 2004).[21] While it is clear that the aim of these changes to the work tests was to encourage older Australians to make voluntary superannuation contributions, it was also important that older Australians used their superannuation as a source of retirement income, rather than for estate planning. For this reason, the compulsory cashing rules were amended so that, from 1 July 2004, superannuation funds were required to start paying benefits, either as an income stream or a lump sum, as soon as a person reached the age of 75. Prior to this change, people aged 75 or older were able to keep their benefits in their superannuation fund if they were working at least 30 hours per week (Australian Government, 2004).

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[21] Prior to the removal of the work test, people under the age of 65 had to have worked at least 10 hours in one week at some time in the previous two years in order to make contributions to their superannuation, people aged 65 to 74 had to work at least 10 hours in each week to be eligible to make contributions, and a superannuation fund was required to pay out a members benefits if they failed the work test (Australian Government, 2004).

The final form of the Choice of Funds legislation came into effect on 1 July 2005. Under the *Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2004*, also known as the Choice of Fund Act, employees have the right to nominate any complying fund for their Superannuation Guarantee contributions to be paid into (APRA, 2007).

To encourage older workers to remain in the workforce, a new category of benefit called a transition to retirement pension was introduced. Since July 2005, those who have reached their superannuation preservation age have been able to access their superannuation as a non-commutable income stream, allowing those who want to remain in the workforce but reduce their working hours to supplement their income with superannuation (Treasury, 2004).[22] Prior to the introduction of these pensions, a person below the age of 65 had to retire or leave employment before they were able to access any superannuation benefits. Under the new measures, once a person reaches superannuation preservation age, they are able to access their superannuation as a non-commutable income stream (Treasury, 2004).

At present, superannuation benefits paid to Government employees are paid from the Federal Budget on a pay-as-you-go basis. As of May 2007, the Government's unfunded superannuation liability was around $103 billion and it was expected to grow to around $148 billion by 2020 (Australian Government, 2008). As Australia's population ages, it is also expected that the Federal Budget will also be under increased pressure as a result of increasing costs of services such as health and aged care. To reduce the pressure on future Federal Budgets, the Australian Government announced in the 2005-06 Budget that it would create the 'Future Fund' for the purpose of accumulating sufficient financial assets to offset the Australian governments unfunded superannuation liabilities by 2020 (APRA, 2007). Seed capital for the fund was allocated from the 2004-05 Budget surplus, and the Government will reinvest the earnings from the fund, as well as investing future surpluses, with draw downs not allowed until assets sufficient to offset the liabilities have been accumulated (Australian Government, 2005). It was also announced in the 2005-06 budget, that to encourage people to make additional superannuation savings, the superannuation surcharge would be completely abolished.

[22] For those who take up a transition to retirement pension, the amount that can be taken as income stream each year is limited to 10% of the person's superannuation balance at 1 July of that year.

From 1 January 2006, contributions splitting took effect. From that date, an individual's Superannuation Guarantee and other superannuation contributions could be split with their spouse at the time the contributions were made (APRA, 2007).[23] Splitting superannuation contributions with one's spouse can provide several financial advantages. For example: where one spouse is closer to preservation age than the other, superannuation can be accessed earlier; where one spouse has reached pension eligibility age and the other has not, the superannuation assets of the younger spouse are not included in assets and income tests for the Age Pension of the older spouse; and for those who have reached preservation age and want to take a lump sum before the age of 60, both members of the couple have access to the tax free threshold, so that $280,000 rather than $140,000 could be accessed tax free.

Simpler Super

With the multitude of policy changes that had been put in place since the introduction of the Superannuation Guarantee in 1992, the superannuation system had become extremely complex, particularly in terms of the taxation of superannuation contributions and end benefits. On 6 May 2006, the Australian Government released a proposal called *A Plan to Simplify and Streamline Superannuation* describing proposed changes to Australia's retirement system. The aim of these reforms was 'to assist and encourage people to achieve a higher standard of living in retirement than would be possible from the Age Pension alone, provide significant benefits over time to Australians with only compulsory superannuation, reward people for making additional superannuation contributions to improve their retirement income, and boost incentives to work and save' (Treasury, 2006).

