

Pension Review Report

27 February 2009

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Abbreviations and acronyms

ABS	Australian Bureau of Statistics
AETR	average effective tax rate
ALCI	Analytical Living Cost Index
COAG	Council of Australian Governments
CPI	Consumer Price Index
CSHC	Commonwealth Seniors Health Card
DVA	Department of Veterans' Affairs
EMTR	effective marginal tax rate
FaHCSIA	Department of Families, Housing, Community Services and Indigenous Affairs
GDP	gross domestic product
GST	goods and services tax
HILDA	Household, Income and Labour Dynamics in Australia survey
MTAWE	Male Total Average Weekly Earnings
OECD	Organisation for Economic Co-operation and Development

Preface

The Pension Review was commissioned by the Hon. Jenny Macklin MP, Minister for Families, Housing, Community Services and Indigenous Affairs, to investigate measures to strengthen the financial security of seniors, carers and people with disability.

This report presents the Review's findings, both in relation to its terms of reference and to the sustainability of the pension system and its role in the broader retirement income system.

The report is the culmination of nine months of research, analysis and consultation, which explored issues facing pensioners in terms of their financial security and wellbeing, and identified priority areas for pension reform. The report draws on a significant body of internal and external analysis, including technical research and modelling, and on feedback from the Review's extensive consultation process.

A report of this breadth and quality is only possible because of the contributions of a number of people. While many individuals have contributed to the development of the report, I would particularly like to acknowledge the hard work of the talented and dedicated staff in the Pension Review Taskforce and would like to thank the following people:

- ▀ Robyn McKay, Nick Hartland, Andrew Whitecross and Ben Wallace for their leadership of the Taskforce and contributions to policy analysis and the development of the report.
- ▀ Rob Bray, Wayne Jackson, Robyn Oswald, Leonie Corver, Cathy Thebridge, Paul Miller, Jenny Thompson, Kyle Mitchell, Paul Martin, Andrew Wojciechowski, Peggy Hausknecht, Andrew Sinstead-Reid, Michelle Girvan and Steven Sue for their contributions to the analysis and research informing the Review, and for their work on drafting and editing the report.
- ▀ Fiona Sawyers, Lauren Nelson, Rose Nightingale, Joanne Harrison, Nikki Ross and Rachel Gibson for their contributions to the coordination of the Review's consultation process and the production of the report, and for their work in supporting the Review's governance mechanisms.

The Australia's Future Tax System Review Panel, of which I am a member, also assisted the Taskforce to explore the interactions between the pension system and the broader retirement income system. I would like to thank my other panel members, Ken Henry AC, John Piggott, Heather Ridout and Greg Smith, for their time and expertise.

I would also like to acknowledge the contribution of members of the Review's Reference Group, comprising Bruce Bonyhady, Ross Clare, Charmaine Crowe, Val French AM, Rhonda Galbally AO, Marion Gaynor, Bob Gregory AO, Lorna Hallahan, Joan Hughes, Gregor Macfie, Michael O'Neill, Patricia Reeve and Peter Whiteford. The Reference Group's knowledge and experience were important in helping me clarify issues and identify priorities for reform. While the Reference Group's input was valuable in helping shape and influence my thinking, the findings in the report are mine and should not be attributed to the Reference Group or any of its members.

Finally, I would like to thank the more than 2,000 Australian pensioners who contributed to the review through their submissions and participation in public forums and focus groups. The views and experiences of those pensioners who provided direct input through the consultations, helped shape and deepen our understanding of the issues central to the Review.

Jeff Harmer

27 February 2009

Summary

On 15 May 2008 the Minister for Families, Housing, Community Services and Indigenous Affairs, the Hon. Jenny Macklin MP, asked the Secretary of her department, Dr Jeff Harmer, to lead a review into measures to strengthen the financial security of seniors, carers and people with disability.

The Review considers that the basic structure of Australia's pension system, with its focus on poverty alleviation, indexation to community living standards and prices, and means testing, is sound. However it faces challenges in both the short and long term and reforms are needed:

- ▶ Pension rates do not fully recognise the costs faced by single pensioners living alone and the approach of paying ad hoc bonuses does not provide financial security. Additionally many pensioners who rent privately have high costs and poor outcomes.
- ▶ Indexation arrangements for pensions need to more transparently link pensions to community living standards and better respond to the price changes experienced by pensioners.
- ▶ Complexity needs to be reduced as it can undermine the financial security of pensioners, and inhibits the flexible delivery of payments.
- ▶ Services are an essential complement to the pension system and can respond to the diversity of needs in ways an income support system cannot. However, they need considerable review and reform to more effectively and sustainably perform this role.
- ▶ Workforce participation by pensioners over Age Pension age should be better supported while a stronger participation focus is needed for those of working age.
- ▶ In the face of demographic change long term sustainability is critical. The situation of pensioners with low to moderate reliance on the pension is different to those who are wholly reliant on the pension, and there is scope for targeting any increases to those who need it.
- ▶ An increase in the Age Pension age needs to be considered as a response to the rapid increases in the life expectancy of Australians and the growing duration of retirement.

The Pension Review

The Pension Review is the first opportunity since the Social Security Review (1986–88) for a comprehensive review of pension payments.

The Review has developed 30 findings across five major areas:

- ▶ the adequacy of the rate of the pension
- ▶ indexation arrangements for pensions
- ▶ the design and delivery of pension payments
- ▶ the concessions and services that support the pension system
- ▶ the targeting and long-term sustainability of the pension system.

The reform directions identified by the Review would involve a very substantial investment in the pension system by the government. The benefit of this would be a pension system that gives financial security to seniors, carers and people with disability, has greater integrity and is more sustainable.

In making its findings, the Review acknowledges the contribution made to its work by Australia's pensioners. Over 2,000 pensioners, in public forums and written submissions, shared with the Review what the pension system means for them. The consultations showed that pensioners and the community have many strong views on the pension system and want to see these addressed.

However, the Review is aware that its findings will not meet all of the expectations that were expressed to it. Some of the proposals made in the consultations essentially sought to transform Australia's pension system from one focused on providing basic income support for those who are most at risk of falling below an acceptable standard of living, to a social insurance style scheme akin to the systems that operate in a number of other OECD countries, or as a universal payment. This would have major structural, equity and budgetary implications.

Compared with many other OECD countries, Australia's income support system is targeted and efficient, and is relatively better placed to deal with demographic change. This is primarily because Australia's focus on providing comprehensive, although conditional, basic income support does not expose the government and taxpayers to the financial risks of many of the social insurance style schemes adopted by other OECD countries. In many cases these social insurance style schemes are not sustainable in their current form and governments in these countries have been scaling back the benefits provided to current and future retirees.

The Pension Review was conducted during a period of potentially profound economic change. Consultations commenced in August 2008 following a long period of strong economic growth and in the shorter-term, rising inflation. The Review's public forums and submission processes were winding up just as the impact of the global financial crisis emerged in late September and early October. The global financial crisis has underlined for the Review the importance of the sustainability of reform directions over the short and medium term.

In addition, government decisions on the rate and structure of the pension cannot be considered in isolation from the impact of demographic change. This is expected to increase pension expenditure by 1.9 per cent of gross domestic product by the middle of the century and increase spending on health and other services even more strongly. The ageing of the population also means that the cost of any current change in the pension rate compounds over time. Treasury modelling indicates, in the absence of other policy changes such as tightened targeting over time, that the cost of a given pension increase today will double as a share of gross domestic product by 2050. Funding these increases will require reduced spending elsewhere, increased taxes, or a combination of both.

These structural considerations and longer-term challenges shaped the Review's approach of maintaining the basic structure of Australia's pension system, building on its strength of focusing on those with the highest needs, and improving its sustainability.

Adequacy

The central question for the Review was the level at which the full rate of pension should be set.

The Review's approach to this question was to test whether current rates of pension are providing a basic acceptable standard of living, accounting for prevailing community standards. The Review considered that the full rate of pension should provide a basic acceptable standard of living for those who are wholly reliant on it, often for extended periods, without any assumptions about access to private income or assets. In adopting this approach, the Review notes that while the question of adequacy can be conceived

of in both absolute and relative terms, ultimately it needs to be answered in the context of contemporary society, and the living standards of others.

The Review examined a range of different measures of adequacy and outcomes to consider both the adequacy of pension payments and the relativities between pensioners. In doing so, the Review observed that no single measure or benchmark could be used to determine whether or not the pension was adequate, but rather a judgement needed to be made across a range of measures.

An initial question for the Review was how to respond to a variety of pressures faced by some pensioners from health and disability costs. The Review thought that the variation in these needs and costs are most effectively addressed through services. This is considered further in the Review's findings on services and concessions. Reflecting this, the Review found that the pension should be paid at the same rate for those who are retired, or not currently expected to work because of their significant disability or caring responsibilities.

Finding 1: The Review finds that the Age Pension, Disability Support Pension and Carer Payment should be paid at the same basic rate.

Finding 2: The Review finds that the specific costs associated with health and disability are best responded to by targeted services rather than generalised differences in base rates of payments or financial supplements. (Section 3.4.3)

In relation to whether current rates of pension are providing a basic acceptable standard of living for all pensioners, the Review considered that the evidence showed that where a pensioner couple lived in their own house or rented from a public housing authority, and did not face unusually high costs of health or disability, the total package of assistance that they currently receive, including the value of the Seniors Bonus, was appropriate.

The Review, however, considered that the current relativities between single and couple payment rates do not take into sufficient account the costs faced by single pensioners who live by themselves, and the relativities should therefore be increased.

A central policy question in implementing reform to these relativities was whether the current two-tier structure of paying single pensioners and pensioner couples different rates should continue, or whether a three-tier structure (single pensioners living alone, single pensioners who live with others and pensioner couples) should be used. There are good reasons for proceeding in either direction.

Finding 3: The Review finds that, on the basis of its analysis of the outcomes achieved by pensioners, evidence provided in the consultations and its analysis of relative needs, the relativity of the rate of pension for single people living by themselves to that of couples is too low.

Finding 4: The Review finds that the case for a change in the relativity of the rate of pension for single pensioners living with others is less compelling. Such pensioners most frequently live with other relatives in owner-occupied housing and have outcomes more akin to couple pensioners than to other single pensioners. This suggests existing relativities are broadly adequate for these pensioners. However, the Review recognises that adding a third level of pension rate may introduce additional complexity.

Finding 5: The Review finds that a relativity in the range of 64 to 67 per cent across the package of support would be more appropriate than the current relativity. Adopting a relativity towards the upper end of this scale would appear to be reasonable if a three-tier approach were to be adopted. Under a two-tier approach, where the same relativity would be applied to single pensioners living alone and those living with others, a relativity at the lower end of this scale would more adequately reflect the average needs across both these groups. (Section 3.4.4)

Finding 6: The Review finds that, taking into account the totality of the package of the current pension base rates, supplements and the value of the Seniors Bonus, the rate of pension paid to couples appears to be adequate for those pensioners living in their own homes or public rental housing, and without unusually high costs of health or disability. (Section 3.4.5)

An additional group for whom the current rates of total assistance do not appear to be providing a basic acceptable standard of living are some pensioners who do not own their own home, and rent privately. The poorer outcomes for these pensioners were both a result of the high cost of rent and other difficulties, including the security of their housing arrangements. Each of these dimensions need to be addressed.

Finding 7: The Review finds that there is strong evidence that many pensioners in private rental housing face particularly high costs and have poor outcomes. Rent Assistance and social housing have complementary roles to play in addressing the financial security of these pensioners. The Review notes that the government has proposed an increased investment in social housing and considers that reforms to Rent Assistance would complement this. (Section 3.4.6)

Indexation

Effective indexation arrangements are essential to maintaining the capacity of income support payments to provide a basic acceptable standard of living over time, and therefore to provide pensioners with ongoing financial security. The Review noted that this question, as with the determination of the rate of pension, needs to consider both the absolute standard of living of pensioners and the relativity of this to the rest of the community.

While there are strong arguments for decisions on changes in the rate of pensions to be taken as deliberative decisions by government, the Review considers that automatic indexation provides greater security for pensioners and should be continued.

In considering how this can be best done, the Review analysed different approaches to price adjustment, including the Consumer Price Index and the Analytical Living Cost Indexes produced by the Australian Bureau of Statistics, and the wide range of different ways in which a community benchmark can be defined and measured. It also analysed the longer term relationship between indexation and sustainability in the light of changes in the population structure, especially the rising dependency ratio between the population aged over 65 years and the 'working age' population.

While supporting the continuation of the current two part indexation to prices and community living standards, the Review considered there should be a different emphasis on the roles of the two components, with benchmarking to changes in community living standards as the central long-term indexation factor for pensions.

Finding 8: The Review finds that automatic indexation of pensions and a two-part approach of benchmarking and indexation should continue. Benchmarking pensions relative to community standards should be the primary indexation factor, with indexation for changes in prices acting as a safety net over periods where price change would otherwise reduce the real value of the pension. (Section 4.4.2)

The Review considered that both the current measures used for indexation, the Consumer Price Index and Male Total Average Weekly Earnings have drawbacks that make them less than ideal measures to ensure the maintenance of an appropriate rate of pension over time.

Detailed analysis of the Consumer Price Index and other measures of price changes led the Review to conclude that an alternative measure of price change which is more fully responsive to specific changes in pensioners' purchasing power would be appropriate.

The Review's analysis also indicates that reforms are needed to the current approach of using Male Total Average Weekly Earnings to benchmark pensions to community living standards because of its lack of transparent relevance to the experience of the wider community. While there was no single measure ideally suited to this task, the Review considered that a measure based on the net income of a full-time worker was the most appropriate, in that it removed the distorting influence of part-time work and focused on the disposable, rather than pre-tax, income of people in the workforce.

Finding 9: The Review finds that pension indexation for price change would be better undertaken through an index that more specifically reflected cost of living changes for pensioners and other income support recipient households. (Section 4.4.3)

Finding 10: The Review finds that no single measure to benchmark the pension to community living standards is without limitations. However, the Review considers that a measure of the net income of an employee on median full-time earnings may be a more appropriate measure than the existing Male Total Average Weekly Earnings benchmark. (Section 4.4.4)

Indexation is however highly technical and the Review's approach would involve some additional data collection and analysis as well as refinement of measurement frameworks. There is also the potential for interaction between the setting of the proposed benchmark and potential policy changes subsequent to the Australia's Future Tax System Review. For these reasons the Review considered that implementation of reform may need to be staged.

Finding 11: The Review finds that, while reform to indexation and benchmarking is important to the financial security of pensioners, implementation may need to be phased in to account for policy developments that may arise out of the Australia's Future Tax System Review and to allow for the development of appropriate mechanisms for benchmarking and indexation. (Section 4.4.4)

The Review also considered how other income support parameters, such as the means test free areas, should be adjusted. These parameters are usually indexed by the Consumer Price Index, and therefore increase less quickly than pension rates. This 'fiscal drag' has the potential to introduce unintended distortions into payment structures. The Review concluded that indexation arrangements that create distortions between different components of the payment systems should be avoided, and if they cannot, should be subject to regular review.

The Review's findings in relation to payment design and administration, and targeting and sustainability—particularly the findings on supplementary payments, Rent Assistance, and the treatment of earned income—are designed, in part, to address the distortions currently within the pension system that have arisen because of the different indexation arrangements for different income support parameters.

Payment design and administration

The way that assistance is delivered and administered is important to the financial security and wellbeing of pensioners. Needlessly complex payment design and administration have the potential to:

- impose high transaction costs on pensioners

- generate poor outcomes for those who are not well placed to manage complexity
- make different elements of the system unintentionally work against each other
- generate consequences for other systems which need to interact with the income support system.

It was clear from the Review's analysis that there is scope to reform the way in which the payments to pensioners are structured to improve flexibility and financial security for pensioners, to reduce complexity and improve program efficiency and effectiveness.

Initial considerations focussed on the components of the total assistance that are provided to pensioners, including the balance between regular and one-off lump-sum and supplementary payments.

The Review considered that one-off lump sum payments were not a particularly effective way of addressing the adequacy of the pension in the long term and their ad hoc provision failed to provide security to pensioners. It did, however, recognise that this type of payment may continue to have a role in some specific circumstances.

Finding 12: The Review finds that one-off lump-sum payments are not particularly effective mechanisms for addressing the adequacy of the pension because they do not provide ongoing financial certainty for pensioners.

Finding 13: The Review finds that one-off payments may have a role in circumstances where pensioners may not otherwise gain from specific budgetary or economic changes, such as from changes to taxation arrangements, to compensate for policy changes, or where a fiscal stimulus is desired. (Section 5.3.1)

With respect to the current system of supplementary payments, the Review considered that the payment of these as individual items, with the exception of Rent Assistance, was largely based in the history of the pension system and there was little justification for maintaining them as separate payments.

Simplification could be done in a number of ways, with the main choices being between integrating all payments into the base rate of pension or bringing these supplementary payments together into a single supplement. While integration into the base payment would bring the greatest simplicity into the pension system, a separate supplementary payment provides more scope for flexible structuring of payments.

Such flexibility could, for example, involve a pensioner having a choice of the timing of the payment of the supplement to reflect their own budget priorities and needs. This approach would provide a mechanism to respond to the diversity of views expressed in the consultations, where some pensioners strongly supported the payment of some portion of the pension as a lump sum to assist them in meeting capital and other expenditures and others preferred to manage on regular payments.

If a separate supplement were to be created the Review considered that it was important to ensure this did not undermine the relativities established in the base pension rates between singles and couples.

Finding 14: The Review finds that integrating supplementary payments (Pension GST Supplement, Pharmaceutical Allowance, Telephone Allowance and Utilities Allowance) into a single supplementary payment or absorbing them into the base rate of pension would simplify the structure of pensions. Integration with the base rate would maximise simplicity while a separate supplement would provide a platform for introducing flexibility around the frequency of the payment of a component of the total pension package.

Finding 15: The Review finds that, if paid separately, any supplementary payment should be paid to singles and couples in proportion to the rate of the base pension to ensure that the relative value of the pension package is maintained. (Section 5.3.2)

Finding 16: The Review finds that an integrated supplement would be an appropriate vehicle for delivering greater flexibility over the timing of payments and would permit pensioners to structure their receipt of income according to their budgetary priorities.

While caution should be exercised in applying a flexible approach to the base rate of pension an option of weekly payment cycles may be preferred by some pensioners. (Section 5.3.3)

Rent Assistance, the largest of the supplementary payments, plays an important role in assisting pensioners who rent in the private rental market and who often face high housing costs. The Review found that the effectiveness and the equity of the program had been reduced by the impact of ‘fiscal drag’ resulting from the way the program parameters had been indexed over time. The Review concluded that there was scope to improve the targeting of this payment so that it better met the needs of those who face the highest housing costs.

Finding 17: The Review finds that there would be merit in restructuring rent thresholds to target Rent Assistance to those who pay higher rents and addressing inequities that have arisen with the sharers rate of Rent Assistance. (Section 5.3.4)

From its examination of the Pension Bonus Scheme, the Review concluded that this program had been developed in different circumstances and was complex, inefficient and inflexible in promoting the continued employment of people of Age Pension age and that alternative mechanisms should be developed.

Finding 18: The Review finds that the Pension Bonus Scheme is not a particularly effective means of increasing workforce participation by older Australians and that this goal would be better pursued through the design of the pension means test to ensure that there are appropriate incentives for employment. (Section 5.3.5)

The current situation where a person above Age Pension age may be eligible for either the Age Pension, Disability Support Pension or Carer Payment was considered by the Review as a needless area of administrative complexity, both for individuals and Centrelink. It also had the potential to reduce the effectiveness of Disability Support Pension and Carer Payment as payments to persons of workforce age. To address this, the Review considered that initial action should be taken to harmonise the treatment of people of Age Pension age across all three payments, with a longer term view to structural change in the context of the Review’s findings on the role of working age pensions.

Finding 19: The Review finds that the current situation where a person above Age Pension age may be eligible for either the Age Pension, Disability Support Pension or Carer Payment is unnecessarily complex, and that the Age Pension should be the appropriate payment for people over Age Pension age. As a first step to achieving this, there should be consistency of treatment across pension payments for those of Age Pension age to remove incentives for payment swapping.

In the longer term, making the Age Pension the payment for people over Age Pension age would focus the Disability Support Pension and Carer Payment on their role as working-age payments, with workforce participation encouraged. (Section 5.3.6)

Concessions and services

Concessions and services play a critical role in the social protection system by responding to the high needs that some pensioners have due to health conditions and some types of disability. This was highlighted in the consultations. Issues about concessions and services were consistently raised

throughout public forums, written submissions and focus groups, with a particular focus on the cost of health care, including medical and dental treatment and pharmaceutical expenses.

While the base rate of pension can address the ‘normal’ level of health and related service costs faced by most pensioners, where the level of need for these services is higher, this is no longer the case. Responding to this variation in the payment system is difficult because of the way in which needs vary considerably between individuals. As noted earlier, the Review does not favour responding to unusually high costs of health or disability through the payment system.

The two main issues addressed by the Review were the targeting and effectiveness of concessions and the reform of services, in particular for people with disability.

Overall the Review considered that the existing wide range of concessions were often poorly targeted and as a result, despite high levels of expenditure, concessions did not effectively complement the pension system by being responsive to the relative needs and circumstances of different pensioners, in particular those with greater needs. The existing structures and levels of concessions were seen as being difficult to sustain in the longer term.

As concession cards play a central role in the access to many concessions the reform of the targeting of these is a priority. Reform needs to be done in coordination with the states and territories.

Finding 20: The Review finds that the targeting of concession cards does not effectively complement the role of income support in addressing the needs of groups with high costs and that this needs to be addressed in consultation with the states and territories. (Section 6.5.2)

In the context of this work, the Review considered that the Commonwealth Seniors Health Card’s role of making health concessions available to people outside of the income support system, but who have similar levels of income to those who receive a payment, should be maintained.

The Review also considered that there is a case for aligning the definitions used in the Commonwealth Seniors Health Card income test with those used in the pension income test, to reduce complexity and the potential for inequitable outcomes.

Finding 21: The Review finds that, subject to more detailed considerations of the targeting of concessions, there is merit in maintaining the function of the Commonwealth Seniors Health Card in making health concessions available to people who are not eligible for the Age Pension, but have similar levels of income to age pensioners. Further, the Review considers that there would be a case for aligning the definitions in the income test for the Commonwealth Seniors Health Card with those of the pension income test. (Section 6.5.2)

In considering services, the Review noted the very significant reform agenda being developed under the auspices of the Council of Australian Governments, as well as the long-term funding and sustainability issues being addressed through the National Disability Strategy and the Disability Investment Group.

The Review considered these processes, which are directed at improving disability services and support, have the potential to contribute significantly to the outcomes of many pensioners with high needs, as well as their carers, and the Review was strongly supportive of the work that is being undertaken.

The Review’s analysis led to priorities for: a more integrated and person-oriented approach to service delivery; the exploration of new approaches to funding, including leveraging private contributions and more effective public and private provision; and ensuring a stronger labour market focus, both for people with disability and their carers.

These priorities also reflect the Review's observation that the long-term sustainability of the services and support provided to people with disability, including sustaining the role of informal care, is as critical as the pension system itself, and contributes to its long-term sustainability.

Finding 22: The Review finds that the reforms to services and support being developed by the Disability Investment Group, and under the National Disability Strategy and the National Disability Agreement, in particular the development of a more person-centred approach that cuts across service boundaries and seeks to tailor a targeted package of support, are vital steps towards providing adequate support to those who have high and complex needs. (Section 6.5.3)

Finding 23: The Review finds that the development of new approaches to funding services and support for people with disability is important to the long-term sustainability of the system. In particular, the idea of a National Disability Insurance Scheme is worthy of further consideration. The Review notes that both the Council of Australian Governments and the Disability Investment Group are examining the long-term sustainability of the services system, and that the Australia's Future Tax System Review Panel has noted that the funding of services is a significant issue and will consider how alternative approaches would fit into the structure of the overall tax-transfer system. (Section 6.5.4)

Finding 24: The Review finds that reviews of funding arrangements should take into account the need to ensure that people with disability and carers have better opportunities to establish and maintain links with the labour market and through that are able to contribute to their own retirement incomes. (Section 6.5.5)

Sustainability and targeting

The questions of the sustainability of the pension system and of the reform directions identified by the Review are critical to the long term financial security of pensioners and the ability of Australian society to support them. Central to this is how payments are targeted, both through program eligibility and related criteria and the operation of means testing. Because of the dual nature of means testing, which on one hand operates as the mechanism for targeting support to those who need it, and on the other can create disincentives for work and savings, careful balances need to be struck.

The Review considered whether the balance of means testing is right by reference to three principles:

- targeting pension assistance to those most in need
- ensuring that incentives remain for people to provide for themselves through savings or work
- ensuring within the pension system that people with similar levels of means and financial circumstances receive similar levels of income support.

Eligibility criteria for programs play both a direct gate keeping role, and more generally contribute to community norms. This is particularly the case with the Age Pension age, which helps to set retirement expectations.

Means testing and adequacy

Complementing the Review's considerations of the appropriate level of the rate of payment of the pension to those who are wholly reliant on it was the question of the appropriateness of the levels of pension payments to these with low to moderate reliance on income support.

The Review found, on the grounds of adequacy, that the means test is not generating inappropriate outcomes in terms of the level of payment made to pensioners who have lower levels of reliance on the pension as a source of income.

The Review considered, on this basis and given its findings on the rate of payment had been directed at addressing the adequacy of those wholly reliant on the pension, that there is no reason for any increase to flow on to those who have much less reliance on the pension. Therefore the Review saw scope for the means test to be tightened, so as to ensure effective targeting and reduce any inappropriate cost impact of addressing the needs it had identified.

Finding 25: The Review finds that there is no evidence that the means test as a whole is operating to provide an inadequate level of support to pensioners with low to moderate reliance on the pension.

Finding 26: The Review finds that, in the case of an increase in the pension rate to achieve an improvement in adequacy and financial security for those pensioners for whom the pension is the predominant source of income, there would be capacity to tighten income test settings to limit the flow-on of the increase to pensioners with low to moderate reliance on the pension. (Section 7.5.1)

Effectiveness and efficiency of means testing

The Review's analysis of the operation of the means test, and on achieving a fair and sustainable balance in the pension system between the effective targeting of assistance and ensuring that there are incentives for people to participate in the labour market and to save and to support themselves, identified a more general need to improve the efficiency of means testing.

These matters are closely allied with wider long term questions that are being considered by the Australia's Future Tax System Review. However, the Pension Review considered there was scope for more immediate action to address the assessment of earnings by pensioners of Age Pension age and the way some superannuation products are treated.

From the consultations, it is clear that the operation of the income test is seen by many age pensioners in particular as a barrier to participation. The Review considered it was important to address this, especially given the poor performance of the Pension Bonus Scheme and the importance of supporting participation by these pensioners. Many older Australians are seeking to better manage their transition from work to retirement and possess skills and experience which offer much to employers. Others simply wish to be able to enjoy a higher standard of living in their retirement and to work to enable this. The Review considered that the preferred mechanism to do this was to treat concessional a moderate amount of earned income.

Finding 27: The Review finds that there is a case to provide more effective mechanisms to support age pensioners to maintain or take up paid work if they wish to do so. A concessional treatment of low to moderate levels of income from employment would better deal with the costs of work which are only partially offset in the current means test and be more effective than the current Pension Bonus Scheme. (Section 7.5.3)

Under the existing means test, superannuation, including the most common account-based products, is treated differently to other financial assets. This treatment is complex, distorts the pattern of pension payments, and favours these products over other investments. The Review considered that a more neutral approach should be taken.

Finding 28: The Review finds that a deeming approach for account-based superannuation products would remove the current distortion in the pattern of payment of pensions to pensioners with such income and assist in equalising the treatment of superannuation products and other financial assets. (Section 7.5.3)

Eligibility criteria for working age pensions

Improving the connections between pensioners on working age payments and employment is a high priority both for the sustainability of the pension system and to improve outcomes for pensioners.

Australia has low levels of workforce participation in a number of groups of working age, including people with disability. The Review noted however this requires a different approach than that identified for age pensioners. In particular, pensions for those of working age have quite a different relationship to employment than the Age Pension. Working age payments are made conditionally on the basis of a person being unable to currently undertake substantial employment because of disability or caring. As such it is important that these pensions actively support people to participate to the extent their capacity permits, to develop this capacity and to be able to re-enter the workforce if their circumstances change.

The Review considered that it is important that this focus be better reflected in these programs to orient them towards actively building these pathways to employment.

Finding 29: The Review finds that the Carer Payment and Disability Support Pension should more actively address questions of workforce participation. This focus needs to be effectively integrated into initial eligibility, policies to promote participation while people are on the payments and in ensuring that, where they have the capacity to support themselves and are no longer eligible for the pension, they can successfully establish or re-establish themselves in the workforce. (Section 7.6.1)

Age Pension age

Demographic change is a major challenge to the pension system. As a result of the ageing population the ratio of people of working age to those aged 65 and over will more than halve from its current 5.0 to 2.4 by 2047. In addition there has been a marked shift in the level of workforce participation of many working age people, including early retirement. This has ramifications for both the tax base and spending.

In this context the Review considers that an increase in the Age Pension age needs to be seriously considered. An increase in the Age Pension age would partially redress the increasing dependency rate and concerns about a largely static workforce. Longer periods in employment would increase the time a person is able to contribute to national levels of production and the tax base. For industry, it would provide extended access to an experienced workforce.

For the retirement income system later retirement would reduce the span of time that people need to cover with their savings, including superannuation, and enable them to add to these savings to provide a higher living standard in retirement. It would also reduce demand on the Age Pension.

The Review considers that a moderate increase of some two to four years in the Age Pension age would be reasonable given the very strong increased life expectancy of Australians.

However, an increase in the Age Pension age represents a major cultural change and would require a substantial change in people's expectations about their working lives and preparations for their retirement. It would therefore have to be introduced gradually, with changes commencing after the Age Pension age for women meets the age for men in 2014.

A change in the Age Pension age would also need to be accompanied by other policy changes. Because a very large proportion of people retire prior to the Age Pension age a change in the age itself will not necessarily result in higher levels of participation or lower levels of receipt of income support. Central to this could be to bring the preservation age for superannuation into alignment with the Age Pension age.

Finding 30: The Review finds that there is a case for a phased increase in the Age Pension age starting from 2014, when the Age Pension age for women will be the same as for men. Such a policy would improve retirement outcomes and support Australia's capacity to address the impact of population ageing. It would reflect the strong increases in life expectancy the nation has experienced, which are expected to continue. Any reform would need to be part of a coordinated approach to retirement, including bringing the settings of the superannuation system into line with the Age Pension age. (Section 7.6.2)

Australia's Future Tax System Review

The findings of this report need to be considered in the context of the broader work of the Australia's Future Tax System Review, which is considering the tax structure needed to position Australia to deal with the social, economic and environmental challenges of the 21st century. Although the Panel overseeing the tax system review is due to report by the end of 2009, the government asked the Chair of the Review, Dr Ken Henry AC, to provide a report on the retirement income system by the end of March 2009. This request was to enable the government to consider the two reports together.

1 Introduction

1.1 Scope of review

On 15 May 2008 the Minister for Families, Housing, Community Services and Indigenous Affairs, the Hon. Jenny Macklin MP, announced that the Secretary of her department, Dr Jeff Harmer, would lead a review into measures to strengthen the financial security of seniors, carers and people with disability. The investigation was to include a review of the Age Pension, Carer Payment and Disability Support Pension.

1.1.1 Terms of reference

The Minister asked Dr Harmer to report to the government on the outcomes of the Pension Review by 28 February 2009. The terms of reference directed the Review to consider:

- ▶ the appropriate levels of income support and allowances, including the base rate of the pension, with reference to the stated purpose of the payment
- ▶ the frequency of payments, including the efficacy of lump-sum versus ongoing support
- ▶ the structure and payment of concessions or other entitlements that would improve the financial circumstances and security of carers and older Australians.

The Pension Review has been undertaken in the context of the wider inquiry into Australia's Future Tax System, which is considering the tax structure needed to position Australia to deal with the social, economic and environmental challenges of the 21st century. The terms of reference for the inquiry into Australia's Future Tax System require it to consider 'improvements to the tax and transfer payment system for individuals and working families, including those for retirees'. While the Panel overseeing the tax system review is due to report by the end of 2009, the government asked the Chair of the Review, Dr Ken Henry AC, to bring forward his report on the retirement income system to March 2009, to allow that report to be considered in conjunction with the Pension Review report.

1.1.2 The Pension Review's scope

The payments that are a focus of the Pension Review (the Age Pension, Carer Payment and Disability Support Pension and, as discussed in more detail in Section 5.1.1, certain Department of Veterans' Affairs (DVA) payments and a number of smaller and closed Families, Housing, Community Services and Indigenous Affairs payments,¹ are part of the broader income support and family assistance systems. Many of the issues considered in this report are also relevant to the wider system of pensions and allowances. However, the Age Pension, Carer Payment and Disability Support Pension are different in that the capacity of people on these payments to undertake full-time employment to support themselves is significantly curtailed. In addition, the community generally does not expect that people receiving these payments should be required to seek work to support themselves, because they:

¹These include the DVA Age Service Pension, Invalidity Service Pension and Income Support Supplement for war widows; as well as two closed FaHCSIA payments, Wife Pension and Widow B Pension; and Bereavement Allowance, which is a short-term pension payment.

- have already reached a specific age, or
- are undertaking a significant caring role that limits their availability for paid employment, or
- are unable to undertake significant employment, including part-time work, at least in the intermediate term, due to disability.

In recognition of the different capacities and expectations around workforce participation, the means test for pensions is more relaxed than that for allowances, where work is required. The pension means test is designed to provide incentives for some workforce participation for those who have the desire, capacity and opportunity to do so, but is not so concerned with the implicit effects of higher rates of payment and longer tapers, which allow people to combine part-rate pensions with income from part-time or casual work, but may reduce incentives for full-time employment. In addition, the structure and rate of the pension take into account the very long durations on payment of many pension recipients and the more limited opportunities some seniors and those with significant disability or ongoing caring responsibilities have for entering or re-entering the workforce.

One important difference between the pensions considered here is that, while eligibility for the Age Pension is based simply on age (and other criteria such as residency and means), eligibility for Carer Payment and Disability Support Pension is tested, on an ongoing basis, against the capacity of individuals to support themselves in the labour market. That is, the Disability Support Pension and Carer Payment are not paid on the basis of a person having a disability or caring responsibility per se, but rather because of the extent to which their disability or caring significantly inhibits their capacity for employment.

The Pension Review, reflecting both the terms of reference and the interrelationship between program components, took a comprehensive approach to the support available to people receiving the Age Pension, Carer Payment and Disability Support Pension. This support includes pension payments, supplementary payments and allowances, and concessions and services. The Review also considered targeting mechanisms, such as the 'income test free' areas and means test taper rates. All of these program components are intended to operate together to provide financial security and an appropriate level of income.

In its work it was clear to the Review that many features of the pension system have developed on an ad hoc basis or as pragmatic solutions to immediate problems. In this report, the Review has sought to identify underlying principles to guide its own considerations and future pension policy.

1.2 Program of work

The Pension Review provides the first opportunity since the Social Security Review (1986–88) for a comprehensive examination of pension payments. To support the development of this report, the Review has drawn extensively on internal and external analysis, including technical research, and has undertaken a wide ranging consultation process.

The Pension Review has progressed during a period of profound economic change. Consultations commenced in August 2008 following a period of rising inflation and strong economic growth. As the impact of the global financial crisis emerged in late September and early October, the public forums and submission process were winding up and the first round of focus groups was commencing. In October 2008, while the first round of focus groups was running, the Australian Government announced a \$10.4 billion Economic Security Strategy to strengthen the Australian economy, which included a \$4.8 billion down payment on long-term pension reform. In December 2008, the Australian Government announced additional support to pensioners to fully meet the expected overall increase in costs flowing from the Carbon Pollution Reduction Scheme. In February 2009, the Australian Government announced its \$42 billion Nation Building and Jobs Plan, which included a major investment in social housing.

Chapter 2 of the report provides further details about the impact of the global financial crisis on pensioners and the pension system.

1.2.1 Background Paper

On 11 August 2008, the *Pension Review Background Paper* (the ‘Background Paper’) was released to inform the public debate about issues surrounding the pension system. The Background Paper included a detailed discussion about the key issues of consideration under each of the Review’s terms of reference. It also provided information on the economic and social context within which the pension system operates and detailed information about the current income support system, including the number of people on payments, payment rates and historical trends.

The Background Paper contained a significant amount of the initial research and analysis undertaken by the Review and should be seen as a companion to this report.

1.2.2 Consultation

The Review engaged in an extensive consultation process, involving a series of public forums, meetings with state and territory government officials, a call for written submissions and a series of small focus groups. The Review draws on material resulting from the consultation process throughout the report.

Public forums

Public forums were held during August and September 2008 to ensure that seniors, carers and people with disability, and the organisations that represent them, had the opportunity to provide direct input to the Review. A total of 485 people attended the forums, which were held in all capital cities as well as Newcastle, Rockhampton and Wangaratta. Forums were held in a town hall format. Participants also had the opportunity to provide written input through feedback forms.

Consultations with state and territory governments and others

Representatives from the Review met with officials from all state and territory governments to discuss the interactions between the Review and policy responsibilities of state and territory governments. These discussions focused on the Review’s third term of reference—the structure and payment of concessions and other entitlements—since state and territory governments are responsible for delivering a wide range of concessions and services to seniors, carers and people with disability.

Representatives from the Review also met with the National People with Disabilities and Carers Council; the Disability Investment Group; the House of Representatives Standing Committee on Family, Community, Housing and Youth; and the House of Representatives Standing Committee on Petitions.

Written submissions

Over 1,800 written submissions were received by the Review. The majority of submissions were from individuals, although some 130 submissions were received from organisations.

The Review has paid considerable attention to the issues raised in the submissions and the breadth of the concerns expressed. It has also analysed the frequency with which issues have been raised.

An important aspect of the analysis of the submissions is that it provided a more systematic insight into issues of concern for particular subgroups, such as people receiving different pension and related payments, singles and couples, and those living in different locations.

Focus groups

The Review commissioned Centrelink to run nine focus groups in October 2008 and three focus groups in January 2009, to further explore issues raised during the public consultation process. Issues covered in the focus groups included financial disadvantage, work incentives, concessions and services, and supplementary payments. Participants were randomly selected Age Pension, Carer Payment and Disability Support Pension recipients. The focus groups involved a mixture of group discussion, data collection and written responses.

The focus groups were also a useful mechanism to explore some of the specific issues raised in submissions.

1.2.3 Reference Group

In her statement of 15 May 2008, Minister Macklin advised that Dr Harmer would convene a Reference Group to ensure that the Pension Review reflected the views and aspirations of those most likely to be affected by any reforms. The Reference Group, which met for the first time on 29 July 2008, included representatives from seniors, carers, disability and general welfare groups, as well as members of academia. The Reference Group met six times between July 2008 and February 2009.

The Reference Group advised on the range of issues facing seniors, carers and people with disability, and on priorities for reform. The Reference Group also considered and provided feedback on much of the research and analysis undertaken by the Review.

1.2.4 Research and analysis

To inform the Review and support the development of the report, the Review engaged in a program of research and analysis. Much of this work fed into the Background Paper, which was released prior to the consultations. The Background Paper should be seen as a complementary volume to this report.

Much of the analysis for the Review was undertaken using existing research and analysis, such as Organisation for Economic Co-operation and Development (OECD) reports and the Australian Treasury's *Intergenerational Report 2007*, and through analysis of existing administrative and survey data. In particular, the Review was informed by analysis of equivalence scales, financial hardship and indexation approaches; analysis of health expenditure data; and modelling of Superannuation Guarantee outcomes. The Review's analysis also benefited from sharing of information and data from other Australian government departments, and from state and territory governments, and by drawing on material from the public consultations.

1.3 Report outline

Apart from Chapter 2, which considers the broad context of the Review, the chapters of the report are presented in a standard manner:

- ▶ overview and findings
- ▶ the terms of reference of the Review and a description of the issues under consideration in the chapter
- ▶ the input the Review received through consultations and submissions
- ▶ the analysis undertaken within the Review
- ▶ reform directions.

1.3.1 Context and challenges

While the terms of reference focus on the Age Pension, Carer Payment and Disability Support Pension, it was not possible for the Review to develop considered views on the operation of these payments under the terms of reference without considering their role in Australia's broader social protection system.

Chapter 2 (Context and challenges) therefore provides an overview of Australia's pension system and how it fits within the broader social protection system. The chapter also discusses demographic change and the ageing of the population, because these long-term trends will have a major impact on the Age Pension, Disability Support Pension and Carer Payment, and are therefore a crucial part of the context of the Review.

Chapter 2 then identifies five major challenges for the pension system that were central in providing a framework for the Review's consideration of its terms of reference: the global financial crisis, sustainability, the management of risk in retirement, workforce participation and interactions with the broader tax-transfer system, and complexity.

1.3.2 Term of reference 1: Appropriate levels of income support

Chapter 3 (Adequacy) examines the central question of the level at which the full rate of pension should be set and identifies the priorities for reform of the Australian pension system. It considers the purpose of payments and the concept of adequacy given the diversity of individual needs and circumstances. It reviews a range of different measures of adequacy and outcomes, to consider both the adequacy of pension payments and the relativities between pensioners. It also considers the need for supplementary assistance for housing costs. The question of the appropriate level of income support for those pensioners with some private means is considered in Chapter 7 (Sustainability and targeting).

The maintenance of adequacy over time in light of changes in the cost of living and in community living standards is considered in Chapter 4 (Indexation). This chapter considers the way in which adjustments are made to the rate of the pension and other parameters of the pension system. It outlines the current indexation arrangements; discusses the merits of different approaches to price adjustment, including the Consumer Price Index and the Analytical Living Cost Indexes; and considers issues around indexation and sustainability. It also outlines the current benchmarking arrangements and discusses the relative merits of different benchmarking measures.

1.3.3 Term of reference 2: Frequency of payments

Chapter 5 (Payment design and administration) considers whether the way that assistance is delivered and administered contributes to the financial security and wellbeing of pensioners. The chapter examines the current components of the total assistance that is provided to Age Pension, Carer Payment and Disability Support Pension recipients. Its focus is the balance between regular and one-off lump-sum and supplementary payments, and arrangements to improve flexibility and financial security for pensioners. It also considers ways in which the delivery of assistance could be simplified to reduce complexity for pension recipients.

1.3.4 Term of reference 3: Concessions and other entitlements

The third term of reference is discussed in Chapters 5 (Payment design and administration) and 6 (Concessions and services). Chapter 5 considers supplementary payments and Chapter 6 focuses on the role that concessions and services play in providing targeted and cost-effective support for those with high needs as a result of illness or disability.

Chapter 6 discusses concessions and services separately, reflecting the fact that they are different policy levers. In relation to concessions, it discusses issues around health care concessions, and the targeting and sustainability of the existing system of concession cards. In relation to services, it discusses the

service delivery reform agenda being developed under the auspices of the Council of Australian Governments, and long-term funding and sustainability issues. It also discusses implications for informal care.

1.3.5 Sustainability and targeting

The Review found that it could not address its terms of reference adequately without considering the sustainability of the reform directions it has identified. Chapter 7 (Sustainability and targeting) discusses the longer-term sustainability of the reform directions identified for pensions. It examines the impact of the income and assets tests on adequacy for part-rate pensioners, issues around targeting, and incentives for people to save and participate in the labour market. Chapter 7 also considers eligibility rules for pensions, including the Age Pension age. In particular, it looks at the impact of changes in the Age Pension age on sustainability and retirement outcomes, and the interaction of the Age Pension with other elements of the retirement income system.

2 Context and challenges

It was not possible for the Review to develop considered views on its terms of reference without taking into account the role of the Age Pension, Disability Support Pension and Carer Payment in Australia's broader social protection system, and the social and economic context in which the Review has been undertaken and how this context is likely to change in the future.

This chapter discusses the nature of Australia's pension system and how it fits within the broader social protection system. It outlines the characteristics of Australia's system and the ways in which it differs from those in other OECD countries. It then considers the effects of demographic change and the ageing of the population because these long-term trends will have a major impact on the Age Pension, Disability Support Pension and Carer Payment.

This leads to the identification of five major challenges that the Review considered as a part of its analysis of its terms of reference: the global financial crisis, sustainability, the management of risk in retirement, workforce participation incentives and interactions with the broader tax-transfer system, and complexity.

This chapter concludes with a discussion of how these considerations relate to the work of the Australia's Future Tax System Review Panel, including its report on retirement incomes.

2.1 Australia's system of social protection

The Age Pension, Carer Payment and Disability Support Pension are part of a broader social protection system designed to assist individuals and families to manage risk and change in their lives.

Australia, in common with most other OECD countries, has developed a social protection system that involves a combination of:

- ▶ basic income support for those who are most at risk of falling below an acceptable standard of living
- ▶ compulsory schemes that manage the risks and smooth income over the course of an individual's life. The most significant of these is the Superannuation Guarantee, which is designed to provide higher living standards in retirement linked to a person's employment earnings. In addition, there are insurance schemes such as workers compensation, third-party motor vehicle insurance and medical indemnity insurance which variously seek to ensure a person is compensated for pain and suffering, medical costs and economic costs following an accident or similar disruption
- ▶ support for private savings and asset accumulation, including home ownership and other mechanisms that allow for private provision for the management of risks and assist in smoothing incomes
- ▶ direct government expenditure on infrastructure and access to goods and services, such as health, education, disability and community services.

The first three of these are often referred to, in the context of retirement income policy, as a 'three pillar' system. The Review considers that focusing solely on the traditional three pillars runs the risk of downplaying the role of services. Having effective services is critical to achieving a balanced income

protection system that has the flexibility to meet the diversity of needs and life-cycle experiences of the pensioner population.

The Review has used the term ‘income support’ to refer to pension payments and associated supplementary payments. The term ‘income protection’ is used to refer to the compulsory and voluntary mechanisms that in combination with income support help smooth an individual’s income over their lifetime and across transitions. The term ‘social protection’ is a wider notion that the Review has used to refer to the whole system of income support, income protection, and concessions and services that assist individuals and families to manage risk and change.

2.1.1 Income support

Australia has historically focused to a greater extent than most other OECD countries on providing comprehensive, conditional, basic income support to those who are most at risk of falling below an acceptable standard of living at a point in time.

- ▶ Access to income support is determined by targeted eligibility requirements and means testing (it is not, for example, a right accrued from having worked or having paid tax).
- ▶ Unlike most social insurance systems in other OECD countries and private savings mechanisms such as superannuation, the level and duration of payment are not related to past earnings or work history.

Compared with other OECD countries, the Australian tax-transfer system is highly efficient in redistributing resources to those with least means. Among the 27 countries for which data are available, Australia has the highest proportion of public transfers flowing to the quintile of the population with the lowest private incomes. Australia also has the lowest rate of direct taxation in the group of 19 countries with data on this (Treasury 2008).

