

# Age Pensions

Issued June 2004

## GLOBAL PENSION ORIGINS

Pensions paid to ex-armed service personnel date back to 1600's in the UK and US. Age pensions paid to the general population first occurred in Germany in 1885. These required contributions from workers. This was followed by old age pensions in Denmark in 1891 and New Zealand in 1898. The US started much later than other countries in 1935 when an insurance-based old-age pension scheme was introduced.

## ORIGINS OF AUSTRALIAN AGE PENSION

In Australia, the first Age Pensions were introduced in 1900 by NSW and Victorian State governments. These were followed in April 1909 by Commonwealth old age and invalid pensions. The initial national Age Pension in 1909 was equivalent to \$1 per week (21.6% of average wage) for both single and married persons. There was a means test for full pension based on assets and property value including own home of \$620 (2.6 times average annual wage) and income of \$104 pa (43% of average annual wage).

## HOW PENSIONS ARE PAID

Age pensions are paid fortnightly from money collected in taxes by the federal government. There is no fund set aside to pay age pensions. If the number of people qualifying for age pensions increases and/or the number of people paying income tax reduces, then tax rates will have to increase to provide age pensions.

## PENSION INCOME LEVEL

Over most of the 20<sup>th</sup> Century the age pension (for a single person) has hovered between 21% around 27% of average weekly ordinary time wages for full time adult persons (AWOTE).

Governments have, however, usually increased pensions six monthly (from 1990 in March and September) in line with prices (CPI increases). Over the last 100 years wages have risen at 1.5% pa faster than prices. There has been occasional catch up adjustments to push the single person pension up towards 25% of wages (AWOTE). The pension level at 25 year points relative to average wages, is summarized in the table below:

Year	Single Age Pension \$per year	% of Average Wages
1909	52	21.6%
1925	104	21.1%
1950	260	26.6%
1975	2,015	27.0%
2000	9,672	24.7%
2003	12,069	24.7%

The graph lower left, shows that in the past 10 years the Single Person Age Pension has drifted about 8% lower relative to AWOTE from being at 27% in the early 1990's.

## MARRIED vs SINGLE

Because overhead costs of housing and utilities per person are lower for a married couple, the married rate of pension (per person) is lower than the single rate. Currently the married rate per person is 83% of the single rate per person.

## QUALIFYING TESTS

The test to qualify for age pension is called a "Means Test". It is based on income and assets thresholds at which people are judged to have the "means" to support themselves without help from the government.

The following table shows the current (March 2004) income limits at which age pension is paid at various levels:

Single Person Age Pensions Using Income Means Test		
Pension Level	Age Pension \$pa	Other Income \$pa
100%	12,069	3,120
75%	9,052	10,758
50%	6,035	18,395
25%	3,017	26,033
Nil	Nil	33,670

Married Couple Age Pensions Using Income Means Test		
Pension Level	Age Pension \$pa	Other income \$pa
100%	20,155	5,512
75%	15,116	18,203
50%	10,078	30,895
25%	5,039	43,586
Nil	Nil	56,277

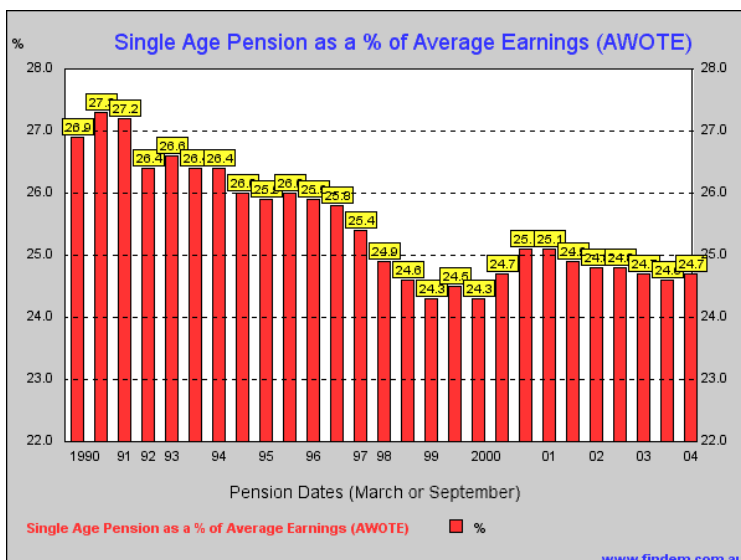
An assets test also applies. The value of the home you live in is not counted currently in assets. With high growth in house prices and investment in houses, this could very easily change to be included in future.