Under this plan, Australia's superannuation system has undergone substantial change, most notably the abolition of the 15% benefits tax on superannuation payouts taken at the age of 60 or later. Prior to these reforms, there were different arrangements for tax on superannuation contributions, earnings and benefits – a lump sum could include up to eight different parts taxed in seven different ways, which made it extremely difficult for people contemplating retirement to understand how their superannuation benefits would be taxed, and also affected younger people considering whether or not to make additional contributions to their superannuation (Treasury, 2006).

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[23] From April 2007 onwards, spouses were only able to split only taxable contributions (APRA, 2007).

As part of the Simpler Super plan, as of 1 July 2007 all lump sum superannuation benefits paid from a taxed source to an individual aged 60 or over became tax free; all pension payments from a taxed source, including pensions which commenced before 1 July 2007, became tax free when paid to individuals aged 60 or over; reasonable benefit limits were abolished; and individuals no longer need to include lump sum superannuation benefits and superannuation pensions from a taxed fund made after 30 June 2007 in their tax returns (Treasury, 2006). For lump sum benefit payments from an untaxed source, for those aged 60 and over a tax rate of 15% will apply to the total of all payments up to $1 million and above that amount the top marginal tax rate will apply and for those aged 55 to 59, a tax rate of 15% will apply for payments up to the low rate threshold ($140,000), 30% above this amount up to the upper threshold ($1 million) and the top marginal tax rate above that amount. Pension payments arising from an untaxed superannuation source will be taxed at marginal tax rates with a 10% offset for people aged 60 and over (Treasury, 2006).

For individuals under the age of 60 who take a lump sum payment, the lump sum will have a tax exempt component and a taxed component. The taxed component will be tax free up to the low-rate threshold, which was set at $140,000 on 1 July 2007 and indexed to average weekly ordinary time earnings, and taxed at a maximum rate of 15% above that threshold (Treasury, 2006).[24] For those who take their superannuation as an income stream before the age of 60, these payments will continue to be taxed under the current arrangements until the recipient reaches the age of 60, at which point the income stream will become tax free.

Also under the Simpler Super reforms, the work tests for receipt of superannuation benefits were removed. As of 10 May 2006, it is no longer compulsory to withdraw superannuation holdings upon reaching the age of 65 and being out of the labour force, giving people greater flexibility in deciding how and when to draw down their superannuation in retirement.[25] Previously, men and women aged 65 and over who were no longer working were required to cash out their superannuation or start a pension, but now, individuals can

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[24] The tax exempt component includes the pre-July 1983 component, the capital gains tax exempt component, the post-June 1994 invalidity component, the concessional component and undeducted contributions. The taxed component is made up of the post-June 1983 component and the non-qualifying component (Treasury, 2006).

[25] Where a person chooses not to draw down on their fund assets as a pension, earnings on these assets will be subject to tax as assessable income of the fund at 15% (Australian Government, 2006).

retain their money in superannuation indefinitely. The rules governing annuities and pensions were amended—from 1 July 2007 the minimum drawdown rules for account based pensions were simplified and the maximum drawdown rules were removed.[26] The transition to retirement rules were also amended to meet the new standards, and from 1 July 2007, pensions commenced under the transition to retirement condition of release would allow no more than 10% of the account balance to be withdrawn in any one year (Treasury, 2006).

The removal of reasonable benefit limits and the tax exempt status of superannuation pension assets, created an incentive for high-wealth individuals to transfer large amounts of assets currently held outside superannuation into the concessionally taxed superannuation system. For this reason, the Simpler Super reforms also included changes to contribution rules, with annual limits of $50,000 on concessional deductible superannuation contributions, to be taxed at 15%.[27] These changes to contributions have applied from 1 July 2007, but between 10 May 2006 and 30 June 2007 individuals were able to make post-tax contributions of up to $1 million into their super fund. After 30 June 2007, contributions were limited to $150,000 per financial year for people aged 65-74 who also satisfy the work test (they work at least 40 hours during a consecutive 30-day period during the financial year) or $450,000 averaged over three years for under 65s, and from 1 July 2007, post-tax contributions over those amounts are to be taxed at the highest marginal tax rate. The rules prohibiting superannuation contributions by people aged 75 and over were not changed.