The adequacy of the Age Pension, Carer Payment and Disability Support Pension in performing this basic income support role is the central focus of this Review.

As discussed in Chapter 3, the Review has defined adequacy as ‘a basic acceptable standard of living, accounting for prevailing community standards’. While the Age Pension, Disability Support Pension and Carer Payment perform a number of roles in the income protection and social protection systems, the Review considers that providing adequate income support to those with little or no private means is the most important role of these payments, both now and into the foreseeable future. This is also an area where reform is needed. There are significant aspects of the current structure and rates of pension, in particular the treatment of single pensioners who live by themselves, that do not currently meet the needs of Australian pensioners.

2.1.2 Income protection

The Review recognises that pension payments cannot be considered in isolation from the other mechanisms that form part of Australia’s system of income protection, especially those components with which the pension system directly interacts.

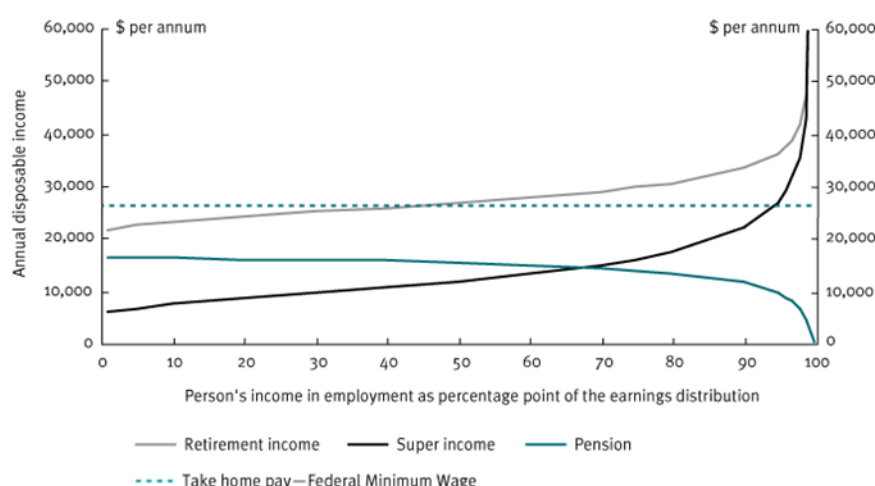
The Age Pension and superannuation

The introduction of the Superannuation Guarantee in Australia made income protection for retirement more widely available to Australian workers. The Superannuation Guarantee provides a mechanism that links retirement savings with a person’s earnings and level of engagement with the workforce over their lifetime. The Superannuation Guarantee reduces the risk of ‘myopic’ behaviour (that is, individuals not saving enough for their retirement), and thereby helps smooth income over an individual’s full lifetime. However,

because it is based on private accumulation plans it does so without guaranteeing a specific final level of retirement income.

The Superannuation Guarantee was designed and operates as a supplement to the role of the Age Pension in providing retirement incomes. Consequently, it increases the level of individual income in retirement to above what would otherwise have been provided through the Age Pension and private savings alone, and most retirees will continue to receive a substantial level of the Age Pension across their retirement. This is modelled in Chart 1 which shows, for full-time, full-career workers, the relative contribution of the Age Pension and the Superannuation Guarantee to their retirement incomes.

Chart 1 Retirement incomes—contribution of the Superannuation Guarantee and Age Pension (modelled results under full superannuation guarantee)



Notes: Model parameters at Appendix E. Average annual retirement income is given in earnings discounted terms, that is, relative to the income of employed people.

Source: Review modelling.

The maturing of the Superannuation Guarantee will see:

- a strong ongoing role for the Age Pension as a significant part of retirement incomes. Treasury estimates that the Superannuation Guarantee will only reduce the total value of pension spending by some 6 per cent
- a pattern of earnings in retirement that, while linked with employment earnings, is moderated by the interaction with the Age Pension. As a consequence, the effective retirement 'replacement rate' of lower income earners will be higher than for those on higher incomes, although those on higher incomes will continue to have higher retirement incomes relative to the community standard
- a proportion of retirees with disposable incomes above those earned by some low-income workers. A consequence of this is that some workers will be paying tax on levels of income lower than the incomes of those who are drawing part of their income from the pension. (This already occurs in some cases under existing program settings.)

Of course actual retirement incomes will vary significantly from this theoretical outcome, depending on people's workforce experience and in many cases that of a partner, and their private savings. Treasury modelling suggests that by 2050:

- 45.3 per cent of the population aged over 65 years will receive a part pension
- 28.3 per cent of the population aged over 65 years will receive a full pension

- 26.4 per cent of the population aged over 65 years will not receive any pension income at that point in time (although some may at a later point in their retirement).

What this means for the Review is that reform directions for the Age Pension need to take account of policy settings for superannuation, including the impact of changes on Superannuation Guarantee outcomes and the impact more broadly on incentives to save for retirement.

In addition, Treasury modelling underscores the importance of the Age Pension's role as a safety net. Many of the 28 per cent of Australians aged over 65 years who are expected to be on the full rate of pension in 2050 will have few if any assets or private income. They will therefore be entirely, or nearly entirely, dependent on the Age Pension to achieve an acceptable standard of living. This group will include people who have been reliant on income support for much, if not all, of their lives because of disability or other factors, such as caring responsibilities, that have prevented their participation in the workforce. In other cases, they will be people who, due to longer than expected longevity or unexpected costs, have exhausted their retirement savings.

The implication of these issues for Age Pension means testing is examined more fully in Chapter 7.

Disability and caring

Disability Support Pension and Carer Payment are the principal forms of income support for people with disability who are unable to support themselves through employment and for people whose caring role limits their employment opportunities, where family incomes would otherwise be insufficient.

There is also a range of private or mandated forms of support such as workers compensation arrangements and motor vehicle insurance systems, as well as income protection and related insurance. In the short term, for some employees, workplace-based sickness and carer leave provisions can provide full income replacement when they are ill or need to care for a family member.

However, in contrast to the Age Pension, which is part of a wider income protection system for retirement, the Disability Support Pension and Carer Payment generally operate as safety nets in cases where private income protection mechanisms are not available or have been exhausted. Rather than supporting mechanisms that operate to smooth income over an individual's lifetime, the Disability Support Pension and Carer Payment focus almost entirely on providing a basic acceptable standard of living for people who have little or no private means.

Chapters 6 and 7 look at these issues in more detail.

Women

The majority of pensioners in Australia are women. Currently women account for 57.4 per cent of age pensioners and 68.8 per cent of those on Carer Payment. While the proportion on Disability Support Pension is lower, at 43.8 per cent, women account for 48.6 per cent of the new entrants into this program, in part reflecting the impact of the increasing Age Pension age for women. Around 55.7 per cent of women on these pensions are single, compared to 40.3 per cent of men.

In large part, therefore, the issues considered by the Review have particular importance for women. The Review notes that while many of the issues and reform directions identified affect women and men equally, the different life experiences of men and women can create significant differences in their experience of the income protection system. In particular, many women have major responsibility for unpaid caring and domestic work, are more likely to have broken patterns of workforce participation and to have lower income and fewer assets.

- Women's longer life expectancy means that they are more likely to be reliant on the Age Pension for longer than men; 71.8 per cent of single age pensioners are women.
- On average, women on pensions have had less engagement with the labour market than men. This means that for many women engaging and re-engaging in the labour market presents particular problems. This can become more difficult for those who become single due to marriage breakdown.
- For many women this broken workforce participation results in lower levels of personal assets, including superannuation savings. While for those women who are members of a couple account also needs to be taken of their partner's assets, for those who are single this is likely to have a significant impact on their wellbeing in retirement.

Analysis by the Review indicates that among the current population the level of superannuation assets varies considerably. There are particularly marked differences by gender, labour force status and age. Men have considerably higher levels of superannuation than women across different age categories of the population. Some of this is related to levels of earnings, with some groups, for example 'middle-earning women', having levels of superannuation assets much more closely aligned to men than other groups. However, women are disproportionately represented in the lower earnings group, in part because of part-time employment. When relationship status is considered, lone mothers have much lower superannuation assets than other women.

- This situation can be made more tenuous due to women's earlier age of retirement and eligibility for the Age Pension, and their longer life expectancies than men. Together these mean that while assets are often accumulated over a shorter working period, which may also be punctuated by periods of caring and part-time work, they are needed to support a longer retirement period.
- Women may often face a range of more complex and frequent transitions. These include transitions into and out of caring, and moving from being a member of a couple to being single, as women are more likely to have their partner predecease them. Among older women this can create adverse outcomes that can be exacerbated by the fact that many of these women may not have developed the necessary financial management skills to allow them to manage their affairs alone.

2.1.3 Services and related social infrastructure

Income support and income protection mechanisms are strongly complemented by social infrastructure such as public housing and aged-care facilities and access to goods and services, including through concessions.

Much of the feedback from the Review's consultation focused on the role of concessions and services in supporting the overall purchasing power of pension payments and the value pensioners attach to them.

However, the Review considers that the unique role that concessions and services play in the social protection system is to provide targeted and cost-effective assistance for specific needs that are not dealt with well by income support or protection. The Review's consultations and analytic work have shown that:

- Some pensioners face particular costs associated with disability, illness and caring. Previous studies of costs of disability have identified wide variations in costs, which are often highly individualised, and which differ both between impairments and within similar levels of impairment.
- There are limits to the extent to which the basic pension rate can anticipate and appropriately address individual circumstances for those whose costs are at the higher end of the spectrum.
- Some services such as public housing are important in complementing income protection by not just addressing current cost issues but also providing protection against risks such as lack of security of

tenure. Helping to manage this type of risk in effect places it in a similar role to home ownership for those who are unable to accumulate private savings over their lifetimes.

- Services can play a vital role in assisting people in managing transitions across their life cycle and again provide a means for addressing the diverse cost impacts of these across the pensioner population.

In cases where levels of need vary considerably across the population, concessions and services entail less risk than transfer payments of undercompensating those with high needs and overcompensating those with low needs. Concessions and services also link funding and assistance to usage better than transfer payments. In some situations co-payments can play a useful role in the framework of service delivery. Co-payments for concessions and services indicate to consumers that they have a value and an economic cost, and can balance reasonable access to them while ensuring they are not overused.

Concessions and services therefore complement the income support and protection systems by providing extra assistance to people who, compared with the general population, have additional needs because of their particular circumstances, such as frailty, disability and caring responsibilities. This is a focus of Chapter 6, which also notes the roles of other reviews including the work of the Council of Australian Governments and the Disability Investment Group.

The policy challenges of the provision of services and social infrastructure go well beyond the scope of issues considered in this report, but are vital to the broader framework of social protection and the role and sustainability of the pension system. To an even greater extent than the income protection system, services will be significantly affected by demographic change and population ageing. While much of the long-term increase in demand will be for aged-care facilities and other services for the frail aged, it has many other dimensions. One of these is supporting the workforce participation of a larger cohort of older workers, some of whom may require services to address the higher level of incidence of health and disability concerns in this age group, while maintaining employment. There will also be a demand for services directed at maintaining and adapting skills to ensure that these older Australians continue to be productive members of the workforce.

However, in contrast to the social security and taxation treatment of superannuation, there are few mechanisms available to facilitate and encourage services with mixed government and private provision beyond the purchaser/provider model, or that take an insurance focus. In addition, existing service models provide little scope for effective empowering of consumers.

2.2 Population ageing and demographic change

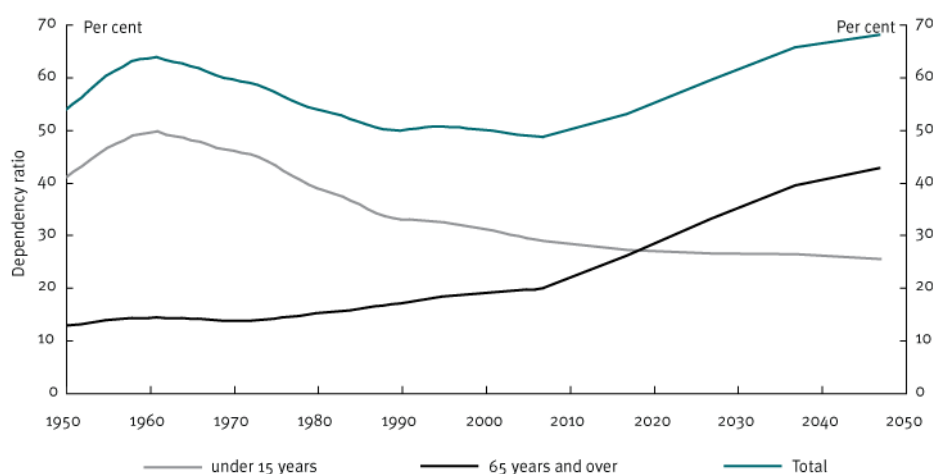
Australia, like most OECD countries, is facing the major challenge of an ageing population. The implications of this were an essential consideration for the Review and are critical to the question of the sustainability of the pension system and the long-term security of pensioners.

As has been documented in the Treasury *Intergenerational Report 2007*, demographic change in Australia will be primarily driven by lower birth rates and increasing life expectancies. The report indicated that:

- By 2047, it is estimated that some 7.2 million Australians will be aged over 65 years, representing 25 per cent of the population, almost double the current proportion of 13 per cent.
- In 2007 the life expectancy of a 60-year-old man is estimated at 22.6 years and for a woman of this age 26.1 years. This is forecast to increase by 2047 to 27.7 and 30.8 years respectively. (More recent estimates of life expectancy are discussed in Chapter 7.)

One of the consequences of these changes, as shown in Chart 2, is a marked increase in the dependency ratio (the proportion of people of working age (15 to 64 years) to those retired or of school age), which has been at historically low rates over the past ten years.

Chart 2 Age dependency ratios 1950–2050



Source: Intergenerational Report 2007.

Currently there are some 5.0 people of working age to support every person aged 65 and over, but this will more than halve to 2.4 people by 2047. This change presents major economic and social challenges. These include a reduced taxation base reflecting the relative decline in the size of the workforce, along with pressures on spending on a larger proportion of the population who are not supporting themselves, many of whom will have high health care and other needs. In addition, this demographic shift will result in a reduction in the level of output per person relative to that which would be achieved with the current population structure, and will generate competition for labour.

Although the magnitude of the impact of this demographic change on the government's fiscal position may be mitigated by factors such as increases in the rate of workforce participation, increasing productivity and future changes to Australia's population profile from fertility and migration, such responses can at best only reduce, but not eliminate, these pressures.

The structure and functioning of the social protection system can also mitigate or magnify the impact of demographic change on the government's fiscal position.

- The structure of the social protection system helps shape incentives for workforce participation for older cohorts of workers and for those with marginal labour force attachment. It also impacts on incentives for those already in the workforce whose return to work may be affected by any increase in the burden of taxation to pay for the higher demands on government.
- Pre-funding expenditure on pensions and services has the potential to mitigate the magnitude of the impact of demographic change on the government's fiscal position and balance the costs between generations.

In this regard, compared with many other OECD countries, while there will be fiscal challenges for governments to face, Australia's income support system is relatively well placed to deal with demographic change. This is primarily because Australia's focus on providing comprehensive, although conditional, basic income support does not expose the government to the financial risks of many of the social insurance style schemes adopted by other OECD countries. Within the Australian system investment and longevity risks are shared between the government and private individuals. Many OECD countries are currently reducing the risk borne by the government.

However, Australia's relatively high emphasis on private provision in itself raises other challenges that may place growing pressure on the sustainability of Australia's income support system:

- ▶ The economy and society are still exposed to the net economic cost of the level of support for retirement income. Increasing expectations, or pressures arising from a gap between expectations and actual retirement income outcomes, will still place the retirement income system under pressure.
- ▶ The balance of government and private risk in Australia mean that individuals must rely on private sector products, the market for which is still under-developed. Many products are potentially affected by risks, including severe economic shocks such as the global financial crisis.

2.3 Challenges

The broad structural and demographic environment has consequences for the Review's approach to its terms of reference. The Review considered that there were five particular challenges that it needed to incorporate into its considerations. While these challenges go beyond an immediate focus on current adequacy and affordability, this broader approach is essential to the underlying concept of 'security for pensioners'—that is, the capacity of pensioners to rely on relatively stable arrangements to meet their long-term needs.

These five challenges are:

- ▶ the global financial crisis
- ▶ sustainability
- ▶ the management of risk in retirement, in particular investment risk and longevity risk
- ▶ workforce participation incentives and interactions with the broader tax-transfer system
- ▶ complexity.

2.3.1 The global financial crisis

An immediate challenge in the Review's considerations was the impact of the global financial crisis. As well as having readily apparent short-term consequences for the pension system, this crisis may affect the longer-term balance of the income protection system.

In the short term, many pensioners and retirees have faced falling asset values and declining income from investments, and for some from employment. With these declines in private means, their pension rate has increased. These aspects have been complemented by administrative changes designed to respond to the crisis, including deeming rate changes and deeming exemptions in cases where investments have been frozen. There has also been a marked increase in claims for the pension, much of which may be attributable to these changes which have seen retirees previously ineligible for assistance becoming eligible for some pension payments. For example, Age Pension applications in December 2008 were around 50 per cent higher than the number recorded in October of the same year. These short-term changes illustrate how the pension system helps manage risk for individuals. However, they also have a direct impact on the cost of the pension and hence on the government's fiscal position.

While long-term structural sustainability is the prime consideration for pension reform rather than cyclical budget considerations, these effects which are part of the automatic budgetary stabilisers cannot be ignored.

The crisis has also eroded the value of retirement savings of many individuals and weakened their capacity and motivation, at least in the short term, for discretionary private retirement savings. This has considerable significance at a time when the first groups of ‘baby boomers’ are approaching retirement (the first baby boomers will reach 65 years of age in 2011). For some members of the current cohort of older workers the consequences of the global financial crisis means they may not be able to reach their target retirement savings within their planned remaining working lives. While some may postpone retirement, a substantial cohort may enter retirement with lower superannuation balances and greater reliance on the Age Pension for the duration of their retirement than intended.

Over the intermediate period there is also the potential for increasing levels of demand for income support, including pensions, as people experience difficulties in the labour market. While pension eligibility focuses on the supply rather than the demand side of the labour market and lack of available employment is not a criterion for eligibility, it is clear from previous economic downturns that lack of employment opportunities does result in an increasing number of pensioners who, even when labour market conditions improve, rarely return to employment.

A more difficult question, in particular given the timing of this report, is whether, in addition to these consequences, the crisis will also have significant longer-term and structural implications for the pension system.

Australia has experienced a long period of relatively steady economic growth, and as a consequence private wealth accumulation and superannuation have grown rapidly over past decades. The impact of the global financial crisis on the type of retirement income products that consumers want, the level of investment risk they are willing to bear, their attitude to longevity insurance, and their expectations of the pension system is not clear at this point. It is also not clear what impact the crisis will have on prudential regulation.

While the Review considers it inappropriate to speculate on the long-term impacts of the global financial crisis on income protection in Australia at this time, it remains an issue that will require very close monitoring.

2.3.2 Sustainability

Population ageing brings with it a significant challenge for social policy. Projections presented in the *Intergenerational Report 2007* indicate that current policy settings would result in social spending increasing from its 2006–07 level of 13.1 per cent of gross domestic product (GDP) to 18.2 per cent in 2046–47, a 5.1 percentage point increase. By way of comparison, the *Intergenerational Report* indicates that Australian Government receipts were 22.1 per cent of GDP. Although there are some off-setting savings, funding these increased social expenditures would require an increase of over 23 per cent in government receipts.

Increased spending on the Age Pension, and related payments for the aged, accounts for 1.9 percentage points of the 5.1 percentage point increase (37 per cent), with the balance being taken up by increases in the costs of aged-care and health spending.

Specifically, these estimates are a projection of the impact of current policy settings and do not take account of how policy may change over time. For example, any increase in the maximum rate of pension will, other things being equal, increase the share of GDP taken by spending on the Age Pension. However, other policy and behavioural changes will also have an effect.

- As discussed in Section 2.2, increased labour force participation would assist in ameliorating the effect of the increasing dependency rate and some gains can be made through increasing productivity. However, to the extent that pensions are linked to wages and wage costs are a key component of

service costs, much of the gain from productivity improvements will not be available for other expenditures.

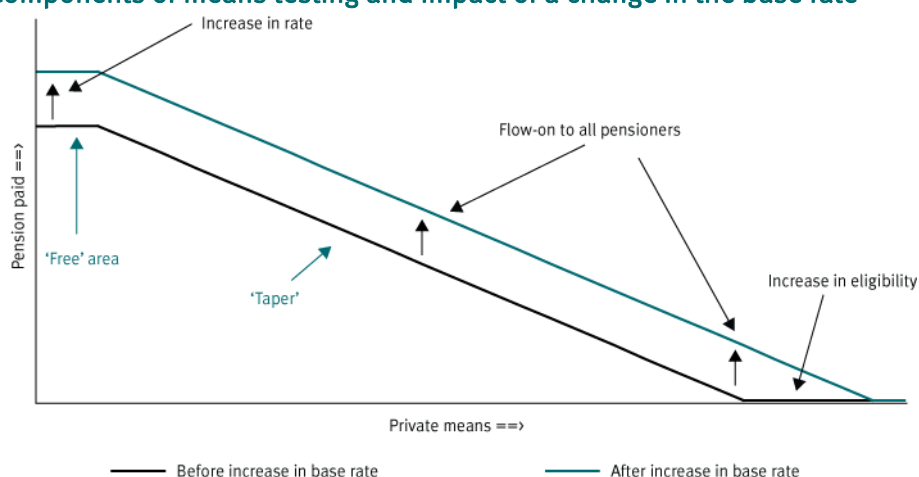
- Increasing the level of pre-funding of future pension costs would also reduce the effect of the increasing dependency rate. However, this would involve trade-offs: between the amount of public spending on pensions and the level of individuals' retirement incomes relative to their earnings; and between consumption in retirement and during individuals' working lives. Both of these trade-offs in turn have effects on incentives to work and save.

Again, in considering these longer-term prospects, the Review was aware of the uncertainties raised by the global financial crisis. Clearly any reduction in superannuation or other savings, or in the financial returns on these, has implications for these longer-term projections of pension spending and associated analysis of the level of wellbeing people will be able to achieve in their retirement.

In this context, it should be noted also that the structure of the means testing of pensions results in any increase in the base rate of the pension flowing on, in full, to all full-rate and part-rate pensioners. For example, an increase in the base rate of pension of \$10 a week would be received by all pensioners, whether they are wholly reliant on the pension, or just eligible for a single dollar of pension.

Indeed, any increase would also act to extend eligibility for pensions and concessions to people who were previously excluded due to their private means. This is illustrated in Chart 3. This aspect of the operation of the means test presents a specific challenge to policies directed at increasing the adequacy of the base rate of pension as a means of targeting assistance to those with the highest needs.

Chart 3 Components of means testing and impact of a change in the base rate



The bottom line is that government decisions on the rate of the pension cannot be considered in isolation from the long-term fiscal impact of demographic change and increasing dependency rates, which magnify the long-term economic cost of any increases. Decisions on pension rates and conditions need to be taken with regard to, and indeed may be constrained by, both the short-term and long-term macroeconomic environment and the capacity of taxpayers to support the pension system. The implications of this for pension reform are considered further in Chapter 7.

2.3.3 Managing risk in retirement

As noted above, the income support system assists with the management of a number of risks. With respect to pensions for the aged, those with disabilities and carers, these include the risk of disability or caring responsibilities that restrict the capacity of individuals to support themselves in the labour market, and the risk that individuals cannot, or because of myopia do not, save sufficiently to support themselves in retirement.

As a part of the broader retirement income system, the Age Pension also plays a role in managing a number of other risks.

- Through the operation of the means test on pensions, individuals who have private savings, including superannuation, are provided with a margin of protection against investment risk. That is, once people have private income above the free area of the income test, lower returns on investments can result in an increase in the amount of pension that is payable to them. In effect the 40 per cent taper rate of the pension means that for each dollar of private income they lose, they gain a 40 cent increase in their income support up to the level of the maximum rate.
- The indexation and benchmarking provisions of pensions provide some protection against inflation risk.
- The Age Pension helps in the management of longevity risk. In effect, the Age Pension ensures that retirees continue to have an income stream if their private means are exhausted or run down. For example, if a person draws down their superannuation in a way consistent with average life expectancy, but in fact has a longer than average life span, then the Age Pension steps in as a source of income to address this, providing insurance against the risk of longevity. Because the labour force participation patterns of women can result in low retirement savings, and because of their relative greater average longevity, this has a greater impact on women compared to men.

The role of the Age Pension in assisting individuals to manage those risks means that Age Pension policy has to take account of broader retirement income policies and work with the private sector, which supplies the products that many individuals use to manage these risks. In this regard it should be noted that:

- While many of the risks are well understood and can be addressed in the private sector through products such as whole-of-life annuities and indexed linked annuities, relatively few such products exist in the marketplace. In many cases where these products are available, the premiums charged to cover the risks are high.
- Another important dimension of risk that is inadequately provided for are the risks of disability and formal care needs, often associated with longevity. These currently are generally self-insured, with government providing some aspects of a safety net through nursing home and hospital care. In some cases the absence of a pooled risk insurance market for these risks may encourage retirees to preserve assets against longer-term contingencies, rather than drawing them down smoothly over an expected length of retirement. Alternatively, to the extent many retirees do not self-insure against these risks a much fuller burden is transferred onto the government.

With a framework that places many of these risks onto the individual, the lack of appropriate products that allow them to effectively manage these risks remains a major gap in, and contributes to the vulnerability of, the whole retirement income and support system.

The role of the Age Pension in supporting the retirement income system's management of risk, including the issues identified above, is being examined in the more comprehensive review of retirement incomes by the Australia's Future Tax System Review Panel. The importance of this role for the Age Pension means that the Pension Review could not ignore this interface in its approach to its terms of reference. The Review has not examined these issues in the breadth and depth that is being undertaken by the broader tax system review.

2.3.4 Participation and interaction with the broader tax-transfer system

Increasing workforce participation in Australia is an important national goal, for both people of 'working age' and beyond. Greater participation by mothers and the mature-aged and those on income support, including pensions, has the potential to lift national incomes and improve living standards as well as more specifically helping to meet the demand for the labour-intensive services associated with the needs of an

older population. While most pensioners do not have an obligation to seek employment, where they do so, not only do they obtain benefits for themselves but they make an additional contribution to the wider community.

Specifically, higher levels of participation can result in:

- ▶ a better functioning labour market that can draw on a wider set of skills and experience
- ▶ increased taxation revenue, without a need to increase the actual rate of taxation
- ▶ reduced public expenditure on income support
- ▶ increased capacity to contribute to, or defer claiming, retirement savings.

Analysis by the Productivity Commission in 2006 (Abhayaratna & Lattimore 2006) shows that while Australia had the fifth highest level of workforce participation in the OECD, the proportion of the population who were employed was below that of countries such as Iceland, New Zealand, Canada and Switzerland. Further, within this total, although Australia had very high rates of youth employment (largely as a result of students having part-time jobs), it performed less well for many other population groups.

- ▶ Among prime-aged workers (25 to 54 years) Australia was ranked 20th out of the 30 countries studied. For men, Australia was ranked 23rd, some 4 percentage points behind the high participation countries. Among women, while Australia ranked somewhat higher at 20th across all countries, the gap in participation was much wider. Australian women in this age group participated in the workforce at rates some 10 percentage points below high participation countries such as the Nordic countries.
- ▶ For people nearing retirement, men and women aged 55 to 64 years, Australia ranked 13th.

For many groups current levels of participation are well below what they were in the past. For example, the participation rate for 55 to 59 year-old men is 77 per cent, compared to up to 90 per cent in the 1970s. The average age at retirement in 2006–07 for recent retirees (those who retired in the previous five years) was 60.3 years. Within this group, the difference between the retirement age of men and women was relatively small, with women retiring a little younger than men (the average retirement ages for this group were 61.5 years for men and 59.0 years for women) (ABS 2008d).

The income support system, including pensions, affects incentives for labour market participation in many ways. At the most basic level, the provision of income support in itself can provide an alternative means of support for people to employment. This is managed in the pension system by targeting payments to those who are not currently able or expected to support themselves through employment because of their disability or caring responsibilities, or those, such as the aged, whom the community no longer expects to support themselves in employment. The activity test plays a similar role for other payments.

The second impact relates to program design in areas such as the means test. While the test is primarily designed to target assistance to those with limited means, at the same time it can operate as a disincentive for people to accumulate assets or to undertake employment while in receipt of assistance.

The third impact is the effect of funding of these payments on the taxes that need to be paid by the working population.

In labour market terms there are both income and incentive effects at work. In some cases, higher tax rates (and effective tax rates) will act to reduce incentives to work since people will have a smaller marginal gain from employment and face the associated loss of leisure time (a substitution effect). In other cases, people may in fact work more to achieve a certain target level of income that they consider adequate for their needs (an income effect).

Workforce participation by pensioners is supported in the pension system in a number of ways, including by the settings of the means test. In addition, people over the preservation age for superannuation can access their superannuation and continue to work. They are also affected by the range of incentives in the taxation system, including the Mature Age Worker Tax Offset and the Senior Australians Tax Offset. These mechanisms are intended to encourage workers to delay retirement and/or to make a more gradual transition into retirement, including by combining part-time employment with receipt of the pension. While, as discussed in Chapter 5, there are issues with the effectiveness of the program, the Pension Bonus Scheme is available to some people who choose to work beyond Age Pension age. Carer Payment and Disability Support Pension recipients under Age Pension age are eligible for 'working credits' which are a means of assisting all working age income support recipients who undertake irregular employment.

Similarly, those receiving Disability Support Pension and Carer Payment have access to participation support, including in-work benefits such as access to Working Credit, a Mobility Allowance to assist those who cannot use public transport, retention of a Pensioner Concession Card or Healthcare Card, as well as in-work support such as special disability employment services and a workplace modification scheme. There are also schemes available to employers to assist with any additional costs of employing a person with a disability.

However, despite these initiatives, the level of workforce engagement for individuals on pensions is low in Australia compared to other OECD countries. Just 4.3 per cent of Age Pensioners, 11.9 per cent of those on Disability Support Pension and 11.1 per cent of those on Carer Payment are employed, in most cases on a part-time basis.

Moreover, despite the strong labour market Australia experienced up until the global financial crisis, there has been a strong increase in the numbers of people of working age on Disability Support Pension and Carer Payment. In December 2008 there were 726,800 people under Age Pension age on Disability Support Pension, despite the implementation of program changes which have resulted in many people with a disability that only partially restricts their work capacity no longer being eligible for the program. There has also been a strong increase in the number of working-age people in receipt of Carer Payment. The total number of people on this payment increased from 52,300 in December 2000 to 137,100 in December 2008. Over the two years to December 2008, the number of working-age recipients of Carer Payment grew by 20 per cent.

Reflecting the importance of participation, the Review was mindful that the reform directions it identifies need to ensure that:

- ▶ any increase in assistance and change in the design of pensions do not increase incentives to rely on income support and/or decrease incentives to work
- ▶ a fair and sustainable balance is struck between support for pensioners and taxation of those in the workforce
- ▶ as pensions are a part of the broader social protection system which also interacts with the labour market, the impact of pension changes on incentives to move between working-age payments does not undermine the effectiveness of the total income support system.

These issues, which again may be sensitive to the impact of the global financial crisis, are discussed more fully in Chapters 5 and 7 and will also be more comprehensively examined by the Australia's Future Tax System Review Panel.

2.3.5 Complexity

Complexity in policies and programs is sometimes necessary because the realities of the modern world are complex. However, like the Australia's Future Tax System Review Panel, the Review considers that

complexity should be avoided where possible. Complexity adds to costs and reduces effectiveness in four ways:

- by imposing transaction costs on the individual, such as the time and administrative effort in dealing with Centrelink and other government agencies
- by generating the risk of poor outcomes for those who are not well placed to manage complexity. For example, some individuals may qualify for more than one type of income support payment and must decide which payment to receive, based on both their understanding of how the very detailed and complex rules of programs apply to them, and their judgements about how these rules may change in the future
- by creating opportunities where different elements of the system may unintentionally work against each other, leading to increased administrative costs and/or system incoherency and inconsistency that might jeopardise system objectives
- by requiring other systems that need to interact with the income support system, such as taxation, to take account of these complexities.

In addressing its terms of reference, the Review has identified several areas of unnecessary complexity, including:

- possibly unnecessary differences in categories of payment
- the existence of different indexation arrangements for different elements of the pension system
- the large number of supplementary payments such as Telephone Allowance, Utilities Allowance and Pharmaceutical Allowance
- the different means test treatment of essentially similar financial products.

At the same time, the Review notes that reducing complexity needs to be balanced against other goals. Two drivers of increasing complexity in the social security system are:

- interacting with other complex systems, including increasingly sophisticated, and often non-transparent, financial instruments and arrangements
- seeking to ensure that income support can respond to diverse needs and circumstances without imposing simplistic ‘one size fits all’ solutions.

The latter reflects one further dimension of complexity with which the pension and the broad social support systems must deal; namely the many complexities and transitions of people’s lives. For example, labour supply decisions are often determined jointly within households and depend on the availability of services such as child care and how family and other caring responsibilities are divided, as well as the particular incentives any one partner faces. Jointly made retirement decisions such as the level and type of asset accumulation can have significant impacts on a survivor after the death of a partner. In addition, at times, simple categorical approaches deal poorly with the realities of life. For example, a person may have a partially incapacitating disability, some caring responsibilities and some part-time employment.

2.4 Australia’s Future Tax System Review

The findings of this report are focused on one aspect of Australia’s tax-transfer and retirement income systems, and need to be considered in the context of the broader work of the Australia’s Future Tax System Review. As indicated in Chapter 1, the government has requested that the Chair of the Review,

Dr Ken Henry AC, bring forward the part of his review relating to the retirement income system and provide a report by the end of March 2009 that contains recommendations ‘on the adequacy of the retirement income system and the appropriateness of the current taxation arrangements’. This request was to enable the government to consider this report in conjunction with other aspects of the retirement income system.

The Pension Review’s relationship with the Australia’s Future Tax System Review was raised in some of the submissions to the Pension Review. Several of these suggested that it was desirable to consider all of the allowances and pensions that are part of Australia’s income support system at the same time to address questions of priorities, fairness, balance and incentives in the social protection system as a whole. One of the concerns raised in these submissions was that a limited focus on a subset of payments would introduce further distortions to the incentives for people to seek to qualify for those payments with higher rates of assistance, leading to increasing numbers on non-activity-tested payments.

The Pension Review recognises the underlying concerns expressed in these submissions. However, it was not appropriate for the Review to defer a full consideration of its terms of reference, as was suggested by some submissions.

While the terms of reference of the Pension Review are more narrowly directed and have shorter time frames than those of the Australia’s Future Tax System Review, the work of the Pension Review could not be conducted without reference to the larger challenges and systems within which the pension system operates and which are the focus of the Australia’s Future Tax System Review.

In doing so the Pension Review has been mindful not to anticipate or circumscribe these broader considerations. In particular, the findings of this Review, with one exception, that of the Age Pension age, are primarily concerned with the operation of the pension system within the current environment.

3 Adequacy

Overview and findings

This chapter considers the central question for the Review: At what level should the full rate of pension be set?

In line with the Review's view that the primary purpose of the Age Pension, Disability Support Pension and Carer Payment is basic income support, the Review's approach to this question has been to test whether current rates of pension are providing a basic acceptable standard of living, accounting for prevailing community standards.

This chapter is concerned with the appropriate level of the rate of payment of the pension to those who are wholly reliant on it, without any assumptions about access to private means. Chapter 7 examines the situation of those with private means more fully.

To address the question 'At what level should the full rate of pension be set?', this chapter considers the underlying purpose of pension payments, the implications of this for the rate of payment, and how the diverse needs of the pensioner population can be best addressed.

It reviews a range of different measures of adequacy and outcomes, to consider both the adequacy of pension payments per se and the relativities between pensioners, in particular those living alone and those who are members of couples. This reflects the Review's views that no single measure or benchmark could be used to determine whether or not the pension was adequate. It also considers the need for supplementary assistance for those with high housing costs in the private rental market.

The Review has developed a number of findings in relation to whether current rates of pension are providing a basic acceptable standard of living for all pensioners. These reflect the Review's finding that there are significant aspects of the current structure and rates of pension that need reform to address the financial pressures that different groups of pensioners are facing.

While the pension population has diverse needs, including pressures arising from health and disability costs, the Review does not believe that, for those who are retired, or not currently expected to work because of disability or caring responsibilities, there should be different rates for the Age Pension, Disability Support Pension and Carer Payment.

Finding 1: The Review finds that the Age Pension, Disability Support Pension and Carer Payment should be paid at the same basic rate.

Finding 2: The Review finds that the specific costs associated with health and disability are best responded to by targeted services rather than generalised differences in base rates of payments or financial supplements. (Section 3.4.3)

Chapter 6 examines in more detail the concessions and services that might meet these needs.

The Review's central finding in relation to whether current rates of pension are providing a basic acceptable standard of living for all pensioners is that the relativities between single and couple rates of payment need reform. In particular, the Review's analysis indicated that the current relativities between single pensioners and pensioner couples do not adequately take into account the costs faced by singles living alone.

A policy question which arises from this is whether the current two-tier structure of paying singles and couples different rates should continue, or whether a three-tier structure (singles living alone, singles and couples) should be used.

Finding 3: The Review finds that, on the basis of its analysis of the outcomes achieved by pensioners, evidence provided in the consultations and its analysis of relative needs, the relativity of the rate of pension for single people living by themselves to that of couples is too low.

Finding 4: The Review finds that the case for a change in the relativity of the rate of pension for single pensioners living with others is less compelling. Such pensioners most frequently live with other relatives in owner-occupied housing and have outcomes more akin to couple pensioners than to other single pensioners. This suggests existing relativities are broadly adequate for these pensioners. However, the Review recognises that adding a third level of pension rate may introduce additional complexity.

Finding 5: The Review finds that a relativity in the range of 64 to 67 per cent across the package of support would be more appropriate than the current relativity. Adopting a relativity towards the upper end of this scale would appear to be reasonable if a three-tier approach were to be adopted. Under a two-tier approach, where the same relativity would be applied to single pensioners living alone and those living with others, a relativity at the lower end of this scale would more adequately reflect the average needs across both these groups. (Section 3.4.4)

The Review's analysis of the total package of assistance provided to couple pensioners did not identify the same level of need as for single pensioners living alone.

Finding 6: The Review finds that, taking into account the totality of the package of the current pension base rates, supplements and the value of the Seniors Bonus, the rate of pension paid to couples appears to be adequate for those pensioners living in their own homes or public rental housing, and without unusually high costs of health or disability. (Section 3.4.5)

However, the Review's analysis did identify an additional group for whom the current rates of total assistance do not appear to be providing a basic acceptable standard of living: pensioners who do not own their own homes and rent privately.

Finding 7: The Review finds that there is strong evidence that many pensioners in private rental housing face particularly high costs and have poor outcomes. Rent Assistance and social housing have complementary roles to play in addressing the financial security of these pensioners. The Review notes that the government has proposed an increased investment in social housing and considers that reforms to Rent Assistance would complement this. (Section 3.4.6)

3.1 Terms of reference

The first term of reference for the Review requires it to report on the 'appropriate levels of income support and allowances including the base rate of the pension, with reference to the stated purpose of the payment' in the context of measures that will 'strengthen the financial security of carers and seniors'.

3.1.1 The purpose of payments

The pension system, as noted in Chapter 2, is one part of a wider tax-transfer system that seeks to meet a range of goals and objectives across the community. As discussed in the Review's Background Paper, while individual payments do not have specific stated purposes with regard to adequacy, the broad approach to adequacy of pensions is to provide 'a basic acceptable standard of living, accounting for

prevailing community standards'. This recognises the role of the pension in providing basic and ongoing income support to a group of Australians who often need to rely on this support for an extended period at vulnerable points in their lives.

As indicated in the Background Paper, adequacy should not be contingent on a person having private resources to supplement this support. Further, reflecting this basic income role, the rate of the pension does not provide support at a level related to past earnings or in lieu of forgone earnings, and neither does it provide compensation for pain, suffering or loss of amenity. Rather, it is concerned with the level of income needed to sustain an appropriate standard of living. This is the question this chapter considers.

The question of the 'appropriate level of income support' for those pensioners with some private means is considered in Chapter 7.

There are also, as discussed in Chapter 2, a number of important interactions between pension rates and other aspects of the tax-transfer system, particularly between the Age Pension and the broader retirement income system, including superannuation. These links concern not only the issue of adequacy but incentives to move between payments and to participate in the labour market. These issues were raised in consultations and submissions, and are also being considered by the Australia's Future Tax System Review Panel in detail.

The Review notes that the criteria and standards it has focused on to answer the question of the adequacy of these pensions are not necessarily the same as those that may be appropriate to determine the needs of people on other payments. While the question of the adequacy of the rates of other transfer payments is outside the Review's terms of reference, the Review notes that for these there may also be other criteria that need to take account of their closer links with the labour market and the differences in the life-cycle trajectories of recipients. The Review similarly considers that adequacy of pensions does not provide a framework for questions of adequacy of the criteria for wage setting or other forms of remuneration and other related purposes.

The Review also notes, as indicated in the approach it has adopted to adequacy, that while concepts of an acceptable standard of living does have both absolute and relative dimensions, inevitably any determination is subjective and must be taken in the context of the outcomes of others in the society.

3.1.2 Adequacy and diversity of needs and circumstances

A significant challenge in considering the rate of the pension is posed by the diversity of circumstances of Australia's pensioner population and the outcomes they achieve. Any particular level of payment will result in different outcomes for different individuals, even if they are in like circumstances, depending on different skills, capacities, priorities and aspirations. What is adequate for one person may well not be adequate for another.

Where people's circumstances vary, more diverse outcomes will occur. Many factors may contribute to this. A person may have high health or support needs due to illness or disability; or their costs may vary depending on whether they are a home owner or renter, or on where they live. In addition, outcomes will vary in regard to the personal resources they have access to, whether these are their own skills, abilities and aspirations, financial assets or networks of support from family, friends and the community.

Therefore, even when considering the basic level of adequacy, striking a rate based on what an average or median person may require can result in many people experiencing inadequate outcomes, and others more than adequate.

In the abstract, there are three approaches for dealing with this:

- setting the pension rate well above that required for most people so as to provide a buffer

- developing a more personalised approach to the pension rate which takes account of individual circumstances, needs and outcomes
- addressing special needs through the provision of services, especially where people have needs associated with health and disability.

The Review considers that the third of these approaches offers, in general, the best means of achieving appropriate outcomes for individuals, dealing with diversity, minimising system complexity and focusing expenditure on those with the highest needs. In some cases, however, it is also appropriate to use tailored payments such as Rent Assistance.

Setting a pension rate well above that which is necessary to achieve appropriate outcomes for the majority of pensioners would improve outcomes for all, but it would overcompensate many and undercompensate those with the highest needs and raise questions of equity and sustainability over the long term. It would need to be tested against other expenditure priorities, including the needs of other groups in the community, and the capacity and willingness of taxpayers to support it.

More personalised payment structures could involve multiple supplementary payments and variations in rates according to the characteristics and circumstances of an individual. Conceptually, this type of approach has some appeal. Elements of this type of approach currently feature in the pension system in payments such as Rent Assistance, Telephone Allowance, Utilities Allowance and Pharmaceutical Allowance. However, as discussed in Chapter 5, with the exception of Rent Assistance which has a very clear role in responding to the significant differences in housing costs experienced by private renters, the merits of this approach are limited, particularly if some components become quasi-universal. A more tailored approach would also add considerably to the complexity of the pension system and create higher transaction costs for pensioners. Having a range of payment rates based on different characteristics could also result in pensioners in substantially similar situations being paid at different rates because marginal differences led to their being categorised differently. Applying it flexibly may introduce inappropriate levels of discretion into public expenditures.

In proposing an approach to addressing variations in need through services rather than by cash transfers, the Review notes that it is important that pensioners with high needs are able to access the services they need. This issue is considered in Chapter 6.

3.2 What the consultations told us

The adequacy of the pension was discussed extensively in the consultations and was a major focus of written submissions and focus group discussions.

3.2.1 Consultations—financial security

The majority of submissions argued that the basic rate of the pension should be increased.

Many pensioners came forward with their personal stories about their recent experiences of living on Age Pension, Disability Support Pension or Carer Payment. These accounts included many reports of individuals ‘doing it tough’ and the challenges they faced in their day-to-day lives, whether because of their financial situation, their disability or their caring and other responsibilities. The Review heard stories of pensioners who have:

- had to move into cheaper accommodation due to large rent increases, or sold the family home because of the costs of council rates and maintenance

- ▶ not used heating systems during winter because of high utility costs, or had these services cut off because they were unable to pay bills
- ▶ sold their cars because of the cost of registration, fuel and maintenance, but then found that due to poor public transport services they had become isolated from family and friends and faced difficulties in accessing health and other services
- ▶ curtailed their discretionary spending on social activities such as travelling interstate to visit relatives, attending social events such as seeing a movie or eating at a restaurant
- ▶ forgone comprehensive insurance of their car or home contents, or cancelled their private health insurance due to rising premiums
- ▶ found it difficult to maintain a varied and balanced diet because of increases in the cost of fresh fruit and vegetables and meat
- ▶ on being widowed and moving to a single rate of pension, struggled with continuing to maintain a home
- ▶ deferred medical and dental care, or faced choosing which pharmaceutical prescriptions they would fill.

3.2.2 Consultations—adequacy of pensions and priorities for change

Overwhelmingly the consultations expressed a strong view that the government should increase spending on pensions, as well as provide greater support to carers and people with disability, and for retirees in general. Forty-seven per cent of submissions from individuals and 59 per cent from organisations called for the pension to be increased.

The consultations reflected a wide range of expectations as to what government should provide through the social security system and in support of retirement incomes. These expectations were often dependent on individual experience, age, duration on payment and family circumstances, including responsibilities such as caring.

While many pensioners clearly articulated the day-to-day problems they faced in meeting basic needs, especially when experiencing high rents, high health care costs or personal misfortune, there were equally strong calls from groups such as self-funded retirees and others with more significant resources who felt that the current system was inequitable or was penalising their efforts.

Reflecting these diverse expectations, there was little consensus on what the priorities should be. Indeed, there were two strong approaches articulated, both based on the grounds of fairness and equity, but reflecting quite different interpretations of what this means.

- ▶ The first was that any additional government assistance should be directed at those with the least means and highest needs. Advocates of this approach often suggested that there was a case for funding such targeted support by redirecting assistance currently provided to those with higher means from the income support system and superannuation.

- The second was that people who have contributed through the tax system over their working lives, or indeed in some cases through ongoing work, were entitled to the Age Pension as a ‘return on their contribution’.²

Some participants argued for the complete removal of means testing, a substantial increase in the ‘free’ area, modification of the treatment of some classes of assets, and non-assessment of foreign pension income. The issue of means testing is considered in Chapter 7.