## RESIDENTS FROM OTHER COUNTRIES

Australia has reciprocal social security agreements with the following countries, which may qualify overseas born residents for Australian Age Pension residency tests (generally 10 years).

- Austria
- Canada
- Chile
- Croatia
- Cyprus
- Denmark
- Germany
- Ireland
- Italy
- Malta
- The Netherlands
- New Zealand
- Portugal
- Slovenia
- Spain
- USA

These countries represented 29% of all overseas born population over age 65 and 45% of non-UK overseas born. The agreement with the UK ended in March 2001 as UK arrivals retain UK pensions scheme pensions.



## THE COST OF PENSIONS

It is possible to calculate the cost of providing a pension. A simple approach is to work out how much money needs to be invested now, if pension payments were paid out of the investment so that at the end of the person's life expectancy all of the money had exactly been used up.

You get different answers for this depending on what you assume about investment returns, inflation, tax and life expectancy. More sophisticated actuarial formula can calculate the cost of lifetime annuities.

The following table illustrates the simple cost of age pensions on a range of life expectancy assumptions. They assume 5% pa net investment return, 2.5% pa inflation and nil taxation on pension payments. Short and long life expectancy use upper and lower quartile values from 1995-97 population mortality tables allowing for future improvement.

Lifetime from 65	Cost of Age Pension in \$'000's	
	Single Men	Single Women
Short	\$150	\$172
Average	\$188	\$211
Long	\$225	\$249

## WHAT IS OLD-AGE

Pensions were referred to as "old age" pensions when introduced. This tag seems to have lasted until the 1950's from whence it is just 'age pension'. Pensions are still paid from age 65 for men as they were in 1908. Women are now being moved progressively from age 60 to 65 (by 2014).

Because of improved living standards and medical technology, "old age" is not what it used to be. The following table shows FinDem's calculations of the proportion of life expectancy after age 65 expected to be lived by people turning 65 from 1900 to 2000:

Year of 65 <sup>th</sup> B'day	Years Lived after 65	% of Life Past Age 65
Men		
1900	11.25	14.8%
1950	12.25	15.9%
1975	13.13	16.8%
2000*	19.78	23.3%
Women		
1900	12.75	16.4%
1950	14.44	18.2%
1975	17.13	20.9%
2000*	23.06	26.2%

\* Allows for future improvement

The above table indicates the pension age should really have been raised as longevity and working life extended. If the pension age were now 73 for men and 75 for women, the percentage of life expectancy after pension age would be the same as it was in 1900.

## SUPERANNUATION, TAX & PENSIONS

In 1993 Australia legislated for compulsory employer paid superannuation contributions for most employees. The **SCG Contributions** percentage started at 3% of salary and increased about every two years to be 9% of salary from 2002/03.

The SGC contributions are invested in superannuation funds selected by the employer or, in some cases, funds as negotiated with unions. The accumulation of these contributions in these individual accounts of members is intended to relieve future taxpayers from increased taxes.

Studies show however that for people who will retire in the next 20 years, the **9% is inadequate** to give benefits to replace the extra demands for Age Pension from **ageing demographics**.

There is no requirement at this stage for SGC benefits to be paid as pensions. Members are free to dispose of the lump sums payable from their fund as they choose when they become entitled to it (generally at age 60). This is a leakage, which may also not relieve extra demands on Age Pensions.

A further weakness in Australia's superannuation system is the **multiple levels of tax**, which are deducted from superannuation contributions, fund income and benefits. No other comparable developed country has such tax complexity.

Past governments have granted **generous retirement lump sums and pensions to public servants**. Like Age Pensions, most of the government financed part of these benefits has to be paid by future taxpayers because funds have not been set aside. The Reserve Bank bulletin quotes the accrued unfunded cost at \$138 billion.

If we assume that say 80% of the public employees that this unfunded cost relates to will retire over the next 20 years, this will require income tax to rise by 7.5% or equivalent to an extra **levy on taxable incomes of 2%**.

The extra demands on Age Pensions will, if current super arrangements continue unaltered, also give rise to tax increases. An extra one million over 65's are expected by 2020. If the current ratio of over 65's receiving Age Pensions remains static, the tax increase by 2015 is estimated by FinDem at 14% or equivalent to a **levy on taxable incomes of 4%**.

Based on the above estimates, unfunded public employee super plus ageing demographic demands on Age Pensions could potentially require a total annual tax levy of 6% of taxable income (equivalent to about \$20 billion in today's dollars). Demographic trends may also require extra public health funding not allowed for in these estimates.

Levies such as this have been common in European countries in the past to support generous unfunded social welfare benefits. Australia had a separate social services levy from 1946 to 1952, following which it was merged into general income tax.

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