From 1 July 2007, the Government co-contribution scheme was extended to include the self-employed, whose income is determined by taking the assessable income of the individual, including any reportable fringe benefits, and reducing that amount by the expenses incurred in carrying on their business (Treasury, 2006). The self-employed and other persons who were previously eligible for a deduction would also be eligible to claim a full deduction for their after-tax superannuation contributions up to age 75.[28]

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[26] The minimum annual pension payments (% of superannuation balance) for those aged 55–64 is 4%, 5% for those aged 65-74, 6% for those aged 75-84, 10% for those aged 85-94 and 14% for those aged 95 and over.

[27] A five year transitional period will apply for people who are aged 50 and above to allow those approaching retirement to make concessional contributions of $100,000 per year.

[28] Before these changes, the self-employed did not qualify for the superannuation co-contribution and could claim a tax deduction for the first $5,000 of superannuation contributions and 75% of any contributions above this amount until they reach their age-based limit (Treasury, 2006).

In the 2007-08 Federal Budget, it was announced that, in recognition of the effort people had already made to save for their retirement, the Government would double the superannuation co-contribution paid for eligible contributions made in the 2005-06 financial year. It was also announced that, because of changes to the income tax thresholds, from 1 July 2008 those who were eligible for the Senior Australians Tax Offset would now pay no tax on their annual income up to $25,867 for singles and $43,360 for couples (Costello, 2007).

The most recent change to superannuation legislation, which took effect on 1 July 2008, was a change in the way employers were required to calculate the amount of superannuation contribution they had to pay to their employees. Before this change took effect, employers were required to make minimum Superannuation Guarantee contributions of 9% of each employee's notional earnings base, as defined under an applicable award. Now, employers are required to calculate employees' Superannuation Guarantee contributions based on ordinary time earnings, which include over-award payments, shift loadings and commissions (ATO, 2007).

III. Effects of Recent Policy Changes

Sections I and II of this paper have outlined the historical evolution of Australia's Retirement Income System and the multitude of changes that have been introduced since employer contributions to superannuation became compulsory. This section provides a review of the existing evidence, research and commentary about the expected consequences of recent changes to retirement income policy, such as the introduction of the Superannuation Guarantee and the superannuation co-contribution, changes to the taxation of superannuation changes to Age Pension eligibility. At present, there is very little evidence available about the effects of these changes. Hence, this review is necessarily brief.

The Superannuation Guarantee

The Superannuation Guarantee has, of course, increased superannuation balances of those who have been in paid work since it began in 1992, and has gone some way towards narrowing the gender gap in superannuation balances. This combined with high investment returns, good wage growth and low levels of unemployment, has seen superannuation balances increase substantially in recent years (Clare, 2008). However, the full effect of the

Superannuation Guarantee is yet to be seen. It will take another twenty to thirty years before the majority of employees will benefit from the Superannuation Guarantee throughout their entire working lives. In the 2005-06 financial year, average retirement payouts were $136,000 for men and $63,000 for women, so it is clear that most will still rely on the Age Pension as their main source of retirement income (Clare, 2008). At this point in time it is still unclear whether more recent policy changes such as the introduction of Transition to Retirement pensions, the superannuation co-contribution and the changes to the taxation of superannuation payouts and assets test thresholds will have their intended effects of increasing mature age labour force participation and reducing reliance on the Age Pension.

Superannuation payouts can be taken from the age of 55 onwards, and accessed tax free at the age of 60 – well before Age Pension eligibility age. For some, particularly those whose superannuation would not be enough to provide an adequate retirement income, the additional superannuation provided by the Superannuation Guarantee may create an incentive to retire earlier, using superannuation to fund early retirement before taking the Age Pension. With no incentive to take superannuation payouts as an income stream rather than a lump sum, an average superannuation payout may provide a means of funding early retirement before reaching Age Pension eligibility age. This effect is augmented by the very slow phasing in of the higher superannuation preservation age, and is exacerbated by the possibility of 'double dipping' – where people dissipate part of their superannuation wealth prior to pension eligibility so that, in effect, the social security system subsidises their early retirement (Ingles, 2000).