3.2.3 Consultations—at what level should the pension be set?

There were many suggestions as to what the pension rate should be. While some simply suggested a dollar value increase, with roughly equal proportions suggesting an increase of \$25 to \$30 a week, \$50 to \$75 and over \$100 a week, others suggested setting it relative to an external benchmark. Among the benchmarks suggested were maintaining the link to Male Total Average Weekly Earnings (MTAWE) but increasing the rate, for example to 35 per cent, using the minimum wage, the Henderson Poverty Line, or the Westpac–ASFA ‘Modest’ Retirement Standard. Others proposed a new benchmark usually based on a ‘budget standard’. Section 3.4.2 considers these types of approaches.

3.2.4 Consultations—groups with poor outcomes

In the consultations and submissions, a number of particular groups of pensioners were identified as having relatively poorer outcomes on a fairly consistent basis. These included single pensioners, private renters, those with high health costs or other cost pressures, and those who live in places with relatively high costs of living.

Single pensioners

The poorer circumstances of single pensioners who were living by themselves were cited widely in the consultations. A central theme in many submissions was that the current relativity between the payment rates for couples and single pensioners is inappropriate. The poorer outcomes for single pensioners were evident in analysis of the feedback from the focus groups.

- A number of suggestions were made about the rate at which the single pension should be paid relative to the couple rate. The main view in written submissions was that the rate of payment to a single pensioner living alone is set too low relative to a member of a couple. This was a view stated in about 14 per cent of submissions from individuals and 28 per cent of submissions from organisations.

Proposed relativities for the single age pension rate varied, but were mainly around 65 to 75 per cent of the couple rate.

- Some submissions argued, on the grounds of ‘fairness’, that pensioners should be paid the same individual rate regardless of their relationship status (about 7 per cent of written submissions from individuals and 15 per cent of submissions from organisations). One example was a suggestion that the couple rate be abolished completely, with all pensioners instead receiving a single rate set at the greater of either a 40 per cent MTAWE benchmark, or the Westpac–AFSA ‘Comfortable Lifestyle: Single Standard Rate’.

² In a number of the submissions that argued this case, reference was made to individuals having made payments into the National Welfare Fund and a belief that these were in effect a prepayment of a future entitlement to a pension. This interpretation is not correct. In a review of social security funding, Stanton and Dapr  (1995, p. 28) conclude: ‘There was however no link (intended or actual) between individual’s contributions paid into the fund and any subsequent entitlements they might have to a social security payment. In other words, the National Welfare Fund and the social services contribution did not, in any way, constitute a move towards funding social security in Australia along social insurance lines’.

Private renters

The cost of private rent, and the stress it places on pensioner budgets, was cited in many submissions as being a priority area. A number of individual submissions outlined household budgets. Some single pensioners in metropolitan areas were paying rents of up to \$220 a week which, even after Rent Assistance, left them with just over \$100 a week for all other costs such as food, utilities, insurance and medical expenses.

Other submissions reported the pressure of rent increases, indicating cases of rents being raised by up to \$60 a week over a year. Many private renters spoke of their insecurity, citing concerns about the affordability of future rent increases, or fears of their homes being sold. Pensioners discussed the affordability of moving costs should they be evicted, as well as their ability to find alternative accommodation within their price range and preferred area. Some pensioners discussed having moved from capital cities to towns where more affordable housing was available to reduce their housing costs. However, this sometimes meant that they had moved away from family and social networks, in turn leading to their having to pay more for transport and services which were once performed by family members or friends (for example, lawn-mowing, meals-on-wheels and taxis).

Health costs

Limits on the capacity of pensioners to meet health costs, or the consequences of health bills for household budgets, were among the most frequently mentioned items in the consultations. The concerns voiced covered the cost of pharmaceuticals, including the cost of items that were not part of the Pharmaceutical Benefits Scheme, as well as having to pay for a large number of Pharmaceutical Benefits Scheme items in a short time period; the costs of specialist fees; the travel, and at times accommodation, costs for people in regional areas to access hospital and specialist services that were concentrated in state capitals; dental costs; and the cost of health insurance.

While many in the community view health insurance as an optional expenditure to enable access to private health care, many pensioners saw it playing a more critical role in maintaining their health, or managing ongoing health concerns, by ensuring that they could access health services quickly and avoid the impact of ‘lumpy’ health care costs.

Numerous cases of individuals failing to fill all prescriptions or delaying health care because of the costs involved were cited. The question of health services and costs is considered in Chapter 6.

Other cost pressures

Additional areas of concern raised in the consultations included home maintenance, food prices and the cost of utilities, as well as more general trends in the prices of services provided by state governments and the impact of state government taxation. Transport and petrol costs were consistently raised during public consultations. Many pensioners reported that their mobility had been impaired due to the sharp rise in the cost of running a car, or increases in the cost of using public transport.

Many home owners spoke of an increasing inability to maintain their homes, citing difficulty in finding money to pay tradespeople to fix essential items such as leaking taps, faulty electrical wiring, heating systems, roofs and guttering. Some home owners also reported on the pressures they faced as a result of sharp rises in council rates, land taxes, or body corporate fees for their properties.

Household utilities such as electricity, gas and water were also mentioned, with many pensioners reporting the impact of rising prices. A number of representative organisations noted current costs and expressed concern that pensioners’ difficulty in paying for utilities may increase with the introduction of a Carbon Pollution Reduction Scheme in the future.

Disability Support Pension recipients and submissions from major organisations frequently mentioned that disability support pensioners had not benefited from the bonus payments received by Carer Payment and Age Pension pensioners.³ This was considered by them to be unfair because, despite the costs of disability many of these pensioners faced, they actually received less financial support than other pension recipients.

Costs of living in different locations

The experience of higher costs in some locations was raised in both the consultations and submissions. In addition to the cost of accessing medical and hospital services for people outside capital cities, the two main themes were high housing costs in some locations, and the higher cost of food and other essentials in regional centres. While housing costs were mainly identified as a matter of concern in capital cities, a smaller number of submissions identified specific regional cost pressures, in particular in those communities that have seen major expansion of mining and related industries.

3.2.5 Consultations—pensions and the broader income support system

As well as addressing the rate of the pension, many submissions indicated concern with the relativity of the rates at which the pensions under review were paid to the payment rates of allowances and other elements of the income support system. These concerns were raised both on grounds of equity and in the context of incentives. Some submissions drew to the Review's attention that increases in allowances in real terms over the last decade have been minimal in comparison to increases in pension rates, increasing the disparity within the social support system.

The difference between pension and allowance levels led some to question whether social security payments were appropriately targeted to those with greatest need. Some pointed out that making pensions and their related benefits available to people with higher income would diminish the future sustainability of the system. Others expressed concern that the differences in rates created strong incentives for people to move onto a pension payment, even when other payments might be more appropriate. The relationship between the Age Pension and superannuation was also raised. These issues, as noted above, are being considered by the Australia's Future Tax System Review Panel.

3.3 What the evidence shows

Much of the initial research conducted by the Review on the adequacy of the pensions has been presented in the Review's Background Paper. Since the release of the Background Paper, additional analysis has focused on examining more closely the relative needs and outcomes of different groups of pensioners and on reviewing the analysis and proposals set forth in the consultations and submissions. The Reference Group was provided with the outcomes of analysis to obtain feedback and inform the ongoing work of the group. In reviewing the evidence, this section draws on both the already published analysis and more recent work.

This section outlines the results of analysis of:

- ▶ the relationship of pension rates to a range of fixed and relative benchmarks
- ▶ wellbeing outcomes for pensioners

³ The consultations were conducted before the government's Economic Security Strategy was announced in October 2008, which included bonuses for disability support pensioners for the first time.

- the relative needs of single and couple pensioners.

As discussed in the Background Paper, the Review considers that there is no single benchmark or indicator that can be considered as providing an authoritative reference point as to what constitutes an adequate rate of pension. There are three reasons for this:

- The adequacy, and even more so the appropriateness, of a rate of payment always involves balancing different objectives and various standards. Since judgements about living standards are relative and subjective, so is any question about the level of income that is needed to achieve an adequate or appropriate living standard.
- At any one level of income, different people, even those in similar circumstances, will achieve different outcomes; hence, of itself the existence of some adverse outcomes or levels of dissatisfaction is not a sufficient indicator of lack of adequacy.
- It is clear that different benchmarks, even when well constructed and justified, generate different estimates of what is adequate.

For these reasons the Review has sought to address this question by considering a diverse set of measures and the wide variety of views presented to it in the consultations, and to make findings in terms of the balance of these inputs.

3.3.1 The value of the pension

In addition to the basic rate of the pension, the pension payment received by pensioners may contain a number of components. As a result, the current pension for a single person may range from \$293.93 a week (base rate, Utilities Allowance and Pharmaceutical Allowance) to \$351.69 a week (including the higher rate of Telephone Allowance and Rent Assistance). When account is taken of the annualised value of the Seniors Bonus, these rates increase further to \$361.31.

Pensioners may also receive other supplementary payments, including Carer Allowance, Pensioner Education Supplement and Mobility Allowance. Chapter 5 discusses the detailed components of pension payments.

As shown in Table 1, a 'typical' single age pensioner, with no private income, would have a total annual income of \$15,923.00 and a couple \$26,222.40⁴ that is, a single age pensioner receives 60.7 per cent of the pension package paid to a couple. This is slightly above the 59.9 per cent ratio of the base pension. Appendixes B, C and D provide further details on the rates of payment.

⁴ These amounts exclude the value of the 2008 Economic Security Strategy.

Table 1 Illustrative Age Pension rates, 1 January 2009

	Annual (\$)		Weekly (\$)	
	Single	Couple (combined)	Single	Couple (combined)
Base Pension including 'Pension Supplement'	14,614.60	24,414.00	281.05	469.50
Pharmaceutical Allowance	156.00	156.00	3.00	3.00
Telephone Allowance	138.40	138.40	2.66	2.66
Utilities Allowance	514.00	514.00	9.88	9.88
Total 'statutory'	15,423.00	25,222.40	296.60	485.05
Seniors Bonus	500.00	1,000.00	9.62	19.23
Total	15,923.00	26,222.40	306.21	504.28

Notes: Higher rate of Telephone Allowance shown, lower rate is \$92.00. Seniors Bonus as provided in 2008–09 Budget, weekly value based on 52 weeks.

3.3.2 Purchasing power of pensions

The value of pensions has increased over time as a result of the indexation of components, ad hoc adjustments and the provision of additional payments.

Using the Australian Bureau of Statistics Age Pensioner Analytical Cost of Living Index (ABS 2000, 2008a) as a measure of the impact of price change on the pensioner population indicates that the real value of the pension package received by a single age pensioner—that is, its purchasing power—has increased by 28.2 per cent over the past 20 years. Over the past 10 years the increase has been 19.1 per cent, and over the past five years 12.7 per cent (Table 2).

The increase in the value of pensions for couples is slightly lower because of the effect of the introduction of the Telephone Allowance, Pharmaceutical Allowance, and in particular the Utilities Allowance, which are paid at the same rate to both single people and couples.

Table 2 Real value of Age Pension

	Single	Couple
Value of pension (2008 \$)		
June 1988	12,054	20,092
June 1998	12,976	21,461
June 2003	13,715	22,717
June 2008	15,456	25,492
Growth to June 2008 (2008 \$)		
5 year	1,741	2,775
10 year	2,480	4,032
20 year	3,401	5,400
Growth to June 2008 (%)		
5 year	12.7	12.2
10 year	19.1	18.8
20 year	28.2	26.9
Annualised growth rate to June 2008 (%)		
5 year	2.4	2.3
10 year	1.8	1.7
20 year	1.3	1.2

Notes: June 2008 dollar values. Deflated by age pensioner Analytical Cost of Living Index.

Source: Price index – ABS 2000, 2008a

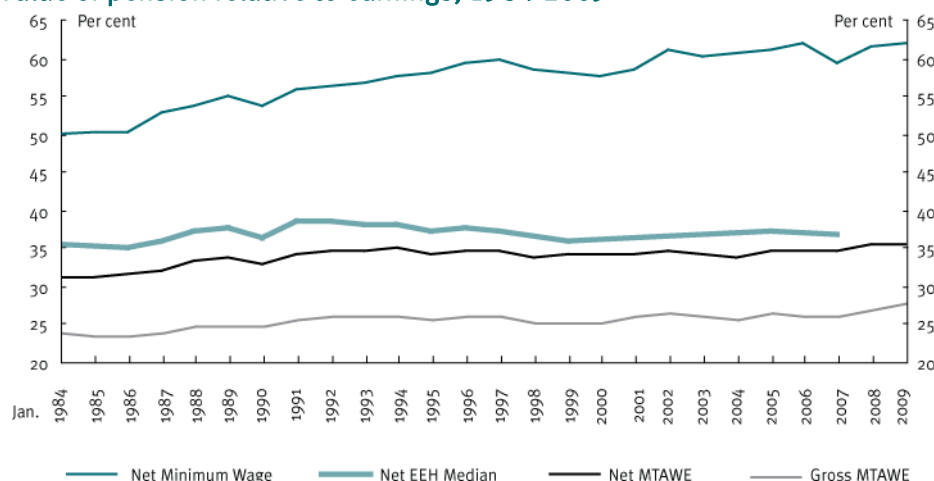
Similar results are obtained if alternative measures of price inflation, such as the Consumer Price Index, are used.

3.3.3 Value relative to earnings

Another approach to benchmarking is to consider the income that a pensioner receives relative to the earnings of an employed person. Because an employed person pays income tax,⁵ these comparisons are best undertaken on the basis of the net, take-home, income.

Three different net earnings measures were considered by the Review: the value of the pension relative to a full-time worker on the Federal Minimum Wage; relative to the net pay of the median (middle) full-time non-managerial employee (as derived from the ABS Survey of Employee Earnings and Hours (ABS 2007b)); and relative to the net income of person who received an income equal to MTAW. These are illustrated in Chart 4, along with the value of the pension package as a proportion of gross MTAW.

⁵ While the pension is taxable income, given the structure of tax rates and rebates, a person wholly reliant on the pension is not subject to a net tax liability. The interaction between pensions, private income and taxation are considered in Chapter 7.

Chart 4 Value of pension relative to earnings, 1984-2009

Notes: Single age pensioner. Calculations based on pension, earnings and taxation rates as at 1 January each year. Pension includes Seniors Bonus when paid. EEH = employee earnings and hours; MTAW = Male Total Average Weekly Earnings.

Source: Review modelling using ABS 2007b, 2008b

In the medium term, the pension has largely maintained, or depending on the measure, improved its relativity with the take-home pay of Australian workers.

- A single age pensioner (including allowances and bonuses, but excluding Rent Assistance) currently receives 61.8 per cent of the take-home earnings of a single worker on the minimum wage. This compares with 57.6 per cent in 1999 and 54.6 per cent a decade earlier.
- The value of the pension has fallen slightly compared to the net earnings of a full-time adult non-managerial worker on median earnings over the past decade, but over the longer term it has risen. (In 2007 it was 36.6 per cent of these earnings, compared with 37.0 per cent in 1997⁶ and 35.6 per cent in 1987.)
- The single rate of pension is equal to 35.1 per cent of the net after-tax earnings of a single worker on MTAW. This is above the 33.6 per cent recorded in 1999 and 33.2 per cent in 1989.

3.3.4 Budget standards

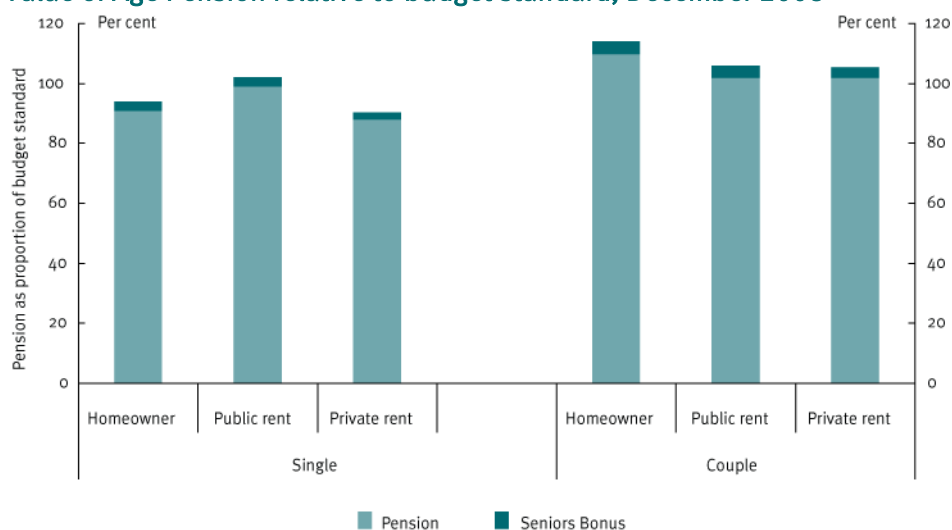
Budget standards, as discussed in more detail in Section 3.4.2, involve costing a theoretical household budget. The Review has updated the Low Cost Budget Standards, which were developed by the Social Policy Research Centre, for six different Age Pension households. This low-cost budget is described as one that would, with careful management, 'allow social and economic participation consistent with community standards and enable the individual to fulfil community expectations in the workplace, at home and in the community' (Saunders et al. 1998).

As at December 2008 pensioner couples were above the stipulated budgets for all three tenure types of households. (Including the value of the Seniors Bonus, the range of adequacy was from 106.1 per cent for a private renter to 114.8 per cent for a home owner.) In contrast, single age pensioners had incomes below the budget standard, with the exception of the single public renter whose pension, again including the bonus, was just above the value of the budget (103.1 per cent). For a private renter, even with the inclusion

⁶ In contrast to the other earnings measures, median earnings are only available every second year.

of Rent Assistance, the value of their pension was only 91.0 per cent of the budget, and for a home owner it was 94.7 per cent.

Chart 5 Value of Age Pension relative to budget standard, December 2008



Notes: Calculation for private renter includes Rent Assistance

Source: Review analysis based on updating of Social Policy Research Centre budget standards.

Analysis of these budget standards over time indicates an increase in the adequacy of the pension against this benchmark. When these standards were initially released in March 1997, the pension for a single aged home owner was only 82.7 per cent of the ‘low-cost budget’, compared with the 94.7 per cent reported above. For an age pensioner couple who lived in their own home the rise over this period was from 99.5 per cent to 114.8 per cent.

3.3.5 Income poverty measures

Two measures of income poverty are often used in social analysis in Australia: the Henderson Poverty Line and the ‘50 per cent median income poverty line’. While the Review cautions that it considers neither of these to be a particularly robust measure of wellbeing, Chart 6 illustrates the value of pension relative to these two measures.

Chart 6 Value of Age Pension relative to Henderson Poverty Line and 50 per cent median poverty line, June 2008



Notes: Fifty per cent of 2005–06 median household disposable equivalised income updated by Full-Time Adult Ordinary Time Earnings

Source: Review analysis using: HPL – MIAESR 2008b; 50 per cent median – ABS 2007b, 2008b

- The value of the 50 per cent median line and the Henderson Poverty Line are almost identical for single people at around \$308 a week. The value of the pension and allowances for a single person is only 93.5 per cent of this, although this increases to 96.6 per cent when the value of the Seniors Bonus is taken into account. When account is also taken of Rent Assistance, the value of payments to an age pensioner rises to be 14 per cent above these poverty lines.
- For couples the two measures produce different poverty lines—\$437 a week using the Henderson Poverty Line and \$463 a week for the 50 per cent median approach. These lines are below the basic value of the pension and allowances. When account is taken of the value of the Seniors Bonus, the package of assistance to a couple is 6.1 per cent above the 50 per cent median line and 12.4 per cent above the Henderson Poverty Line. If such a pensioner couple receives Rent Assistance then the total value of income support increases to be 17.0 per cent above the 50 per cent median line and 24.0 per cent above the Henderson Poverty Line.

As well as using these poverty lines as ‘benchmarks’, population-based analysis of the incidence of poverty can also been undertaken using household surveys. Review analysis of the ABS 2005–06 survey of income (ABS 2007c), as reported in the Background Paper, revealed a complex set of results which are highly dependent on the measures used. Using the simplest 50 per cent median poverty measure, poverty rates for the population as a whole and children have fallen slightly over the past decade, while those for the aged have increased. On the other hand, if a ‘real’ rather than ‘relative’ poverty line is used, an approach which considers whether or not there have been real increases in living standards of poor households, a very strong fall in poverty is seen, with the incidence for the population as a whole reducing from 9.1 per cent in 1994–95 to 3.8 per cent in 2005–06.

These simple measures, however, deal poorly with some resources available to households, including the high level of housing assets of older households and access to subsidised rents in public housing. When this is taken into account, the aged have low poverty rates. For example, if housing is ignored, the poverty rate for single people aged over 65 years in 2005–06 is estimated at 47.4 per cent, but when housing is taken into account this falls to just 7.0 per cent.

Such a diversity of estimates is common in ‘poverty rate’ analysis, given the variety of available measures and methods. For example, Whiteford (2008) found that estimates of poverty rates for single older people

in the mid-1990s varied as little as 2.3 per cent (using the ‘half median and noncash social wage’ measure) to as much as 34.8 per cent (using a Henderson weekly measure).

3.3.6 International comparisons

Comparisons between Australian pensions and those in other countries are difficult because in most studies retirement incomes are analysed in terms of earnings replacement rates, which reflect the characteristics of the contributory schemes that are the basis of most overseas pensions.

Some more simple comparisons can be made of the relative value of social assistance on the basis of adjustments for the relative costs of living in different countries.⁷ These indicate that, in 2004, the Australian pension⁸ was towards the top of the middle band of countries in the OECD. While the single rate of pension was somewhat lower than the value of pensions paid in the Scandinavian countries and Canada, it was above that of other countries such as the United Kingdom, Germany, France and the United States. Given, as discussed in Section 3.3.8, that Australia is relatively less generous to single pensioners than to couples, these data would suggest that outcomes based on a comparison of the assistance provided to couples would be somewhat better.

Such comparisons are only indicative, since they do not take full account of the many national differences, including different ways of delivering health care, housing and other services which can affect the living standards and outcomes of pensioners.

3.3.7 Wellbeing outcomes

A different approach to measuring the adequacy of pensions is the actual levels of wellbeing reported and experienced by pensioners. The Review’s research into this had two objectives: to inform decisions on the overall wellbeing of pensioners and to identify who does most poorly under the current pension system.

Wellbeing can be measured in many ways. A number of these were considered by the Review drawing on data from the ABS and from the Household, Income and Labour Dynamics in Australia (HILDA) survey.⁹ The Review found two measures to be particularly informative. The first was the way in which pensioners themselves perceived their own level of wellbeing. The second was a measure that identified the extent to which particularly poor outcomes occurred among different populations. For this, the Review derived a measure of financial stress from the HILDA survey to identify the 5 per cent of the population with the most adverse outcomes.

This section also considers the results from the focus group research that was undertaken for the Review.

Wellbeing—reliance on pension income

Although many pensioners are wholly reliant on the pension for their income, others have private resources. These additional resources are reflected in wellbeing outcomes. As shown in Chart 7, when asked about their ‘level of prosperity’, pensioners who were more than 95 per cent reliant on the pension

⁷ These comparisons are made using ‘purchasing power parity’, which is based on the comparative cost of a basket of goods and services in different countries. Because they are based on the population overall, they may not accurately reflect the specific relative parity of particular groups, such as pensioners.

⁸ In this analysis the Age Pension is compared with ‘social assistance to the aged’. These are the payments made to those who may not be eligible for an earnings-related scheme. Data derived from OECD 2007 and SSA 2006a, 2006b, 2007.

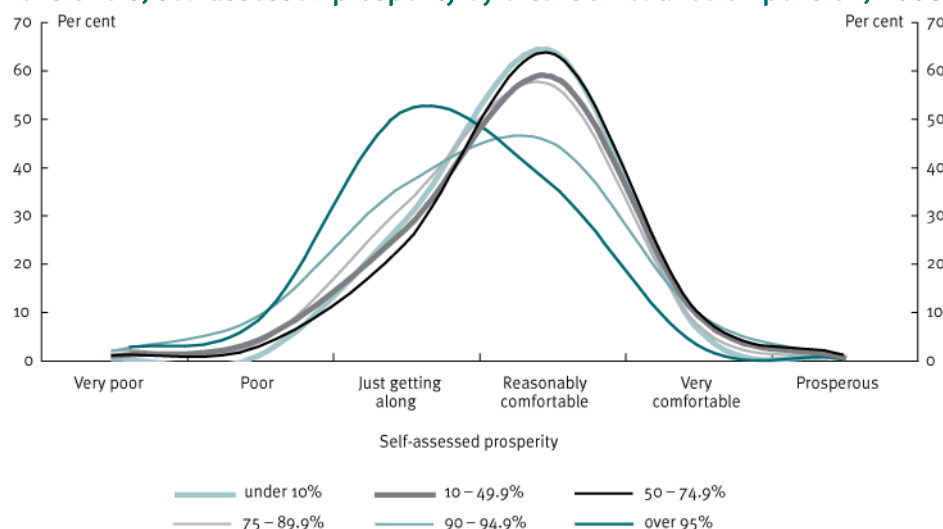
⁹ HILDA is a longitudinal household survey conducted by the Melbourne Institute on behalf of the Department of Families, Housing, Community Services and Indigenous Affairs. Further information is available at <<http://www.melbourneinstitute.com/hilda>>.

Results presented here are mainly drawn from Wave 6 which was collected in late 2006. As HILDA is a sample survey results are subject to sampling error.

were much more likely than other pensioners to respond that they were ‘just getting along’ or ‘poor’. However, even in this highly dependent group many reported that their financial situation was ‘reasonably comfortable’.

Analysis of these responses shows however that the difference between the groups of pensioners was one of degree, and there was in fact a large amount of overlap between the groups, despite large differences in the extent to which they rely on government transfers.

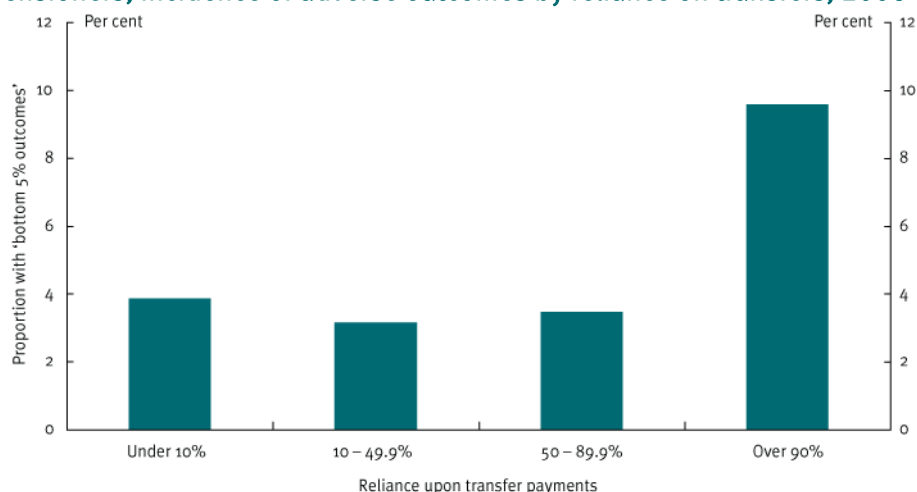
Chart 7 Pensioners, self assessed prosperity by extent of reliance on pension, 2006



Notes: Age and related pensions, Carer Payment and Disability Support Pension. Reliance on pension is proportion of household income derived from transfer payments.

Source: Review analysis of HILDA Wave 6, MIAESR 2008a

These outcomes are, of course, not just a result of differences in income. They also reflect differences in wealth, including home ownership, and access to other resources such as family support, as well as differences in expectations.

Chart 8 Pensioners, incidence of adverse outcomes by reliance on transfers, 2006

Notes: Age and related pensioners, Carer Payment and Disability Support Pension. Adverse outcome is the proportion with financial stress outcomes that place them in most stressed 5 per cent of the population. Reliance on pension is proportion of household income derived from transfer payments.

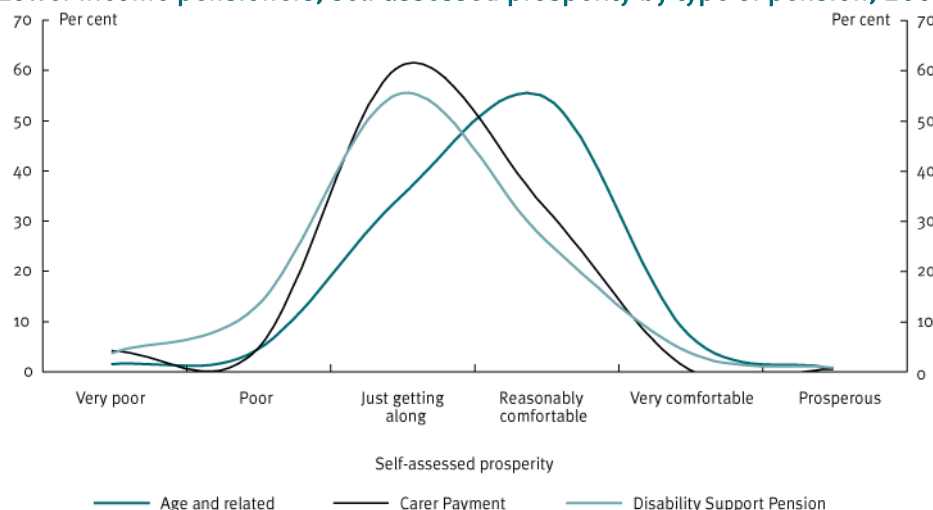
Source: Review analysis of HILDA Wave 6, MIAESR 2008a

Chart 8 shows the second approach, the relative incidence of adverse outcomes. As this measure is based on identifying the 5 per cent of Australians with the worst levels of financial stress, the chart shows the proportion of particular types of pensioners who are in this population with poor outcomes. (In this chart pensioners are classified by the extent to which the household they live in relies on income support payments.) Therefore, groups with rates of incidence above 5 per cent represent those with above average poor outcomes, and rates below show a better than average outcome. As the chart shows, those pensioners who rely almost entirely on the pension are twice as likely as the population as a whole to be in the group with very adverse outcomes. Pensioners in households with a lower reliance on transfer payments had levels of incidence below the average.

Wellbeing—pension type

Age and related pensioners report markedly higher levels of perceived wellbeing than other pensioner households (Chart 9).¹⁰ While Disability Support Pension and Carer Payment recipients were concentrated around the response 'just getting along', age pensioners most frequently described themselves as being 'reasonably comfortable'.

¹⁰ To reduce some of the interactions between pension type and levels of non-pension income, the data have been limited to those who are mainly reliant on transfers.

Chart 9 Lower income pensioners, self assessed prosperity by type of pension, 2006

Notes: Age and related pensions, Carer Payment and Disability Support Pension in households where more than 50 per cent of income is derived from transfer payments.

Source: Review analysis of HILDA Wave 6, MIAESR 2008a

A complementary approach to perceptions of wellbeing is asking pensioners about their degree of satisfaction with their level of income. This was done in the focus group workshops conducted for the Review, where people were asked a series of questions about their satisfaction with the level of the pension, their standard of living, and how they ranked their standard of living compared with the rest of the community.

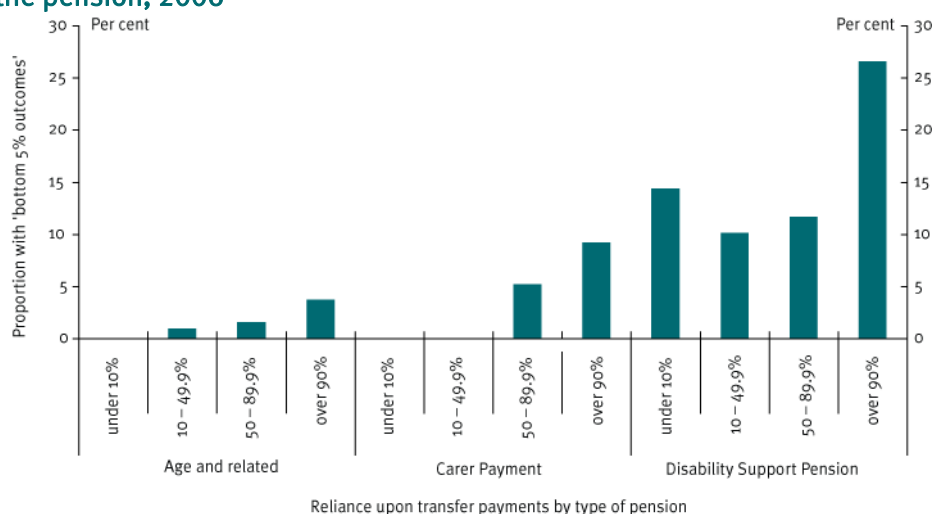
- When asked about their **level of satisfaction with the rate of pension**, 23 per cent of pensioners expressed total dissatisfaction. In contrast, just 5 per cent said they were wholly satisfied. Overall, 46 per cent reported a degree of dissatisfaction, 43 per cent were neutral and 11 per cent reported a degree of satisfaction.

Using a nine-point scoring scale (with a value of five representing a person who was totally neutral, and scoring total dissatisfaction as one and total satisfaction as nine), lowest average scores were reported by recipients of Disability Support Pension (score of 2.9). Carer Payment recipients reported an average of 3.7, while the average for age pensioners was 4.1.

- In response to a question about **satisfaction with their standard of living**, a slightly less negative response was reported. Thirty-eight per cent of the pensioners reported varying degrees of dissatisfaction, 39 per cent were broadly neutral and 23 per cent indicated degrees of satisfaction. Again, the average scores by payment showed the lowest level of satisfaction for Disability Support Pension, an average of 2.9. Carer Payment recipients were middle-ranked at 3.8, and Age Pension recipients reported an average of five—just on the mid-point of the scale.
- Pensioners were also asked to **compare their standard of living against the community as a whole**. Here the central score of five indicates a standard of living ‘no different’ to others in the community. Nineteen per cent reported that their standard of living was ‘no different’ to others in the community, 23 per cent that it was better, and the remaining 58 per cent that it was poorer. However, only 10 per cent reported it as being ‘much worse’. Again the relative positions of disability support pensioners, Carer Payment recipients and age pensioners persisted.

More detailed analysis of these results again points to many other factors influencing these responses. Home owners, members of married couples and those on part-rate pensions all tended to have more positive assessments.

Chart 10 Pensioners, incidence of adverse outcomes by pension type and extent of reliance on the pension, 2006



Notes: Adverse outcome is the proportion with financial stress outcomes that place them in most stressed 5 per cent of the population. Reliance on pension is proportion of household income derived from transfer payments.

Source: Review analysis of HILDA Wave 6, MIAESR 2008a

Chart 10 combines analysis of adverse outcomes with the type and level of reliance on pensions. This shows that age pensioners, including those who have a high level of reliance on income support, have an incidence of poor outcomes below the overall population average. The rates of poor outcomes were higher for other types of pensioners. In particular, among Disability Support Pension recipients who were more than 90 per cent reliant on transfers, the rate was five times the average. However, even when these pensioners were in households with very low reliance on pensions, they still had levels of adverse outcomes over two and a half times those of the population as a whole. Other analysis suggests that the outcomes for disability support pensioners are associated with the younger age of this group and the direct impact of some disabilities on wellbeing and on the capacity to manage.

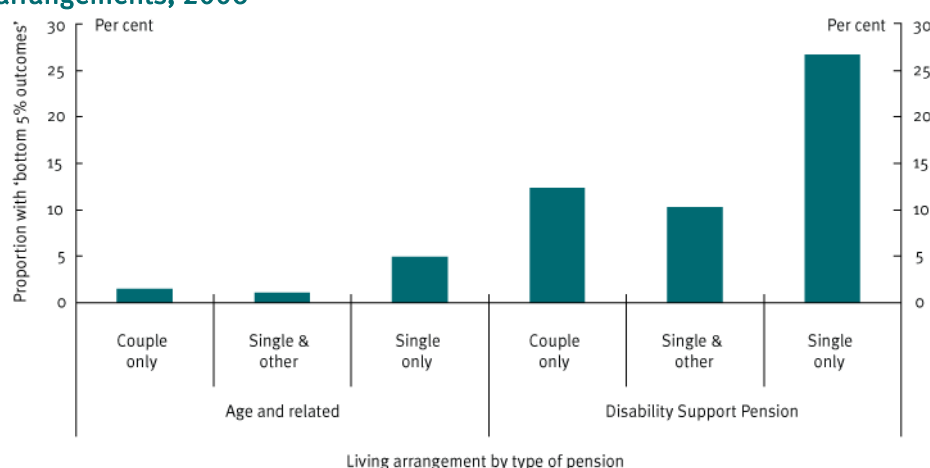
Wellbeing—living arrangements

Pensioners live in many types of households. While, as discussed in the Background Paper, it is difficult to obtain definitive data, household surveys indicate that most pensioners either live in a couple only household with their partner (42.9 per cent) or as single people living alone (25.0 per cent). The balance live in a wide variety of circumstances.

The wellbeing outcomes of pensioners vary with living arrangements. Chart 11 illustrates this for recipients of Disability Support Pension and Age Pension¹¹ for the three most common arrangements: living as a member of a couple-only household, as a single person household, or as a single person living with others. Again, the measure of very poor outcomes is used in this comparison.

¹¹ Data for recipients of Carer Payment are not included due to the small size of this group and thus the difficulty in obtaining robust estimates from household surveys.

Chart 11 Age and disability support pensioners, incidence of adverse outcomes by living arrangements, 2006



Notes: Adverse outcome is the proportion with financial stress outcomes that place them in most stressed 5 per cent of the population.

Source: Source: Review analysis of HILDA Wave 6, MIAESR 2008a

Chart 11 illustrates two key features:

- As seen earlier, outcomes for disability support pensioners are considerably worse than for age pensioners.
- Outcomes for single pensioners who live by themselves are much worse than for those who live with others. Indeed, the outcomes for single pensioners living with others are much the same, if not slightly better, than those recorded by members of couples.

This latter point provides strong support for the case put in many of the submissions that the outcomes for single pensioners living by themselves are markedly worse than for other groups of pensioners.

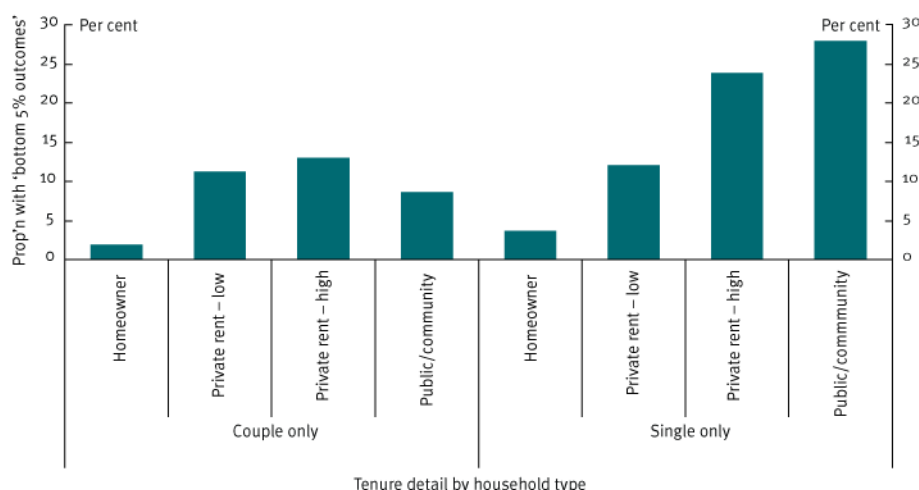
Wellbeing—housing tenure

Housing tenure was identified in the Background Paper and in consultations as an important determinant of outcomes. This is considered in Chart 12, which again uses the measure of the proportion of pensioners who are in the 5 per cent of the population with the most disadvantage as measured by financial stress.¹²

Two consistent features emerge from the chart and the more detailed analysis undertaken on the data. Outcomes for home owners are considerably better than for pensioners living in other tenures; and those in private rental housing who are paying higher rents (rents that are more than 30 per cent of income including Rent Assistance) have, on average, worse outcomes than those paying lower rents. This is particularly noticeable for single pensioners who rent privately. The proportion of these in the most disadvantaged 5 per cent of the population is double that of those in this group who are paying lower rents.

¹² Only single person and couple households are shown as it is difficult to determine tenure in more complex household arrangements.

Chart 12 Couple-only and single person pensioners, incidence of adverse outcomes by tenure, 2006



Notes: Age and related pensions, Carer Payment and Disability Support Pension. Adverse outcome is the proportion with financial stress outcomes that place them in most stressed 5 per cent of the population.

Source: Review analysis of HILDA Wave 6, MIAESR 2008a

Less consistent outcomes are seen for pensioners living in public and community housing. Couples living in these tenures have a lower incidence of adverse outcomes than similar pensioners living in private rental housing, although for both groups these outcomes are much poorer than those of home owners. Among single pensioners this tenure is associated with even poorer outcomes than similar pensioners in high-cost private rental housing. It is probable that this result reflects the priority entry processes for public housing and as a result the group of lone people in this sector is more likely to face significant other disadvantages.

In the consultations, a concern raised by private renters was the rate of increases in rents over recent years. Analysis of the rents paid by recipients of Rent Assistance bear this out. Between June 2001 and June 2008, rents paid by these tenants increased by 40.8 per cent.¹³ This is considerably above the overall increase in the Consumer Price Index (CPI) of 23.0 per cent and in the CPI rental component of 27.5 per cent.

Summary

Examination of the wellbeing outcomes of pensioners provided the Review with some valuable insights into the question of the adequacy of the pension:

- It identifies some marked concentrations of significant disadvantage among pensioners, including single pensioners living by themselves, disability support pensioners and pensioners renting privately and paying high rents.
- At the same time, it clearly shows a diverse range of outcomes, even when pensioners have similar levels of resources. This clearly suggests that low income is not the only factor influencing outcomes.

For some groups of pensioners, results were largely positive. Age pensioners living in their own homes (the largest single group of pensioners) have low levels of poor outcomes, and couples in this group

¹³ This index was based on the rents paid by both pensioners and allowees who received Rent Assistance, but excluded those families who received Rent Assistance as a result of eligibility for Family Tax Benefit alone.

have the lowest levels. Even among those age pensioners who were almost wholly reliant on government support, the frequency of adverse outcomes was lower than the community average.

- As with other analysis, it identifies a strong feeling of dissatisfaction with the rate of the pension, although some 42 per cent of pensioners in the focus groups considered that their standard of living was around the same, or better, than that of others in the community.

In drawing these conclusions, the Review noted that much of the analysis is based on data for 2005–06. Since that time, while pensioners have faced increased prices, the rate of the pension has also increased as a result of indexation and benchmarking and has been supplemented by an increase in the value of Utilities Allowance and the payment of bonuses.

The relative wellbeing of pensioners has also been studied in recent research by Saunders and Wong (2008). This used a wide range of different measures. It reported that among the pensioner groups it examined, age pensioners had better outcomes than disability support pensioners and other income support recipients. It then compared age pensioners with other groups and concluded:

A clear and consistent ranking of the living standard of these groups is provided by the deprivation-based indicators, and by the other objective and subjective indicators examined. On virtually all of the indicators, the self-funded retiree group has the highest standard of living, followed by veteran's affairs pensioners, age pensioners and low-wage workers.

3.3.8 The relative needs of single and couple pensioners

The analysis of outcomes shows the important differences in the wellbeing of pensioners in different living arrangements. These differences, and in particular the relative needs of single pensioners which were also identified in the analysis of budget standards and poverty lines, are a key area of interest to the Review.

The single rate of pension is currently 61.1 per cent of the couple rate (taking into account allowances but not bonuses). In the case of private renters receiving Rent Assistance it is 65.5 per cent, as Rent Assistance is paid at almost the same rate to couples (\$51.90 a week) as to singles (\$55.10 a week).¹⁴

The living costs of individuals vary with their living arrangements. In particular, when people live together there are opportunities for some items of expenditure to be shared and for economies of scale. The Review undertook extensive analysis to estimate the value of these economies.

Relative needs—single person and couple-only households

The main analysis focused on a comparison of couples living together by themselves compared to singles living alone. Together these two groups account for 68 per cent of all pensioners and 77 per cent of age pensioners. The relative position of single pensioners sharing with others is considered separately below.

The Review considered a range of different methodologies for estimating the relative needs of couples and singles. Econometric estimates were derived using three different approaches.¹⁵ All of these approaches

¹⁴ The only analysis of equivalences for households by tenure undertaken by the Review was based on the budget standards. This generates an equivalence for a single privately renting age pensioner of 75.2 per cent of the couple rate. This differs only slightly different from the 72.3 per cent for home owners.

¹⁵ The approaches used in this analysis were:

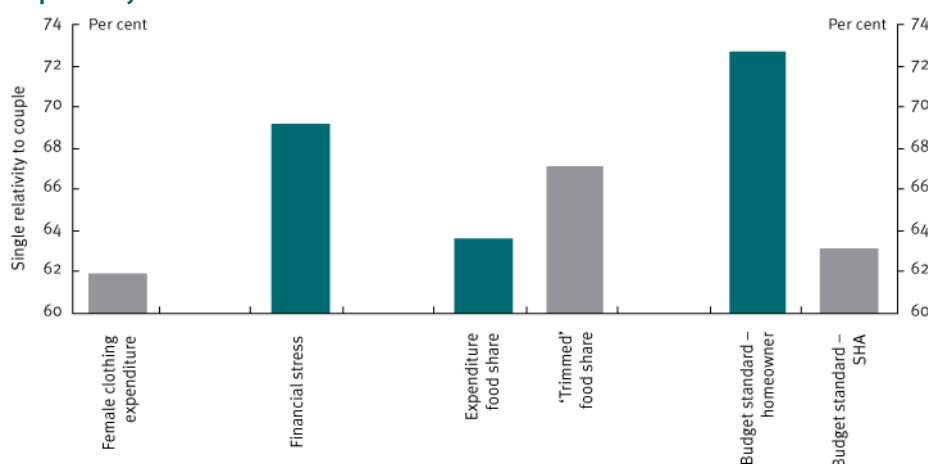
- 'Engel' scales, which are based on the share of household expenditure that is allocated to food
- 'Rothbarth' scales, which use expenditure on individual goods
- outcome equivalent measures, which consider the relative resources used by households of different compositions to achieve similar levels of wellbeing utilising measures of financial stress, hardship and satisfaction with financial circumstances.

sought to derive the level of income at which the different household types (single and couple) could be said to be in basically equal circumstances.

- ▶ The first relies on a well-established statistical relationship between household spending on food, level of income and composition to identify where households of different compositions have a similar relationship between these factors.
- ▶ The second matches households with different compositions on the basis of how much they spend on items that are specific to only one person (for example, the amount of money spent on women's clothing in couple households and by single women). It then compares the levels of income of these households to establish a ratio of the relative amount they need to achieve this equal level of spending.
- ▶ The third uses a similar approach, but rather than looking at spending on particular items, it matches households on the basis of an outcome such as a level of financial stress. Again, the ratio of incomes for households with different compositions but the same level of outcome provides the estimate of equivalence.

In all cases additional statistical techniques were used to avoid bias because of age and other factors that also influence outcomes, and different models were developed and tested to best estimate the relative level of resources available to households and to control for limitations in the data. In addition, the Review used the relative estimated budgets for single and couple households from its updated budget standards analysis as the basis for a further series of estimates of relative needs.

Chart 13 Estimates of the income needs of older single person households relative to older couple-only households



Notes:

'Female clothing expenditure'—A Rothbarth type estimate based on expenditure on women's clothing (i)

'Financial stress'—An outcome-based estimate which utilises the rate of incidence of financial stress as the independent variable (ii).

'Expenditure food share' and 'Trimmed food share'—Engel estimates using the proportion of food expenditure by older home owner households, the first using raw estimates and the second using a more restricted sample to remove outlying observations (i).

'Budget standard—home owner' and 'Budget standard—SHA'—Two estimates using the basic household budget standard. The first compares singles and couples who are home owners, the second those who are renting public housing from a State Housing Authority (iii).

Sources: Review analysis using (i) ABS 2003-04; (ii) HILDA Wave 6, MIAESR 2008a; (iii) updated budget standards.

Six of these approaches are illustrated in Chart 13. While the analysis of these diverse approaches points to the existence of significant economies of scale, there is much variation in the estimates of magnitude.

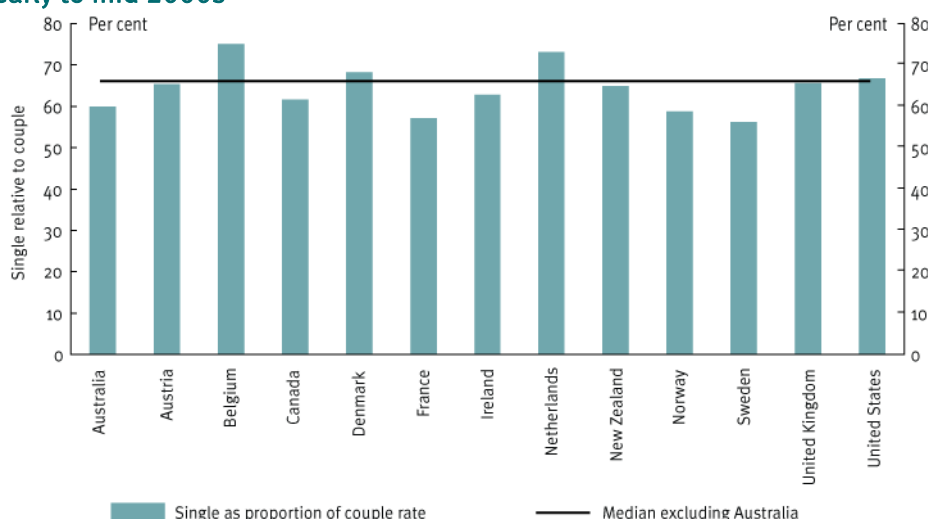
Three of these estimates are considered to be particularly useful: the financial stress estimate, the expenditure food share, and the budget standard for home owners. These measures estimate the costs of a single person household relative to those of a couple household at 69.1 per cent, 63.6 per cent and 72.7 per cent respectively.

The geometric mean¹⁶ of these three estimates is 68.4 per cent. While these are considered to be the more robust estimates, it is noted that the majority of other estimates derived in the Review's analysis tend to be lower. Taking the full range of equivalences shown in Chart 13, the geometric mean is 66.2 per cent and the median 65.4 per cent.

The Review's analysis has also been complemented by some recent estimates of equivalence scales for age pensioners produced by the Social Policy Research Centre (Bradbury 2009b). The results of this analysis range from 62.5 per cent to 75.8 per cent; the author proposes a preferred value of 68.5 per cent.

A further perspective on the possible relative needs of single people and couples can be obtained from the rates of income support paid in other countries. The analysis of comparative equivalences in other countries' income support systems presented in the Background Paper has also been extended to now incorporate 13 major OECD countries. Across these, the ratio of single to couple rates of assistance varies from 56 per cent in Sweden to 75 per cent in Belgium. The median rate is 65.2 per cent and the geometric mean is 64.4 per cent.

Chart 14 Payment to single pensioner relative to combined couple, selected OECD countries, early to mid 2000s



Notes: For most countries the data is for social assistance systems to the aged; the ratios in social insurance systems that also include an earnings-related component can vary significantly. Data was not available for all OECD countries.

Sources: Derived from SSA 2006a, 2006b, 2007.

Relative need—single pensioners living with others

Many pensioners who are paid at the single rate because they are not living with a partner, live with other people. This includes just over half of single rate disability support pensioners, 30 per cent of single rate age pensioners and most single rate Carer Payment recipients.

The living arrangements of these pensioners vary. For the 55.4 per cent of this group who live with just one other person, the most common arrangement for an age pensioner is living with a (usually adult) child (69.8 per cent). This is followed by 18.2 per cent who are living with a non-related person, 5.7 per cent who

¹⁶ The geometric mean is a preferred way of calculating an average to obtain a measure of central tendency.

live with a sibling, and 4.4 per cent living in the same dwelling as their ex-spouse. Among single people on Carer Payment, 63.7 per cent are living with a parent, who in most cases is likely to be the recipient of care, and the balance is split between those living with a child and those living with an unrelated person. Sharing arrangements of those single Disability Support Pension recipients living with one other person are more diverse. Around 40 per cent are living with a parent and almost 30 per cent with a child. The balance is split mainly between those living with a sibling or with an unrelated person.

The living arrangements of the 27.4 per cent of these pensioners who are living in three-person households are largely similar. Most of the single age pensioners are sharing with their adult children (including children-in-law). Carer Payment recipients are living with their parents, or a parent and sibling, and disability support pensioners are living with their parents.

Although it can be expected that the costs of living of these pensioners are not the same as those of a member of a couple, equally they do benefit from some economies of scale from being members of a larger household that can share certain fixed costs. Hence, they do not face the full costs of a single pensioner living alone.

Because of the problems of differentiating individual costs within households, econometric analysis was not attempted to estimate the relative needs of couples and single people in more complex living arrangements.

However, it is possible to gain a general insight by using the wellbeing data discussed in the previous section. As shown in Chart 11, single pensioners who live with others have outcomes more akin to couples and better than single pensioners living by themselves. This suggests that the current single–couple relativities in the pension system, while not appropriate for singles living alone, could be close to the equivalence required to ensure that single pensioners who are living with others are able to achieve similar levels of wellbeing to couple-only pensioner households.

Relative needs—pensioners with children

Some 17.8 per cent of Carer Payment recipients, 5.9 per cent of disability support pensioners and 2.5 per cent of age pensioners receive family payments. With the exception of some submissions concerning grandparent carers, there was little put to the Review on the circumstances of these families.

The provision of support for families, including those on pensions, is primarily through the Family Tax Benefit. This payment, which has increased substantially over recent years, is outside the terms of reference of the Review.

The cost of children was considered in research undertaken for the Ministerial Taskforce on Child Support (Henman et al. 2007). This provided two estimates of the range of costs: \$45 to \$121 in research based on actual expenditure and \$94 to \$129 using theoretical budgets. These were not inconsistent with the levels of support provided to families.

The Review notes that the Australia’s Future Tax System Review Panel will be considering aspects of payments to families.

Summary of relative needs

Currently the ‘package’ of assistance paid to a single pensioner relative to a pensioner couple is 61.1 per cent for those not receiving Rent Assistance, rising to 65.5 per cent where the maximum rate of Rent Assistance is paid. Analysis drawing on a range of different approaches suggests that this rate of payment

for single pensioners living alone relative to the rate for couple-only pensioner households is too low. While there is considerable variation in the estimates of the relative cost of living a range of 64 to 67 per cent appears reasonable.¹⁷

In contrast, the current relativity to the couple rate appears to be appropriate for those single pensioners who live with others.

3.4 Reform directions

Consultations and analysis conducted by the Review indicate that there is a need for reform of the Australian pension system to enable it to provide adequate support to Australia's 3.3 million age, disability, carer and related pensioners being considered by the Review.

The consultations highlighted a strong belief by many pensioners that they both required and deserved higher levels of support. This was a recurrent theme in many of the submissions.

The Review's approach, as outlined in the Background Paper and presented above, has been to consider a range of measures to judge whether current pension payments are adequate. This reflects the Review's analysis, which indicates that no one benchmark or measure can definitively settle a level of payment that provides a basic acceptable standard of living.

Analysis undertaken by the Review noted a wide diversity of outcomes. However, the net result of the analysis has been to identify particular groups who have considerably worse outcomes than others.

These issues are considered below. The discussion initially considers the wider implications of reform; specific proposals for standards-based approaches to the determination of the pension rate; and relative need and types of pension. This is followed by consideration of the relativity of the rates of payment between single pensioners and couples; the assessment of the current rate; and the adequacy of support for those who rent privately.

3.4.1 Implications of reform

Varying the rate of the pension by even one dollar a week is expensive. As discussed in Chapter 2, consideration of these costs is important to ensuring the robustness of the pension system over time and hence its capacity to deliver financial security to pensioners.

While the cost of any change in rates is dependent on how it is structured, a broad estimate of the cost of increasing the rate of payment of the pension to single pensioners by \$10 a week is around \$785 million a year. Increasing the rate of payment to each member of a couple by the same amount would cost an additional \$855 million a year.

While the short-run costs are considerable, the ageing of the population will result in the cost growing over time. Treasury modelling indicates, in the absence of other policy changes such as increased targeting over time, that the budget cost of a given pension increase as a proportion of GDP will double by 2050. Funding these increases will require reduced spending elsewhere, increased taxes, or a combination of both. There are therefore possible opportunity costs that arise, including reduced capacity to invest in competing public goods that may otherwise benefit directly or indirectly pensioners and other sections of the population, or higher taxes.

¹⁷ This in effect encompasses the range from the geometric mean of the relative rates of payment in OECD countries of 64.4 per cent to the geometric mean of the main equivalences of 66.2 per cent.

These costs underline the need, especially in the current fiscal environment, to ensure that any increase in the pension rate is well targeted, both in the sense that any increases are directed to those in most financial need and in the sense that the increases address areas where the pension is clearly failing to achieve its purpose of providing a basic acceptable standard of living accounting for prevailing community standards.

Chapter 7 examines the question of the appropriate level of income support for pensioners with some private means. The reform directions identified in this section are focused on the adequacy of the pension for those who are wholly reliant on the pension.

3.4.2 Setting rates—budget standards and tribunal approaches

A number of submissions proposed the adoption of an existing measure, such as the Westpac–ASFA Retirement Standard or the Henderson Poverty Line, or the development of a new measure of adequacy, as a reference point for pension setting. In most cases these proposed the use of a ‘budget standard’ such as that used in Section 3.3.4. Budget standards involve the creation of a detailed household budget that itemises all goods and services a household is considered to need to achieve a particular lifestyle.

While budget standards have a strong intuitive appeal, experience in Australia and overseas is that they cannot provide an objective measure of need. The underlying budgets are normative, and make strong assumptions about detailed aspects of people’s lives. They are highly dependent on the value judgements of the people involved in establishing them and totally inflexible with regard to the diverse lifestyles of Australians and the day-to-day trade-offs people make in their lives. They are also highly sensitive to assumptions around the longevity of capital items and how they are purchased and maintained. The Review considered that this approach does not provide an effective basis for determining pension rates.¹⁸

The Review similarly considered that a range of other benchmarking approaches, such as the use of various poverty lines, all have limitations that preclude their use. These limitations include the arbitrary nature of relative income measures, their sensitivity to assumptions around equivalence scales and the treatment of housing and other non-cash benefits that are so important to outcomes.

A second approach that was suggested in submissions is to establish an independent commission to set pensions and other income support payments. Proponents of this approach cited as examples the role played by bodies such as the Commonwealth Remuneration Tribunal and the Australian Fair Pay Commission.

This approach is not favoured. The Review considers that decisions on the level of support the nation is willing to provide to those with limited or no means, including pensioners, are most appropriately made by the Australian Government and Parliament as the elected representatives of the Australian people, rather than being a function that can, or should, be delegated. In this regard the analogies with the Commonwealth Remuneration Tribunal and the Australian Fair Pay Commission are not considered to be robust. In the case of the Remuneration Tribunal, the purpose of having an independent tribunal is to remove the conflict of interest that would result from parliamentarians determining their own rates of pay and to preserve a clear division of powers in setting remuneration for judicial offices. The commission, and in future the Minimum Wages Panel of Fair Work Australia, determines a minimum wage which is primarily paid by private sector employers, in clear contrast to the use of public money and political accountability involved in setting the rate of the pension.

¹⁸ Budget standards have similarly been rejected in the United Kingdom as a means to define a minimum income standard (Deeming 2005). The Department for Work and Pensions (2003) concluded that: ‘Despite a wide range of research into budget standards, there is no simple answer to the question of what level of income is adequate. Different research methods tend to make different assumptions that are essentially subjective. Even methods that purport to define the cost of a “scientifically determined diet” in effect have to make a number of subjective assumptions about needs. This can produce inconsistent answers to the same questions.’

3.4.3 Adequacy and pension type

The Review is concerned with three main pensions: the Age Pension, the Disability Support Pension and the Carer Payment. While these are paid at the same base rate, over recent years, with the exception of the 2008 Economic Security Strategy payment, they have been treated differently with regard to the payment of bonuses. For example, in the 2008–09 Budget, while a Seniors Bonus of \$500 was paid to recipients of the Age Pension, veterans pensions, Widow B Pension and a number of other related payments, and a Carer Bonus of \$1,000 was paid to Carer Payment recipients, no payments were made to those on Disability Support Pension.

While some submissions argued for the recipients of particular pensions to be paid at a higher rate than others, this approach is not supported.

The case for such differentiation, while presented in many different ways, usually centred on three main arguments:

- ▶ The first, in particular in the case of people in receipt of Disability Support Pension, was that of the additional costs associated with disability.
- ▶ The second, in the case of Carer Payment, was that the payment should provide some compensation either for forgone income, as a premium reflecting the saving to the public purse from the non-provision of residential care to the recipient of care, or to cover the costs of care.
- ▶ The third was that the Age Pension should reflect a recognition of the contribution these pensioners had made during their working lives.

Conceptually these contain two grounds of argument. The first is that particular groups of pensioners systematically and consistently face costs that others do not. The second is that some groups of pensioners should be provided with a higher rate of assistance in recognition of what they have done in the past or are currently doing.

While it is recognised that many individual pensioners face higher needs and possible costs because of disability, the Review did not consider that this was an issue that is appropriately responded to by setting the rate of any one pension on this basis. There are two reasons for this:

- ▶ Such needs are distributed across pensioners on every type of pension. The research presented in the Background Paper shows, for example, that over half of all income support recipients with a core disability were on the Age Pension. Similarly, carers can be on one of a number of payments and the costs of care are in large part functions of the disability of the person being cared for.
- ▶ As discussed in Section 3.1.2, these variations in need are considered best met through the provision of targeted and appropriate services. Chapter 6 explores this further.

The other grounds for differentiation are those associated with concepts of compensation or reward. This is also rejected. As discussed in Chapter 2, the Review considers the current fundamental goal of the pension system—providing income support to enable those eligible for pensions to achieve a basic but appropriate standard of living—remains sound. Paying ‘premiums’ to selected pensioners on the basis of their opportunity costs or some recognition of the public good would represent a fundamental shift in the principle of pensions as a safety net.

The Review notes that Carer Allowance is paid in recognition of the caring role, and that the consultations indicated that this payment is often used as a means of funding services associated with the needs of the person who is being cared for. Further discussion of this payment is in Chapters 5 and 6.

Finding 1: The Review finds that the Age Pension, Disability Support Pension and Carer Payment should be paid at the same basic rate.

Finding 2: The Review finds that the specific costs associated with health and disability are best responded to by targeted services rather than generalised differences in base rates of payments or financial supplements.

3.4.4 Relativity of payments to single people and couples

Both the weight of submissions and the analysis undertaken by the Review suggest that the current relativities between the single and couple rates of pension do not fully take account of the costs of a single person living by themselves, relative to a couple in a similar situation.

As indicated above, the analysis undertaken by the Review shows that the relativities are higher than currently provided for in the pension rate, but does not point to a single figure at which the rate should be set. Rather, a range of relativities from 64 per cent to 67 per cent was identified. The balance of views presented in submissions and consultations tended towards the upper end of this band.

At the same time, the Review notes that a significant proportion of single pensioners were not living alone but sharing accommodation, and often other costs, with other people. The analysis undertaken by the Review indicates that wellbeing outcomes for this group are similar to those living in couples, suggesting that this group does not face the same financial pressures as single pensioners living alone.

One option would be to introduce a differential rate of payment for those single people who live by themselves to recognise the unique costs of this arrangement, and to set this at the higher rate while maintaining the current relativity for those living with others. This would result in a three-tier payment system. The other option would be to pay the higher single rate to all singles.

Both approaches have the potential to create some adverse incentives and administrative complexity:

- Under a three-tier system, the higher rate of payment to a single person living alone may be seen as an inducement to those single pensioners living with others to change their housing arrangements. Concern has been expressed that this may result in negative outcomes by reducing the extent of these living arrangements and the benefits of companionship and social integration that they offer. The likelihood of this is considered to be small. The extent of the differential is such that it is unlikely to represent a significant incentive, and as most single pensioners living with others are living with members of their families, it is probable that the wider range of considerations of intra-family relationships and support would prove to be the dominant factor.
- Under a two-tier system, with a higher rate for singles, there would be a considerably higher payment to a household comprising two single pensioners compared to a couple in a marriage-like relationship.¹⁹ The risk associated with this is that this difference may create an incentive for the misstatement of the type of living arrangement or for the termination of the relationship. While the financial effects of this may be ameliorated by compliance activities, these can be intrusive and add to the complexity of the system.
- By setting three different rates, with the relativities set appropriately to match the differences in living costs, a structure of payment would be established that was neutral to the choices people made,

¹⁹ If the relativity of the single to couple rate were set at two-thirds, a household with two single pensioners would receive 33.3 per cent more income than if the two pensioners were members of a couple within the scope of a 'marriage-like relationship'. This is over a 50 per cent increase on the current differential of 21.4 per cent in the total package of assistance, including the Senior's Bonus.

creating neither incentives nor disincentives to any particular living arrangement. This approach would need to be weighed against the complexity an additional classification would introduce.

Finding 3: The Review finds that, on the basis of its analysis of the outcomes achieved by pensioners, evidence provided in the consultations and its analysis of relative needs, the relativity of the rate of pension for single people living by themselves to that of couples is too low.

Finding 4: The Review finds that the case for a change in the relativity of the rate of pension for single pensioners living with others is less compelling. Such pensioners most frequently live with other relatives in owner-occupied housing and have outcomes more akin to couple pensioners than to other single pensioners. This suggests existing relativities are broadly adequate for these pensioners. However, the Review recognises that adding a third level of pension rate may introduce additional complexity.

Finding 5: The Review finds that a relativity in the range of 64 to 67 per cent across the package of support would be more appropriate than the current relativity. Adopting a relativity towards the upper end of this scale would appear to be reasonable if a three-tier approach were to be adopted. Under a two-tier approach, where the same relativity would be applied to single pensioners living alone and those living with others, a relativity at the lower end of this scale would more adequately reflect the average needs across both these groups.

3.4.5 The base rate of pension, supplements and bonuses

As has been emphasised in the introduction and analysis presented in this chapter, a critical difficulty in determining an appropriate base level of the pension to ensure a basic acceptable standard of living, accounting for prevailing community standards, is the diversity of outcomes achieved by pensioners, even when they have an equal level of resources.

Achieving a rate of payment that balances the goal of meeting the needs of the ‘average’ pensioner with the goal of protecting those in more disadvantageous positions is the central challenge.

As was highlighted in a range of submissions, the answer is not independent of the level of support and other services available to pensioners. Indeed the evidence is that very often the costs that generate financial difficulties for some pensioners are those associated with health care and related services. Further, as noted above, the Review does not consider that any single indicator or measure provides a basis for determining the adequacy of the rate of the pension.

The base pension rate for couples

While there is a clear and consistent case for increasing the rate of assistance for single pensioners living alone relative to other pensioners, this is not the case with regard to the level of assistance to be provided to couples.

While many submissions to the Review from couples reported adverse outcomes and proposed an increase in the rate of payment, the strength of these views was weaker than those expressed with regard to single pensioners, whose concerns were generally centred around other issues such as the operation of means testing. Analysis of wellbeing outcomes tends to support this. Under some measures, the level of wellbeing reported by pensioner couples, even those reliant on transfer payments, was comparable with overall community outcomes.

Benchmarking the couple rate against budget standards and poverty lines similarly points to a base level of adequacy once account is taken of the full pension package. Analysis of trends in the real value of the pension and its value relative to the take-home pay of employed workers clearly indicates that pensioners

have had an increased level of purchasing power, and, in general, have maintained, or in some cases improved, their relative level of income compared to the take-home income of employees.

In undertaking this analysis the Review noted that over recent years, as well as the impact of indexation and benchmarking of the pension and compensation for the introduction of the goods and services tax (GST), the effective rate of the pension has been enhanced by the introduction and increase in value of the Utilities Allowance and the payment, on an ad hoc basis to some, but not all, pensioners of an annual bonus. The current value of the 2008–09 Seniors Bonus and Utilities Allowance for a couple is \$1,514 a year, or almost \$30 a week.

On balance, it is considered that the current package of assistance, including the amount of the Seniors Bonus as provided in the 2008–09 Budget, provides couple pensioners who are living in their own homes, or accessing public housing, and who do not face disproportionate costs associated with health and disability, with a basic, acceptable standard of living.

Finding 6: The Review finds that, taking into account the totality of the package of the current pension base rates, supplements and the value of the Seniors Bonus, the rate of pension paid to couples appears to be adequate for those pensioners living in their own homes or public rental housing, and without unusually high costs of health or disability.

The package of assistance to disability support pensioners has been below this rate because, with the exception of the 2008 Economic Security Strategy payment, bonuses had only previously been paid to seniors or carers. The rationale for this is weak and a common rate should be applied across payments.

The issues of the cost of health and related services are discussed in Chapter 6 and housing in Section 3.4.6 below.

3.4.6 Housing costs

It is clear from the submissions and the analysis undertaken by the Review that a key pressure faced by some pensioners is the high rent they are paying in the private rental market. While the higher costs encountered by many private renters is acknowledged through the payment of Rent Assistance, the evidence suggests that the rate of this support has been outstripped by price increases in the rental market. Moreover, as discussed further in Chapter 4, the payment has become less effectively targeted as a result of the way in which it has been indexed.

The magnitude of these impacts is significant. If Rent Assistance had been indexed by the changes in actual rents paid by Rent Assistance recipients between 2001 and 2008, rather than by the CPI, it would be some \$8.00 a week higher than it currently is. Noting that the last major adjustments to Rent Assistance occurred in the context of the GST changes in 2000, this suggests that the gap over this longer period is more likely to be around \$9.00 to \$10.00 a week.

In addition to the cost of rent, housing security is a key issue for the financial security of pensioners. Private renters face uncertainty about their future rent costs and security of tenure. Costs of moving and establishing tenancies can be high, and moving house often brings with it disruption to networks and dislocation from familiar neighbourhoods.

Social housing, through the community sector and State Housing Authorities, provides both security of tenure for those with an ongoing need and rent setting policies that ensure affordability. Enhanced options for more affordable housing are being developed as a consequence of other Australian Government initiatives, including the Affordable Housing Strategy and the proposed \$6 billion investment in social housing being undertaken as part of the government's Nation Building and Jobs Plan.

Currently it is estimated that 6 per cent of age pensioners live in public housing and 11 per cent receive Rent Assistance. For disability support pensioners, the proportions are 18 per cent and 27 per cent and for carers 15 per cent and 21 per cent.

Within budget constraints, this is an area where a careful balance of responses is called for. While increasing Rent Assistance would have some impact in relieving the direct and immediate costs faced by some pensioners in the shorter term, the alternative of investment in social housing would provide a less immediate response but generate long-term secure housing. Chapter 5 considers targeting issues for Rent Assistance to improve its effectiveness.

Finding 7: The Review finds that there is strong evidence that many pensioners in private rental housing face particularly high costs and have poor outcomes. Rent Assistance and social housing have complementary roles to play in addressing the financial security of these pensioners. The Review notes that the government has proposed an increased investment in social housing and considers that reforms to Rent Assistance would complement this.

Another issue raised in consultations was the cost of maintaining a home. These costs, and the adverse consequences of failing to respond to maintenance needs, were most acutely reported by older women, in particular widows living in older homes who had traditionally relied on their partners for household maintenance. There is no single solution to this. From one perspective, any additional support can be seen as simply funding the maintenance of a very valuable asset that is exempt from means testing. From another, these needs can have a considerable negative impact on the wellbeing of pensioners.

There is also a need to consider the impact of transaction costs on people seeking to move into housing that is more appropriate to their needs, where stronger community and family support can also play an important role. The means test, considered in detail in Chapter 7, has provisions that may have an impact on decisions to move out of or ‘down-shift’ an owner-occupied home.

4 Indexation

Overview and findings

This chapter considers the adjustment of the rate of the pension and other parameters of the pension system over time. The Review considers that effective indexation arrangements are essential to maintaining the capacity of income support payments to provide a basic acceptable standard of living, and therefore to provide pensioners with ongoing financial security.

This chapter outlines the current indexation arrangements; discusses the merits of different approaches to price adjustment, such as the Consumer Price Index and the Analytical Living Cost Indexes; and considers issues around indexation and sustainability. It also outlines the current benchmarking arrangements and discusses the relative merits of different benchmarking measures.

In this consideration, the Review notes that while there are strong arguments for determinations on changes in the rate of pensions to be taken as deliberative decisions by government, automatic indexation provides greater security for pensioners.

In addition to the benchmarking and indexation of the rate of the pension, this chapter considers how other income support parameters should be adjusted. The chapter notes the potential of ‘fiscal drag’ to introduce unintended distortions into structures, and concludes that indexation arrangements that create distortions between different components of the payment system should be avoided or, if they cannot, they should be subject to regular review.

The Review has concluded that there is a need for reform of the current indexation arrangements and that better measures are required of the price changes experienced by pensioners and of the community benchmark.

The Review has therefore developed specific findings in relation to both the indexation and benchmarking mechanisms that are used to set pension rates.

The Review’s first finding concerns the general approach to indexation and the relative roles of the community living standards benchmark and the index of price changes.

Finding 8: The Review finds that automatic indexation of pensions and a two-part approach of benchmarking and indexation should continue. Benchmarking pensions relative to community standards should be the primary indexation factor, with indexation for changes in prices acting as a safety net over periods where price change would otherwise reduce the real value of the pension. (Section 4.4.2)

This broadly conforms with the current structure of indexation, although the relative roles of the two components are differently structured to place an emphasis on the pension being benchmarked to a community standard.

However, the Review’s analysis of the different available measures of price changes has led it to conclude that reforms are needed to the price indexation mechanism for pensions to ensure that it is fully responsive to changes in pensioners’ purchasing power due to price changes.

Finding 9: The Review finds that pension indexation for price change would be better undertaken through an index that more specifically reflected cost of living changes for pensioners and other income support recipient households. (Section 4.4.3)

The Review's analysis also indicates that reforms are needed to the current approach of using Male Total Average Weekly Earnings (MTAWE) to benchmark pensions to community living standards because of its lack of transparent relevance to the experience of the wider community.

Finding 10: The Review finds that no single measure to benchmark the pension to community living standards is without limitations. However, the Review considers that a measure of the net income of an employee on median full-time earnings may be a more appropriate measure than the existing Male Total Average Weekly Earnings benchmark. (Section 4.4.4)

Indexation is, however, a highly technical area of policy, and the Review has therefore found in relation to the timing of the implementation of reform.

Finding 11: The Review finds that, while reform to indexation and benchmarking is important to the financial security of pensioners, implementation may need to be phased in to account for policy developments that may arise out of the Australia's Future Tax System Review and to allow for the development of appropriate mechanisms for benchmarking and indexation. (Section 4.4.4)

4.1 Terms of reference

The question of how rates of payment should be adjusted over time is the second part of the Review's consideration of the first term of reference concerning 'appropriate levels of income support'.

This adjustment process is central to the question of how to maintain 'appropriate levels of income support'. Effective indexation methodologies are a critical component of reporting on 'measures that might be adopted to strengthen the financial security of carers and seniors'. Maintaining the purchasing power of the pension and ensuring that pensioners can share in improving living standards are fundamental to the concept of financial security.

4.1.1 Current indexation and benchmarking mechanisms

A complex set of arrangements currently applies to the indexation of components of the pension system. While most payments and some allowances are indexed twice annually, others are only adjusted once each year and a few are not indexed at all. Indexing of various components occurs on four different dates each year: 1 January, 20 March, 1 July and 20 September, although no payment is indexed more than twice yearly.

Legislative provisions and benchmarking to community standards

The *Social Security Act 1991* provides for the rate of the pension to be reviewed twice annually, in March and September. Technically, this is undertaken by a two-stage process:

- The base rate of the pension (known in the legislation as the 'Maximum Basic Rate') is indexed by calculating an indexation factor (the ratio of the CPI index number of the most recent reference quarter over the index in the base quarter), applying this factor to the current rate of payment, and rounding the resultant rate (called the provisional indexed amount) by the rounding base.
- For the single rate, this result is then compared with 25 per cent of the annualised MTAWE for the specified quarter. If this is higher, a 'top-up amount' is added to the pension rate so that it equals 25 per cent of MTAWE, and the resultant rate is rounded up by the rounding base.
- For the partnered rate, where a top-up amount has been added to the single rate, 83 per cent of this top-up amount is added to the partnered rate, and the resultant rate is rounded up in the same way as for the single rate.

Indexing other components of the pension system

Most other components of pension payments are subject to CPI indexation, which occurs once or twice each year depending on the component. The indexation periods of the Pension GST Supplement, Rent Assistance and Utilities Allowance are on the same schedule as the base rate; Carer Allowance, Pharmaceutical Allowance and Mobility Allowance are adjusted each January, and Telephone Allowance each September.

Some supplementary payments, including the Pensioner Education Supplement, are not subject to any indexation or formal review. Indeed, the rate of the Pensioner Education Supplement, which was introduced in 1998, has been adjusted only once, in July 2000, when it was increased by 4 per cent, from \$60.00 to \$62.40 a fortnight to take account of the impact of the introduction of the GST and other taxation changes.

Most means testing and related parameters for the payment of pensions are indexed to changes in the CPI. As with the indexation of rates, a series of different approaches is applied to the timing and frequency of indexation of other parameters. There are, however, some parameters that are not indexed: the ‘income test free’ areas for allowances and student payments, the child amounts of the pension income test, the additional child amounts of the Youth Allowance parental income test, and the Student Income Bank and Working Credit maximum accrual limits and fortnightly maximum accrual amounts.

There are also some direct links between the pension rate and other components of social assistance. These include the benchmarking of certain Family Tax Benefit rates to the pension, and the consequence of changes in the rate of the pension for the income-based concessional rents charged by public housing authorities and the basic daily fee charged by aged-care facilities, which is capped at 85 per cent of the annual single basic Age Pension, which is currently \$32.95 a day.

4.2 What the consultations told us

Although some specific views on how the pension should be adjusted over time were put to the Review in consultations, most of the contributions took the form of concerns by individual pensioners that the cost of living for them had risen more rapidly than the pension rate.

4.2.1 Consultations—experiences of living cost changes

Submissions to the Review indicated a strong belief by pensioners that the cost of living has exceeded increases in the pension and that their living standards had fallen. This view was firmly put in the public forums and was raised in 28 per cent of individual submissions and 46 per cent of submissions from organisations. It was more frequently reported by single or widowed pensioners and by those on Carer Payment and Disability Support Pension.

Many pensioners provided detailed information on household spending and how the prices they have paid for various items have changed over time. Areas where particular concerns were voiced, both because of the apparent rate of price change and importance of the item to pensioners’ budgets, were the cost of food, especially fresh fruit and vegetables and meat, the price of fuel, and the cost of utilities, particularly electricity and water.

The issue of price change was also highlighted in many of the submissions from organisations. A clear message was that these organisations considered, from their experience, that there is a significant group of pensioners who are totally reliant on the pension who are finding it extremely difficult to manage from day to day. There was a strong view expressed that increases to the Age Pension had not kept pace with the cost of living and that this was often placing pensioners in precarious situations. It was also claimed that the purchasing power of the pension has diminished to the point where it is completely inadequate.

A number of the submissions also made specific comments about the appropriateness of different mechanisms for adjusting pensions, these are considered below. Some submissions raised specific concerns about the CPI. Chief among these was a concern that, because it is designed to indicate general price inflation, the CPI does not recognise distributional impacts of changes in costs of goods and services and differing consumption patterns across various household types.

Less comment was made on the use of MTAW as the basis of pension benchmarking, although one submission from a national organisation proposed that Full-Time Adult Ordinary Time Average Weekly Earnings be used as a new benchmark. It was argued that MTAW was significantly distorted by the inclusion of part-time earnings and the effect of a growing proportion of part-time workers. The submission also suggested that it would be appropriate to adopt a measure that recognises the role of women in the workforce.

4.2.2 Consultations—proposals for alternative indexation mechanisms

Most of the submissions addressed the question of indexation by expressing their view that current indexation arrangements have failed to maintain living standards in the light of changing prices. A number made specific proposals as to how pensions should be adjusted in the future. These included:

- ongoing indexation through benchmarking (at a higher level) to MTAW
- regular updating of a budget standards benchmark, either using an existing measure such as the Westpac–ASFA or a new measure (as discussed in Chapter 3)
- linking to the minimum wage
- redevelopment of an extended version of the ABS Analytical Living Cost Index for age pensioners.

Another proposal was for more frequent pension adjustments. Several submissions suggested that quarterly changes were more appropriate, given rapidly changing price levels.

In addition to voicing criticisms of the current indexation of pensions, in a number of submissions the claims made clearly indicated that the way in which pensions are currently indexed is not well understood. For example, many suggested that the pension had only been indexed for price increases, while others suggested that although it had been adjusted for wages, no account had been taken of changes in prices.

4.3 What the evidence shows

This section initially describes the current structure and outcomes of pension indexation in Australia and internationally. It then considers the following three major areas of analysis of indexation conducted by the Review:

- the nature of the CPI and the marked discrepancy in the views received in submissions and consultations on changes in the cost of living, and price change as measured by the CPI
- the nature of an earnings benchmark and the interrelationship between earnings and pension indexation
- the modelling the Review has undertaken of the sustainability of indexation arrangements.

4.3.1 International approaches

There is considerable diversity, and flux, in the way in which different countries index income support. A recent OECD study (OECD 2007) described the process in many countries as follows:

Pension uprating policy is a classic example of ad hoc policy-making. Even if most countries now have a formal link to prices, indexation is still often suspended as an emergency measure to relieve strong financial pressures on the pension system.

The same study reported that many countries had changed their approach to maintaining the level at which pensions are set, noting that ‘there is a clear underlying trend towards a reduced pension promise for today’s workers compared with past generations’. More specifically, the study reported that many countries had moved away from indexation based on earnings to price-based indexation, a strategy characterised as one that ‘preserves the purchasing power of pensions, but means that pensioners do not share in the general growth in living standards’. This is an approach that is also advocated in a recent OECD working paper (Whitehouse 2009).

These findings, although indicative of the problems many other OECD countries are experiencing in financing their retirement income systems, are generally not directly applicable to Australia.

A central reason for this is that in many countries indexation of the contributory pensions that form the main support for the aged has two components. The first is ‘valorisation’, which is how the individual’s pension is initially set relative to their own earnings or a measure such as average earnings. The second is the indexation of this pension over time.

Valorisation is not a part of the Australian pension system. In Australia, indexation sets the original value of the pension relative to a community benchmark and maintains that relative value over time. That is, while in Australia simply using price indexing would mean that the overall level of pensions relative to other members of the community would decline, in other countries this would not be the case because of the additional valorisation element.

4.3.2 The Australian Consumer Price Index

The CPI produced by the ABS is specifically designed to provide a general measure of price inflation for the household sector as a whole. This section considers issues associated with the use of the CPI as a measure of living cost change for those in receipt of pensions. These questions relate to the underlying concept of the index and its applicability for understanding the experience of price changes by pensioners.

Calculating the Consumer Price Index

The CPI comprises two components: a weighted pattern of consumption of goods and services—referred to as the ‘basket’—and price change data, which is then applied to the basket to derive a quarterly CPI.

- The weighting pattern for the basket of goods and services is largely based on the detailed information on household spending derived from the ABS Household Income and Expenditure Survey. Adjustments are made for the underreporting of some expenditure, especially alcohol and tobacco, and to housing, banking and insurance, to reflect the conceptual approach of the CPI. The basket contains 90 expenditure classes grouped into 33 subgroups and 11 major groups.
- Price change data are collected by the ABS from a wide range of retail and other sources, with over 100,000 separate price quotations collected each quarter. These price data, along with some ABS modelling of some components and the offsetting role of subsidies, are then aggregated into an estimate of price change within each of the 90 expenditure classes. Over the decade to June 2008, while the prices of some of these expenditure classes have increased very rapidly, for others they have fallen. At one extreme is the cost of automotive fuel, which has increased by 118.8 per cent. At the other, the price index for audio-visual equipment and computers has fallen by 81.3 per cent. The CPI effectively balances these different movements, based on the pattern of consumption of different items, to estimate the overall impact of prices across the community.

Analytical Living Cost Indexes versus the Consumer Price Index

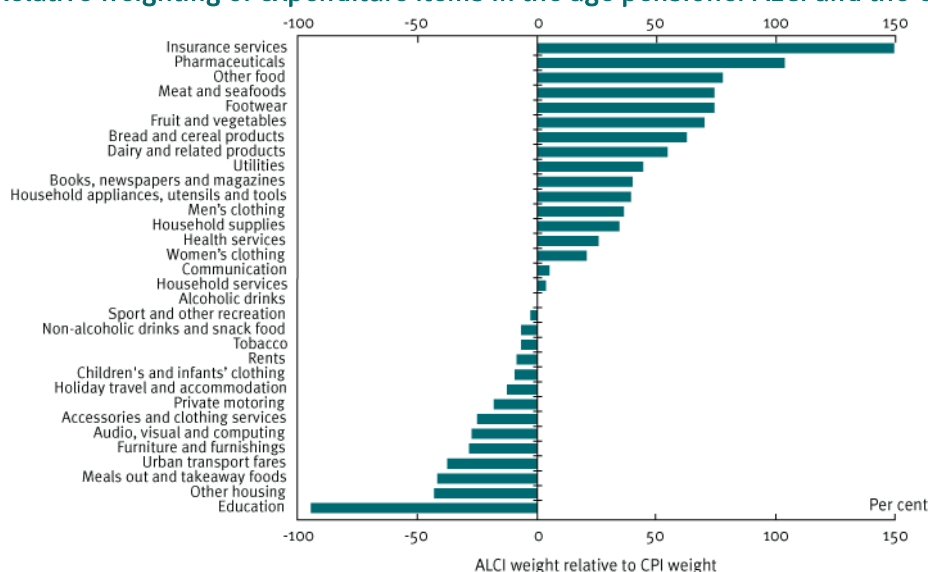
In addition to the CPI, the ABS produces ‘Analytical Living Cost Indexes’ (ALCIs). These are described by the ABS as having been designed to answer the question: ‘By how much would after tax money incomes need to change to allow households to purchase the same quantity of consumer goods and services that they purchased in the base period?’

Such indices are produced for four household types: employee households, age pensioner households, other government transfer recipient households, and self-funded retiree households.

There are two major differences between the CPI and the ALCIs. The first difference is that while weights for both are based on the ABS Household Income and Expenditure Survey, as the overall survey sample size is not large enough to provide reliable estimates for the specific ALCI households at the capital city level, the expenditure weights are estimated at the national level only. Expenditure weights for the CPI (all private households) are estimated separately for each capital city. The second difference is that, in contrast to the ‘acquisitions’ approach of the CPI, the ALCIs use an ‘outlays’ approach. This affects the treatment of purchases of housing and financial and insurance services in the indexes.

The consumption patterns of the different types of households for which ALCIs are constructed vary considerably from those of Australian households overall, as illustrated in Chart 15. For example, age pensioner households are estimated to spend 21.1 per cent of their household budgets on food, compared with 15.4 per cent for households in the CPI. As well as these differences at the aggregate level, the more detailed composition of spending within the groups varies. For example, with the ‘food’ group, the age pensioner households spend a much higher proportion of their budget on tea, coffee and food drinks; meat, including beef, lamb and pork; and eggs. They spend much less on soft drinks and fast food.

Chart 15 Relative weighting of expenditure items in the age pensioner ALCI and the CPI



Notes: Expenditure weights calculated excluding financial services.

Source: Derived from ABS 2005, 2007a.

Although the ALCIs have only been available since June 1998, a longer-term estimate of the series for age pensioner households is available by linking an earlier experimental index for age pensioner households with the age pensioner ALCI. The results of this estimate are shown in Chart 16. Over the almost 28 years for which the two indexes are available, the CPI estimates that prices have risen by 244.4 per cent, while the index for age pensioner households indicates that the prices these households face have grown by 251.8 per cent. In annualised terms, these increases represent growth rates of 4.56 per cent and 4.64 per cent respectively. While noting that the two series are designed to measure different economic

phenomena (that is, price inflation in the case of the CPI, and out-of-pocket living expenses in the case of the ALCIs), detailed analysis indicates that:

- On average, the rate of changes in the living costs of households mainly reliant on the Age Pension has been marginally higher than the rate of inflation recorded by the CPI. The cumulative impact of the difference over the almost 28-year period is, however, only 3 per cent
- At certain times, the rates of changes in the out-of-pocket living costs experienced by age pensioner households have moved faster or slower than the CPI. Over most of the 1980s, living costs for age pensioner households as measured by the age pensioner ALCI rose more slowly than for other households. This pattern was reversed in two stages between 1991 and 1994, and again in 1997 and 1998. There was a further, but somewhat smaller, relative increase in the age pensioner ALCI in 2006.

Chart 16 Comparison of age pensioner ALCI and CPI from 1980 to 2008



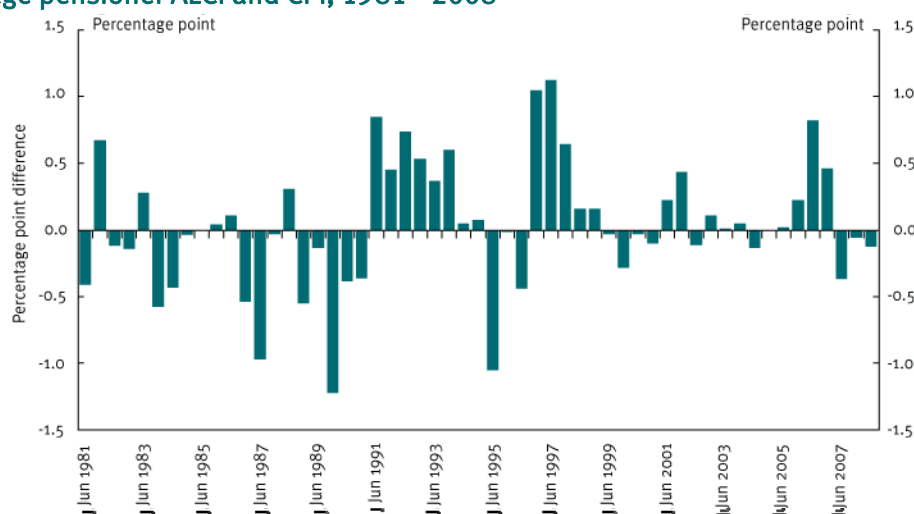
Sources: Derived from ABS 2000, 2008a, 2009a

However, in comparing these two series from the perspective of pension indexation, particular attention needs to be given to the shorter-term movements in the two series. The reason for this is that when the CPI is used as an indexation factor for pensions, it essentially operates as a safety net to maintain the real value of the pension at times when wages growth is slow, or where there are particular spikes in prices that may impact on living standards.

Hence, while the two series may show similar patterns over time, they may behave quite differently in this short-term role. The degree to which this occurs is shown in Chart 17, which presents, for each six-month indexation period, the difference between the measurement of price change between the age pensioner ALCI and the CPI. The chart plots the percentage point difference in the change. A positive figure indicates that the ALCI showed higher price movements, and a negative that the CPI was higher. The chart indicates that:

- Over any six-month period, there can be considerable variation in the rate of price change recorded by the CPI and the age pensioner ALCI. The magnitude of these differences exceeds 1 per cent on a number of occasions.
- While there is no consistent pattern, on several occasions these discrepancies have been consistently in one direction over a number of indexation periods. This, in the absence of stronger earnings growth, would have a cumulative effect in terms of the implications for those on pensions.

Chart 17 Percentage point difference in estimated six-monthly cost increases as measured by age pensioner ALCI and CPI, 1981–2008



Note: Positive indicates high ALCI growth

Sources: Derived from ABS 2000, 2008a, 2009a

The Consumer Price Index and changes in living costs

The CPI is designed as a measure of overall price inflation for the household sector. There are some differences when measuring changes in the out-of-pocket expenditure needed to gain access to consumer goods and services.

- ▶ While consumers tend to vary their pattern of spending depending on price movements (for example, purchasing more rice if potato prices increase), the CPI uses a fixed basket of goods that assumes no such behaviour. This is known as ‘substitution bias’ and leads to the CPI overestimating the cost of living.²⁰
- ▶ The CPI as a measure of price inflation over households does not reflect the actual way price changes may impact on any particular household. As a consequence, price change can be experienced by individual households at rates quite differently to the rate predicted by the CPI.
- ▶ As a measure of overall price movements for the household sector, the CPI is weighted by total goods and services consumption across all households. This means that it is more heavily weighted by the spending patterns of higher income households. Reflecting this weighting pattern, the CPI is what is termed a ‘plutocratic index’.²¹ A contrasting conceptual approach is to weight the CPI on a household basis so that it represents the average experience of ‘equal’ households. This produces a ‘democratic index’. Analysis by the Review,²² using a restricted basket of goods, estimated that over the decade to June 2008, while the annualised rate of price change for a ‘CPI’ calculated on a plutocratic basis was

²⁰ The Boskin Commission reported an estimate of this bias at 0.15 per cent a year for the United States CPI (Advisory Commission to study the Consumer Price Index 1996). The ABS is unable to quantify the possible impact on the Australian CPI, but employs a number of strategies to minimise item substitution. Analysis by the Review estimated it at around 0.22 per cent a year.

²¹ This terminology reflects the weighting approach adopted by the difference indexes. The democratic index weights each household’s expenditure equally, while the plutocratic index weights it by the level of expenditure of the household. The use of a plutocratic approach is necessary in a price index that seeks to identify price changes across the household sector as a whole, as this would not be identified as the sum of democratically weighted households.