The superannuation co-contribution

There is already some evidence that the superannuation co-contribution scheme has delivered benefits to some low income employees, particularly women. Among those who participated in the co-contribution scheme in the 2003-04 financial year, around 55% of beneficiaries had total individual incomes of less than $30,000 per year, 39% of beneficiaries were single, 63% of beneficiaries were female and 47% were baby boomers, aged between 45 and 65, the group that has the lowest level of superannuation savings relative to their expected retirement needs (Nielson, 2005). However, participation in the scheme has been low (so far) relative to the eligible population. In the 2004-05 financial year, less than 10% of those who were eligible participated in the scheme (Nielson, 2005). According to Borowski (2008), this low level of take-up suggests either ignorance of the scheme, or a lack of discretionary income available to make the contribution required to attract the co-contribution.

It seems unlikely that individuals with genuinely low incomes (that is, those in low income households) would be able to put aside $1000 to add to their superannuation, and there is some concern about the benefits of the co-contribution scheme going mostly to beneficiaries with high income partners. However, it appears that for the majority of beneficiaries this is not the case. Only 4% of beneficiaries' spouses earned $100,000 or more in the 2003-04 financial year, while 81% of beneficiaries' spouses had a taxable income of $60,000 or less (Nielson, 2005). Furthermore, Nielson (2005) argues that even if some women with high income spouses accumulate larger superannuation balances than would otherwise be the case, this is not such a bad outcome considering the fact that superannuation is based on individual entitlement and a large number of marriages end in divorce.

Removal of tax on superannuation after 60

The removal of taxes on superannuation benefits taken as either a lump sum or an income stream after the age of 60 may encourage some people to remain in the workforce until age 60 in order to maximise their superannuation income. Based on a survey of 2501 Australian workers aged between 40 and 59 in 2006, Walter, Jackson and Felmingham (2008) found that the vast majority of older Australian workers were aware of this policy change, and around half indicated that it is likely to persuade them to remain in the workforce until the age of 60.[29] On the other hand, it may also encourage earlier retirement among those who would have otherwise continued working until a later age. At present, the abolition of taxes on superannuation payouts for those aged 60 and over will only affect a minority of perspective retirees, as relatively few are likely to receive a lump sum in excess of the Reasonable Benefit Limit (tax free) threshold that previously applied to superannuation benefits (Clare, 2007). However, as the Superannuation Guarantee matures, the proportion of retirees benefiting from the abolition of this tax will increase. Still, Sharp and Austen (2007) have noted that the average superannuation balance would not have reached the Reasonable Benefit Limits threshold for another 30 to 35 years.

[29] The Australian Survey of Retirement Attitudes and Motivations (ASRAM) is a nationally representative survey of Australian workers aged 40 to 59. It was conducted by telephone between July and November 2006.

It has been argued (Freebairn, 2007, Sharp and Austen, 2007) that the change to superannuation tax that came into effect on 1 July 2007 is unlikely to have its intended effect of increased workforce participation, as those high wealth individuals who will benefit from the change will have income and substitution effects operating in opposite directions. That is, given that leisure is a normal good (demand for leisure increases when income rises), the windfall gain from the tax change will induce many people to work less and retire earlier (a negative income effect). On the other hand, eliminating the tax on benefits may encourage older workers to remain in the workforce or re-enter the workforce by effectively raising their after-tax wage and therefore raising the price of leisure (a positive substitution effect). According to Freebairn (2007), the tax change will result in a large increase in the value of superannuation stocks, creating a large income effect, while the substitution will be smaller. So, at least for the next few years, Freebairn estimates that the income effect will dominate the substitution effect and create an incentive for older workers, particularly those with substantial superannuation savings, to either reduce their labour force participation or retire early.

There is also the simpler argument that people who intend to rely either fully or partly on superannuation in retirement build up a target stock of wealth in order to generate their desired retirement income, and retire once they reach their savings goal. The windfall income generated from the abolition of tax on superannuation payouts will lead some individuals to reach their target wealth stock at an earlier age, enabling them to retire earlier (Freebairn, 2007).