²² The Review’s analysis of price changes was undertaken in order to investigate the extent to which the CPI was affected by various methodological approaches, and the results are merely illustrative. Because the analysis did not use the full basket of goods, and there are limitations imposed on the distributional analysis because household expenditure patterns are relatively short-term snapshots, **these estimates should not be considered to be alternative estimates of actual price changes over the period.**

2.7 per cent over the decade price change measured by a democratic 'CPI' was 3.1 per cent. This suggests that the average experience of price change by households was higher than the average price change overall. Moreover, when the distribution of price change at the individual household level was considered, one-half of all households experienced price changes outside of the range of 2.5 per cent to 3.5 per cent.²³

- ▮ As the objective of the CPI is to measure pure price change over time, identical goods and services should be priced from one period to the next (called 'pricing to constant quality'). This can lead to some apparent discrepancies in the way price changes are perceived and the way in which they are measured.
- ▮ Over the past 20 years, the CPI index for the purchase of motor vehicles has increased by just 7.3 per cent. This in part reflects the extent to which cars today are better equipped. From a consumer perspective, where such quality upgrades are often taken as granted or involve changes that consumers may not necessarily have chosen to purchase, the estimate is seemingly at odds with the prices of any particular model of new car, which may have risen by some 25 to 50 per cent over the same period.
- ▮ The largest decline in prices at the expenditure class level of the CPI has been in the 'audio-visual and computer equipment' category, where prices have declined by 81.3 per cent. In some cases, this reflects declining nominal prices, especially as items such as DVD players have changed from being expensive luxury products to commonplace consumer items. In other cases it represents the marked improvement in the quality of products. For example, although the prices of computers may not have changed all that much in nominal terms, their power, storage capacity and other specifications have increased enormously. The pricing of computers to constant quality in the CPI reflects this improved computing capacity, rather than the computer as an item per se. Such treatment, while appropriate for the assessment of pure price change, is different to measuring the impact of these changes on the cost of living experienced by consumers, where quality changes may add little to the utility of the product for many consumers.
- ▮ A third area in which the pricing to constant quality approach to the CPI may differ from consumer experience concerns the cost of renting. While the CPI rental component increased by 22.9 per cent between December 1994 and December 2005, the average rent paid by private tenants, as surveyed in the ABS Survey of Income and Housing over the same period, increased by 41.2 per cent (ABS 2005–06). Again, much of this difference can be related to improvements in the quality of the rental stock.
- ▮ Similarly, the conceptual treatment of some other items in the CPI does not reflect common conceptions of consumer price change. For example, the land value of housing is excluded, as this is seen as investment rather than consumption. There are similar exclusions of the price of established housing, as this is seen as a transaction between households with no net impact across the household sector. Banking services reflect the cost of fees and the margin between deposit and lending rates, and are hence insensitive to changes in interest rates, and insurance is similarly the difference between premiums and claims.

While some of these issues do not apply in the case of the ALCIs (for example, a different approach to home purchase and financial services is taken in the ALCIs), and more homogenous populations with a lesser plutocratic bias are used, issues such as those concerned with quality adjustment remain in the ALCIs.

²³ The analysis may overestimate the actual extent of dispersion of price change experiences due to the limited time period for which expenditure data are available at the individual household level and hence its sensitivity to abnormal as opposed to average expenditures.

In making these comments the Review emphasises that these are not issues with the way in which the ABS operationalises the CPI. The Review recognises that the ABS approach is consistent with international best practice and for the purposes of measurement of generalised price inflation across the household sector. Rather, the Review questions whether a measure of generalised price inflation is the best way of indexing pensions.

It is also emphasised that many of these distortions are not necessarily consistently in one direction or another.

This is particularly true of the distinction between democratic and plutocratic estimates of price change. International data show that the direction of difference varies between countries and between periods—largely as a result of the specific factors that are driving price change at that particular point in time.

With regard to the other biases, substitution bias always tends to lead to an overestimate of price change, while the discrepancy between the constant quality approach and the actual capacity to purchase products is likely to be in the other direction.

The cost of living in contemporary society

In addition to the cost of purchasing a set basket of goods and services, considering the ‘cost of living’ raises a broader question about the capacity of people to participate in society. This is particularly important with regard to changing living standards and changing social and technological structures in society.

For example, a decade ago, a computer with internet connections was useful for most households but not necessary. This is increasingly changing, in part because many government and commercial transactions that were previously undertaken through face-to-face contact, or even call centres, are being streamed into electronic formats. Similar transformations have occurred in many other fields including, for example, community organisations moving from paper-based to electronic newsletters. With this type of change it can be considered that simply ‘maintaining’ a living standard now increasingly requires individuals to purchase a computer and internet connection.

This type of shift is not easily measured through conventional approaches to the cost of living, which simply treat households acquiring these new capabilities as improving their living standard. There are similar issues in addressing changes in charging regimes by government and other bodies and in the provision of services. For example, an increased supply of services may have a considerable impact on the wellbeing of householders, especially those with a disability or other high service need, while a contraction of services will have the opposite impact. Neither of these will be identified in a price-based measure of living standards.

These types of changes are one rationale for benchmarking pensions to community living standards. However, they are discussed here to emphasise that price changes and changes in living costs as experienced by a specific group may not coincide with price changes as measured by mechanisms like the CPI.

Clearly the adoption of an ALCI to index the pension rather than the CPI may result in a lesser or greater price indexation factor at any given point in time. Either way, the effect is likely to be temporary due to the operation of the wages benchmark, which is the dominant factor in determining pension increases. This is consistent with price adjustment operating as a safety net to protect purchasing power at a time of rising costs. The essential question is what the better measure of the cost change is for pensioners over these periods.

Perceptions of price changes

Another insight into the relationship between price changes and perceptions of changes in living standards has been given in recent analysis by Bradbury (2009a). In ‘Regular inflation in Australia’, he suggests that the way in which price change has unfolded has resulted in consumers seeing the price of more regularly purchased products increase much more quickly than more discretionary and less regularly purchased items. He estimated that between June 2005 and March 2008, the price of ‘regular goods’ increased by 4.3 per cent compared with a rise of just 0.5 per cent in the price of ‘irregular goods’.

It is likely that this effect may also be compounded by normal patterns of risk aversion which mean that people are more likely to be aware of losses—such as those associated with rising prices—than the gains they make, for example when prices drop. In addition, the longer time periods between purchases of irregular goods may mean that people are less likely to recall the previous price they paid, and the duration may mean that there is less of a tendency to realise the real change in the price of the product.

Analysis such as this highlights the way in which divergences between perceptions and actual trends can occur. While clearly this type of experience is not a basis for a policy change, it points to the importance of public confidence in pension setting arrangements.

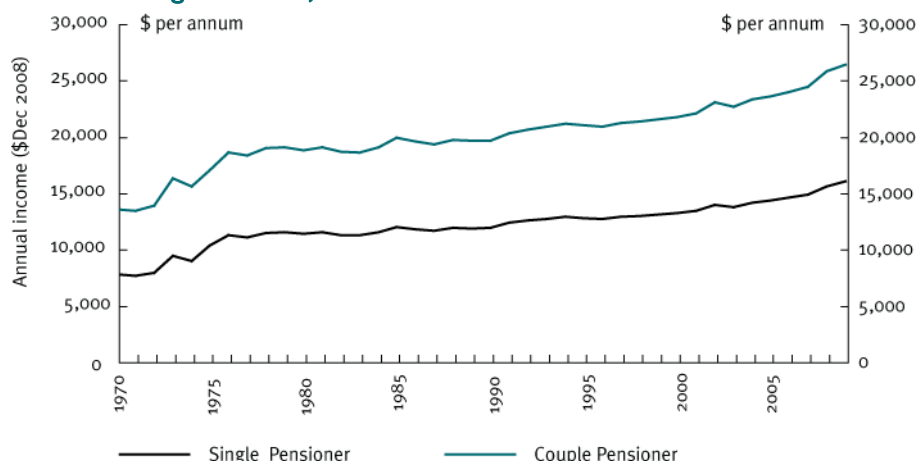
4.3.3 Benchmarks—measures of change in living standards

The goal of benchmarking is to maintain the relativity of the pension to a measure of living standards or income of another group. Currently the pension is benchmarked to MTAW.

Impact on pension rates

Since the introduction of legislative provisions for benchmarking which became operative in September 1997, while the CPI alone would have seen the pension increase by 37.1 per cent to take account of rising prices, the base pension has increased by 56.1 per cent. That is, the single rate of the pension has risen by \$1,978.60 a year (including the Pension GST Supplement)—\$38 a week—more than if it had been subject to CPI indexation alone. Over the last 23 pension indexation points, pension increases have been driven by wages growth as measured by the MTAW benchmark on 15 occasions and by CPI increases on eight occasions.

Over the longer term, the rate of the pension has not only reflected the impact of indexation, but also the impact of policy changes, such as the inclusion of compensation for the introduction of the GST, the introduction of additional allowances such as the Utilities Allowance, and ad hoc initiatives such as the payment of bonuses. The real value of the pension over time is shown in Chart 18.

Chart 18 Real value of Age Pension, 1970–2009

Notes: Calculations are based on Age Pension at 1 January each year, and December quarter CPI, including Seniors Bonus when paid.

A difficult question faced by the Review in considering the adequacy of the indexation mechanisms for pensions is the relationship between these ad hoc adjustments and the effectiveness of indexation. That is, to what extent were some of these additional payments and changes a response to the recognition that the indexation of pensions was inappropriate to maintain the relative wellbeing of pensioners?

There is no clear answer to this question. However, one interpretation would be that, to the extent that a number of these payments have become embedded in the structure of the pension and into the expectations of pensioners, the historical indexation approach has not been wholly adequate.

Taken together, these various changes in the rate of the pension have not only resulted in an increase in its real value, but also (as noted in Chapter 3) an improvement, in most cases, in its value relative to the take-home earnings of working Australians.

Approaches to benchmarking

The base rate of the pension is benchmarked to 25 per cent of MTAW, however, the value of the total pension package is higher than the benchmark. In September 2008, when the pension rate was last indexed against the May 2008 MTAW of \$1,069.00, the combined pension and allowances for a single age pensioner was 27.7 per cent of MTAW rising to 28.6 per cent when the weekly equivalent value of the Seniors Bonus is included.

The Review notes, though, that MTAW is only one of the measures of community living standards available in Australia.

A range of different reference series could be considered as being appropriate for benchmarking. These include household incomes and various earnings measures. Within these approaches, the use of earnings benchmarks introduces an additional level of conceptualisation, namely that of payments being set as a 'replacement rate' for what people may have been able to earn if they were able to participate in the labour market or had not retired. Obviously, such an approach is a broad conceptualisation relating to some average outcome not at the individual level.

Household income

One way to achieve a direct link to the living standards of the community would be to use a measure of household income. Two different types of measure are available for this. The first is 'household disposable

income' from household surveys. This reports the incomes received by households from earnings, investments and transfers, less income tax. The second is National Accounts–based measures.

Survey-based equivalised household disposable income

Between 1994–95 and 2005–06, median equivalised household disposable (after-tax) income grew by 75.6 per cent, in real terms a 31.9 per cent increase. This is considerably higher than the growth in the rate of the pension. The growth in household income reflects higher earnings, a slight decline in taxation and considerable shifts in the structure of households. During this period, the average number of employed people per household increased from 1.22 to 1.26 and the average number of people in households declined from 1.96 to 1.88 adults and from 0.73 to 0.63 dependant children (MIAESR 2008a). In essence, much of the apparent growth in this measure of income is a consequence of these households working more and having fewer people to support.

Although there is some intuitive appeal to benchmarking pensions to a measure of household income as being representative of the community as a whole, the nature of the various drivers of household income, as seen above, casts doubt on this option. In particular is the extent to which changes in household income have been affected by changes in the composition of households and the nature of labour force participation. This type of change makes the estimates of income sensitive to a wide range of social changes, such as decisions by children as to when to leave the parental home. It is also hard to see a rationale for such changes to impact on the rate of the pension.

National Accounts measures of income

National Accounts–based measures of household income take a broader approach to the concept of household income. In addition to aggregating the total value of wages and salaries of employees, it includes the incomes of unincorporated enterprises, including an estimate of imputed rent for owner-occupied housing. Offset against these are the interest payments on dwellings and consumer debt, insurance premiums, fines and transfers to non-residents. As such, it includes many items that are not immediately available to individuals as consumption such as superannuation savings, and, as with the CPI, various items are netted out across the household sector as a whole. While this is a very comprehensive concept, it is not clear whether it provides a useful reference point for the adjustment of cash incomes of pensioners, given the way in which it is constructed, and the degree to which it does not focus on the day-to-day capacity of households to consume.

The approach has two other limitations. The first is that as a per capita measure it does not take account of the way in which household income needs vary on the basis of household composition and age. For example, a decline in fertility with fewer children being born in one year would show up as an increase in per capita income. Secondly, as with other National Accounts measures, the estimates published by the ABS are subject to considerable revision over time.

Male Total Average Weekly Earnings

Over the 20 years to August 2008, earnings (seasonally adjusted) as measured by MTAWWE have increased by 122.6 per cent. The real value of MTAWWE, taking into account price change as measured by the CPI, has increased by 20.6 per cent. Over the past 10 years, the nominal value has grown by 50.8 per cent and the real value has increased by 9.9 per cent. As indicated by its title, 'Male Total Average Weekly Earnings', it is an estimate of the average total (ordinary time and overtime) earnings of all male employees, including full-time and part-time workers, and both adults and juniors. As an average of currently paid wages, it is affected by changes in the composition of the workforce, hours worked and changes in the structure of employment, including occupation. The series also does not take account of the value of amounts salary sacrificed by employees, although this will be available in a new experimental series in 2009.

While use of MTAW as a benchmark has delivered significant real increases in the value of the pension, it also has some limitations:

- ▶ MTAW has grown relatively slowly compared with total adult male full-time earnings (which includes overtime) and male adult full-time ordinary time earnings. Over a longer term, the value of earnings as measured by MTAW has fallen from being 92.8 per cent of full-time male total earnings in 1972 to 84.0 per cent in August 2008.

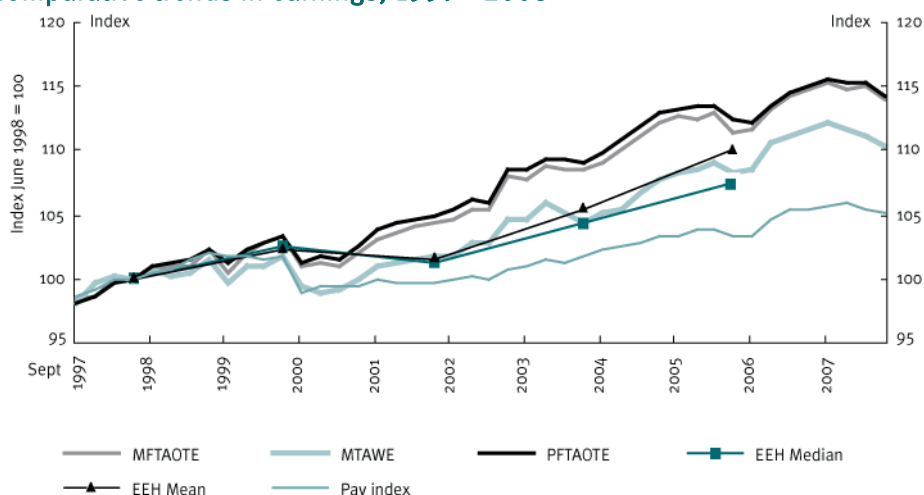
In large part, this is a consequence of the increase in the proportion of men working part-time, including the extent to which a considerable proportion of young people combine some part-time employment with their studies. The proportion of all employed men who are working part-time increased, between January 1989 and January 2009, from 7.4 per cent to 15.1 per cent.

- ▶ The use of male earnings alone in the measure is anachronistic in that it ignores the participation of Australian women in the workforce.
- ▶ While the concept of ‘average weekly earnings’ is often conflated with the idea of the earnings of an average employee, this is not the case because most employed people earn less than average earnings. Using data from the 2005–06 Survey of Income and Housing, it is estimated that 56 per cent of full-time male employees and 75 per cent of full-time female employees earn less than the average of full-time earnings estimated from the series.

Earnings growth also varies across the income distribution. Data from the ABS Survey of Employee Earnings and Hours shows that between 1996 and 2006, average full-time adult earnings grew on an annualised basis by 1.7 per cent. Looking at the rate of growth at points in the income distribution, earnings grew at the median (that is, the ‘middle’ employee) by 1.4 per cent, by 1.1 per cent for a lower-paid worker (25th percentile) and 0.9 per cent for a low-paid worker (10th percentile).

- ▶ The measure is affected by changes in the workforce including enhanced skills and does not reflect what is happening to the earnings of individual employees. In comparison, data from the Wage Price Index, which is adjusted to eliminate the impact of such changes, shows lower growth. Over the decade from June 1998, average real full-time ordinary time earnings increased by 14.2 per cent but the real wage rate for a ‘constant quality position’ only increased by 5.0 per cent.

The comparative movements in these series over the past decade are illustrated in Chart 19.

Chart 19 Comparative trends in earnings, 1997–2008

Notes: Index numbers, June 1998=100, real values derived using CPI. MFTAOTE = Male Full-Time Adult Ordinary Time Average Weekly Earnings; MTAW = Male Total Average Weekly Earnings; PFTAOTE = Persons Full-Time Adult Ordinary Time Average Weekly Earnings; EEH = employee earnings and hours.

Sources: Derived from ABS 2007b, 2008b, 2008c

4.3.4 Indexation and sustainability

Decisions on the indexation of pensions have a range of consequences. In the case of automatic changes, this occurs without any consideration of the state of the budget or current economic conditions. It also impacts on the pattern of income distribution across the community.

- Increasing pensions at a rate less than that of overall growth in community incomes can result in increased income dispersion and rising inequality, as the gap increases between the incomes of pensioners and those of others in the community who gain their income from employment increasing.
- Conversely, increasing pensions faster than the net income growth, say, of working households, will close the gap between these households. This in turn may raise questions about the rewards for work as the incomes available to those on income support grow relative to earnings, and the relative net gains from employment decrease. As noted in Chapters 2 and 7, pensioners receiving a part rate of pension can already have a higher disposable income than low-income taxpayers who are funding pension spending through their taxes.
- The extent to which indexation arrangements seek to maintain a link with increasing living standards, as opposed to simply maintaining purchasing power, also directly affects budget sustainability. More generous indexation arrangements have a higher fiscal cost over time because their effect on payment rates compounds with the aging of the population. Less generous indexation arrangements have less of an effect.
- A further issue, highlighted by the current disruption to global markets, is that guaranteed increases to pensions, which are a means of improving the financial security of pensioners, are in contrast to the level of security of those who rely on private investments or earnings. A consequence of this is that indexing of pensions during periods of economic downturn may see the real value of pensions maintained while earnings and returns on investment for others in the community decline.

Relationship between the pension, wages and taxes

In addition to its impact on the rate of pension payment, the most immediate impact of pension indexation is on the government's budget.

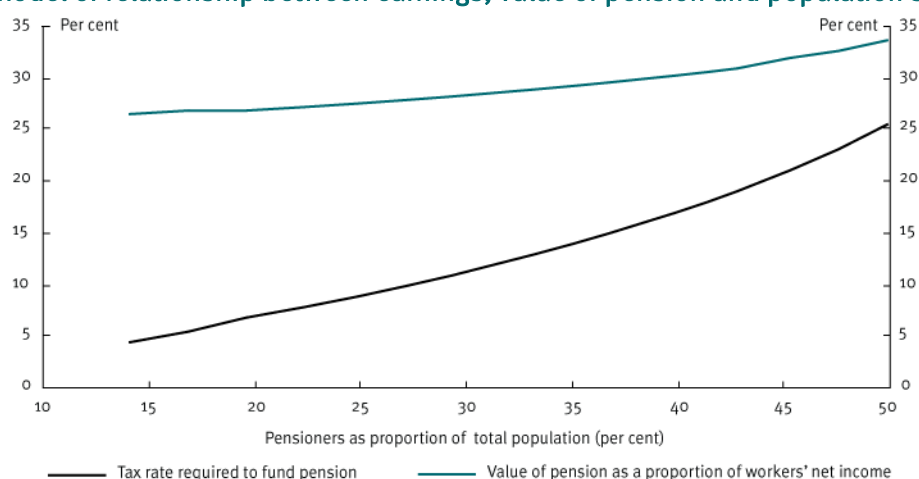
The payment of pensions and other transfers relies on taxation revenue, especially income tax. A consequence of this is a relationship between the tax rate and the rate of payment. More specifically, if as a result of demographic or other change, the size of the population eligible for income support increases relative to the size of the population with employment (who are taxed to provide this income support), then maintenance of the rate of pension payment at some relativity to earnings can only be achieved by increasing the rate of tax required to fund these benefits. To the extent this is funded by taxes paid by those with employment, this in turn results in a relative increase in the net income of those on transfers compared to the net income of those with employment.

Chart 20 illustrates a simple hypothetical model that shows this effect. It comprises two population groups, employed people and pensioners, and assumes that the only government expenditure is on pensions and the only tax is income tax on employees. What is modelled is the effective tax rate on employed people to pay for a pension that is set at a ratio of gross earnings and the relationship between the net incomes of these two groups.

The model shows that as the pensioner share of the population changes, the tax rate needs to increase to pay for the larger number of pensions, but that the value of the pension increases relative to the take-home pay of the working population who are having these taxes deducted from their earnings. In the illustrated scenario, a pension set at 25 per cent of gross earnings would increase in value from 26.1 per cent of the disposable income of an employed person to 33.3 per cent as the ratio of pensioners to workers increases from 1:6 to 1:1.

Obviously, the relationship is much more complex in contemporary Australia than illustrated in the model. The convergence between the pension and net wages may be less obvious if governments choose other approaches to finance Age Pension pressures, including the use of indirect tax increases, spending cuts, and policies that increase aggregate participation such as immigration. There may be some offsetting savings from the shift in the share of the population, such as lower demand for education, as well as the impact of the Superannuation Guarantee in reducing pension reliance. However, the broad relationship remains, and in the long run it may prove that a pension benchmarked directly to a net rather than gross wage may be more sustainable as it is likely to be a better measure of community living standards.

Chart 20 Model of relationship between earnings, value of pension and population structure



Source: Pension Review modelling.

As discussed in Chapter 2, the issue has direct relevance to the indexation of pensions in Australia. The *Intergenerational Report 2007* indicates that the ratio of people of working age to people over the age of 65 years will decrease from 5.0 in 2007 to 2.4 in 2047 (Treasury 2007). Again, in a simple two-sector model taking into account current and projected participation and pension take-up rates, this would involve an increase in the tax required to fund a 25 per cent gross income pension from 5.5 per cent to 10.4 per cent;

and on the basis of this being the only tax paid, the relative value of the pension would increase from 26.4 per cent to 27.9 per cent of the disposable income of employed people. However, this effect would, in addition to the factors discussed above, be in part offset by the increasing proportion of the aged who will have superannuation and other savings.

While the linking of pensions to earnings is often argued as being a mechanism to share the benefits of productivity gain across the community, the indexation of pensions is not the only claim on this gain:

- ▶ Employed people who have generated this increase through their efforts including investing time in education see themselves as being entitled to much of this gain. This is particularly so when the higher productivity results from their own efforts and investments.
- ▶ The return on capital to companies and investors is important, not just to ensure adequate flows of capital for the future, but increasingly to the funding of retirement incomes of those with superannuation.
- ▶ As indicated in the Intergenerational Reports, these productivity gains are also critical to fund increasing levels of health care and other services needed across the community, in part because of the ageing population, as well as the costs of health services as a result of technological and pharmacological development.

A key question is how these competing claims can be balanced, taking into account issues of both equity and sustainability, while ensuring sufficient incentives remain to achieve future productivity growth.

4.4 Reform directions

The indexing of pensions is critical to maintaining the standard of living of pensioners. This section outlines a series of principles that the Review considers should guide future policy decisions on indexation. Building on these, and the technical analysis provided in this chapter, the Review has developed findings in relation to price adjustment and benchmarking to community living standards.

Before discussing the principles, the Review considers that it is important to address two specific proposals for indexation approaches that were made in the consultations.

4.4.1 Consideration of specific indexation proposals

There was widespread support in the consultations for two alternative approaches to indexation. These were to link the pension to the Federal Minimum Wage and to utilise an existing or new budget standard. Neither of these is supported.

Linking the pension to the Federal Minimum Wage has a strong intuitive appeal in the context of considering the pension from the perspective of a replacement rate for what a person may have earned. It has, however, the potential to significantly distort the processes and considerations of the setting of the Federal Minimum Wage. In particular, the 3.3 million pensioners who would see their pensions affected by the determination of the Federal Minimum Wage would well outweigh the 1.3 million Australians who rely directly on the Australian Fair Pay Commission's decision. Further, it is noted that several of the criteria used by the commission for determining the Federal Minimum Wage as a 'safety net for the low paid' and the impact of decisions on 'employment and competitiveness across the economy' and the capacity of the 'unemployed and low paid to obtain and remain in employment' may not be considered appropriate for pension setting (Australian Fair Pay Commission 2008).

The use of a budget standard as the basis for indexation has four significant problems. The first concerns the question of the representativeness of the standard for the diversity of living circumstances of

Australian pensioners. It would in essence result in indexation being based on a single normative set of purchases. As well as being unrepresentative, it would be considerably more volatile than a broader-based measure. Secondly, regular repricing of the budget would involve either extensive data collection in order to price the many hundreds of individual products, in different locations, or the use of broader indexes such as the CPI class-level indexes, which are not product specific. Thirdly, as a fixed basket of goods, the measure would totally ignore product substitution, as well as be insensitive to new products. Fourthly, is the question of how the budget would be readjusted over time for changes in living standards.

The Review notes that these types of measure can have a role, along with other indicators, in social policy analysis, but relative cost effectiveness would rule them out.

4.4.2 Indexation principles

The Review proposes that the following principles be used to guide future policy development for pension indexation.

Automatic indexation

Changing pension rates can be undertaken automatically through the inclusion of indexation and benchmarking criteria in legislation, or through regular review, typically in the budget process. Such reviews can be guided by particular benchmarking objectives such as the MTAW benchmark, or be more ad hoc.

Each of these approaches has merit. Automatic legislative indexation provides for a greater degree of certainty and security. At the same time, because legislative provisions can be changed, they are not a guarantee of a particular outcome over time.

A downside of legislated automatic change is that it can result in policy being set on ‘autopilot’ without serious consideration of questions of adequacy and affordability. In such circumstances there is a risk that little attention will be paid to actual outcomes with regard to these issues, as it is assumed that the indexation process will ensure appropriate outcomes.

Where changes are not done automatically, governments must consider the question of the appropriate rate of payment on a regular basis. In some areas of government policy—such as the determination of taxation rates and thresholds—indexation is not done automatically. This approach provides a greater degree of flexibility to governments to take decisions on when and to what degree adjustments should be made to program settings, thereby allowing decisions to take into account the range of economic circumstances at the time, including the affordability of changes in rates.

There are strong arguments for decisions on indexation of pensions to be taken as deliberative decisions by government. However, taking account of the current outcomes for pensioners, trends in living standards across the community and the ability to fund any changes, the Review considers that automatic indexation is a better approach. The major advantage of this approach is that it provides greater financial security for pensioners, the focus of the terms of reference for the Review.

This neither removes the need for indexation to be regularly reviewed, nor precludes the capacity of government to intervene if circumstances require this. Automatic mechanisms should also not be considered as sufficient to ensure that payments and payment structures are meeting their goals or responding to changes in the broader economic and social environment. Consequently, a need remains for regular reviews of the rates and structure of pensions.

An alternative view to this is that automatic indexation limits government flexibility, particularly in the light of changing economic circumstances. In cases where other groups in the community may be facing

constraints on their living standards, this approach would tend to fully shelter pensioners, and where governments may face cost pressures, it tends to ‘lock in’ expenditure.

While the Review recognised the force of these arguments, it does not consider that they provide sufficient grounds to overrule the broader principle. In particular, where these constraints are significant and questions of national priorities demand it, governments would remain free to make decisions through suspending or otherwise modifying these policies and any related legislation.

Continuation of the two-part approach

Given the goals of reflecting improvements in the quality of life of the society and in protecting pensions from falls in purchasing power, the Review considers a two-part approach should continue to be used—that is, adjustment of the pension both against a community benchmark and to account for price change.

This dual approach has advantages in that each component acts as a stabiliser to the weaknesses of the other. Benchmarking can provide an effective link to changes in living standards, something a price index cannot do, while the use of a price index protects pensioners in the case of any surge in costs that might otherwise act to reduce their living standards. The dual mechanism also reduces the risk associated with the compounding of any small discrepancies in the price index over time.

Under this arrangement, the benchmarking of the pension would be the principal mechanism, and the price mechanism would be limited to safety net adjustments to maintain the purchasing power of the pension at times when it would otherwise be eroded.

Finding 8: The Review finds that automatic indexation of pensions and a two-part approach of benchmarking and indexation should continue. Benchmarking pensions relative to community standards should be the primary indexation factor, with indexation for changes in prices acting as a safety net over periods where price change would otherwise reduce the real value of the pension.

Relativities of components in the pension system

Because different approaches to indexation have been taken for different elements of the pension system, along with various ad hoc changes, the relativities between components have changed over time.

Table 3 Relativities of components of the pension system

	September 1997	September 2000	September 2008
% relative to base payment single pension			
Newstart Payment Rate			
Over 21 no children	92.4	89.0	79.9
With children or over 60 years	100.0	96.2	86.5
Rent Assistance			
Single person	21.5	21.9	19.6
Minimum rent	20.6	19.0	17.4
Income test			
Free area for single pensioner	28.8	26.9	24.9
Cut-out single pensioner	231.9	280.4	281.5
Free area single pensioner with child	35.7	33.1	28.9
Free area single allowee	17.3	15.7	11.0
Assets test	Multiple of fortnightly rate of pension		
Threshold (single home owner)	362	338	306
Cut-out (single home owner)	700	676	979

Source: FaHCSIA modelling.

Note: The relativities are with the single rate of pension not including the value of Pharmaceutical Allowance, Utilities Allowance or Telephone Allowance.

Table 3 shows how these factors have impacted on a number of the relativities between components of the income support system and introduced imbalances in the structure of payments and other program parameters. For example, the Rent Assistance threshold was 20.6 per cent of the single pension rate in September 1997. It is now 17.4 per cent.

In addition, because the threshold at which means testing cuts in grow less quickly than wealth and living standards, the use of the CPI for the means test thresholds tends to increase the proportion of the pensioner population receiving a part rate of pension. In fact, some of these parameter changes represent a form of ‘fiscal drag’ similar to the effect in the taxation system, where the lack of automatic indexation means that average tax rates will increase unless decisions are made to change the tax thresholds and rates. Of course, in the pension system in most cases this issue is generated by the two different components of indexation, rather than the lack of indexation. Therefore, fiscal drag will be less aggressive in the pension system than in the taxation system.

There are three main arguments for continuing with the current approach:

- The lack of automatic indexation of taxation rates provides a greater degree of flexibility to governments to take decisions and therefore allows decisions to take into account the range of economic circumstances of the time. The same is true for the indexation of many pension components to the CPI, though the magnitude of the effect is much less.
- The approach of not indexing all payments and parameters by a community benchmark such as wages has been used as a means of reducing the effect of policies or program parameters that are likely to become less relevant over time.
- While CPI indexation of thresholds has led to changes in pension relativities, CPI indexation is a way of gradually increasing the aggressiveness of the means tests for individuals who have real increases in their level of income and wealth.

The Review considers that indexation approaches that result in distortions between components of programs should be avoided. This is also the case with the use of fiscal drag, other than as part of an explicit policy adjustment process, such as being a part of a formal grandfathering mechanism.

One approach to avoiding the creation of distortion is to index all program parameters, including rates and thresholds, on a consistent basis. In pure policy terms this is considered the best solution as it maintains the deliberative intent of all policy settings, while permitting changes by formal policy decisions. In some cases this approach may be seen as generating an inappropriately high level of ‘lock in’ to parameters that may have been set with more than one policy objective in mind. The fiscal cost of indexing all program parameters on a consistent basis (such as wages growth) is difficult to determine as it would operate differently on different components, and would need to be judged against what might otherwise be done through ad hoc and other adjustments. Locking in means test parameters would tend to increase costs, while moving payment thresholds up (for example, for Rent Assistance), will increase targeting and potentially reduce costs.

An alternative to a unified approach to indexation would be to maintain different indexation approaches but establish a formal process to review relativities on a regular basis. Because the creation of distortions tends to be a gradual process, this would enable any emerging imbalances to be examined before they have a deleterious effect on the program structure. This is the approach the Review has adopted.

The Review considers that its findings with regard to specific settings of the pension system, including the current treatment of supplementary payments, changes to Rent Assistance, the treatment of earned income and other changes to the means test, provide the potential to fix most of the distortions currently within the pension system. These issues are considered in Chapters 5 and 7.

4.4.3 Price adjustment

The Review considers that price adjustment is a ‘safety net’ and anticipates that the wages benchmark, in whatever form, will generally drive pension rates and will almost certainly be the dominant indexation factor over the medium and long term.

However, the Review notes that the times when price adjustments are the dominant indexation factor are those when pensioners are at most risk of experiencing a fall in their living standards. Hence, a price measure that is responsive to their costs in the short term is important. As seen in the Review’s analysis, while the CPI moves similarly to the age pensioner ALCI in the long term, it can differ markedly over shorter periods.

Therefore, the Review considers that a specific price index, along the lines of the ALCI, should be developed for income support recipients.

- ▶ The index should be based on the expenditures of households that are mainly reliant on government transfer payments. Restricting the measure to these lower-income households limits the distortionary impact of the expenditure pattern of higher-income households from the measurement of price change.
- ▶ The measure should treat insurance and consumer debt on an acquisitions basis and exclude rent and home purchase. The ABS should also undertake and publish further analysis of the issues associated with the purchase of items that are significantly affected by quality adjustments.
- ▶ Given that this index will specifically consider the impact of price change on low-income households, it should be the only price index used for the adjustment of pensions.

However, even a pensioner-specific index will not eliminate the inherent limitations of any index measuring the actual price impacts on all households within a specific group.

As the Review’s preferred approach involves significant changes in the Australian approach to price indices involving the construction of a second purposive price index, and raises several conceptual issues, there may be merit in considering these issues in a way that can draw on both expert input and the views of the

community, as well as the interests of key users of current price data, to provide for a more thorough and public analysis of the issues.

Finding 9: The Review finds that pension indexation for price change would be better undertaken through an index that more specifically reflected cost of living changes for pensioners and other income support recipient households.

Indexation of rent assistance

Rent Assistance plays a very specific role in the income support system since it is conditionally linked to a particular expenditure incurred by a minority of pensioners. As discussed in Sections 3.4.6 and 4.3.2, the evidence indicates that the pattern of changes in the cost of private rental housing is not well reflected in broader measures of price change. This suggests that the basis for using such measures for the indexation of Rent Assistance is not strong. However, to the extent the payment is associated with actual expenditure on rent, there similarly is no clear reason to link the rate of assistance to a more general community benchmark.

For these reasons the use of a separate index that more appropriately reflects changes in the costs of private rent would have merit. Such an index could, for example, be based on the actual rents paid by income support recipients to obtain a good measure of the actual changes experienced in the particular segment of the market in which this group operates.

However, it was also noted in Section 4.4.2, and is further discussed in Chapter 5, that the structure of this payment has been significantly distorted over time as a result of differential indexation that apply across the range of social security parameters. In line with the Review's general approach to fiscal drag, which involves reviewing and adjusting review relativities on a regular, deliberative basis, the Review has developed findings on the targeting of Rent Assistance. The Review's findings on Rent Assistance are discussed in Chapter 5.

4.4.4 Benchmarking

Benchmarking requires the linking of the pension to a measure that reflects changes in the wellbeing of the community. This has traditionally been done through the benchmarking of the pension to MTAW. E.

The Review considers that the key objectives of the benchmark should be to reflect:

- ▶ a relativity to a consistent work effort of an employed person, which is not affected by changes in the proportion of full-time and part-time employees
- ▶ the earnings of the 'average' worker rather than the average earnings of all workers (which is disproportionately affected by income change among high-income earners), as well as the earnings of both men and women
- ▶ the disposable after-tax income of an employed person. This is a more appropriate reference point, especially from the perspective of maintaining a relative replacement rate between the disposable incomes of those on pensions and the disposable incomes of those in employment. It also links pensions to the experience of the wider community and the impact of changes in income taxation over time.

On this basis, the continuation of benchmarking to MTAW is inappropriate in the long term. It is proposed that the measure used for this purpose should be the net income of a single person earning a wage paid at the rate of the median earnings of a full-time employee.

Finding 10: The Review finds that no single measure to benchmark the pension to community living standards is without limitations. However, the Review considers that a measure of the net income of an employee on median full-time earnings may be a more appropriate measure than the existing Male Total Average Weekly Earnings benchmark.

Implementation

In coming to these findings, the Review recognises that there are two factors that may limit immediate implementation. The first is that several of the reforms would involve some work to ensure that appropriate and timely measures of price change and earnings are available. The second concerns the degree to which benchmarking may be affected by other reforms to the tax-transfer system.

As the goal of benchmarking is to create a link between community living standards and the rate of the pension, the issue of benchmarking is closely associated with a range of other policies that impact on wellbeing. Hence, the final determination of the level of the benchmarking of the pension may be more appropriately delayed until the Australia's Future Tax System Review Panel has made its report. This reflects the extent to which:

- ▶ considerations and recommendations of the Australia's Future Tax System Review Panel may have a direct impact on the level and distribution of resources across the community and between sectors
- ▶ more specific consequences of policy reforms, such as any changes to the personal income tax system, may have direct impacts on a benchmark that reflects net earnings.

The Review considers that such a delay in the implementation of any reforms to indexation does not pose any major concerns around the adequacy of pensions in the short term, as long as existing indexation approaches were maintained, as reform in this area is primarily concerned with long-term adequacy and sustainability.

Finding 11: The Review finds that, while reform to indexation and benchmarking is important to the financial security of pensioners, implementation may need to be phased in to account for policy developments that may arise out of the Australia's Future Tax System Review and to allow for the development of appropriate mechanisms for benchmarking and indexation.

Implications of revised benchmark

The proposed approach of using a net median full-time employee benchmark builds two linkages into the rate of the pension:

- ▶ It would pass on to pensioners the full rate of any productivity gains that are reflected in the earnings of employees, less the degree to which some of this is received by government through the tax system.
- ▶ It thus links the pension system into any changes in the income tax system and the income tax experience of the median worker.

Both of these features have positives and negatives:

- ▶ The linking of the pension rate to productivity growth as reflected in full-time earnings would ensure that the pension remains closely linked to changes in living standards. While indexing to a benchmark that is likely to grow less strongly can be argued for, over the longer term it can only result in a widening gap between the wellbeing of those on pensions and others in the community, and therefore pressures for ad hoc increases. As discussed earlier, although a number of overseas countries have moved away from full wage indexation, this is usually associated with a dual valorisation–indexation approach that still maintains an earnings link for the initial setting of the pension rate.

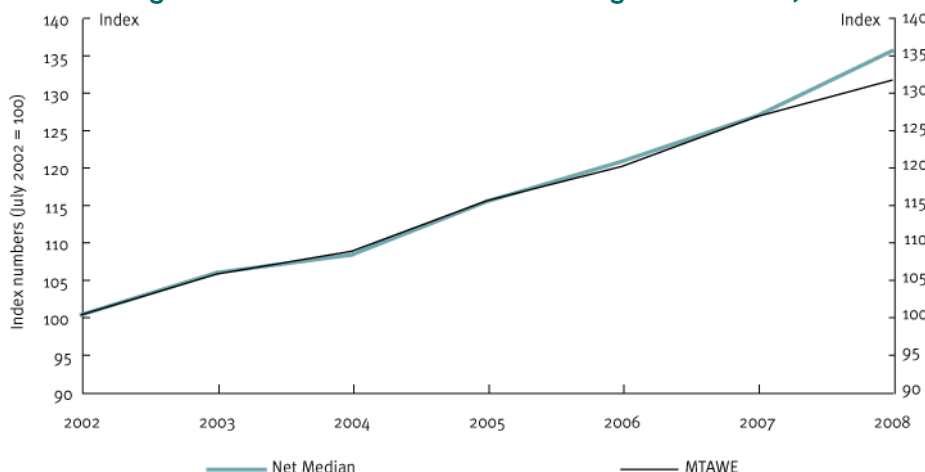
- Linking the pension to the tax system is considered by the Review to be important for long-term sustainability in the context of an ageing population. It means that if tax increases are required to fund higher support for an older population, then pensions will increase more slowly than they would if they were indexed to gross earnings. That is, if current workers have growth in their take-home pay reduced by a higher tax burden, this is reflected in a slower pension growth. This is important for sustainability, is more transparent, and sets the pension against the actual standard of living experienced by the community. An implication of this approach is that decisions on taxation structures and levels would need to consider the impact on pensions. In some cases the nature, or purpose, of the taxation change may appropriately require an adjustment to the benchmark.

In considering benchmarking, the Review was primarily concerned with developing an approach that is conceptually robust and fair, rather than with the specific outcome it would generate relative to other measures. Nevertheless, the question of how this approach would compare with ongoing MTAW indexation is a legitimate one. In large part the answer depends on three factors: the proportion of men working part-time, changes in the earnings distribution, and future income tax rates.

- If the proportion of men employed part-time increased relative to full-time male employment, the benchmark based on full-time earnings would increase more rapidly than MTAW because part-time employment brings down the average earnings in that series.
- If earnings inequality increased, in particular if driven by a continuation of the more rapid growth in high incomes seen over the past decade, then the median measure, all other things being equal, would grow less quickly than MTAW since it is driven by changed earnings in the middle and not the extremes.
- If the income tax burden on ‘middle earners’ increased, then the net median measure, again all other things being equal, would not increase as quickly as a gross measure such as MTAW.

Unfortunately, only a relatively short time series of net median earnings of all full-time employees is available.²⁴ (A longer time series is available for the subset of ‘non-managerial workers’; this was used in Chart 4.) Over the shorter period between 2002 and 2008, as illustrated in Chart 21, the net median measure and MTAW tracked quite closely until the end of the period, when the effect of the tax cuts introduced in July 2008 kicked in.

²⁴ As the data are only available up to 2006, later values have been estimated using trends in full-time earnings from Average Weekly Earnings.

Chart 21 Relative growth in net median full-time earnings and MTAW, 2002–2008

Notes: Index numbers, July 2002=100. Net median calculated as at July each year using interpolated values of earnings in years for which data are not available from the ABS Survey of Employee Earnings and Hours, and projected using FTAOTE for 2007 and 2008. MTAW original for August quarter.

Source: Review modelling using ABS 2007b, 2008b.

The Review recognises that these historical changes are not necessarily indicative of any future change.

A further matter of implementation arises because of the more limited availability of data on median earnings. Unlike MTAW, which is available quarterly, median earnings data are currently available only every two years, but could be available annually. Unless the survey of earnings were undertaken on a rolling basis—with a ‘moving average’ earnings estimate—this would suggest that six-monthly benchmarking would not be possible. To address this, a reasonable approach may be to benchmark annually and to utilise a cost adjustment every six months to maintain the purchasing power of the pension. In a relatively low inflation environment this would not appear to have any material impact on adequacy. It would still place the security of the purchasing power of the pension on a much more robust basis than earnings, where most employees have, at best, an annual adjustment.

5 Payment design and administration

Overview and findings

The way that assistance is delivered and administered makes an important contribution to the financial security and wellbeing of pensioners. As noted in Chapter 2, needlessly complex payment designs and administration have the potential to impose high transaction costs on pensioners, generate poor outcomes for those who are not well placed to manage complexity, make different elements of the system unintentionally work against each other, and have consequences for other systems that interact with the income support system. All of these effects potentially undermine the capacity of the Age Pension, Disability Support Pension and Carer Payment to improve the financial circumstances and security of pensioners.

This chapter examines the current components of the financial assistance that is provided to Age Pension, Carer Payment and Disability Support Pension recipients. It looks at the balance between regular and one-off lump-sum and supplementary payments, and issues raised during the consultation process about the efficacy of lump sums as a way of addressing living costs. The chapter then examines arrangements that could improve flexibility and financial security for pensioners. It also considers ways in which the delivery of assistance could be simplified to reduce complexity for pension recipients and improve program efficiency and effectiveness. These considerations specifically address components of the pension system including the Pharmaceutical Benefits Scheme, Rent Assistance and payments to people of Age Pension age.

The Review has developed a number of findings to improve the financial security and wellbeing of pensioners, to improve the flexibility and to reduce the complexity of the income support system.

Although one-off lump sums may continue to have a role in the income support system, the Review found that they are not a particularly effective way of addressing the adequacy of pension in the long term.

Finding 12: The Review finds that one-off lump-sum payments are not particularly effective mechanisms for addressing the adequacy of the pension because they do not provide ongoing financial certainty for pensioners.

Finding 13: The Review finds that one-off payments may have a role in circumstances where pensioners may not otherwise gain from specific budgetary or economic changes, such as from changes to taxation arrangements, to compensate for policy changes, or where a fiscal stimulus is desired. (Section 5.3.1)

The Review found that there is considerable scope to simplify the current system of supplementary payments, to ensure that it does not undermine the single-couple relativities established in the base pension rates and to introduce additional flexibility into pension payments.

Finding 14: The Review finds that integrating supplementary payments (Pension GST Supplement, Pharmaceutical Allowance, Telephone Allowance and Utilities Allowance) into a single supplementary payment or absorbing them into the base rate of pension would simplify the structure of pensions. Integration with the base rate would maximise simplicity while a separate supplement would provide a platform for introducing flexibility around the frequency of the payment of a component of the total pension package.

Finding 15: The Review finds that, if paid separately, any supplementary payment should be paid to singles and couples in proportion to the rate of the base pension to ensure that the relative value of the pension package is maintained. (Section 5.3.2)

Finding 16: The Review finds that an integrated supplement would be an appropriate vehicle for delivering greater flexibility over the timing of payments and would permit pensioners to structure their receipt of income according to their budgetary priorities.

While caution should be exercised in applying a flexible approach to the base rate of pension an option of weekly payment cycles may be preferred by some pensioners. (Section 5.3.3)

In line with the findings in Chapter 3 on private renters and the analysis in Chapter 4 on fiscal drag, the Review found that there is scope to improve the targeting of Rent Assistance.

Finding 17: The Review finds that there would be merit in restructuring rent thresholds to target Rent Assistance to those who pay higher rents and addressing inequities that have arisen with the sharers rate of Rent Assistance. (Section 5.3.4)

The Review examined the Pension Bonus Scheme and concluded that alternative mechanisms to encourage workforce participation should be explored.

Finding 18: The Review finds that the Pension Bonus Scheme is not a particularly effective means of increasing workforce participation by older Australians and that this goal would be better pursued through the design of the pension means test to ensure that there are appropriate incentives for employment. (Section 5.3.5)

Finally, the Review identified the current situation, where a person above Age Pension age may be eligible for either the Age Pension, Disability Support Pension or Carer Payment, as a needless area of administrative complexity for both individuals and Centrelink that should be reformed.

Finding 19: The Review finds that the current situation where a person above Age Pension age may be eligible for either the Age Pension, Disability Support Pension or Carer Payment is unnecessarily complex, and that the Age Pension should be the appropriate payment for people over Age Pension age. As a first step to achieving this, there should be consistency of treatment across pension payments for those of Age Pension age to remove incentives for payment swapping.

In the longer term, making the Age Pension the payment for people over Age Pension age would focus the Disability Support Pension and Carer Payment on their role as working-age payments, with workforce participation encouraged. (Section 5.3.6)

5.1 Terms of reference

The chapter is primarily concerned with the second and third terms of reference:

- ‘The frequency of payments, including the efficacy of lump sum versus ongoing support’.

The importance of regular fixed payments and one-off lump sums, particularly for those with limited financial resources, is evident from the consultations and submissions to the Review and is the primary focus of this chapter.

- ‘The structure and payment of concessions or other entitlements that would improve the financial circumstances and security of carers and older Australians’.

This chapter will examine the operation of income support entitlements provided in the form of supplementary payments. Chapter 6 deals with the role of concessions and services in relation to this term of reference.

In its considerations, the Review was concerned with the total package of assistance provided: base pension, regular fixed payments, one-off lump sums and supplementary payments. Chart 22 illustrates the scope of the payments under consideration.

5.1.1 Scope of income support payments considered by the Review

The Review's discussion focuses on the Age Pension, Carer Payment and Disability Support Pension. The Review also covers closed (Wife Pension and Widow B Pension) and short-term (Bereavement Allowance) pension payments. These payments are subject to the same means test, rates and indexation arrangements and have generally received similar lump-sum payments as the major pension types covered by the Review.

Chart 22 Income support payment components and structure

PAYMENTS WITHIN THE SCOPE OF THE REVIEW	
<p>Income Support Payments</p> <p>Age Pension Disability Support Pension Carer Payment Bereavement Allowance (a short-term payment) Wife Pension (a 'closed' payment) Widow B Pension (a 'closed' payment) Age Service Pension (a DVA payment) Partner Service Pension (a DVA payment) Invalidity Service Pension (a DVA payment) Income Support Supplement (a DVA payment)</p>	
<p>Major Components of Pension Payments</p> <p>Components that are in all pension payments under review</p> <p>Base rate of pension GST Supplement Pharmaceutical Allowance Utilities Allowance</p> <p>Components that are available depending on circumstance</p> <p>Telephone Allowance Rent Assistance Remote Area Allowance</p>	
<p>Associated Payments</p> <p>Payments that may be received by non-pensioners, depending on circumstance</p> <p>Seniors Concession Allowance Carer Allowance (including Child Disability Assistance Payment) Mobility Allowance</p> <p>Payments that may be received by pensioners, depending on circumstance</p> <p>Payments resulting from the Pension Bonus Scheme Pension Bonus Bereavement Payment</p>	
<p>Irregular Lump Sum Payments</p>	

- Wife Pension is paid to female partners of age pensioners and Disability Support Pension recipients who are not eligible for a pension in their own right. It was closed to new entrants from 1 July 1995.
- Widow B Pension is paid to women above Age Pension age only. It was closed to new entrants from 20 March 1997.
- Bereavement Allowance is paid for a maximum of 14 weeks to a recent widow or widower following the death of their partner.

The Review also covers some income support payments paid through the Department of Veterans' Affairs (DVA). DVA Service Pensions are paid to veterans on the grounds of age or invalidity, and to eligible partners, widows and widowers. DVA Service Pensions are paid at the same maximum rates and subject to the same means-testing arrangements as Age Pension. Income Support Supplement provides additional assistance to War Widow/Widower pensioner recipients who are not in receipt of another income support

payment. Income Support Supplement paid below the ceiling rate (that is, a means-tested rate) is calculated using the same rates and means-testing parameters as DVA Service Pension.

Another area of importance to some pensioners, especially those who have migrated from another country or worked extensively overseas, concerns the interaction between Australian pensions and those in other countries. This was raised in consultations and submissions. To overcome the gaps in social security coverage that may arise and enable countries to share the social security coverage of individuals who move between them, bilateral treaties in the form of International Social Security Agreements operate. Australia currently has 22 agreements that involve payments to just under 50,000 people. These agreements perform an important function in reflecting a person's association with different countries and ensuring these countries share the responsibility for the pensions of these people. The Review supports the continued establishment of such agreements.

Relationship with other payments

While the terms of reference for the Review provide a clear demarcation of the scope of payments under consideration, there are a number of interactions between some policy components of these and other elements of the income support system.

Although also currently paid at the same pension rates and subject to the pension income test, but a different assets test, Parenting Payment Single is out of the scope of the Review. This payment shares many features with other income support payments for parents, such as Parenting Payment Partnered and Newstart Allowance, and is also a part of the wider system of assistance to families which includes Child Care Benefit and Family Tax Benefit. Any change to Parenting Payment Single needs to be carefully considered in the context of the relationship between it and these other working-age payments, as well as the wider system of support for families.

However, it is also important to note that a number of the supplementary payments to Age Pension, Carer Payment and Disability Support Pension recipients are also available to Parenting Payment Single and allowance recipients. This extends to allowees with a partial capacity to work, single principal carers, those aged 60 and over with at least nine months duration on income support and recipients of Partner and Widow Allowance. Hence, while Parenting Payment Single and allowees are not specifically covered in the terms of reference, their receipt of supplementary payments means that impacts on these payments needed to be considered at points by the Review. For example, reforming supplementary payments by integrating Utilities Allowance, Telephone Allowance and Pharmaceutical Allowance, or absorbing these into a base rate of pension, will have an impact on Parenting Payment Single and some allowance recipients.

5.1.2 Lump-sum payments

As discussed in the Background Paper, one-off lump-sum payments have become a feature of the income support system in recent times. These payments have increased the total amount provided to age pensioners, Carer Payment recipients, and more recently disability support pensioners, well above the base rate of payment. Appendix D outlines one-off lump-sum payments provided since 2004–05.

The provision of one-off lump-sum payments has been associated with:

- compensating pensioners for policy changes that affect them, such as the introduction of the GST
- providing a benefit from economic growth to those who would otherwise have had limited opportunities to benefit
- providing an economic stimulus, as with the 2008 Economic Security Strategy.

The consultations confirmed that one-off lump-sum payments have enabled some pensioners to pay for large unexpected costs, or items they may have found it difficult to afford or budget for, such as the replacement of whitegoods or house maintenance. Lump-sum payments are not treated as income for the pension income test, are not considered assessable income for taxation purposes, have not generally been affected by their own separate income test, and are not treated as pension income for the purpose of public housing rent or nursing home charges.

5.1.3 Supplementary payments

In addition to the base rate of pension, a range of supplementary payments is available to pensioners and, in some cases, to holders of the Commonwealth Seniors Health Card on a regular basis.²⁵ These supplementary entitlements are outlined in Appendix C.

Supplementary assistance generally aims to recognise that people in different circumstances have different costs and require different levels of assistance to achieve a similar standard of living. For example, the first supplementary payment, introduced in 1958, was ‘Supplementary Assistance’, a forerunner to the present-day Rent Assistance. The payment provided additional assistance to widowed, aged and invalid pensioners who were single, entirely dependent on the pension as their only source of income and living in rental accommodation (Kewley 1973). The payment was the first instance of the income support system recognising that some pensioners were in situations of greater need than others.

Currently, there are around 16 different supplementary payments available to income support recipients and they range in value from \$6.00 a fortnight for Pharmaceutical Allowance to \$110.20 a fortnight for Rent Assistance. These payments may be paid fortnightly, quarterly or annually, may be taxable or non-taxable, and may or may not be related to the existence of additional costs.

This chapter focuses on Carer Allowance, the Pension GST Supplement, Pharmaceutical Allowance, Telephone Allowance, Utilities Allowance, Seniors Concession Allowance, Rent Assistance and the Pension Bonus Scheme, the most significant supplementary payments in terms of coverage and monetary value.

- Carer Allowance is paid to those who provide daily care and attention to those with a severe disability or medical condition or the frail-aged. The payment is available to a wide group of carers both inside and outside of the pension and broad income support system as it is not income or assets tested.
- The Pension GST Supplement and Pharmaceutical Allowance are paid to all pensioners; Telephone Allowance is paid to those eligible (that is, pensioners with a telephone subscription); and Utilities Allowance is paid to all pensioners with the exception of Parenting Payment Single recipients.
- Those eligible for the Commonwealth Seniors Health Card are able to obtain the Seniors Concession Allowance, and Telephone Allowance provided they are telecommunication subscribers.
- Rent Assistance is a particularly important determinant of living standards for pensioners who pay private rent.
- The Pension Bonus Scheme was designed to promote the financial security of older people by encouraging them to undertake or continue some level of workforce participation.

The remaining supplementary payments are not covered as they are available to select groups of income support recipients for specific purposes, including many allowees, and are therefore considered beyond

²⁵ The Commonwealth Seniors Health Card provides assistance to self-funded retirees of Age Pension age with incomes above the amounts that enable access to a pension. The card recognises that these retirees have provided for their own retirement and do not receive concessions from state and territory governments. Card holders are also able to claim Telephone Allowance and the Seniors Concession Allowance. In December 2008, the Commonwealth Seniors Health Card was held by around 284,300 people.

the scope of this Review. For example, the Remote Area Allowance is a supplementary payment available to income support recipients residing in remote areas of Australia who, because they do not pay tax, or pay very little tax, do not receive the full benefit of the tax zone rebate. The Remote Area Allowance provides a cash alternative to the tax rebate.

Carer Allowance

Carer Allowance is available to carers who provide daily care for a person with a severe disability, medical condition or who is frail aged either at home, or in the home of the person being cared for. The Carer Allowance was introduced in 1999, combining the payments of Child Disability Allowance and Domiciliary Nursing Care Benefit payments.

In contrast to the other payments, it is not income or assets tested and is paid to people on income support and others at the same flat rate. An assessment process operates to ensure specified levels of care are met. Carer Allowance is currently paid at \$105.10 a fortnight. Although a reasonable number of age pensioners, disability support pensioners and Carer Payment recipients are in receipt of Carer Allowance, the supplement has broader coverage including wage earners and others.²⁶

Carer Allowance is a payment made in recognition of the caring role. It is not an income support payment. While it is not intended to cover the costs of caring for someone with a disability, the consultations indicated that Carer Allowance is frequently used to meet the costs associated with the needs of the person being cared for. Given that Carer Allowance has important links to the service delivery system, it is also considered further in Chapter 6.

Pension GST Supplement

The Pension GST Supplement was introduced as part of the 1 July 2000 Tax Reform Package. The Pension GST Supplement is generally treated as part of the base rate of pension and, for this reason, is largely unrecognised as a stand-alone supplement. This lack of transparency may in part explain why a number of pensioners raised the question of the GST in the consultation process, generally claiming they had not been compensated for its introduction.

The Pension GST Supplement is indexed according to movements in the Consumer Price Index at the same time as the basic rate, can be reduced by the application of either the pension income or assets tests and, for taxation purposes, is treated in the same way as the pension with which it is paid. However, because it is paid as a supplementary amount, the Pension GST Supplement is not counted when determining the levels of certain fees and charges, such as Commonwealth-regulated residential aged care fees. The Pension GST Supplement is currently worth \$19.30 a fortnight for a single person and \$16.20 a fortnight for each member of a couple.

Pharmaceutical Allowance

Pharmaceutical Allowance, a payment provided to all pensioners on a fortnightly basis, was introduced in 1990 as part of a major restructure of the Pharmaceutical Benefits Scheme. The restructure resulted in pensioners, who had previously received free pharmaceuticals, paying a certain amount for each prescription. The Pharmaceutical Allowance offsets some of the costs of prescriptions, and the Pharmaceutical Benefits Scheme allows access to free pharmaceuticals once a specific number of

²⁶ At December 2008, there were 443,800 people in receipt of Carer Allowance. This included 85,400 age pensioners, 19,400 disability support pensioners and 120,500 Carer Payment recipients, as well as 136,200 people in receipt of other payments. Although not all Carer Payment recipients also receive Carer Allowance, the development of a single assessment process for these two payments was announced in the 2008–09 Budget. While ensuring concurrent coverage for those on Carer Payment, Carer Allowance will continue to be a payment available across the population as a whole.

prescription items have been reached in a calendar year (currently 60 items). Pharmaceutical Allowance is not paid to Commonwealth Seniors Health Card holders, although these people do have access to subsidised pharmaceuticals through the Pharmaceutical Benefits Scheme. The supplement provides \$6.00 a fortnight and is paid at a half rate to each member of a couple. In some cases, allowance recipients are also able to obtain the supplement.

Telephone Allowance

Telephone Allowance was introduced in 1992 as a quarterly payment for telephone subscribers²⁷ to replace the previous administratively cumbersome system of telephone rental concession vouchers. Provided the requirement of a telephone subscription is met, the supplement is available to all pensioners, selected allowance recipients and those eligible for the Commonwealth Seniors Health Card. The allowance provides \$23.00 a quarter and is paid at a half rate to each member of a couple. A higher rate of \$34.60 a quarter is available for those who subscribe to a home internet service.

Utilities Allowance and Seniors Concession Allowance

Utilities Allowance was introduced in 2005 as a biannual payment acknowledging that some older income support recipients may have difficulty in saving to meet their utility bills. The coverage of Utilities Allowance has broadened and it is now available to other income support recipients younger than Age Pension age and is paid on a quarterly basis.²⁸ Utilities Allowance provides \$128.50 a quarter and is paid at a half rate to each member of a couple.

A payment similar to the Utilities Allowance, the Seniors Concession Allowance, is available to those eligible for the Commonwealth Seniors Health Card. The Seniors Concession Allowance is paid quarterly at the same rate as the Utilities Allowance, but at a full rate to each Commonwealth Seniors Health Card holder regardless of their relationship status.

Rent Assistance

Rent Assistance is an important element of supplementary payments in the income support system, being of the highest value, but in contrast to the other components it is relatively highly targeted.

Rent Assistance is available once private rent reaches a certain amount each fortnight (rent threshold). The payment then provides assistance at the rate of 75 cents for each dollar of rent above the rent threshold, until the maximum rate of Rent Assistance is received. Table 4 indicates the amount of the rent threshold, the maximum payment of Rent Assistance and the level of rent at which the maximum payment of Rent Assistance is reached (rent ceiling).

²⁷ A telephone subscriber also includes a person who is a subscriber to a mobile phone service in Australia.

²⁸ Utilities Allowance is available to recipients of Disability Support Pension, Carer Payment, Partner Allowance, Widow Allowance, Widow B Pension, Wife Pension and Bereavement Allowance.

Table 4 Rent Assistance, 1 January 2009

Household arrangement	Maximum amount of Rent Assistance (\$ a fortnight)	Rent threshold (\$ a fortnight)	Rent ceiling (\$ a fortnight)
Single	110.20	98.00	244.93
Sharer (each)	73.47	98.00	195.96
Couple (combined)	103.80	159.60	298.00

Notes: Higher amounts are available for families with children. Sharer rate does not apply to Disability Support Pension or Carer Payment.

At December 2008, Rent Assistance was received by around 11 per cent of age pensioners, 20 per cent of disability support pensioners and 21 per cent of Carer Payment recipients.

Pension Bonus Scheme

The Pension Bonus Scheme commenced on 1 July 1998 as a means to encourage older Australians who reach Age Pension age to remain in employment if they wished to do so. The scheme provides for the payment of a lump sum to people who would otherwise qualify for the Age Pension but delay claiming while they, or their partner, remain in employment. Under the scheme people are required to work at least 960 hours each year. The tax-free lump-sum bonus payment is made when the person eventually stops working and begins receiving the Age Pension. The amount of the pension bonus is based on the period of time a person deferred their receipt of Age Pension and the amount of Age Pension that is eventually received.

5.2 What the consultations told us

Many different aspects of payment structures were raised in the consultation process. While views varied, there was a general preference for regular fortnightly payments, although many made reference to the value of lump-sum payments in meeting irregular or unexpected expenses. There was also support for introducing more flexibility into the system to allow people to choose the frequency of payments.

The most frequently raised issues in relation to supplementary payments related to requests for increases to Pharmaceutical Allowance and Rent Assistance, although there was a general call in much of the feedback for all supplementary payments to be increased to meet increases in actual costs.

5.2.1 Consultations—frequency of payments

On balance, submissions and participants at the public forums showed a general preference to continue with current fortnightly payments (for day-to-day expenses) complemented by additional quarterly utility payments and an annual lump-sum bonus to assist with larger, more infrequent expenses, but this was far from unanimous.

Some submissions argued against the current payment structure suggesting that it is patronising and implies that pensioners are poor money managers who require this type of arrangement to ensure that they spend their pensions appropriately. Reflecting this, and a diversity of other views, some participants suggested that technological advances mean that government should be able to deliver payments in flexible ways that would allow pensioners to choose their own frequency of payment.

A range of more specific issues were considered by focus group participants, and while again a diverse set of responses was obtained, the overall perspective was that the frequency of payment had little impact on their standard of living. Many participants had come from paid employment where they received fortnightly

payments. Some could see benefits in weekly payments as this might make budgeting easier, while others thought this might cost more to deliver (with the implication that this would reduce funds available for payments). The idea of a monthly payment was generally rejected; most agreed that it would complicate their budgeting arrangements, or provide the conditions for getting into difficulty for those who spent their payment all at once.

5.2.2 Consultations—supplementary payments

A central theme in consultations on supplementary payments was a view that these payments were insufficient for the actual cost of the items to which they relate. This is not surprising given that the payments were generally not designed to meet fully the specific cost (such as rent or utilities) but rather as a supplement to the base rate of pension.

Many submissions from organisations called for increases to the full range of supplementary payments, including Rent Assistance, Pharmaceutical Allowance, Utilities Allowance and Telephone Allowance. The most common proposals in written submissions from individuals were for increases in Pharmaceutical Allowance, to reflect the costs of those needing multiple medications (this is discussed further in Chapter 6); and in Rent Assistance, to address increasing housing costs.

5.2.3 Consultations—lump-sum payments and future payment options

Many pensioners indicated that one-off lump-sum payments were more useful than their fortnightly income for large, one-off costs that they found difficult to cover, such as repaying accrued debts, performing essential maintenance on their car or home, visiting the dentist, replacing an essential household appliance, visiting relatives, or simply spending on other basic needs such as food, clothing or utility bills.

Pensioners were divided over whether lump-sum payments should be paid regularly or rolled into the base rate of the pension. Among written submissions some 7 per cent of all individuals supported maintaining lump-sum payments, with a further 3 per cent wanting any additional increases to be paid as lump sums. This sentiment was somewhat stronger among organisations, with nearly 18 per cent of submissions supporting lump-sum payments and 8 per cent of submissions indicating they wanted any increases paid as lump sums. In the forums, many participants argued strongly against rolling the lump-sum bonus into the base rate of pension, fearing the value of the bonus would be reduced by increases in charges, such as public housing rents or nursing home fees, that are directly linked with the pension rate.

In contrast, 2 per cent of written submissions from individuals and 6 per cent of organisations argued for lump-sum payments to be rolled into fortnightly pension payments. Some participants in public forums argued that the provision of lump-sum payments on a regular basis was an indication that the government acknowledges that the pension on its own is insufficient. Others pointed out that pensioners currently receive the same level of lump-sum payment irrespective of any other income received or assets owned. These people suggested that the bonus might be better used to increase the base pension for those in greatest need.

When asked how they would like to receive any additional money, in the event that extra support could be made available, half of the participants in focus groups indicated a preference for an increase in the base rate of pension, while just over one-quarter indicated a preference for any additional money to be paid as a lump sum.

For those who preferred a lump-sum increase, the danger of it being ‘frittered away’ was balanced by the opportunity to create a buffer in case of unexpected expenses. The lack of funds to fall back on in difficult times contributed to a fear of the future, and was a source of insecurity for many participants.

There were calls for more flexibility in payment provisions. Submissions from organisations proposed allowing pensioners to have a choice in whether to receive supplements as an addition to their fortnightly

base rate of pension or as occasional lump sums. In focus groups, some participants could see merit in their payments being structured around their specific needs. This included accumulating a portion of payment for release at specific times of the year, for example, to coincide with large bills, such as council rates, or times of high expense, like Christmas.

A number of submissions and participants in public forums also discussed the need to address inequity in eligibility for lump-sum payments (before the announcement of the government's Economic Security Strategy in October 2008, Disability Support Pension recipients, unlike Carer Payment and Age Pension recipients, had not received one-off lump-sum payments).

5.3 Reform directions

The analysis of the Review and the balance of views expressed in the submissions indicate that reforms to one-off lump-sum payments, the frequency of payments, and supplementary amounts are warranted.

5.3.1 One-off lump-sum payments

The consultations showed that, for some, one-off lump-sum payments are operating as financial buffers to meet large fixed costs that for a range of reasons pensioners would otherwise find it more difficult to meet from fortnightly pension payments. It is, however, unclear to what extent this relates to the question of the adequacy of the base rate of pension excluding the value of the supplements or issues of budgeting for unexpected and 'lumpy' expenditures from a fixed income.

The experience of the Department of Families, Housing, Community Services and Indigenous Affairs in administering these one-off payments shows that many people are not satisfied with the administrative process. The simple administrative mechanisms by which one-off lump-sum payments are provided have given rise to a number of issues. For example, because eligibility is determined at a point in time, some people will not receive a one-off payment if they have lost their eligibility for the pension or the Commonwealth Seniors Health Card just before the 'test day'.

The administrative arrangements for the payment of lump sums also mean that eligibility is generally tied to simple indicators, such as the type of pension or payment type received. For instance, around 85,500 age pensioners are in receipt of Carer Allowance as they care for a person with a disability, generally their partner. However, those receiving Carer Payment received a \$1,000 lump sum, compared with the \$500 lump sum received by age pensioners. Differentiating between the amounts of one-off lump sums on the basis of pension type can therefore have the unintended consequence of introducing incentives to access particular payment types.

However, it should be noted that the December 2008 Economic Security Strategy payments provided a level of assistance to pensioners based on relationship status (that is, single versus partnered amounts were paid), with additional assistance provided to carers through a bonus to Carer Allowance recipients.

The lump-sum payments that were a part of the Economic Security Strategy also provided payments to disability support pensioners for the first time. Among those pensioner groups that are part of this Review, disability support pensioners have generally been ineligible to receive the one-off lump-sum payments. Many communicated their dissatisfaction about this in the consultation process.

As discussed in Chapter 3, the Review considers that a common rate should be applied across the pensions under consideration. The Review notes that disability support pensioners share many of the characteristics of age pensioners and Carer Payment recipients that made a one-off lump-sum payment

appropriate. The Review also notes that within the pensioner group, disability support pensioners are the most frequent users of advance payments²⁹, suggesting that they experience particular financial pressure issues. Over the 12-month period of April 2007 to April 2008, advance payments were made to 32.3 per cent of disability support pensioners, compared to 5.4 per cent of age pensioners.

One-off payments may continue to have a role in the social security system, operating to:

- ▶ compensate recipients for policy changes (for example, the Aged Persons Savings Bonus of July 2000 was part of a compensation package for older Australians affected by the introduction of the GST)
- ▶ enable those assumed to have a limited opportunity to participate in the labour market to benefit from budget surpluses
- ▶ provide a fiscal stimulus.

However, the Review considers that one-off lump-sum payments are a poor way of improving the adequacy of basic income support payments, primarily because they are ad hoc and cannot deliver certainty. During the consultations some participants suggested that providing a one-off lump-sum payment confirmed that the pension on its own is insufficient. Moreover:

- ▶ For many, adequacy is about ensuring that finances are available to meet the ongoing costs of day-to-day living, including the large fixed costs that occur from time to time.
- ▶ If recourse to one-off lump sums has become widespread practice for those who find it difficult to meet large fixed costs, the lack of certainty over one-off bonuses means that a reliance on one-off lump sums may undermine other financial strategies for generating the amount required.

Therefore, while it is clear that one-off payments could continue to have a role, they are a poor way of addressing the adequacy of pension payments. The Review considers that reforms to address adequacy need to be designed and administered in a way that gives recipients of the Age Pension, Disability Support Pension and Carer Payment certainty over their total payments.

Finding 12: The Review finds that one-off lump-sum payments are not particularly effective mechanisms for addressing the adequacy of the pension because they do not provide ongoing financial certainty for pensioners.

Finding 13: The Review finds that one-off payments may have a role in circumstances where pensioners may not otherwise gain from specific budgetary or economic changes, such as from changes to taxation arrangements, to compensate for policy changes, or where a fiscal stimulus is desired.

5.3.2 Simplification of Pension GST Supplement, Pharmaceutical Allowance, Telephone Allowance and Utilities Allowance

While supplementary payments are intended to recognise that people in different circumstances have different needs and associated costs, over time the distinctions between the Pension GST Supplement, Pharmaceutical Allowance, Telephone Allowance and Utilities Allowance have become blurred as there is little to connect the payments to their original purpose. For example, the payments are commonly provided to pensioners universally despite individual cost differences and there is no restriction attached to their use. For all of the payments, the amounts provided are only a partial contribution to the costs. As indicated above, this aspect of the payments was rarely acknowledged in the consultation process. Instead, most

²⁹ An 'advance payment' is an amount of up to \$500 of a person's income support payment that can be requested as an advance, and then paid back through a reduced pension rate over the next 13 fortnights.

pensioners considered that, since the supplements appeared to be specific to a particular type of expenditure, they should be adequate for the expenditure as a whole.

These features of the payments may largely account for the responses during the consultations, which expressed annoyance at the level of assistance provided by the individual supplementary payments. Two examples are summarised below.

- ▶ The rate of the Pharmaceutical Allowance attracted some criticism for being out of step with the costs of pharmaceuticals. This has arisen through a combination of the low rate of the payment, its current disconnection from the level of the co-contribution payment for medicines (now \$5.30 for each script), the number of 'free' scripts in a year, the operation of the Pharmaceutical Benefits Scheme safety net and the indexation method requiring increases to be a multiple of 10 cents. Prior to the increase that took place on 1 January 2009, the last indexation increase had occurred in January 2001.
- ▶ As most pensioners have a telephone, the Telephone Allowance has effectively become almost a universal payment—it is received by 89 per cent of pensioners. Relative to telephone costs, the level of the higher rate of payment, \$5.32 a fortnight, is relatively small and it is difficult to see the justification for the administrative complexity involved in the payment.

Supplementary payments are also inconsistent in the treatment of singles and couples. For example, for Pharmaceutical Allowance, Telephone Allowance and Utilities Allowance, each member of a couple receives half the amount a single person receives. However, in the case of the Seniors Concession Allowance, which is paid to holders of a Commonwealth Seniors Health Card at the same rate as the Utilities Allowance (\$128.50 a quarter), no distinction is made between singles and couples. Each eligible person receives the full amount of the Seniors Concession Allowance.

This inconsistent treatment can reflect the differing purposes of payments. For example, the Seniors Concession Allowance was introduced to recognise that Commonwealth Seniors Health Card holders could not access the same level of concessions available to Pensioner Concession Card holders and it was administratively simpler to pay each Commonwealth Seniors Health Card holder the same rate. The half rate of Pharmaceutical Allowance paid to members of a couple is compensated for in the operation of the Pharmaceutical Benefits Scheme safety net, which ensures that once 60 eligible medicines are purchased in a calendar year, all further eligible prescriptions in that year are obtained free. In the case of couples, the prescriptions of both partners count towards this threshold.

Nevertheless, the different relativities between singles and couples in the payment of supplementary amounts can mean that these payments inadvertently work against the single–couple relativities established in the base rate of pension payments, which are in turn based on total household expenditure, including specific aspects associated with supplementary payments. While the rationale of Telephone Allowance and Utilities Allowance rates is based on the premise that couples can share their living costs and achieve some economies of scale, a common argument is that a couple's telephone and utilities costs are still greater than a single person's costs.

Supplementary payments have been provided separately to the base rate of pension as a result of both the history behind the individual types of assistance and previous delivery mechanisms, such as changes to the Pharmaceutical Benefits Scheme resulting in pensioners having to purchase their pharmaceuticals in lieu of cash. However, the fact that these supplementary payments are nearly universal and only provide part compensation suggests that the base rate of pension may be a better support for a person's basic costs of living than specific part payments like the Pension GST Supplement, Pharmaceutical Allowance, Telephone Allowance and Utilities Allowance.

Integrating the Pension GST Supplement, Pharmaceutical Allowance, Telephone Allowance and Utilities Allowance into a single supplementary payment, or absorbing some or all of these into the base rate, would go some way towards simplifying the system of payments and resolving specific issues. For example, as with the payment of lump sums, some supplementary payments, such as the quarterly

payments of Telephone Allowance and Utilities Allowance, are based on eligibility on a specific 'test day'. If a person loses eligibility on the day before the test day, they will not receive any amount of the supplement, despite the previous payment being provided almost three months earlier. Providing a single integrated supplement, or absorbing these payments into the base rate of pension, could set eligibility on the same basis as that applying to pensions. That is, if a person's pension payment was cancelled part-way through a fortnight, a proportional amount of income support would be provided for that period. The integration of these supplements would also facilitate any move towards improving the flexibility of the frequency of payments discussed in Section 5.3.3.

It should be noted that the option of absorbing supplementary payments into the base rate of pension raises a number of issues:

- An increase in the base rate of pension results in a higher level of income or assets that reduces the amount of pension to nil, thereby broadening access to the pension.
- There are taxation implications that need to be considered. While Pharmaceutical Allowance, Telephone Allowance and Utilities Allowance are not taxable, the Pension GST Supplement is treated in the same way as the base pension for taxation purposes.

However, either option for the integration of the Pension GST Supplement, Pharmaceutical Allowance, Telephone Allowance and Utilities Allowance would reduce the level of unnecessary complexity in the pension system.

Finding 14: The Review finds that integrating supplementary payments (Pension GST Supplement, Pharmaceutical Allowance, Telephone Allowance and Utilities Allowance) into a single supplementary payment or absorbing them into the base rate of pension would simplify the structure of pensions. Integration with the base rate would maximise simplicity while a separate supplement would provide a platform for introducing flexibility around the frequency of the payment of a component of the total pension package.

Finding 15: The Review finds that, if paid separately, any supplementary payment should be paid to singles and couples in proportion to the rate of the base pension to ensure that the relative value of the pension package is maintained.

5.3.3 Frequency of payments

One of the rationales for quarterly payments such as Telephone Allowance and Utilities Allowance is that these charges were historically based on quarterly billing cycles. However, quarterly billing cycles are now less common and rarely coincide with the payment cycle of the allowances. Customers can also choose alternative payment arrangements such as credit card billing or direct deductions from bank accounts.

The consultations indicated that many pensioners would much prefer a flexible approach that enables them to choose, and modify over time, the cycle of their payment arrangements. One approach to reform in this area would be to combine a number of the existing supplementary payments and provide pensioners with a choice over the timing of their receipt of this support.

- If quarterly payments of Telephone Allowance and Utilities Allowance are combined into a fortnightly payment, together with the current fortnightly supplements of Pharmaceutical Allowance and Pension GST Supplement, an amount of \$50.39 would be available each fortnight for a single person. This is equivalent to a quarterly payment of \$327.55 or an annual payment of \$1,310.20.
- A payment system that provides flexibility in the frequency of payments could provide pensioners with access to their pension and supplementary payments at a time of their own choosing.

While many of the written submissions were highly supportive of pensioners determining the frequency of their own payments, arguing that pensioners are very adept at managing their household budgets, for some, the merits of a reliable, regular payment in responding to the overall financial security of pensioners should not be underestimated. For this reason, extending any options around frequency of payments to the base rate of pension should be approached cautiously. These considerations mean that on balance an integrated supplement would be a better vehicle for delivering payment flexibility than the base rate of the pension. However, the Review notes as well that the option of weekly payment cycles may be of assistance to some pensioners. Weekly payment cycles are provided in some cases in the income support system to enable recipients who have difficulty budgeting to be able to manage their finances more effectively.

Finding 16: The Review finds that an integrated supplement would be an appropriate vehicle for delivering greater flexibility over the timing of payments and would permit pensioners to structure their receipt of income according to their budgetary priorities.

While caution should be exercised in applying a flexible approach to the base rate of pension an option of weekly payment cycles may be preferred by some pensioners.

The Review also notes that financial management counselling, financial information services and services that assist with the management of finances such as Centrepay, have an important role to play in assisting pensioners to manage their financial commitments.

5.3.4 Rent Assistance

Chapter 3, in considering the adequacy of the pension, found that pensioners who were renting privately experience particularly poor outcomes. It found that an immediate response to improve the circumstances of pensioners who rent privately could be achieved through an increase in Rent Assistance. Chapter 4 noted that the change in costs in private rents was not well reflected in the Consumer Price Index. This section considers some of the more detailed aspects of the structure of this payment.

The basic elements that determine the amount of Rent Assistance a person receives include:

- a threshold amount of rent that is required to be paid before a person is entitled to receive Rent Assistance
- a co-contribution rate that provides an entitlement to Rent Assistance of 75 cents for each dollar of rent above the rent threshold
- the maximum payment rate for Rent Assistance, which varies depending on circumstances.

As shown in Table 3 in Chapter 4, the value of the Rent Assistance threshold (the amount of private rent paid before Rent Assistance is available) has fallen as a proportion of the base rate of pension. This decline is even more marked when the whole package of assistance to pensioners is considered. A consequence of this is that some Rent Assistance is provided to pensioners who have relatively modest levels of rent, and the maximum rate of Rent Assistance is paid to households with both very high and medium rental costs.

This ‘fiscal drag’ effect on the targeting of Rent Assistance is exacerbated because, as highlighted in Chapter 4, rents have increased more quickly than the Consumer Price Index.

An increase in the threshold point for payment of Rent Assistance would remove access to Rent Assistance for those who pay low rent, allow for an increase in the rate for those with the highest housing costs, and thereby improve the targeting of the payment.

In addition, a more common approach across pensions would require consideration of the sharers rate of Rent Assistance that applies to the Age Pension but not to the Disability Support Pension or Carer Payment.

Also, because Rent Assistance is paid to other income support and eligible Family Tax Benefit Part A recipients, consideration needs to be given to the implications of any change in the arrangements for these groups.

Finding 17: The Review finds that there would be merit in restructuring rent thresholds to target Rent Assistance to those who pay higher rents and addressing inequities that have arisen with the sharers rate of Rent Assistance.

5.3.5 Pension Bonus Scheme

The Pension Bonus Scheme was developed to provide support to those older Australians who, while eligible for the Age Pension, wish to defer their retirement. It was meant to encourage pensioners to undertake or continue some level of workforce participation where they have a desire, capacity and opportunity to do so. The scheme provides a one-off tax-free lump-sum payment to those who would otherwise qualify, but defer claiming the Age Pension and remain working for at least 960 hours a year. The amount of the pension bonus is based on the length of time a person deferred their receipt of Age Pension and the amount of Age Pension that is eventually received.

However, the Review considers that in practice the program has been less successful than anticipated in achieving its objectives, and that the goal of improving labour market participation by older, pension eligible, Australians can be done more efficiently, effectively and equitably by alternative approaches. Of particular note in the analysis were the complexity of the program and the extent to which changes in other aspects of the retirement income system have very much diminished the potential role of the program.

As with Carer Allowance, the Pension Bonus Scheme is not essentially income support. The focus of the Pension Bonus Scheme on voluntary deferral of pension receipt is also a very limited focus for supporting higher levels of participation, in that it establishes an ‘either-or’ contrast between employment and retirement which is increasingly at odds with a focus on transitions into retirement which seek to establish a pathway between these two status.

Administrative data from 1999–2000 to 2006–07 show that of those who received a pension bonus payment, time spent in the scheme was fairly evenly distributed between one and five years. This suggests that working beyond Age Pension age is often of relatively short duration and other factors (other than the bonus amount) influence individuals’ decisions to work beyond Age Pension age. This is consistent with anecdotal reports that suggest that to a large degree the bonus is flowing to individuals who would have continued employment (and not claimed the pension) even in its absence, with the bonus coming as a windfall gain rather than working as an incentive.

Because of the objectives of the program and the need to balance a range of different and often unknown future patterns of participation and to establish theoretical eligibility, the program has complex rules. These make it difficult for people to understand the program, and in particular to make a decision as to whether or not they would be better off using the program or simply receiving a part-rate pension. The rate of payment varies because of numerous factors, such as the length of time in the scheme, including whether or not this was for part- or full-year periods, the single or partnered status of the person over the accrual period and when they claim, and the amount of the Age Pension when it is eventually received.

Aspects of the program may also inadvertently penalise people. Some older workers miss out on being eligible for the program because they simply continued to support themselves in employment after reaching the Age Pension age and hence never pre-registered for the bonus. In other cases the requirement that a person not claim income support creates difficulties for a person on the program who may experience a short period of unemployment or reduced employment.

Other factors that have affected the program have been the introduction of a range of generous tax offsets for older people,³⁰ which have significantly improved returns from work for seniors, reducing the need for a policy lever like the Pension Bonus Scheme to encourage workforce participation.

Changes to superannuation have improved work incentives for older people. The superannuation changes introduced in 2007 mean that superannuation from a taxed sourced is tax-free for people over 60 years. Eligible people now pay lower tax on any income from employment, and retain more of their superannuation payments. Further workforce incentives are provided through the 'Transition to Retirement' measure, which allows people who have reached their superannuation preservation age to access superannuation savings as a non-commutable income stream while continuing to work.

Modelling by the Review has highlighted the impact of these changes, and the complex interactions that a person needs to know to determine whether or not they are better off by applying for the Pension Bonus Scheme or simply moving onto a pension. This can be seen, for example, in the case of a single person who wishes to continue working part-time in a job with earnings of \$14,138 a year (around half the 2008 federal minimum wage). If this person registers for the Pension Bonus Scheme and defers the Age Pension for five years, on claiming the pension, they would receive the maximum Age Pension, along with a lump-sum pension bonus of \$34,344.30 (the maximum amount of pension bonus for five years' deferral by a single person). However, if this person had chosen to claim Age Pension while continuing to work, a part-rate pension and employment income of around \$25,341 each year would have been payable—a total of \$121,833 over five years. That is the person would be \$22,422 better off by claiming the Age Pension while working instead of registering for the Pension Bonus Scheme.

Because of these interactions, those who may benefit from the Pension Bonus Scheme are a small group who have sufficiently high income from employment that would either disqualify them for any pension during the deferral period or return only a small amount of pension, but have low levels of other income and assets when they exit the scheme (thereby qualifying for a high bonus payment).

Taking these factors into account, the Review considers that the Pension Bonus Scheme is a cumbersome and inefficient mechanism to achieve higher levels of workforce participation. It is a program that was developed in a different program and retirement income environment and is no longer effectively serving the role it was established for. Chapter 7 discusses alternative approaches to supporting workforce participation by older Australians, including the important question of incentives and the operation of the means test.

Finding 18: The Review finds that the Pension Bonus Scheme is not a particularly effective means of increasing workforce participation by older Australians and that this goal would be better pursued through the design of the pension means test to ensure that there are appropriate incentives for employment.

³⁰ Tax offsets include:

- . the Mature Age Worker's Tax Offset is aimed at encouraging older workers to remain working or rejoin the workforce. The offset is available to workers aged 55 years and over who have net income from working of less than \$63,000. The maximum offset in 2007-08 was \$500.
- . the Senior Australians' Tax Offset, when combined with the low income tax offset, ensured that eligible single older Australians could have income up to \$25,867 in 2007-08 without paying income tax or the Medicare levy.
- . the Low Income Tax Offset, is designed to reduce the tax paid by Australian low and middle –income earners. In 2007-08 the maximum value was \$750.
- . the Pensioner Tax Offset is available to taxpayers who are not entitled to the senior Australians tax offset and who receive certain pension payments. The effect of the offset is to ensure that no tax is paid by a person whose assessable income consists of the full pension and, in some cases, a small amount of non-pension income. In 2007-08 the maximum Tax Offset was \$2,129 for those with net income below \$20,194.

5.3.6 A common 'Age Pension'

Currently there are some 13,800 disability support pensioners and 12,300 Carer Payment recipients above Age Pension age. There are a number of differences in the entitlements between these payments and the Age Pension. While in some cases a person of Age Pension age is on these payments as a result of not being residually qualified for the Age Pension but eligible for one of these other pensions, in other cases it is a matter of choice. For example, a person who is already on Disability Support Pension when they reach Age Pension age is eligible to continue on that payment, and age pensioners are permitted to apply for Carer Payment. In contrast to these choices, a person who has reached Age Pension age is ineligible to apply for Disability Support Pension even if they otherwise meet the criteria.

Current differences between these pensioners include:

- ▶ The 'sharers rate' of Rent Assistance does not apply to Disability Support Pension and Carer Payment compared with the Age Pension.
- ▶ More generous lump sum bonus payments have been provided to Carer Payment recipients compared with age pensioners.
- ▶ Unlike Age Pension and Disability Support Pension recipients, Carer Payment recipients are entitled to a bereavement payment in cases where the person being cared for was not their partner.
- ▶ Age Pension is generally paid for the entire period of an overseas absence subject to proportional portability rules, while Disability Support Pension and Carer Payment are not.
- ▶ The higher rate of Mobility Allowance, a payment that assists with transport costs for people with disability, ceases to be available if a disability support pensioner transfers to Age Pension.
- ▶ The Pensioner Education Supplement, providing up to an extra \$62.40 a fortnight for approved students, is available for disability support pensioners and Carer Payment recipients, but not age pensioners. Those receiving Pensioner Education Supplement are also eligible for the Education Entry Payment, an amount of \$208 paid each 12 months.
- ▶ Disability support pensioners who are 'saved' Incentive Allowance recipients may also continue to receive additional support from this program while they remain on the Disability Support Pension.³¹

In considering the appropriateness of the maintenance of these three pension types for people over Age Pension age the Review identified three specific concerns:

- ▶ the extent to which this arrangement imposes unnecessary complexity on the administration of the pension system and the decision making of individuals
- ▶ inequities in the treatment of different pensioners in similar situations depending on which particular pension they are on
- ▶ the potential of these arrangements to obscure the focus of Carer Payment and Disability Support Pension on a person's capacity for labour market participation.

³¹ Incentive Allowance was 'closed' in November 1991, when Disability Support Pension was introduced. The allowance remains payable at the rate applicable in 1991 to those who qualified for the disability payment at that time. The rates are \$62.00 a fortnight for recipients without dependants, \$72.40 a fortnight for recipients with one or two dependent children and \$82.70 a fortnight for recipients with three or more dependent children.

Complexity

The provisions of the three payments vary. A person who is eligible for two or more of these payments must make a decision on which payment is the most beneficial for them. This complexity imposes transaction costs on individuals and increased administrative costs on Centrelink when implementing assessment and review criteria. While the assessment for the Age Pension is simply based on age, assessment for the Disability Support Pension and for Carer Payment involves consideration of eligibility based on labour force capacity. The additional costs do not appear warranted for people who are simply already identified as eligible for a pension based on their age.

Equity concerns

There are associated risks of inequitable treatment of pensioners. These arrangements can produce less favourable treatment for those whose circumstances change or who are not aware of the benefits offered by another payment for which they may be eligible. Similarly, a pensioner who is not willing to deal with the complexities of seeking to establish eligibility for another payment may be disadvantaged relative to one who is more willing to deal with these issues.

Very clearly the different conditions of the payments will result in pensioners in the same position being treated differently; for example:

- ▶ A person caring for someone other than their partner is eligible for a bereavement payment if they happen to be on Carer Payment, but not if they are on an Age Pension.
- ▶ An aged disability support pensioner who travels overseas may have their payment suspended in circumstances where an age pensioner would not.

While the current arrangements offer ‘choice’, such choice is limited once a pensioner has passed Age Pension age. For example, while a pre-existing disability support pensioner can choose to continue on this payment past Age Pension age, an age pensioner who develops the same disability—but does so once they are past Age Pension age, or did so while they were on Carer Payment prior to taking up the Age Pension but at that time did not move onto Disability Support Pension—no longer has the choice to move onto Disability Support Pension. That is, the relative treatment of these pensioners is less dependent on their current circumstances than on the pathway by which they entered the pension system.

Participation objectives

The clear demarcation between the Age Pension and the Carer Payment and Disability Support Pension relates to the fact that the latter two payments are contingent on the person continuing to be unable to support themselves in the labour market due to their disability or caring responsibilities. This is reflected in the specific provisions and criteria of the Disability Support Pension and Carer Payment:

- ▶ Disability Support Pension is targeted to people with a physical, intellectual or psychiatric impairment that prevents them from working for at least 15 hours a week in the next two years.
- ▶ Carer Payment targets those with caring responsibilities that prevent them from engaging in substantial workforce participation.

While the circumstances of many recipients of these payments are unlikely to change, labour force capacity needs to be tested regularly to ensure that where a change occurs the person does not inappropriately remain on the payment and is provided with incentives and support to enable them to enter or re-enter employment. This is a reasonable administrative overhead for those of workforce age, but not for those over Age Pension age.

The different approaches of these payments to workforce participation is also seen in the mechanisms they use to support this. In common with the other working age payments, recipients of Disability Support Pension and Carer Payment are eligible for ‘working credits’ which allow them to more effectively benefit from undertaking irregular employment and build up such credits to assist in a transition into employment. In contrast the focus of the Pension Bonus Scheme is on voluntary deferral of a potential entitlement.

Summary

The current situation where a person above Age Pension age may be eligible for either the Age Pension, Disability Support Pension or Carer Payment, appears to have little merit.

It introduces additional administrative complexity both for individuals and Centrelink, and can result in people in similar situations being treated differently depending on which pension they are on.

Of most concern to the Review is that, because they encompass a population both above and below Age Pension age, there is a risk that focus of the Disability Support Pension and Carer Payment on labour market participation is obscured.

Finding 19: The Review finds that the current situation where a person above Age Pension age may be eligible for either the Age Pension, Disability Support Pension or Carer Payment is unnecessarily complex, and that the Age Pension should be the appropriate payment for people over Age Pension age. As a first step to achieving this, there should be consistency of treatment across pension payments for those of Age Pension age to remove incentives for payment swapping.

In the longer term, making the Age Pension the payment for people over Age Pension age would focus the Disability Support Pension and Carer Payment on their role as working-age payments, with workforce participation encouraged.

5.3.7 Grandfathering

The final source of complexity in the pension system considered by the Review is the ‘grandfathering’ or ‘savings’ provisions that are sometimes introduced to preserve the entitlements of existing recipients when policy settings are changed.

The main grandfathering arrangements in the current system include the ‘closing’ of payments to new entrants as an alternative to abolishing payments and the application of new eligibility rules to new entrants only, with existing customers retaining entitlement based on previous eligibility rules.

There are a number of grandfathered payments in the current income support system.