Limits on deductible superannuation contributions

The changes to the limits on deductible superannuation contributions, introduced as part of the Simpler Super reforms, will also mostly affect high income individuals. Sharp and Austen (2007) suggest that these contribution limits may affect those who reach their earnings peak later in life, for example, women returning to work after a period of career interruptions, as the contribution limits will restrict their ability to make up for periods where little or no superannuation contributions were made.

Transition to Retirement pensions

The introduction of Transition to Retirement pensions is likely to have encouraged some people to remain in the labour force and reduce their working hours, rather than retiring completely. It is possible that this would mean that some people who continue working and use their superannuation to supplement their labour income would run down their superannuation assets substantially before they actually retire, increasing the likelihood that they would be eligible for a full or part Age Pension.

It is also unclear whether take up of this option will result in an overall increase in workforce participation among older workers. Walter, Jackson and Felmingham (2008) suggest that while this policy aims to encourage workforce participation among those who are able to retire, it may also tempt older workers to reduce workforce participation at an earlier age than they might otherwise have done without access to a Transition to Retirement pension, resulting in an overall reduction in labour force participation of older workers.

The Deferred Pension Bonus plan

It appears that the Deferred Pension Bonus, introduced in 1998, has had very little effect on labour force participation rates men and women of Age Pension eligibility age. Take up of the scheme has been quite low, with less than 10% of those who would have been eligible participating in 2004 (Dunsford and Rice, 2004). The main reasons for the low levels of take up include the absence of publicity for the scheme, the modest level of benefit (approximately 10% of pension income foregone if retirement is postponed for one year, and 40% of pension income foregone if retirement is postponed for five years), and the complexity of registering and proving eligibility for the period of entitlement.[30]

Changes to Age Pension eligibility and means tests

The gradual increase in Age Pension eligibility age for women is likely to have a positive effect on the labour force participation of older women, particularly those with low levels of superannuation savings or other assets that could be used to generate income in retirement. Ingles (2000) suggests that the effect on participation of raising the Age Pension eligibility age depends strongly on the extent to which people are able to access other forms of income

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[30] Using the Australian Survey of Retirement Attitudes and Motivations (ASRAM) Data, a nationally representative survey of 2501 Australian workers aged 40 to 59 in 2006, Walter, Jackson and Felmingham (2008) found that only one quarter of respondents were aware of the Pension Bonus Scheme, and among those who were aware of the scheme, only 40% indicated the scheme was likely to persuade them to remain in the workforce past the age of 65.

support, such as Disability Support Payment and Mature Age allowance, as early retirement options.

According to Clare (2007), changes to the Age Pension means test currently make up the largest proportion of the costs of the Simpler Super package. It is estimated that at least 200,000 current retirees will benefit from the easing of the assets test for the Age Pension in 2007, either in the form of higher pension income for those on part pensions, or becoming eligible to receive a pension for the first time, and that over time, the number of people benefiting from this change will increase as superannuation balances become larger. However, this easing of the assets test appears to be at odds with the Government's goal of reducing reliance on the Age Pension and encouraging the labour force participation of older workers. Apart from increasing government spending on Age Pensions, the liberalisation of the assets test may also discourage some of those people who would not have otherwise been eligible for an Age Pension, or who would have received only a part pension, from continuing in the labour force past Age Pension eligibility age.

At this point, the total effect on of recent changes to retirement policy on mature age labour force participation unclear. However, based on the available evidence, it appears that several of the more recent policy changes may not actually have their intended effects. Take-up of schemes such as the Deferred Pension Bonus and the superannuation co-contribution scheme has been quite low; the removal of tax on superannuation benefits taken after the age of 60 will not affect the majority of those who will retire in the near future; and it is unclear whether Transition to Retirement Pensions will increase overall labour force participation of the mature age population. The one policy change where effects can be seen immediately is the liberalisation of the Age Pension assets test threshold, which has increased the number of people eligible to receive a full or part Age Pension – a result that is contradictory to the Government's stated goal of containing the costs of the Age Pension.