- ▶ The closure of Wife Pension to new entrants from 1 July 1995 required new entrants to claim another pension or an allowance payment from that date. The payment will potentially remain available until 2042 when the youngest recipient reaches Age Pension age.
- ▶ The closure of Partner Allowance to new entrants from 20 September 2003 required new entrants to claim the activity-tested Newstart Allowance from that date. As recipients of Partner Allowance can transfer to Age Pension on reaching qualifying age, the payment will potentially need to remain available until 2020 when the youngest reaches Age Pension age.
- ▶ Disability Support Pension and Parenting Payment Single recipients were grandfathered as part of the July 2006 Welfare to Work changes. Entrants unable to meet the new qualifications for these payments are required to claim Newstart Allowance. The disparity between the grandfathered and partial capacity Newstart Allowance recipients will potentially exist until 2055, when a 16-year-old Disability Support Pension recipient at 30 June 2006 reaches Age Pension age.

There are clear grounds for limiting the adverse consequences of program changes on individuals, especially where they may be poorly placed to change their behaviour (such as their pattern of earlier labour force participation or savings). However, grandfathering is a source of considerable complexity in the income support system, and its benefits needs to be balanced with treating people in similar circumstances equitably, and in achieving outcomes consistent with new policy directions.

For these reasons, when such provisions are used, they should operate over a relatively short period to serve as a transition path to the new program arrangements. Arrangements that would assist this may include:

- ▶ moving all people into the new arrangements and addressing any disadvantage through lump-sum compensation, or possibly a regular fixed dollar amount
- ▶ simply maintaining individuals on older program arrangements at their current nominal or real income levels until the rates payable under the new arrangements reach this level
- ▶ introducing strict time limits on the application of any grandfathering—say, for example, a three- to five-year adjustment period.

6 Concessions and services

Overview and findings

Concessions and services play a critical role in the social protection system by responding to the high needs that some pensioners have because of health conditions and some types of disability. These high needs, as discussed in Chapter 3, are difficult to respond to through the payment system. While the base rate of pension can address the ‘normal’ level of health and related service costs faced by most pensioners, where the level of need for these services is higher this is no longer the case.

This chapter discusses issues around health care concessions, and the targeting and sustainability of the existing system of concession cards. The chapter presents evidence relating to the relative needs of different pensioners, and the long-term sustainability of the services system, including the demand for and supply of informal care. In relation to services, it discusses the service delivery reform agenda being developed under the auspices of the Council of Australian Governments, especially the National Disability Strategy, as well as the work of the Disability Investment Group.

The Review considered that reform of the targeting of concession cards is a priority. This is a long-term area of work because of the administrative and policy complexity of concession cards, which needs to be undertaken in close consultation with others, including state and territory governments.

Finding 20: The Review finds that the targeting of concession cards does not effectively complement the role of income support in addressing the needs of groups with high costs and that this needs to be addressed in consultation with the states and territories. (Section 6.5.2)

The Review has also identified reform directions for the Commonwealth Seniors Health Card.

Finding 21: The Review finds that, subject to more detailed considerations of the targeting of concessions, there is merit in maintaining the function of the Commonwealth Seniors Health Card in making health concessions available to people who are not eligible for the Age Pension, but have similar levels of income to age pensioners. Further, the Review considers that there would be a case for aligning the definitions in the income test for the Commonwealth Seniors Health Card with those of the pension income test. (Section 6.5.2)

The Review supports the reform processes for the long-term funding and sustainability of the services and support system currently in train. The Review has therefore made a number of findings intended to strengthen the contribution that these reform processes will make to the capacity of the services system to support pensioners with high needs because of health or disability.

Finding 22: The Review finds that the reforms to services and support being developed by the Disability Investment Group, and under the National Disability Strategy and the National Disability Agreement, in particular the development of a more person-centred approach that cuts across service boundaries and seeks to tailor a targeted package of support, are vital steps towards providing adequate support to those who have high and complex needs. (Section 6.5.3)

Finding 23: The Review finds that the development of new approaches to funding services and support for people with disability is important to the long-term sustainability of the system. In particular, the idea of a National Disability Insurance Scheme is worthy of further consideration. The Review notes that both the Council of Australian Governments and the Disability Investment Group are examining the long-term sustainability of the services system, and that the Australia's Future Tax System Review Panel has noted that the funding of services is a significant issue and will consider how alternative approaches would fit into the structure of the overall tax-transfer system. (Section 6.5.4)

Finding 24: The Review finds that reviews of funding arrangements should take into account the need to ensure that people with disability and carers have better opportunities to establish and maintain links with the labour market and through that are able to contribute to their own retirement incomes. (Section 6.5.5)

6.1 Terms of reference

In addition to their relevance to the first term of reference on the adequacy of the pension discussed above, services and concessions are directly considered in the third term of reference concerning 'the structure and payment of concessions or other entitlements that would improve the financial circumstances and security of carers and older Australians'.

In considering these matters the Review was mindful that the question of the provision of services is also the focus of the work of a number of other processes, including the Council of Australian Governments, which is seeking to implement systematic reform in the areas of aged care, mental health and disability services; the development of the National Disability Strategy; and the work of the Disability Investment Group.

While a number of aspects of concessions and services are considered in this chapter, and specific findings made, it is recognised that in some cases these will serve as inputs to, or complement, these other processes rather than forming the basis of immediate policy options. It is also noted that in these considerations the Review did not substantively address the issue of aged care services, including the important implications of population ageing for these services. As discussed in Chapter 2, the consequence of the funding of these to meet the needs of a larger, older population is a major driver of projected expenditures in the Intergenerational Reports and represents one of the important aspects of risk, including longevity risk. This issue is one of the matters being considered by the Australia's Future Tax System Review Panel.

6.2 Role of concessions and services

In Section 2.1 services were identified as core elements of the social protection system in Australia, in complementing the role of pensions, compulsory superannuation and private savings. Further analysis in Chapter 3 identified the more specific role of services in addressing the diversity of needs across the pensioner population, a function that is difficult to achieve through transfer payments alone.

The most important areas where concessions and services are provided to pensioners are:

- the purchase of essential products and services, including non-discretionary expenditures that are important to maintain a basic quality of life, such as the cost of health care, pharmaceuticals, medical services, and aids and equipment for people with health conditions or disability
- supporting housing and personal infrastructure. This includes the provision of social housing and accommodation and living support services including respite care and other services that play an

important role for people with disability and their carers. In addition, concessions are provided for much larger, often periodic expenditure, such as rates, utilities and motor vehicle registration

- daily expenditures relating to economic and social participation, which are often small but frequent, such as the cost of public transport. In addition to concessions offered by government, many private sector concessions are also offered in these spheres
- employment, education and training services to help pensioners, and former pensioners, to support themselves through the labour market.

Concessions and services are dealt with separately in this chapter because the Review considers that, despite their similar purpose, concessions and services are different policy levers that operate in different ways:

- The Review has used the term ‘concessions’ to describe fee or price reductions, subsidies and discounts for demand-driven goods and services, that are usually applied at the point of sale or through taxation (for example the GST exemption on cars for people with disability). Concessions are generally used to provide more affordable access for low-income groups to necessary goods and services such as water, power, health care and transport. As user charges are increasingly applied to these goods and services, concessions are becoming more important to low and fixed income groups.
- The Review uses the term ‘services’ to encompass a range of capped and uncapped programs funded by different levels of government to ensure that demand for specialised individual assistance can be met in cases where ‘natural’ market-based solutions are not available or appropriate.

However, in many cases the boundaries are blurred. While the Review has used the term ‘concession’ in a specific sense, ‘concessionally provided goods and services’ go wider than this and potentially include all government services that are delivered below market price.

6.2.1 Administration of services and concessions

The Commonwealth concession card system generally acts as a gateway to concessions throughout Australia. However, all levels of government are involved in the delivery of concessions and services.

The Australian Government plays a central role in the provision of health and related services and concessions, including the Pharmaceutical Benefits Scheme and Medicare co-payments and safety nets, as well as the Commonwealth Dental Health Program, which provides funding to the states to deliver public dental services. The Australian Government also provides a rebate on the cost of private health insurance cover. The value of this rebate is currently 30 per cent for people aged under 65 years, rising to 35 per cent for people aged 65 to 69 years, and 40 per cent for people aged 70 years and over.

Individual state and territory governments largely fund and administer concessions in their areas of responsibility and, along with local governments, make decisions on the type and level of concessions they offer. In addition to the provision of concession cards as a ‘gatekeeper’ to concessions, the Australian Government contributes funding towards state-based concessions through a national partnership developed as part of the Council of Australian Governments Specific Purpose Payment reform agenda. This partnership specifies a number of core concessions the states must provide to all Pensioner Concession Card holders, and stipulates that the states will provide public transport concessions for all Seniors Card holders, irrespective of their state of residence.

The scope of state concessions includes council and other property based rates; utilities, including energy, water and sewerage; public transport; and motor vehicle registration. The forms of concessions include fixed amount discounts; percentage discounts that may also be capped at a maximum dollar amount; rebates on or exemptions from charges; and vouchers.

Central to the needs of Australian pensioners are also the services delivered through Commonwealth funding of payments to the states for specific purposes, in particular the:

- ▶ \$60.5 billion National Healthcare Specific Purpose Payment
- ▶ \$5.3 billion National Disability Services Specific Purpose Payment
- ▶ \$6.2 billion National Affordable Housing Specific Purpose Payment.

These payments and associated national agreements contain objectives, outcomes and performance indicators, and clarify the roles and responsibilities that will guide the Commonwealth and states in the delivery of services.

In addition, the Australian Government requires Telstra, as part of its carrier licence conditions, to have in place a package of products and arrangements for low-income consumers. This package, called 'Access for Everyone', comprises initiatives that address a wide range of low-income consumer needs, including concessions to help offset line rental for eligible pensioners. It contains measures specially targeted at holders of Pensioner Concession Cards, Health Care Cards and Low-Income Health Care cards, as well as more specific assistance targeted at the homeless and other high needs individuals and more general obligations concerning access to payphone and fixed line services across locations.

Finally, the private and not-for-profit sectors also offer concessions on specific goods or services.

6.2.2 Charging regimes

In most cases consumers are required to pay a fee or charge to purchase or access services and concessionally provided goods. The charging regimes for services and concessions can have a number of goals:

- ▶ Charges can be levied to provide for a degree of cost recovery, often based on an assessment of ability to pay.
- ▶ Co-payments are often used as a means of limiting the consumption of particular services through introducing a price signal to indicate that services have an economic cost and to limit over consumption.
- ▶ At the same time, concessions seek to minimise the impact of such signals where they are considered to create a barrier to accessing the service. In this way concessions moderate the impact of price signals for those on low or fixed incomes, which is particularly important in areas where demand is inelastic.
- ▶ While some concessions relate to a reduction in user charges, in other cases the charges they apply to are more akin to taxes, and the targeted 'concession' should be seen as a targeted taxation offset (for example, concessions on rates and motor vehicle registration charges).
- ▶ In some cases 'concessions' involve subsidies from government or cross-subsidies between consumers, in other cases they can be a pricing mechanism. For example, concessional off-peak fares may reflect the very low marginal cost of transport service during those periods.

The charging regimes for concessions and services therefore have to achieve a balance between sending a price signal to consumers, providing for cost recovery and ensuring that low-income households have access to essential goods and services.

6.3 What the consultations told us

Participants in the consultations expressed very strong views on access to services and concessions. Pensioners stated that they consider concessions to be important to their standard of living and many called for their extension. Indeed, 35 per cent of all written submissions from individuals and 65 per cent of submissions from organisations proposed additional assistance through concessions. They also saw gaps in services and the high cost of obtaining them, especially in the area of health, as being two of the largest risks to their wellbeing and security.

Consistently throughout the public forums, written submissions and focus groups that formed the consultative process, the most frequently raised concern in the area of concessions and services was the cost of health care, including medical and dental treatment and pharmaceutical expenses.

Other recurring issues were the cost of transport, as well as the complexity of the current system of services and concessions, targeting of concessions and the lack of consistency in services and concessions across state boundaries.

6.3.1 Consultations—adequacy and targeting

A large proportion of submissions discussed concessions as part of their concerns about the adequacy of the pension. This reflects the way in which increased concessions, if directed at the goods and services pensioners wish to consume, can have a similar impact to increased levels of income—or reductions in cost.

Participants in the focus groups said they strongly valued the reduction in the price of medical prescriptions, public transport and council rates that they received through concessions, reporting that these were central to their ability to get around including accessing medical services, visiting family, going shopping and socialising. Participants expressed strong views that existing concessions were not set at ‘realistic levels’ and had not kept up with ‘real world’ increases in prices.

There was also a feeling that concessions and services should be more flexible in order to meet people’s differing needs, particularly those with high service needs. Pensioners with ill health or disability and carers noted the extra costs many of them incur, and pointed out that pension payments do not take into account differences in the level of care required. Many submissions cited the circumstances of people with multiple disabilities or health conditions who often have significantly greater medical costs and requirements for aids and assistance. In such situations it was pointed out that while any one particular co-contribution or cost may not be an impediment to access, when a large number of services were required, the co-contributions could be overwhelming.

In addition to concerns about costs, a number of submissions referred to the limited range of services available and the poor coordination of services.

Other concerns related to the complexity of the system. Issues included a lack of awareness of entitlements, especially for those on a part-rate pension or who had a spouse who was not a pensioner. Others cited the problem of having to navigate new systems of concessions and processes after moving interstate. Many were concerned about the lack of consistency between states in the availability of concessions and differing levels of concessions and entitlements. There were calls for concessions to be nationally consistent in the written submissions from organisations (15 per cent), particularly among organisations representing people with disability and carers’ representatives (26 per cent and 43 per cent respectively). There was a clear message that state and Commonwealth governments need to work together to improve the system and ensure equity and consistency in the way core concessions and services are delivered.

A number of submissions argued that services and concessions should be better targeted to address the circumstances of those pensioners with the highest needs and lowest means. They suggested that the very broad-brush approach of current policies was resulting in services and concessions flowing to those who were considered by others as being capable of supporting themselves. A central theme in this argument was the fact that benefits are available to Commonwealth Seniors Health Card holders, despite the fact they had incomes much higher than that of a pensioner.

6.3.2 Consultations—medical and dental services

Of all services that pensioners use, health services were seen overwhelmingly as the most important. Among written submissions, 13 per cent of individuals and 31 per cent of organisations indicated that health care costs were a major concern. This concern was particularly apparent among people receiving Disability Support Pension, the organisations that represent them and carers' organisations (21 per cent, 52 per cent and 43 per cent of submissions respectively).

Participants at the focus groups thought that additional health services would be the most useful means of improving their standard of living. When participants were asked to nominate one thing they refused to go without, the most popular category identified was 'medicine and health care'. Difficulties in accessing affordable dental care and medical specialists, particularly for people with chronic or multiple conditions, were frequently discussed.

While many medications, aids and services are subsidised, pensioners are concerned that others are not. Many mentioned the high costs of specialist fees, the difficulty in finding bulk-billing doctors and the inconsistent approach to bulk-billing by those doctors who do offer this service. Even where items are subsidised, there can be delays while the subsidy is approved, or it may be necessary to pay for the service up front and claim reimbursement later (for example, when seeing doctors or specialists who do not bulk-bill). Several individuals talked about forgoing specialist treatment due to cost.

Dental services and concessions were also identified as a pressure point. A number of submissions discussed long waiting lists for public dental services (of up to two years) and the choices individuals have to make between paying high prices for private dental treatment and putting up with pain and discomfort and neglecting their dental care. Additional assistance for medical and health-related expenses (including dental care) was the most frequently raised proposal relating to concessions and services in submissions from individuals (raised in about 13 per cent of submissions).

Submissions from organisations also raised concerns about the current level of assistance for medical and health-related expenses. One peak non-government organisation suggested that all those not in paid employment be allowed access to bulk-billing from all medical practitioners, and that bulk-billing be extended to dental services for this group.

Largely as a consequence of the above concerns, maintaining private health cover was seen by many in focus groups as essential to gaining access to services. A high proportion of participants at each of the focus groups reported facing significant health care costs in the form of prescription medication, specialist visits, medically related travel and/or health insurance. Without private cover, they said they would face long delays to access treatment through the public system. Although it placed a significant financial strain on the budget and was seen as excessively expensive, these pensioners said that they had chosen to make sacrifices in other areas to ensure they could afford private cover.

6.3.3 Consultations—cost of pharmaceuticals and aids

Numerous pensioners identified the financial strain caused by the cost of medications, particularly those not covered by the Pharmaceutical Benefits Scheme or included in its safety net. There were calls for an increase in the level of Pharmaceutical Allowance and/or changes to the Pharmaceutical Benefits Scheme.

Single pensioners in particular felt they were disadvantaged by being required to meet the same Pharmaceutical Benefits Scheme safety net threshold as couples. (This was \$290, or around 58 scripts in a calendar year for each single person or couples combined at the time of consultations.) Many also pointed out that the increase in the co-payment had affected their ability to manage their pharmaceutical costs.

Some pensioners indicated that they were at times unable to fill all the prescriptions issued by their medical practitioners and as a consequence found they were attempting to determine which of the drugs prescribed for them were of the highest priority.

Although the cost of aids affects a smaller group, there was concern about the very high costs of some aids, such as electric wheelchairs, that may be essential for even a basic standard of living for those experiencing some forms of disability. Similarly, the recurrent cost of aids such as incontinence pads can also be very high.

6.3.4 Consultations—transport

Pensioners highly value transport concessions and services but believe that additional assistance is needed. Around 4 per cent of written submissions from individuals and 12 per cent of written submissions from organisations requested additional assistance with transport costs and/or transport concessions. Rising costs associated with running a car (petrol, servicing and insurance), catching a taxi, or taking trains or buses was a significant issue. (It should be noted that the consultations were largely undertaken at a time when fuel prices were around \$1.50 to \$1.60 a litre.)

Many pensioners discussed the importance of transport as a link to the community and for access to medical services. Lack of access to and/or the cost of transport were particular problems for people in regional areas, who talked about the considerable additional transport (and sometimes accommodation) costs faced in accessing specialist treatment in larger centres or capital cities.

Many pensioners felt that the public transport services in many places in Australia were inadequate, especially for those living in suburban and rural areas. Participants also criticised the current practice of offering public transport discounts at certain hours of the day (such as off-peak times) because they considered this falsely assumed pensioners have a choice around the times they need to access public transport in order to get to medical appointments or part-time jobs.

6.4 What the evidence shows

While particular areas of service provision have been subject to considerable analysis, comprehensive information on the cost and effectiveness of concessions and services is limited. This section considers three matters: the relative needs of different groups of pensioners; the cost and sustainability of concessions and services and the current processes in place for service reform.

6.4.1 Relative needs of different groups of pensioners

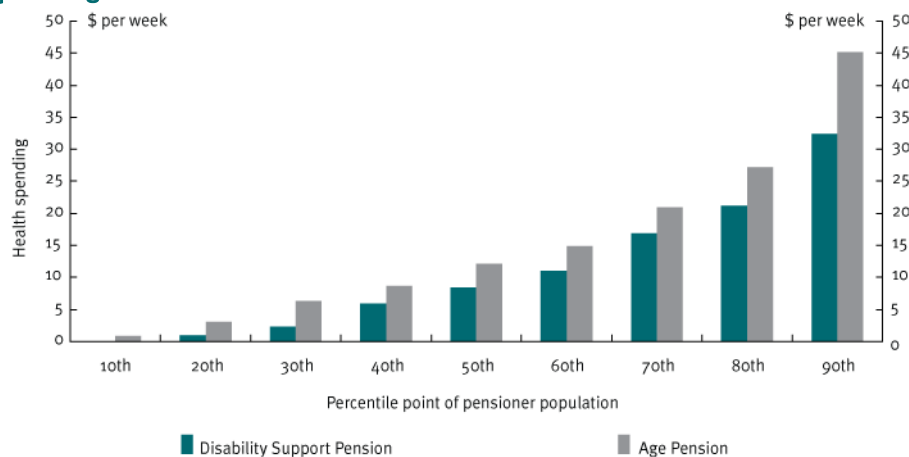
As discussed in Section 3.4.3, a particular question faced by the Review was the distribution of need for services across the pensioner population and how to respond to the situation of those who have high needs (often associated with disability or a health condition). A number of proposals were made that there be additional support to particular groups of pensioners, such as those on the Disability Support Pension, to respond to these high needs.

The characteristics of those with disability and caring responsibilities, including the range of disability conditions of those in receipt of the Disability Support Pension, were considered in the Background Paper (Section 3.3.5). The Review considers that the categorical program structure of pensions is a very poor indicator of this type of relative need for support services.

The Review's analysis has been extended to consider the distribution of health and related costs across pensioners on the Age Pension and Disability Support Pension using data from the ABS Household Income and Expenditure Survey.³²

Chart 23 shows the distribution of health expenditure for couple-only households where one member is in receipt of either the Age Pension or the Disability Support Pension and the household receives at least three-quarters of its income from transfer payments. While the expenditure on health services varies considerably across households³³ both on the Age Pension and on Disability Support Pension, the overall expenditures of age pensioner households are higher. A similar result is achieved when the expenditure of single person only households is considered.

Chart 23 High dependency pensioner couple-only households, health services spending 2003–04



Notes: Pensioner couple households where more than 75 per cent of income is derived from transfer payments. Health service spending includes all medical, hospital, pharmaceutical and related costs but excludes health and ambulance insurance.

Source: Review analysis using ABS 2003-04.

In addition to the difference between couples on these two pensions, Chart 23 also highlights that 50 per cent of age pensioners spend over \$12 a week on health services, with 20 per cent of pensioners spending more than \$27 a week. While these levels of expenditure reveal little regarding the claim throughout the consultations of unmet health needs due to cost, they do indicate the significance of health services as an item of expenditure for these pensioners.

6.4.2 Cost and sustainability of concessions and services

While, as noted above, only limited systematic information is available on the costs of concessions and services, the available data suggest that the cost to governments of providing these are high:

- The three main Specific Purpose Payments in the area of health, disability and housing services have a value of over \$70 billion dollars.

³² The sample size of the survey did not allow this analysis to separately identify recipients of Carer Payment.

³³ While the data on the distribution of expenditure also invite some comment on the capacity of households at different points to be able to meet the cost of health care, it is noted that this is not possible given the nature of the Household Expenditure Survey, as it only records expenditures over a relatively brief period, and many health costs are sporadic. It also gives no indication of the extent of unmet health needs and the costs associated with them over and above actual expenditure. While this does not limit the data being used in a comparative analysis such as the relative outcomes for different groups of pensioners, it does restrict the ability to perform within-group analysis or answer the fundamental claim by pensioners in the consultations of unmet health needs due to high health costs.

- Estimates of the expenditure on concessions (both direct and through revenue forgone) by the Victorian Government (DHS 2008) suggest an aggregate value of over \$1.1 billion in 2006–07.
- The New South Wales Government's submission to the Review identified the value of rates concessions for pensioners at \$132 million a year and energy concessions to those in financial need at \$94 million dollars a year.

Sustainability

The long-term fiscal sustainability of the system as a whole is an overriding constraint on the extent to which it can provide security to pensioners. As discussed in Chapter 2, demographic change will place considerable stress on the social safety net, including services and concessions:

- The *Intergenerational Report* indicates that the major impact of demographic change on social expenditures is an estimated increase in the cost of health services from 3.8 per cent of GDP to 7.3 per cent between 2006–07 and 2046–47.
- Analysis by the Victorian Government shows that already there are many Local Government Authority Areas where over one-third of residents have a concession card.

Demand and supply of informal care

At the same time that demographic change will lead to an increasing number of people needing care, there will be relatively limited growth in the number of people available to provide that care.

In analysis undertaken for Carers Australia by the National Centre for Social and Economic Modelling in 2004, Percival and Kelly (2004) estimate that between 2001 and 2030 the ratio of principal carers to older people living in private dwellings who require informal care will fall from 57 to 35. In their modelling this was largely as a result of increasing numbers of older people with a care need, rather than a decline in carers.

In addition to these demographic forces, there are other important questions related to the supply of carers and future caring models. It can be expected that the current full-time informal caring model is likely to be affected by changing economic and social circumstances, including preferences for combining work and caring, and/or shared caring arrangements.

6.4.3 Current processes of reform

The reform of concessions and services is already being considered by a number of different processes.

Central to this is the work of the Council of Australian Governments (COAG) in the context of the Intergovernmental Agreement on Federal Financial Relations. In March 2008 COAG agreed to a new framework for Commonwealth–state financial relations which reduced the number of Specific Purpose Payments from over 90 to five new national agreements and involved the Commonwealth taking full responsibility for aged care. The reforms are aimed at enabling the state and territory governments to deliver services funded by the Commonwealth more effectively and creatively. COAG also has work under way to achieve greater consistency across states and territories, including the portability of transport concessions on which very strong views were presented in consultations.

A new National Disability Agreement aimed at improving and expanding services for people with disability, their families and their carers came into effect in January 2009.

COAG further agreed to consider in 2009 a program of reforms to roles and responsibilities for funding and delivery of services to the community. The goals of these reforms are to deliver more integrated and

responsive services to individuals and families, to clarify accountabilities between governments and to improve the performance of service systems. COAG requested development of specific proposals in relation to community mental health, disability services and aged care in the first half of 2009 as part of this program.

This reform agenda encompasses measures to address the long term sustainability of the services system. The COAG National Disability Agreement reform agenda is partly aimed at creating efficiencies to improve ability to meet unmet demand by streamlining processes such as assessment and early intervention to reduce the cost of life long care, as well as removing duplication. In addition, the July 2008 Disability Assistance Package of \$1.8 billion for increased respite and supported accommodation will assist the long term sustainability of the services system.

The Disability Investment Group is investigating new funding arrangements aimed at addressing future unfunded liabilities and unmet needs, including models of insurance and ways to leverage greater private sector and family investment in support of people with disability and to find avenues for new products and services to assist families in planning their children's future.

6.5 Concessions reform directions

Given current processes, the Review has focused on three key areas:

- the targeting of concessions
- the delivery of services
- longer-term funding options for services.

These specific areas have been identified because the Review considered that, within the context of the other reform activities, these are the areas with the highest potential for change directed at enhancing the capacity of services to complement the income support system and enhancing the security of pensioners. They also reflect some of the central concerns that were expressed by pensioners in the consultations.

In addition, while the detailed operations of Australia's health care system is beyond the scope of the Review, it is important to record the issues raised on this matter.

6.5.1 Health care

Pensioners believe that access to health care services is one of the most important issues relating to their security and wellbeing. The consultations indicated a number of concerns pensioners had around health care services, including the costs of accessing such services. Pensioners stated that, despite the concessions and safety nets provided through Commonwealth programs, such as Medicare and the Pharmaceutical Benefits Scheme, aimed at ensuring costs are not a barrier to accessing universal and necessary health care services, they were often struggling to cope with the high health costs related to disability and ageing. The Australian Institute of Health and Welfare (2008) reported that in 2006–07, 17 per cent of health expenditure on average is funded by the out-of-pocket payments of consumers.

The Review therefore considered it important to examine in more detail the operation of these schemes.

It should be noted that all concession card holders, including those not receiving income support payments, have access to the same Pharmaceutical Benefits Scheme and Medicare health care benefits.

Pharmaceutical Benefits Scheme

The Pharmaceutical Benefits Scheme plays a vital role in the health of all Australians in ensuring they have affordable access to necessary pharmaceuticals and medicines. It does this by subsidising the cost of medications so they are available to consumers for the price of a moderate co-payment.

In the case of concession card holders, the co-payment is currently set at \$5.30 per prescription up to the safety net threshold of \$318, above which prescriptions are free (with the exception of brand and therapeutic premiums, which apply to some medications). In 2007–08, concession card holders contributed over \$560 million in patient co-payments towards the total cost of their Pharmaceutical Benefits Scheme listed medications, which was over \$5.3 billion.

The payment of Pharmaceutical Allowance through the income support system was originally intended to cover the cost of pharmaceuticals until the safety net threshold was reached. As discussed in Chapter 5, Pharmaceutical Allowance appeared as a part of the major restructure of the Pharmaceutical Benefits Scheme in 1990, which introduced a co-payment for pharmaceuticals that were previously free for pensioners.

Pharmaceutical Allowance is not directly linked to the operation of the Pharmaceutical Benefits Scheme, so changes to the scheme's co-payments have not been accompanied by changes in the level of the allowance. Both the Pharmaceutical Allowance and Pharmaceutical Benefits Scheme co-payments are subject to indexation process each year, using the Consumer Price Index. The indexation formula and rounding arrangements that apply to the pharmaceutical allowance differ from those applied to the Pharmaceutical Benefits Scheme co-payment. That is, as the Pharmaceutical Allowance is rounded down to the nearest 10 cents, there may be no annual increase to Pharmaceutical Allowance as a result of applying the Consumer Price Index. Until 2009, the allowance remained at the 2001 amount of \$5.80 a fortnight for singles (or a member of a couple separated by illness, respite care or prison) and \$2.90 a fortnight for each member of a couple. The Pharmaceutical Allowance increased on 1 January 2009 to \$6.00 a fortnight for singles and \$3.00 a fortnight for each member of a couple.

The concerns about the operation of the Pharmaceutical Benefits Scheme and access to affordable medication may be due to a number of factors, including:

- pensioners being prescribed or using a range of pharmaceuticals or over-the-counter medications that are not covered or only partially subsidised by the Pharmaceutical Benefits Scheme
- increases in the level of co-payment resulting in a gap of around \$162 a year between Pharmaceutical Allowance and the Pharmaceutical Benefits Scheme safety net threshold
- a potential cash flow problem for a small number of pensioners with very high medical costs who reach the safety net amounts quickly. While on an annual basis this means that for a large proportion of the year pensioners' costs for fully subsidised Pharmaceutical Benefits Scheme-listed medications are fully met, in the period before they reach the safety net they have to fund their co-payments from a lower amount of total income. For example, instead of paying \$318 in small amounts evenly across the year, people may have to find this amount over a quarter.³⁴ This was raised in a number of submissions.
- difficulties in keeping track manually of Pharmaceutical Benefits Scheme safety net records, particularly where patients use multiple pharmacies.

At the same time the Review noted:

³⁴ To address cash flow issues, up to seven fortnightly instalments of the Pharmaceutical Allowance can be paid in advance (\$42.00 for a single person and \$21.00 for each eligible member of a couple).

- ▶ Pharmaceutical Benefits Scheme data for 2007 indicate that only 0.4 per cent of all concession card holders who reached the safety net that year did so in the first quarter, with the majority (54 per cent) reaching the tally after 1 September. These data suggest that the cash flow problem is not an issue for the majority of concession card holders.
- ▶ Most dispensing software allows pharmacies to electronically tally a patient's contributions towards the Pharmaceutical Benefits Scheme safety net which have been made at that particular pharmacy. Patients can be electronically linked to their eligible family members and once the safety net threshold is reached, the pharmacist is prompted to issue the relevant safety net card.

Medicare

Pensioners also reported difficulties in meeting the increasing costs of medical services such as general practitioner visits and attendance at specialist appointments. Most of these difficulties were reported to arise from the gap between the scheduled Medicare fee and the fees charged by doctors.

While under the Medicare safety net, concession card holders receive additional discounts on the cost of medical care after they reach the threshold of \$555.70 that should be able to be met from basic income support payments, those with high needs may find these costs difficult to meet for two reasons:

- ▶ lack of access to bulk-billing doctors, even for those with concession cards
- ▶ the ensuing co-payment and fee levels gaps, particularly for the costs of specialists.

Commentary

While any increase in the base rate of the pension may reduce the extent to which poor outcomes are experienced by those with high health and related needs, health concessions and safety nets play an essential role for all pensioners, especially for those with higher needs.

The charging regime for pharmaceuticals and health services must achieve a delicate balance between appropriately sharing costs between government and the individual and sending price signals to individuals to judiciously manage consumption, while ensuring charges do not prevent Australians, particularly those with limited means, from accessing the health goods and services they require.

6.5.2 Targeting

Where services and concessions are targeted towards pensioners and low-income households, the most usual targeting mechanism is a concession card.

Over 5.2 million Australians—or around one-quarter of Australia's total population—hold one of many Commonwealth concession cards (principally Pensioner Concession Cards and Health Care Cards). Around 85 per cent of people over Age Pension age hold an Australian Government concession card (either a Pensioner Concession Card, or its equivalent in Veterans' Affairs, or a Commonwealth Seniors Health Card).

There are two major features of the design of the targeting of concessions and concession cards:

- ▶ Concessions and concession cards are not tapered like income support payments. While a blunt form of targeting is achieved by providing different concessions to different concession cards, all individuals who have the same concession card get the same concessions whether they receive the maximum income support payment or only qualify for \$1 of payment.
- ▶ Eligibility for concession cards has also been extended beyond those on income support payments for other policy reasons.

- Health concessions are usually made available to people who are outside of the income support system but who have similar levels of income to part-rate pensioners. This is intended to reduce incentives for people to arrange their affairs to receive low amounts of pension, and to ensure that people who cannot receive a pension because of their assets or other eligibility requirements, but have low income, are able to get access to health concessions. This approach has also encompassed extending the income cut out for concession cards beyond the level that would disqualify a person from income support. The Commonwealth Seniors Health Card and the Low-Income Health Cards are examples.
- As a part of the working credit scheme, some disability support pensioners can retain their Pensioner Concession Cards for a period of time after starting work and moving off payment to assist them with the welfare to work transition.

The consultations undertaken by the Review indicated that card holders valued this aspect of the design of the concession system and saw access to concession cards as a form of insurance against unpredictable health costs.

This structure of access to concession cards and concessions means that individuals with different capacities to pay receive the same level of concessions. For example, an individual holding a Commonwealth Seniors Health Card and earning \$50,000 a year may be eligible for similar Commonwealth health concessions to a single pensioner holding a Pensioner Concession Card and receiving around \$15,923 a year. As at December 2008, around 35 per cent of single Commonwealth Seniors Health Card holders had income in excess of the minimum wage, with around 13 per cent receiving over \$40,000 a year.

The result of such broad concession card coverage can be a dilution of the level of concessions available to card holders as their numbers increase, and consequently, concession cards become devalued as an indicator of financial need. For example:

- Anecdotal reports supplemented by input from the Review's consultation process suggest that some general practitioners may be less willing to bulk-bill concession card holders, as not only do they represent a very high proportion of their patients, but some card holders have significant private income.
- In some areas the real value of concessions is reducing because indexation arrangements for the cash value of the concession are not keeping pace with price changes, or because concession providers are setting caps on concessions in order to keep the cost of the concessions manageable. For example, the increase in general rates in virtually all states has far outstripped any indexation arrangements for concessions on rates, leaving pensioners to fund any difference.

This dilution of the value of concessions ultimately affects those who may need concessions the most. Population ageing will tend to further extend the proportion of the population who hold a concession card and may therefore exacerbate pressures on providers to reduce the overall per person cost of providing concessions.

However, there is a tension between the need to target concessions progressively to those most in need, and the current structure and broad access to concession cards to achieve other policy objectives such as incentives to gain access to, or remain on, income support.

One further issue with respect to the targeting of concessions is that of equity. In some cases subsidies embedded in concessions may operate regressively. For example, rates concessions can be regressive because the value of the concession can be greater for those with higher value properties. While public transport concession can be of value to those in areas served by public transport, pensioners in other locations gain no benefit, and indeed may have very poor transport outcomes.

A more targeted approach to concessions

To address the concern that access to Commonwealth concession cards is becoming too broad, some states are considering developing their own more tightly targeted concession cards. A strategy of reducing the population who have access to concession cards is one approach to tighter targeting. However, this approach does not address the policy concerns that initially prompted a broadening of coverage such as incentive and participation issues.

The Review considers that other options for tighter targeting should be explored, including the scope for varying the types and levels of concessions available to different card holders. This would provide the capacity to enhance the value of concessions and services to those with the least means and highest needs while maintaining a broader coverage of concession cards, albeit with a different access to concessions.

However, the consultations and analysis undertaken by the Review indicate that this is a complex matter.

- The administrative arrangements for concessions make it hard to manage the ‘concession system’ from end to end. Broadly, the Commonwealth’s concession cards, administered as a part of the income support system, control the eligibility arrangements. However, the actual form and level of the concession that is delivered to card holders is a responsibility of the Health portfolio at the Commonwealth level, individual states and territories, local governments, and in many cases individual private enterprises.
- It is important that any changes to more tightly target services be based on a good understanding of the full circumstances of different groups: both their resources and needs. Financial need is based, in very broad terms, on eligibility for income support payments. However, in the consultations concession card holders who have high needs or specialist requirements indicated that they were looking for higher levels of assistance.
- A further complicating factor in assessing how concessions can be better targeted to support pensioners with higher than average costs is that the concession system, like the income support system, has to assist people through transitions not just those in a ‘steady state’. A family that is adjusting to the diagnosis or onset of disability of one of its members will often need different types and levels of support over time. The same is true of other transitions such as family breakdown, increasing frailty with age and bereavement.

This is an area where the Commonwealth cannot act alone, and a coordinated approach with the states and territories is needed.

Finding 20: The Review finds that the targeting of concession cards does not effectively complement the role of income support in addressing the needs of groups with high costs and that this needs to be addressed in consultation with the states and territories.

Commonwealth Seniors Health Card

Notwithstanding the need for further work on the targeting of concessions, consultations indicated that there is currently pressure on the income limits of the Commonwealth Seniors Health Card. While some submissions, in line with the principle of tighter targeting, proposed a reduction in the scope of concessions and services to holders of these cards, other submissions, primarily from current Commonwealth Seniors Health Card holders, expressed concerns about the indexation of the income limits of these cards.

The current limits, which are not indexed, have been in place since 1 July 2001. In the absence of changes to the Commonwealth Seniors Health Card threshold, it is likely that indexation increases will mean that the pension cut-out will overtake the income limits for the Commonwealth Seniors Health Card in the near

future. The Review considers given the policy rationale of making health concessions available to people outside of the income support system, but who have similar levels of income to those who receive a payment, that this should be avoided. This could be done by either introducing indexation arrangements for the cut-outs for the Commonwealth Seniors Health Card or periodically adjusting the cut-outs to reflect the lack of indexation.

However, there are balances to be achieved in this area of policy. Increasing the cut-outs for the Commonwealth Seniors Health Card would tend to increase the coverage of concessions to a small degree. This benefit would flow to people with relatively high levels of private income.

The Review also considers that there is a case for aligning the definitions used in the Commonwealth Seniors Health Card income test with those used in the pension income test. At present, the two income tests are quite different. This arrangement is cumbersome for pensioners who lose eligibility for short periods, because they have to lodge a separate claim for the Commonwealth Seniors Health Card. It can act as a disincentive for age pensioners to take paid employment. Aligning the two tests would remove a needless source of complexity in the social protection system.

In the longer term, however, the Review considers that the more general question of the type and level of concessions available to the Commonwealth Seniors Health Card population should form a part of the work on the tighter targeting of concessions outlined above.

Finding 21: The Review finds that, subject to more detailed considerations of the targeting of concessions, there is merit in maintaining the function of the Commonwealth Seniors Health Card in making health concessions available to people who are not eligible for the Age Pension, but have similar levels of income to age pensioners. Further, the Review considers that there would be a case for aligning the definitions in the income test for the Commonwealth Seniors Health Card with those of the pension income test.

6.5.3 Services and support

Feedback from consultations and submissions to the Review raised a number of issues in relation to the effectiveness of the services and concessions systems that are confirmed to some degree by recent research. People reported that they are experiencing:

- complex and confusing assessment processes, and services that are not delivered flexibly to meet individual needs
- difficulties affording services in some specific areas
- difficulties with access to some services and areas of unmet demand.

The service system is not well integrated across different service domains. For example, services for aids and appliances tend to be delivered separately from care. This is a particular issue for many pensioners who because of their high level of need have to access a range of services and support. Because of their financial circumstances, when they seek to do this they are usually reliant on the often partially subsidised and often rationed public provision rather than being able to purchase services from the private sector.

In effect, pensioners have to negotiate through a services system spread across different levels of government, where each service offer has its own mechanisms to prioritise access to services within budget constraints. One of the main reasons for this is that the system largely revolves around different levels of government that are funding services on a program-by-program basis through different departments, with access determined by program criteria not a threshold level of client need.

This lack of flexibility is often most evident in terms of the packaging of services which, in some areas, has been criticised by pensioners for being a one-size-fits-all approach that is unresponsive to individual needs.

As noted in Chapter 3, the Review's analysis is that it is difficult for the income support system to effectively respond to the circumstances of pensioners with high needs. This was also illustrated in the consultations, where it became apparent that additional support needs could not be generalised by payment type, or even type of disability. This led the Review to conclude that there is a need for a more person-centred service system, which would enhance the security of pensioners and would reduce the risk of a 'missing link' in the assistance they need. One mechanism for achieving this within the structure of a common gateway would be through consumer-directed budgets. A key advantage of this approach is its potential to better align services and financial support to individual needs and empower pensioners to influence service delivery through their own consumer choice.

This approach to budgeting would specifically link funding to needs and the achievement of individual outcomes. It would achieve reduced spending and increase efficiencies by removing duplication and gaps. It would provide government and service providers with much better data on the cost of disability and frailty, and would enable government, service providers, and individuals themselves to assess the cost of meeting their individual service needs. This would enable a better understanding of the impact of co-payments and high service costs on individuals with high needs.

These are major changes to the delivery of services. However, models of similar approaches can be found. Aged Care Assessment Teams, for example, help older people and their carers to decide on the types of services they need to maintain themselves at home by conducting assessments and determining eligibility for packages of care. Assessment team approval is required before a person can access residential aged care.

The National Disability Strategy will consider the exceptional costs associated with the economic and social participation of people with disability as part of the strategy's whole-of-government, whole-of-life approach to disability issues. Strategies to address these circumstances are expected to include both person-centred and service system responses and will also be explored as part of the disability reform agenda under the National Disability Agreement. As part of the new agreement, all governments are committed to helping people with disability to achieve economic and social inclusion and to have the opportunity to live as independently as possible, as well as providing support to their families and carers.

Finding 22: The Review finds that the reforms to services and support being developed by the Disability Investment Group, and under the National Disability Strategy and the National Disability Agreement, in particular the development of a more person-centred approach that cuts across service boundaries and seeks to tailor a targeted package of support, are vital steps towards providing adequate support to those who have high and complex needs.

6.5.4 Investment in services

As noted in Chapter 2, in contrast to the structure of retirement incomes, there are few mechanisms available to facilitate and encourage services with mixed government and private provision.

The exceptions to this are compulsory government-sponsored and privately based compensation and insurance systems. People with disability who currently enter the services system through the compensation and insurance path achieve better outcomes than those who do not. This is partly because most insurance-based systems are already some way down the path of the reforms discussed above. These schemes introduce service delivery efficiencies and disciplined spending—for example, better data analysis because of the availability of unit record systems, early intervention approaches and so on. For people eligible for compensation, access to services is based on a needs assessment that determines the suite of services required to support their basic quality of life and their rehabilitation. However, it is also

because these schemes are able to leverage private funding through actuarially based pooled risk arrangements. This allows insurance schemes to better cover each person's costs.

The Review considers that there is a strong policy rationale for developing additional mechanisms to facilitate and encourage the private funding of disability and ageing services. In essence, the risks that need to be managed for the care and accommodation of people with disability and the aged are similar to those that are managed by the social security and taxation treatment of superannuation.

- ▶ The goal of the social security and taxation treatment of superannuation is to enable individuals to smooth their income over their lifetime, and thus maintain their standard of living once they retire.
- ▶ The funding of aged-care accommodation is similar. Some people have accumulated sufficient savings over their working life to allow them to fund aged-care accommodation when they need it. However, in the absence of pre-funding mechanisms, most Australians have no dedicated source of funding for their aged care needs and therefore rely on the capital in their principal residence to fund accommodation bonds.
- ▶ This is also illustrated in relation to the inter-temporal funding of accommodation for people with disability. In many cases, families of people with disability support their family member's disability accommodation, care and support costs (often with income assistance from the income support system and other services) while they can. When they no longer can, usually in response to a crisis, government has to step in and fully meets the full costs of supported accommodation. Again, the policy goal in this area should be to smooth assistance and private contributions over the individual's lifetime.

National Disability Insurance Scheme

These issues were discussed at the 2020 Summit, which recommended the creation of a National Disability Insurance Scheme that would provide comprehensive coverage similar to the role played by the Superannuation Guarantee in retirement income policy. Such a scheme would represent a significant extension of the no-fault injury insurance schemes that currently operate very successfully in some states.

The goals of these arrangements would include:

- ▶ a person-centred approach over an individual's lifetime
- ▶ investment, including in early intervention services, in meeting the personal and social needs of the individual as well as maximising their potential for work
- ▶ planning and case management
- ▶ nurturing and supporting carers while also giving them choices through respite care and opportunities to work
- ▶ governance and management arrangements designed to reduce the long-term costs of disability and maximise individual and community benefits, possibly through pooling risks.

Further work

The costs and benefits of such a National Disability Insurance Scheme as well as other funding options are being considered by the Disability Investment Group. The Australian Government has commissioned the Disability Investment Group to investigate private and insurance-based options for funding services and supports for people with disability. The group's report will include a detailed analysis of the feasibility of a National Disability Insurance Scheme.

The Australia's Future Tax System Review Panel will consider how alternative funding arrangements for services fit with its wider inquiry into the tax-transfer system.

The Review considers that the response to the sustainability of services has to include different ways to fund their provision. Different approaches to funding may not only support more sustainable services—by increasing the total pool of funding through leveraged private contributions— but also lead to much better access to services and improved outcomes for individuals.

While it is possible that these approaches could replace the existing fully funded government schemes, even if these schemes are an addition to existing programs they have great potential to reduce the long-term pressures on these programs, and thereby help to put them on a more sustainable footing. Even low levels of private contributions would greatly improve the total funding available for services.

In addition, a more integrated approach could reduce stress on carers and reduce the need for state-based services to operate continually on a crisis-alleviation basis.

Finding 23: The Review finds that the development of new approaches to funding services and support for people with disability is important to the long-term sustainability of the system. In particular, the idea of a National Disability Insurance Scheme is worthy of further consideration. The Review notes that both the Council of Australian Governments and the Disability Investment Group are examining the long-term sustainability of the services system, and that the Australia's Future Tax System Review Panel has noted that the funding of services is a significant issue and will consider how alternative approaches would fit into the structure of the overall tax-transfer system.

6.5.5 Implications for carers

There is also a need to complement the reform directions identified above with measures to sustain the role of informal carers.

Section 6.4.2 noted that population ageing and changing preferences will inevitably result in a reduction in the number of people (principally women) available and prepared to act as full-time informal carers.

Informal care allows people with disability and the aged to remain in, and be part of, their communities. However, the expectation of full-time informal caring is embedded in many service delivery approaches and income support rules. For example, a 25 hour a week cap on paid work applies to Carer Payment recipients. There is already evidence of carer 'burn out'. A service delivery system that relies heavily on full-time, stay-at-home carers will be increasingly unsustainable.

Sustaining the role of informal care in service delivery will require a different model of informal caring, possibly involving a mix of daily in-home assistance, group day care and respite services. The availability of tailored support from the services systems would enable carers to better combine caring with employment and their other interests and responsibilities.