Conclusion

Australia's retirement income system, consisting of the Age Pension, superannuation, and other savings, has gone through substantial changes over the past two decades, the most significant being the introduction of the Superannuation Guarantee in 1992. For most Australians, the main source of retirement income has been the Age Pension, and this will continue to be the case until the Superannuation Guarantee is fully mature.

Since the beginnings of compulsory superannuation, starting with Award Super in the 1980s, the Australian Retirement System has undergone a spate of changes, which, for the most part, have added to its complexity. Furthermore, these policy changes have not always been consistent. Examples of policy inconsistencies include the introduction and subsequent removal of measures designed to encourage the taking of superannuation as a lump sum rather than an income stream, and the introduction of the superannuation surcharge, which was then gradually reduced until it had been completely abolished.

This constant flux in government regulation and policies – particularly changes in the tax treatment of superannuation and the level of benefit available from the Age Pension – may, in itself, make it difficult for those planning their retirement in the short- to medium-term to make informed decisions about their retirement arrangements. Uncertainty about how long any particular retirement policy will be in place, or in its current form, may prevent people from responding to policy incentives that might have persuaded them to change their retirement plans.

It is still unclear whether recent policy changes such as the superannuation co-contribution, the abolition of taxes on superannuation benefits taken after the age of 60 and the introduction of Transition to Retirement pensions will have their intended effect of increasing mature age labour force participation and moving the focus of the retirement system from the Age Pension towards self funding of retirement through superannuation. Indeed, some have argued that these policy changes create perverse incentives, and will encourage early retirement. However, it is clear that one major shortcoming of Australia’s current retirement income system is the different ages that various policies take effect, with the superannuation preservation age currently at 55, tax concessions on superannuation applying at age 60 and Age Pension eligibility at 65 for men and being gradually increased to 65 for women. This variation makes it possible for individuals to draw down their superannuation prior to Age Pension age, creating an incentive for early retirement.

Appendix: Chronology of the Development of Australia's Retirement Income System

1862	First formal superannuation scheme established by the Bank of New South Wales
1900	Means tested age pensions introduced in New South Wales and Victoria
1908	Means tested age pensions introduced in Queensland
	Invalid and Old Age Pensions Act 1908 passed and Commonwealth Age pension introduced
1909	Payment of Commonwealth age pension commenced
1910	Age pension paid to women aged 60 and over
1912	Family home exempt from age pension means test
1915	Tax concessions for voluntary superannuation contributions introduced
1922	Commonwealth employees superannuation fund established
1926	Widows' pensions introduced in NSW
1933	Provision for automatic increases in pension rates on the basis of the cost of living introduced
1936	Tax concessions for voluntary superannuation contributions strengthened
	First service pensions paid
1937	Provision for automatic increases in pension rates repealed
1940	Provision for automatic increases in pension rates reintroduced
1942	Commonwealth widows' pensions introduced, superseding NSW widows pension
1943	Wife's allowance introduced for dependent spouses of incapacitated male pensioners
1945	Introduction of Commonwealth unemployment and sickness benefits
1952	Means test on age and invalid pension removed for the permanently blind
1954	Income from property excluded from the age pension means test
1958	Supplementary assistance (now known as rent assistance) introduced for single pensioners
1961	Property and income tests for age pension eligibility replaced by the merged means test
1962	Residence qualification for age pension eligibility reduced from 20 years to 10 years
1963	Single pensioners entitled to a higher age pension payment
1965	Wife's allowance extended to cover any pensioner wife not herself entitled to a pension
1969	Tapered age pension means test introduced
1972	Wife's allowance replaced by wife's pension
1973	Whitlam Labor Government established the *National Superannuation Committee of Inquiry*
	Age pension means test abolished for pensioners aged 75 years and over
1975	Age pension means test removed for persons aged 70 to 74
	Pensions linked to 25% of average weekly earnings, to be indexed annually
1976	Assets test for age pension abolished for all persons, only income test applied
	The *National Superannuation Committee of Inquiry* (Hancock Inquiry) recommended a partially contributory, universal pension system with an earnings-related supplement
1978	Reintroduction of assets test for those aged 70 and over
	Income test free part of age pension frozen for those aged 70 and over
1979	Fraser Government rejected the recommendations of the Hancock Inquiry

	Pension increases subject to twice yearly increases
1983	Base pension for those aged 70 and over subject to a special income test
	5% taxes on lump sum superannuation benefits introduced
	Increased tax deductibility for superannuation contributions made by employees and the self employed
	Spouse Carer’s pension introduced for men caring for a severely handicapped or invalid wife
1984	Tax concessions for annuities introduced
1985	Age pension assets test reintroduced
	Labor Government and trade unions finalise Accord Mark II which included a 3% employer superannuation contribution
	Spouse carers pension subsumed by the carer’s pension
1986	3% award superannuation endorsed by Conciliation and Arbitration Commission
1987	Pensions earning credit introduced
1988	Introduction of 15% tax on superannuation income
	Reduction of lump sum taxes
	15% annuity rebate introduced
	Introduction of marginal reasonable benefit limits (RBL) scales
	Increased tax deductibility on superannuation contributions for uncovered workers and the self employed
1989	Special income test applying to age pensioners 70 years and over no longer applied
1990	Age pension means tests liberalised for pensions and annuities
	Income test deeming rules introduced
	Introduction of tax rebates for superannuation contributions by low-coverage employees
1991	Industrial Relations Commission reject further 3% productivity award superannuation
1992	Superannuation Guarantee commenced
	Allocated pensions become subject to both the income and assets test
1993	World Bank endorses Australia’s three pillar system for the provision of retirement income as world’s best practice
1994	Age determined employer contribution limits introduced
	Increased eligibility for 15% annuity rebate
	Commencement of phase in of superannuation preservation age 60
	Reasonable benefit limits changed from marginal rates to flat rate
1995	Commencement of the phase in of the increase in age pension age for women from 60 to 65
1996	Extended deeming applied to financial investments under the age pension income test
1997	15% tax rebate for voluntary superannuation contributions introduced
	Age pension to be formally maintained at 25% of average weekly ordinary time earnings
	Retirement savings accounts established
	Superannuation surcharge implemented
	Opt-out from Superannuation Guarantee allowed for those earning less than $900 per month
	Maximum age for Superannuation Guarantee contributions increased from 65 to 70

	18% rebate introduced for contributions made on behalf of a low income spouse
1998	Deferred Pension Bonus scheme introduced
	Complying annuities 100% exempt from age pension assets test
1999	Superannuation preservation age to be gradually increased from 55 to 60 by 2024
2000	Age pension income test taper rate reduced from 50% to 40%
	15% tax rebate on superannuation contributions abolished under the new tax system
	4% GST supplement added to pensions
	Senior Australians' Tax Offset (SATO) replaces pensioner tax offset
2002	Maximum age for superannuation contributions increased from 70 to 75 for people working at least 10 hours a week
	Superannuation assets able to be divided between the parties in a marriage breakdown
2003	Government co-contribution for low and middle income earners introduced
	Superannuation surcharge reduced from 15% to 12.5%
	Superannuation guarantee required to be paid quarterly
2004	Superannuation co-contribution extended to individuals earning up to $58,000
	Superannuation regulations changed to allow portability of funds between different accounts
	Assets test exemption applied to complying annuities reduced from 100% to 50%
	Superannuation surcharge reduced from 12.5% to 10%.
	Work test for superannuation contributions made by those under the age of 65 abolished
2005	Superannuation Surcharge abolished
	Transition to Retirement Pensions available
	Choice of funds legislation introduced
2006	Superannuation guarantee and other contributions may be split with a spouse
2007	Exemption from tax on superannuation end benefits for Australians aged 60 or over
	Reasonable benefit limits abolished
	Age pension assets test threshold raised
	Assets test taper rate reduced from $3 to $1.50 per $1000 over the threshold
	Complying annuities no longer exempt from the assets test
	Post-tax superannuation contributions subject to an annual cap of $50,000
2008	Employers must make minimum Superannuation Guarantee contributions based on ordinary time earnings rather than notional earnings base

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