Therefore, the Review considers that the reform direction for the service delivery system needs to be combined with additional support for carers to maintain links with the labour market through better access to respite or other forms of care to help them balance work and caring, and targeted assistance to gain employment. Indeed, the shift towards a more flexible, person-centred approach to identifying and addressing the needs of people with disability implies a more adaptable and integrated approach to informal care than is implicit in the current income support arrangements.

There are reasons to believe that this approach would be supported by many carers, particularly among younger cohorts of women.

- In the submissions and consultations many carers stated that they need additional assistance to combine caring and paid work, including formal care services, household maintenance, personal and emotional support, and help with taking the care recipient to medical appointments.
- Better labour force outcomes would also allow carers to secure their own economic future including an increase in current income and benefit from the general superannuation system. The lack of access to superannuation was also identified as a key issue for carers in submissions to the Review.

Finding 24: The Review finds that reviews of funding arrangements should take into account the need to ensure that people with disability and carers have better opportunities to establish and maintain links with the labour market and through that are able to contribute to their own retirement incomes.

As noted in Chapter 5, Carer Allowance is distinctly different to the income support payments and allowances considered by the Review, in that it is not a targeted component of income support. Although Carer Allowance is paid in recognition of the caring role and is not intended to cover the costs of caring for someone with disability, the consultations indicated that Carer Allowance is often used to meet the costs associated with the needs of the person being cared for. The findings above (Findings 22, 23 and 24) reflect the Review's conclusion that the services system is the most appropriate way in the long term of addressing concerns about the costs associated with the needs of people with disability, and caring needs, and their opportunities for community and workforce engagement.

Consultations also identified that, in addition to the costs and availability of services, carers were concerned about the impact of caring on their aspirations for community and workforce engagement. Finding 24 reflects the importance of responding to these on longer-term outcomes.

Once supports for carers to maintain links with the labour market are developed, it may be appropriate to review the role of Carer Allowance. However, the Review considers that a review would require better access to respite, or other forms of care, to help balance work and caring, and targeted assistance to gain employment to be in place. Until then, Carer Allowance will continue to have a role in supporting the provision of informal care.

7 Sustainability and targeting

Overview and findings

This chapter considers the sustainability and targeting of the pension system.

- ▶ It was not possible for the Review to develop considered views on its terms of reference without taking into account the sustainability of the reform directions it has identified. This required the Review to consider whether the current targeting of income support payments will continue to be effective in the short, medium and longer term.
- ▶ As noted in Chapter 3, there is also a need to consider the appropriateness of the levels of pension payments for those with low to moderate reliance on income support. The analysis and discussion in Chapter 3 was concerned with the appropriate level of the rate of payment of the pension to those who are wholly reliant on it, and made no assumptions about access to private means.

This chapter outlines how the pension means test operates, and discusses the issues that need to be considered in seeking to achieve a fair and sustainable balance in the pension system, in particular between effective targeting of assistance and incentives for people to participate in the labour market and support themselves.

The chapter analyses the current impact of means testing on the appropriateness of the levels of pension received by those with private means, the relationship between the two principal elements of the means test (the income and assets tests), and the effectiveness of the current definitions of income and assets used in the means test, including the treatment of earned income and income from superannuation.

In the context of demographic change, including strong gains in life expectancy and the importance of workforce participation, the chapter considers the focus and eligibility criteria for pensions, including the Age Pension age.

The Review's findings in this chapter are presented in two groups:

- ▶ the efficiency and effectiveness of the pension means test
- ▶ the eligibility criteria for pensions, including the question of the appropriateness of the current Age Pension age.

In relation to the efficiency and effectiveness of the pension means test, the Review has made a number of findings concerning the impact of the means test on the level of support for pensioners with private means, incentives to take up paid work, and the treatment of account-based superannuation products.

The Review's findings on these aspects of the means test reflect two objectives. The Review considers that there would be merit in targeting any increase in payments designed to support pensioners who are wholly reliant on the pension. There is no evidence that the means test is operating to leave pensioners who have a low to moderate level of reliance on the pension with inadequate total income.

Finding 25: The Review finds that there is no evidence that the means test as a whole is operating to provide an inadequate level of support to pensioners with low to moderate reliance on the pension.

Finding 26: The Review finds that, in the case of an increase in the pension rate to achieve an improvement in adequacy and financial security for those pensioners for whom the pension is the predominant source of income, there would be capacity to tighten income test settings to limit the flow-on of the increase to pensioners with low to moderate reliance on the pension. (Section 7.5.1)

The second objective was to improve the efficiency of the means test through responses to increase incentives for workforce participation and to redress anomalies in the treatment of different forms of income.

Finding 27: The Review finds that there is a case to provide more effective mechanisms to support age pensioners to maintain or take up paid work if they wish to do so. A concessional treatment of low to moderate levels of income from employment would better deal with the costs of work which are only partially offset in the current means test and be more effective than the current Pension Bonus Scheme.

Finding 28: The Review finds that a deeming approach for account-based superannuation products would remove the current distortion in the pattern of payment of pensions to pensioners with such income and assist in equalising the treatment of superannuation products and other financial assets. (Section 7.5.3)

In relation to eligibility criteria for pensions, the Review considered that pensions for those of working age should where possible build stronger links with workforce participation. Therefore the Review developed a finding in relation to the degree to which the Carer Payment and Disability Support Pension actively encourage workforce participation.

The Review has also developed a finding in relation to the eligibility age for the Age Pension, reflecting increased longevity and the impact this has on the sustainability of the retirement income system.

Finding 29: The Review finds that the Carer Payment and Disability Support Pension should more actively address questions of workforce participation. This focus needs to be effectively integrated into initial eligibility, policies to promote participation while people are on the payments and in ensuring that, where they have the capacity to support themselves and are no longer eligible for the pension, they can successfully establish or re-establish themselves in the workforce. (Section 7.6.1)

Finding 30: The Review finds that there is a case for a phased increase in the Age Pension age starting from 2014, when the Age Pension age for women will be the same as for men. Such a policy would improve retirement outcomes and support Australia's capacity to address the impact of population ageing. It would reflect the strong increases in life expectancy the nation has experienced, which are expected to continue. Any reform would need to be part of a coordinated approach to retirement, including bringing the settings of the superannuation system into line with the Age Pension age. (Section 7.6.2)

7.1 Terms of reference

Two terms of reference are specifically addressed in this chapter: the first, which addresses 'appropriate levels of income support'; and the third, which addresses the 'structure of and payment of concessions or other entitlements'.

The Review's findings on the appropriate levels of income support were presented in Chapter 3, which focused on the adequacy of the pension for those who are wholly reliant on the pension. This chapter focuses on the question of the appropriate level of income support for those who have additional private resources and low to moderate reliance on the pension.

This chapter also considers the sustainability issues identified in Chapter 2. Here the focus is on the impact of the pension means test on incentives to work and save, as well as the interaction between the pension system and the superannuation system. While the Review considers that these issues are important to its consideration of its terms of reference, it should be noted that the primary mechanism for consideration of these is the Australia's Future Tax System Review.

7.2 The means test

The means test is the primary mechanism for determining the rate of pension payment made to individual pensioners. With the exception of a period in the 1970s when means testing was abolished for certain groups of older age pensioners, income support payments in Australia have always been targeted through means testing.

Settings for the means test have varied between payments and over time. This has occurred in response to a range of different priorities and circumstances. Drivers of change have included different notions of need, equity or fairness; different views on the balance between the support that should be provided to pensioners and the funding burden placed on taxpayers; to complement taxation and industrial relations policy settings; and to provide incentives for behavioural change in individuals or families in areas such as employment, saving, education and child-rearing.

7.2.1 The role of means testing

The primary purpose of means testing is to target the payment of income support to those most in need. That is, while the pension system in Australia is primarily directed at providing an adequate level of income to those who are unable or not expected to support themselves, means testing is the mechanism that withdraws assistance as private capacity increases.

This task is made complex because, as discussed in Chapter 2, means testing needs to target payments in a way that does not induce inappropriate behavioural responses, and which is seen as fair and equitable. To achieve this, balances need to be struck:

- between effectively targeting assistance and minimising disincentives for employment and savings, including not unfairly penalising, or discouraging, those who seek to provide for themselves
- between the level of assistance and the impost on taxpayers who ultimately fund spending on pensions.

Because means testing of retirement incomes operates in an area of often complex financial arrangements, its structure and operation are also inevitably complex.

The Review has therefore considered whether the balance of means testing is right by reference to three principles:

- targeting pension assistance to those most in need
- ensuring that incentives remain for people to provide for themselves through savings or work
- ensuring within the pension system that people with similar levels of means and financial circumstances receive similar levels of income support.

In addition, it is important that the operation of means testing effectively integrates the pension system, in particular for age pensioners, with the broader retirement income system including superannuation, so that these mechanisms together can effectively address the key longevity, investment and inflation risks that are important to provide security for pensioners and ensure the sustainability of the tax-transfer system.

One of the mechanisms that contributes to this integration, as discussed in Chapter 6, is the CSHC which provides a transition between the benefits made available to age pensioners and those older Australians with more substantial means.

7.2.2 The design of the means test

Pensions are subject to two means tests: an income test and an assets test. Administratively, a person's entitlement to a pension is assessed under both tests, with payment then being made at the lower of the rates they determine.

Structurally, the means test comprises two elements, a 'free area' and a 'withdrawal rate'.

- Free areas permit people to have certain levels of income or assets without affecting their pension. In addition to reducing the administrative burden, this ensures that people face no disincentives to acquiring low to moderate levels of private means, and allows for the costs of gaining the income including some costs of employment.
- Withdrawal rates, also known as 'tapers', operate to ensure that the rate at which the pension is reduced at higher levels of private means is such that people with higher levels of assessable means are still financially better off in net terms from having private means.

These structural elements are supported by a series of definitions of assets and income, and exemptions that determine whether and how private means are assessed. The objective of these settings is to ensure that people in effectively similar financial circumstances receive similar levels of support. (The extent to which this actually occurs is considered in Section 7.5.2.)

Current income and assets test parameters are detailed in Tables 5 and 6.

- Under the income test, the level of the potential pension payable is reduced by 40 cents for each dollar of private assessable income over the free area.
- The assets test operates by reducing the potential pension by \$1.50 a fortnight for each \$1,000 of assessable assets over the free area amounts. This equates to a \$39 reduction in pension a year for each \$1,000 of assets above the free area.

Table 5 Income test: main parameters, 1 January 2009

Family situation	Maximum pension is paid if assessed income is up to		No pension is payable if assessed income exceeds ^a	
	Fortnightly (\$)	Annually (\$)	Fortnightly (\$)	Annually (\$)
Single pensioner	138.00	3,588.00	1,558.25	40,514.50
Pensioner couple (combined)	240.00	6,240.00	2,602.50	67,665.00
Single pensioner with one child	162.60	4,227.60	1,582.85	41,154.10

Notes: Pension cut-out point is higher for people receiving Rent Assistance.

Table 6 Assets test: main parameters, 1 January 2009

Family situation	Maximum pension is paid if assessable assets are up to (\$)	No pension is payable if assessable assets exceed (\$) ^a
Single home owner	171,750	550,500
Single non-home owner	296,250	675,000
Partnered home owner (combined)	243,500	873,500
Partnered non-home owner (combined)	368,000	998,000

Notes: Pension cut-out point is higher for people receiving Rent Assistance.

As shown in Tables 5 and 6, pension free areas and cut-outs differ depending on household circumstances and whether they own their own home.

- ▶ Single pensioners, single pensioners with a child and couples are all treated differently. In addition to the thresholds shown in the tables, there are more specific thresholds covering circumstances such as couples separated by illness.
- ▶ Non-home owners have a higher free area under the assets test than home owners. This partially compensates for the benefit that home owners receive from the exemption of the family home from the assets test.

The operation of means testing and the outcomes for different groups of pensioners are also affected by the definition of which income and assets are ‘assessable’ or ‘exempt’ from means testing, and the particular treatment of different sorts of assets and income.

- ▶ In the case of the assets test, the two significant exempt assets are a person’s owner-occupied house, or in some cases the proceeds of the sale of the house, and for pensioners under Age Pension age, superannuation assets. Other exemptions are relatively minor and cover items such as funeral savings and aids for people with disability.
- ▶ The income test is more complex:
 - Income from employment and from ‘non-financial assets’ such as real estate is assessed on an actual income basis.
 - Income from ‘financial investments’ like bank deposits and shares is assessed on a ‘deemed’ basis—that is, based on the asset value, rather than the actual income received by the pensioner.
 - In most cases lump-sum receipts, such as gifts, the proceeds of the sale of a house, and loans (including reverse mortgages), are not counted as income as they are received, but may be assessed if these amounts are invested in other assets.
 - A more complex set of rules exist around superannuation income.

These tests are discussed in more detail in Section 7.5.3.

7.2.3 Operation of means testing for pensioners

While the means test operates by way of single tapers, the actual relationship between increasing private income and net income is much more complex. This is largely the result of interactions with the tax system, but also because of the way in which some additional allowances are withdrawn.

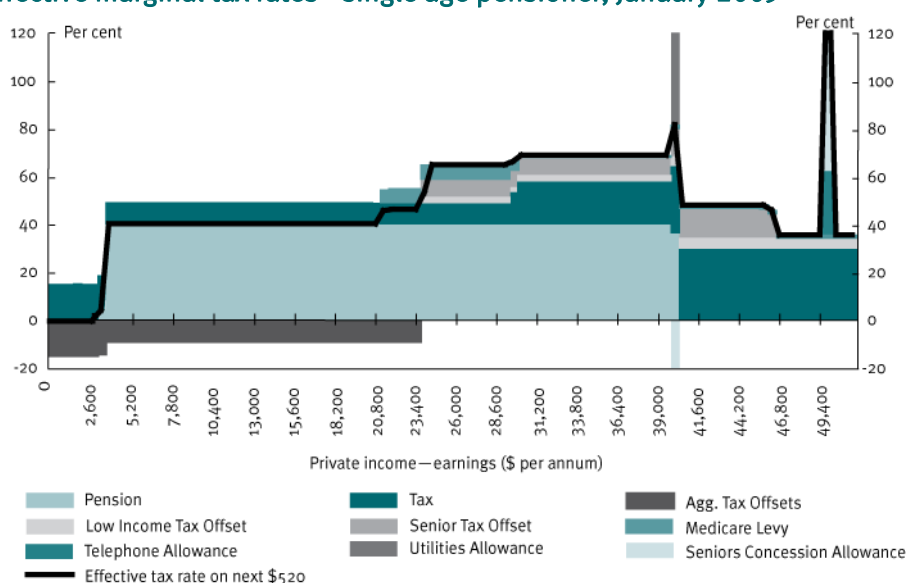
Because of the interaction with the tax system, the relationship also differs for various groups of pensioners and types of income. Of particular note in this regard are the tax offsets such as the Senior Australians Tax Offset, which is age-related, and the Mature Age Workers Tax Offset, which is again dependent on age and applies to earned income only.

These interactions are shown in Chart 24, which illustrates effective marginal tax rates. An effective marginal tax rate is the proportion of an increment of private income that, due to imposts such as taxation and reduced payments due to the means test, does not flow through to net disposable income. The chart shows effective marginal tax rates on increments of \$10 a week of private income. The chart also shows, at each point the components of the tax-transfer system that are responsible for the rate.

In the case illustrated, that of a single age pensioner whose private income is earnings, the effective marginal tax rate is initially zero while earnings are within the free area before rising to 40 per cent as the income test withdrawal rate operates. While initially any tax impact is offset by increasing tax offsets, at around \$20,800 a year a more substantial interaction occurs as the value of the offsets reduce and the Medicare Levy begins to shade in. There is then a spike at around \$40,000 associated with the loss of

Utilities Allowance. The effective tax rate then drops, and while initially higher due to the withdrawal of the Senior Australians Tax Offset, it falls to the marginal tax rate at some \$46,800, before a final spike associated with the withdrawal of the Seniors Concession Allowance.

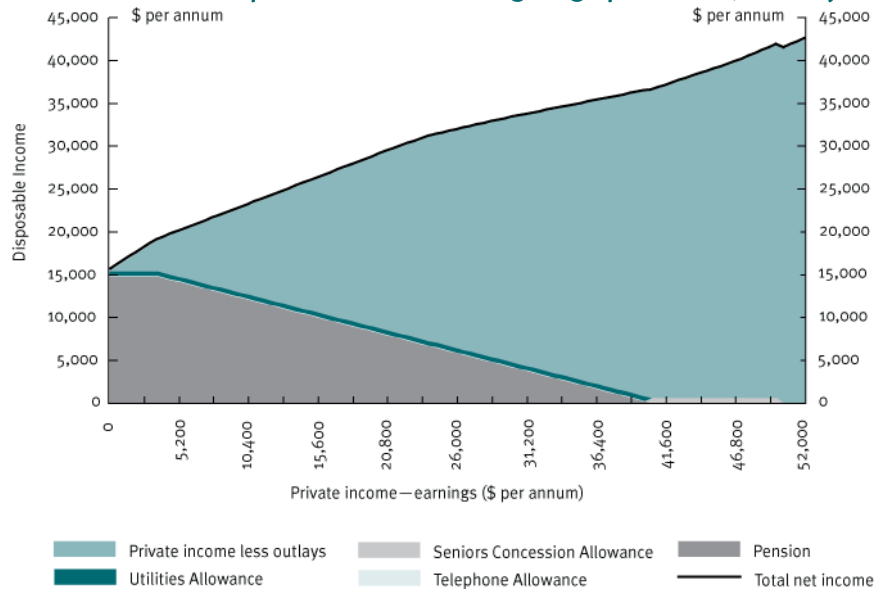
Chart 24 Effective marginal tax rates—single age pensioner, January 2009



Notes: Effective marginal tax rates shown are on the next \$520 a year (\$10 a week) increment of earnings, at each \$520 earnings point. Effective marginal tax rates vary between pensioners depending on factors including the type of pension, the type and source of income and the pensioner's age.

Source: Review modelling.

While this pattern appears to be very complex, the reality of its impact on the disposable income of pensioners is somewhat smoother. Chart 25 illustrates how, with the exception of the point at which the Seniors Concession Allowance is withdrawn, additional earnings increase the disposable income of the pensioner, notwithstanding the tapering away of the pension.

Chart 25 Private income and disposable income—single age pensioner, January 2009

Notes: The disposable income level in the chart does not include the value of bonus payments such as the Seniors Bonus.

Source: Review modelling.

Charts 24 and 25 illustrate the operation of the pension income test. It should be noted that at points above a moderate level of assets the assets test generates higher effective marginal tax rates and different impacts on total disposable income (Section 7.5.2 discusses the assets test in more detail).

7.3 What the consultations told us

As discussed in Chapter 3, there was a fundamental divergence in the views expressed in the consultations about what people see as a 'fair pension system'. In the context of means testing, while some believed the test should be eliminated or relaxed, as they saw the pension as a 'right', others believed it should be tightened to better target pensions to those with least private means.

7.3.1 Consultations—the pension as an entitlement

The theme of a 'right' to the pension, particularly the Age Pension, and means testing of pension payments as either inappropriate or too harsh, was a feature of all consultations.

At the public forums and other consultations, many pensioners expressed their belief that they had 'earned' the right to an Age Pension in retirement through having paid taxes over their working lives. These participants indicated that they saw it as unfair that the means test operated effectively as a high marginal tax rate on earned income, and as a penalty for having built wealth over a lifetime.

This view was more marked in the written submissions. Around 19 per cent of submissions from age pensioners supported the view that age pensioners had already earned the right to the pension through a lifetime of work and paying taxes.

7.3.2 Consultations—adequacy of part-rate pensions

Overall, while many submissions to the Review came from pensioners who were on a part-rate pension and raised concerns about the living standards these pensioners could achieve, the extent of adverse

outcomes indicated in these was considerably less than that raised in submissions from those who were wholly reliant on the pension.

This was also seen in the focus groups, where participants were asked a series of questions about their satisfaction with income support payments, standard of living, ability to meet daily living costs, financial security and comparative standard of living. Part-rate pensioners consistently reported having better outcomes against all measures than pensioners receiving the maximum rate.

7.3.3 Consultations—incentives to work

Many of the pensioners participating in the public forums indicated that they would like to undertake some part-time work but felt that this was discouraged by the income test. This view was reinforced by many focus group participants: more than one-third of participants expressed a strong interest in performing paid work of some sort, even though participants involved in the focus groups were either older than Age Pension age, had a disability which significantly affected their capacity to work, or were caring full-time for someone else.

There were repeated calls in all consultations for work incentives to be improved:

- ▶ One-third of public forum participants who submitted self-completion forms³⁵ called for improvements to work incentives through relaxing income test thresholds or the tax treatment of earnings.
- ▶ Around 18 per cent of age pensioners and 20 per cent of organisations who made a written submission called for a more generous treatment of earned income.
- ▶ More than three-quarters of focus group participants (who indicated they were able to work) thought that the current design of the pension system did little to encourage people to take up work.

Reasons to participate in employment

In addition to the financial gain, paid employment was seen as helping to maintain a balanced and active lifestyle. Some submissions talked about the social, mental and physical benefits of work, arguing that the government should encourage pensioners to undertake some paid work, if pensioners wish to. Some submissions suggested that participation in the workforce could save the community money in the long term through reduced health and welfare costs. Around 11 per cent of submissions from organisations mentioned the benefits of pensioners being in work.

This perspective was also reflected by focus group participants, who saw work as having many objectives: as a way to supplement their income, as an opportunity for stimulation and social interaction, and as a means of ‘giving something back’ and making a useful contribution.

Barriers to employment

A consistent theme across the consultations was that pensioners felt, because of the pension income test, that there was little or no financial incentive to work.

Participants in the public forums generally saw the pension taper rate as a tax, and pointed out that outside the social security system only high-income earners face a 40 per cent tax rate. Participants also thought that they should be able to earn more than \$69 a week (for singles) before it affected their pension.

³⁵ Of people attending the public forums, 38 per cent submitted self-completion forms.

This view was also reflected in the written submissions and focus groups. Some submissions argued that current income test arrangements resulted in part-time work being of little or no economic benefit to many pensioners, even though they were keen to participate in the workforce. Some focus group participants stated that it simply cost too much to go back to work.

Some participants criticised the complexity of the means testing rules, which can make it difficult to identify how undertaking extra work or saving money might affect pension payments.

Participants in the public forums also felt that the costs associated with looking for and travelling to work were not sufficiently recognised in the setting of means test thresholds.

In addition to the income test issues, many people receiving Disability Support Pension spoke of the difficulty of finding suitable employment, the negative attitudes of some employers towards people with disability, and the challenges posed by the current work capacity assessment process required to qualify for payment.

7.3.4 Consultations—the assets test

About 8 per cent of submissions from individuals and 9 per cent from organisations called for assets test thresholds to be reviewed or for the assets test to be abolished. Several were concerned that savings gained from work and careful budgeting were being included in income and assets tests, even if those savings were being held for purposes such as home maintenance, car repairs or appliance replacement.³⁶

Other submissions expressed concerns at what people felt was a harsh means test treatment of non-productive, high-value assets, such as holiday homes and non-productive farms, from which they derived no income, but because of which they were entitled to little, if any, pension payment.³⁷ Similarly, there was criticism of gifting rules and the treatment of overseas pensions.

Older participants in the public forums argued that they had no opportunity to benefit from the introduction of the Superannuation Guarantee and that the policy settings in place during their working lives actively encouraged investment in the family home rather than saving for retirement.

7.3.5 Consultations—targeting and sustainability

Balancing these views that means testing should be relaxed were views that there was a need to better target assistance to those with the least means. Some submissions, mainly from peak organisations, but also some individuals, called for tightening of means test rules for people with significant private income or assets. These submissions argued that tighter targeting of pensions to those most in need was required to maintain a fiscally sustainable pension system.

7.4 Reform directions and sustainability

The Review identified a number of important short- and long-term priorities that need to be taken into account in considering possible changes to the means testing and targeting of pensions.

³⁶ As at January 2009, under the income test, a single pensioner with no other private income can have up to \$99,950 in financial assets, including bank accounts, prior to having their rate of pension reduced through the operation of the income test and deeming.

³⁷ The Pension Loans Scheme is available to provide a top-up of the pension to people who receive a lower rate because of the operation of the assets test on such non-productive assets. The value of the loan is recovered from the estate of the pensioner. There are also special hardship provisions in the assets test.

The group of short-term issues principally flow from other findings of the Review. A key question is whether, if there was an increase in the pension rate to meet the objective of adequacy for those wholly reliant on income support, it would be appropriate for this to flow on to those with higher private incomes and low to moderate reliance on the pension. In addition, there are a number of areas where reform is needed to ensure that the income and assets tests operate effectively and efficiently.

As discussed in Chapter 2, the long-term sustainability of the pension system is a crucial issue for governments, and for pensioners: financial security can only be achieved for pensioners if the pension system is sustainable.

These longer-term issues are discussed in Sections 7.5 and 7.6. However, the Review recognises that many of the issues of long-term sustainability are best considered in the broader context of the Australia's Future Tax System Review. The Pension Review has considered these issues to ensure that its findings are soundly based, and to ensure that the shorter-term reform directions that it has identified are compatible with the longer-term directions that might be taken by the Australia's Future Tax System Review.

7.4.1 Role of the Age Pension

Before discussing the reform directions for the means test, the Review considers that it should address one area where its view of the role of the pension system is at odds with the views presented in consultations.

In the consultations there was a strong view that the Age Pension is a right and that means testing is inappropriate because pensioners consider that they have earned the pension. As discussed in Chapter 2, while this may be appropriate for overseas models of contributory social insurance, it is not appropriate for Australia's income support system. The Review considers that Australia's model of pensions is different: the payment of pensions is primarily driven by the objective of providing an adequate level of income to those unable or not required to support themselves.

The view that pensioners have 'pre-paid' their pensions is also out of line with current policy settings. Pensions are paid out of current receipts and by current taxpayers. Indeed, with the changing structure and size of the population, current and future cohorts will be required to provide support to a much larger population of pensioners than has been the case for earlier generations.

It should also be noted that even at current values for the pension, and despite the perceptions of many, for a large proportion of the population, the level of taxation they have paid, even if wholly allocated to the pension, would not have been sufficient to fund the current rates of pension over current projected lifetimes.

An important consequence of this perspective is, as discussed in this report, the question of equity between pensioners and taxpayers, and in particular the extent to which a pensioner with private income can be receiving some pension payments generating a level of income on which a non-pensioner would be a net taxpayer.

If the pension were a pre-paid entitlement, this might not be seen as an issue. When the pension is a targeted payment based on need as well as eligibility criteria, means testing must be considered.

7.5 Reform directions—means testing

Three key aspects of means testing have been considered by the Review:

- The appropriateness of the levels of pension payments to pensioners with private means.
- The relationship between the income and assets tests.

- The definition and treatment of particular types of income and assets.

7.5.1 Appropriate levels of pension payment

Chapter 3 considered the question of appropriate rates of pension for those who wholly rely on it. To address the terms of reference in relation to appropriateness of the levels of pension payment for those who have additional private means, the Review has focused on two questions:

- Are the current rates of payment made to pensioners with private means appropriate, within the context of an income support system designed to achieve adequate outcomes and to ensure that there are incentives for self-provision?
- If the rate of pension were increased to improve adequacy for some groups of pensioners who are wholly reliant on income support, would there be the same need for these payments to be passed on to pensioners with low to moderate reliance on income support?

This section considers four specific issues associated with the appropriateness of the levels of payment made to pensioners who have private means and are affected by the means test:

- incentives and how these impact on behaviour
- the current outcomes for these pensioners
- the implications of any change in the rate of pension
- the effects of possible short-term changes on the outcomes of the Superannuation Guarantee.

The impact of incentives

The means testing of pensions needs to balance the objective of targeting taxpayer-funded transfers against the equity and efficiency impacts of high effective marginal tax rates, which introduce disincentives for participation and savings.

However, the impact of incentives on behaviour is complex.

- The existence of a social safety net may result in a willingness to accept risk and a lower commitment to self-provision. While the first of these can be seen as a positive when it is reflected in areas such as labour market flexibility, the second can result in a willingness to rely on the safety net which does not benefit the individual and costs the community.
- The outcomes of effective marginal tax rates also depend on both income and incentive/substitution effects. While some people may respond to higher effective tax rates by reducing effort because of the trade-off between leisure and income, others may respond by increasing their effort so as to achieve the same level of income they would otherwise have received.
- In practical terms, there are also inter-temporal impacts that need to be taken into account. In the case of the Age Pension, for example, a shift in the means test treatment of assets, while potentially causing a behavioural shift by those in employment who are accumulating assets, may have little impact on the behaviour of current pensioners who have little scope to change their level of assets.
- In such cases where behaviour is inelastic in the short term but elastic in the longer term, the short-term consequences of policy may be quite different to the longer-term goal. At least in the short term, policies intended to encourage the accumulation of private means may result in an increase in government outlays because of higher rates of pension being paid to those people on a part rate of

pension, while any reduction in outlays due to increased savings as a result of the change in incentives may not be obtained for many decades.

Therefore, while the Review considers that the incentive effects of means test design are important, the final impact on behaviour and outcomes is a result of many factors and cannot always be accurately predicted.

Current outcomes

Four approaches were considered in trying to measure the outcomes of the current means test regime:

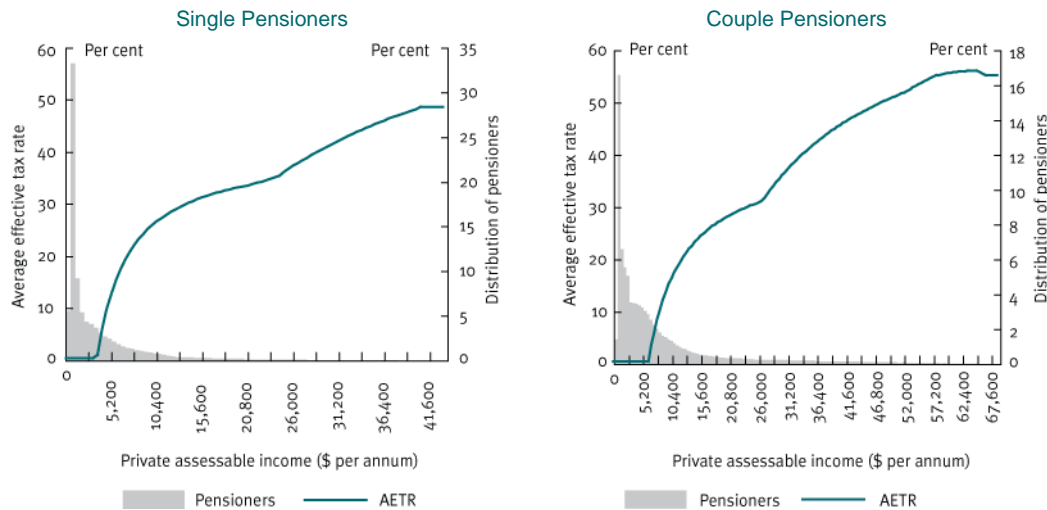
- ▶ the current distribution of average effective tax rates
- ▶ the cut-out points of payments
- ▶ whether there is evidence that the current pattern of incentives is introducing distortions in behaviour
- ▶ the levels of wellbeing achieved by pensioners.

Effective tax rates

The impact of means testing is illustrated in Chart 24, which shows that, with the exception of some spikes, effective marginal tax rates remain below the point at which a person would see their disposable income drop if they were to gain an additional dollar of private income—a situation often referred to as a ‘poverty trap’.

The pattern of incentives is also considered in Chart 26. In these charts the focus is on the average effective tax rates for age pensioners. Average effective tax rates measure the amount of pension withdrawn and tax paid as a proportion of private income in a cumulative sense from the first dollar of income. They provide a different view of the impact of income testing than effective marginal tax rates for a number of reasons. Average effective tax rates are less volatile than effective marginal tax rates. They take account of the fact that income changes can be ‘lumpy’, moving from one point to another, rather than moving in small dollar increments; and unlike effective marginal tax rates, they take account of the role of free areas across the income range.

Along with these average effective tax rates, Chart 26 also shows the distribution of the current age pensioner population.

Chart 26 Average effective tax rates from first dollar of income, age pensioners

Notes: The distribution of pensioners by private assessable income is at December 2008.

The AETRs are at 1 January 2009 and are generated by earned income. In the chart regarding couples, all the private assessable income is earned by one member of each couple.

While average effective tax rates reach levels of around 50 per cent (slightly lower for single pensioners and slightly higher for couples), these rates are only generated at quite high levels of private income. In the case of a single pensioner, the average effective tax rate reaches 30 per cent for a pensioner with a private income of around \$14,000, and for a couple it reaches 50 per cent for private incomes above \$48,500. These rates are, however, of course well above the actual tax rates paid by working age taxpayers with similar levels of income.

In both cases, these high rates only affect a small proportion of the population. For single pensioners, 68 per cent of all pensioners have income within the free area only and hence face no withdrawal rate at all. More than 80 per cent have average effective tax rates of under 20 per cent, and less than 2 per cent face rates at or above 47 per cent. The situation is similar for couples. The average effective tax rates in the couple pensioners graph show that around 80 per cent have incomes below the free area and 76 per cent have average effective tax rates of under 20 per cent, with less than 4 per cent experiencing a rate of 50 per cent or higher.

It should also be noted that Chart 26 illustrates outcomes where the private income is from earnings. As discussed above, where the private income is from investments or bank savings, the means test 'deems' that the pensioner receives an income. To the extent that a pensioner obtains an actual return that is higher than the deeming rate, average effective tax rates on their actual private income can be significantly less.

Chart 26 illustrates the operation of the income test. Higher average effective tax rates can apply to asset-tested pensioners (Section 7.5.2 discusses the assets test).

Pension cut-out points

A consequence of current means testing parameters is that, while the primary purpose of the pension system is to assist those with limited means, a part rate of pension can be received by people with relatively high levels of personal resources. Under current policy settings a single pensioner can have a private income of \$40,514.50 a year before their pension entitlement is extinguished, while a couple can have an income of \$67,665. If pensioners receive Rent Assistance, their cut-outs are higher than these figures.

By community standards these levels of means are quite high. The cut-out for a single pensioner is equal to the gross earnings of a full-time worker at the 30th percentile of the earnings distribution, while that for a couple is the equivalent of a worker at around the 73rd percentile of full-time earnings. When compared with the incomes of taxpayers, the cut-out for a single person is around the 47th percentile of taxpayers and for a couple around the 78th percentile.

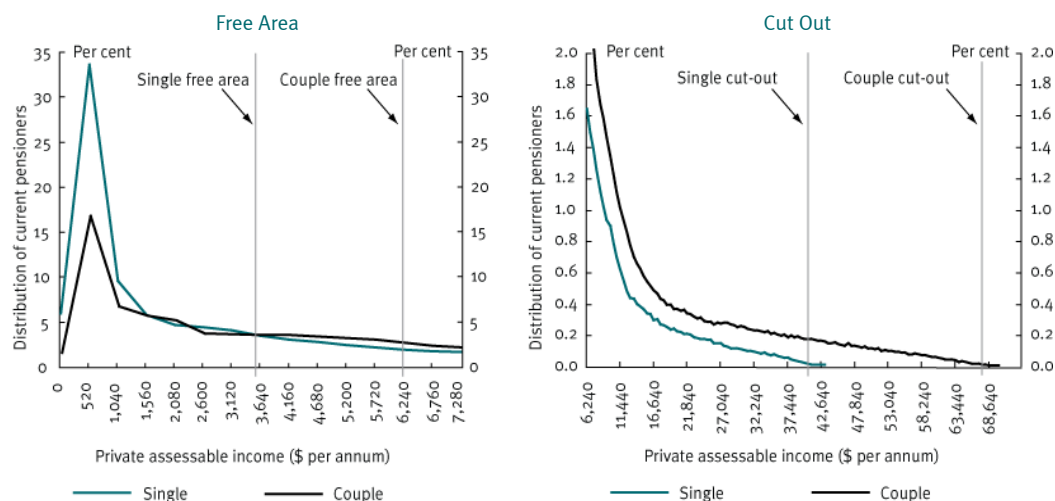
Impact of cut-out and related points

As the pattern of effective marginal tax rates is not consistent across the range of income, incentives will vary. A particular concern in pension design is whether or not these variations introduce distortions in people's behaviour. While there are many anecdotal reports of pensioners seeking to adjust their financial affairs to minimise the impact of means testing, or to maintain the particular benefits associated with access to concession cards, this type of behaviour is much harder to capture in analysis.

If these means test thresholds had a strong behavioural impact, it would be expected that the distribution of pensioners by their level of assessable private income would show a concentration at points just below the free-area thresholds and pension cut-outs, and in the case of the free area, a compensating reduction in numbers immediately above this point.

As is shown in Chart 27, no such distortion appears in the distribution of age pensioners, either around the cut-out of the free area for pensioners or at the cut-out point for receipt of any pension payment.

Chart 27 Distribution of age pensioners by private income, December 2008



Note: The free areas and cut-outs are at 1 January 2009.

The cut-outs refer to pensioners who do not receive Rent Assistance.

Source: Review modelling and administrative data.

These distributions suggest that the current structure of means testing is not introducing a significant degree of distortion, or in the case of the cut-out point of the pension that the CSHC is effective in eliminating a 'sudden death' cut-off in support which may otherwise encourage people to maintain pension eligibility even if they only received minimal income support from this.

Wellbeing

Wellbeing outcomes were discussed in Chapter 3. This analysis indicated that across a range of measures it was clear that those pensioners who had private means had more positive outcomes than those who were wholly, or close to wholly, reliant on income support.

These findings were confirmed in the focus groups conducted by the Review. Across the set of questions that they were asked, part-rate pensioners reported higher levels of satisfaction with the rate of the pension, their standard of living, and how their standard of living compared to the community as a whole.

Summary of current outcomes

Taking these four aspects together, the Review considers that there is no evidence that the current means testing of pensions is leading to an inappropriately low level of pension payment to those pensioners with private means. In particular, wellbeing analysis does not indicate a need for concern about the adequacy of the rate of the pension received by groups with low and moderate reliance on pensions.

Impact of changes to the base rate of payment

As indicated in Section 7.4, one immediate short term issue considered by the Review was the implication for those with low to moderate reliance on the pension, of a change based on the adequacy of pension rates for these wholly reliant on the pension.

Under current means test arrangements, such a flow-on occurs automatically unless there are changes in the means test parameters. In contrast to this, the Review considers that any increase should be targeted. This issue is considered here with regard to the income test. Because of complexities in the interaction of the income and assets test, the assets test is discussed separately in Section 7.5.2.

A threshold question is whether the parameters of the income test can be tightened without adversely affecting incentives to work and save.

- The Review considers that the analysis of marginal and average taxation rates above demonstrates that there is, in the context of an increase in the maximum rate of pension, some capacity for moderate tightening of the income test settings without adversely affecting incentives to work and save.
- The Review considers that this also holds for the Age Pension's role in providing a foundation for the replacement rates achieved by individuals through the Superannuation Guarantee. In the context of an increase in the maximum rate of pension, it would be possible to moderately tighten income test settings without significant adverse effects on the replacement rates achieved by the combination of the Age Pension and the Superannuation Guarantee.

Therefore, the Review considers that in the case of an increase in the pension rate, there is the capacity to tighten income test settings to prevent the increase flowing to pensioners with low and moderate reliance on the pension.

Limiting the flow-on could be undertaken in two ways: by a reduction in the free area of the means test or by an increase in gradient of the taper rate.

While either a reduction in the income test free area or an increase in the income test taper rate would increase the average effective tax rate faced by pensioners, the points at which they impact differ. A reduction in the free area increases the average effective tax rate at the lower end of private incomes, with the most marked effect at incomes between the old and the new free areas. In contrast, an increase in the taper rate has a much smaller impact on those with low private incomes and a relatively stronger impact at higher levels of private income distribution.

It should also be noted that the issue of incentives to work and save, arising from the interactions of the tax-transfer system, and the interaction of the Age Pension and the Superannuation Guarantee, are being considered in the wider Australia's Future Tax System Review. That review will, in this context, identify long-term reform directions for the pension means test. The Pension Review has developed its findings in

this area within the context of the current structure of means testing, and with a view to developing shorter-term reforms that do not pre-empt future reform direction that might be developed by the wider Review.

Finding 25: The Review finds that there is no evidence that the means test as a whole is operating to provide an inadequate level of support to pensioners with low to moderate reliance on the pension.

Finding 26: The Review finds that, in the case of an increase in the pension rate to achieve an improvement in adequacy and financial security for those pensioners for whom the pension is the predominant source of income, there would be capacity to tighten income test settings to limit the flow-on of the increase to pensioners with low to moderate reliance on the pension.

7.5.2 Relationship between income and assets test

The rate of pension a person is entitled to is the lower of the rates generated by the income test and the assets test. The concept of taking account of both income and assets in determining pension rates has been the predominant form of means testing over the history of Australian pensions, with the exception of the period between 1976 and 1984. The way in which this has been done has varied. The current structure of the tests largely reflects the approach implemented in 1985.

Within the current two test structure, the Review considers that the income and assets tests should act in a complementary way:

- ▶ The income test should be the primary test, taking account of the income a person has from employment and other sources, such as a deemed return on financial assets.
- ▶ The assets test should be a supplementary mechanism to address those situations where a person may have had significant non-financial wealth that they do not effectively use for self-support.

In this design, the assets test should be essentially a pragmatic mechanism to capture the small proportion of the population with significant assets in a form that does not generate income, and to discourage people from seeking to move their wealth into assets that do not form part of the income test. This objective is incorporated into the assets test by taking one approach to all assets, and through a very sharp withdrawal rate.

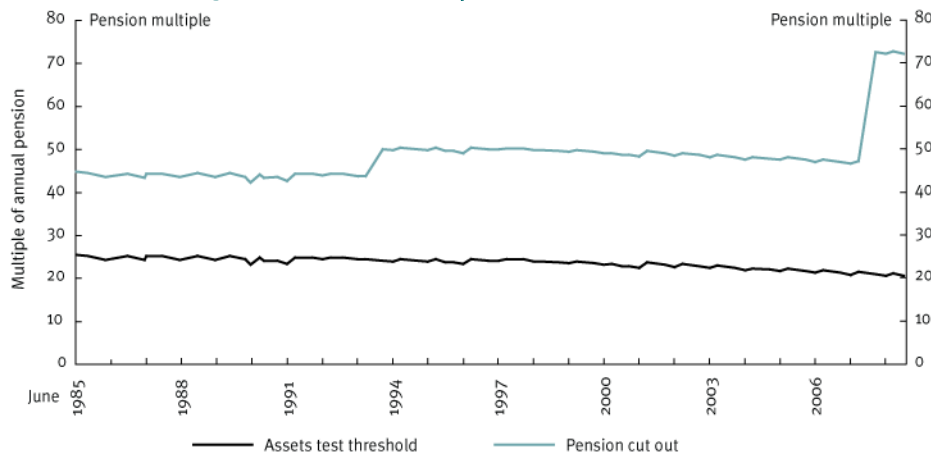
There are also operational efficiency and simplification arguments for placing a greater reliance on the income test as the primary mechanism. Income is usually easier to identify and value than assets, in particular non-financial assets. Non-financial assets, which include items such as holiday homes, non-productive farms and artworks, often require professional valuation. These valuations can be very volatile reflecting the nature of markets, which can add considerably to the complexity and onerous burden placed on applicants, especially when valuations are contested.

The relative roles of the two tests are reflected in the pension system. However, the balance between the tests has been changing over time. Currently, around 9 per cent of all age pensioners receive a reduced rate of pension due to the assets test, compared with 32 per cent due to the income test. New entrants to the pension system are more likely to have higher assets than existing pensioners and to be affected by the assets test. The proportion of new entrants for the 12 months to December 2008 who received a part-rate pension due to the assets test was around 24 per cent.³⁸ This difference in the asset levels of the stock of age pensioners and new entrants is in part due to growth in real wealth and in part to the fact that some age pensioners deplete their assets over time.

³⁸ This figure, however, has been somewhat boosted by a one-off influx of people who became newly eligible for pension when the assets taper was halved in September 2007.

Age pensioners today are also more likely to receive a part-rate pension due to the assets test than in past decades due to the indexation arrangements discussed in Chapter 4. These arrangements mean that the value of the threshold for the assets test has fallen in relative terms when compared with the pension rate. This is illustrated in Chart 28. While the cut-out point for pensioners has increased over time under the assets test, primarily because of changes in the taper rate, the assets test free area has declined in relative terms. The result is that the assets test can now be the primary test for pensioners with moderate financial assets alone, which in principle, should be captured through the income test. This reflects the fact that this parameter, as discussed in Chapter 4, is indexed by the Consumer Price Index alone.

Chart 28 Assets test settings, home owner couples, 1985–2009

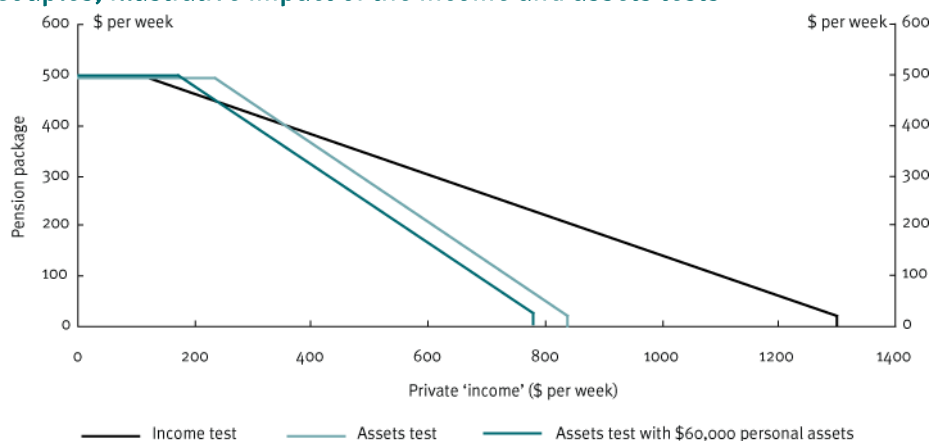


Notes: Assets test threshold and point where no pension payable expressed as multiples of annual rate of pension.
Source: Review calculations

Another way of conceptualising the relative impact of the assets and income tests is to compare the way in which the assets test would effectively be operating if all the assets were generating an income and the value of this income was compared to the levels of pension payable. This approach is illustrated in Chart 29 which, for a homeowner couple, shows the rate of pension that would be paid with different levels of private income, under the income test, and then how the assets test actually operates assuming all assets were financial and generated a rate of return of 5 per cent. While initially more generous, the assets test then operates aggressively and reduces the pension entitlement rapidly. For example, at levels of assets of around \$370,000 (an amount that would produce a weekly income of \$356 a week), the assets test would result in a lower pension than the income test.

However, because most pensioners also have personal assets—such as cars, clothing and furniture—that are incorporated into the assets test, the cross-over point between the two tests is reduced even more in the real world. In the case of a couple with, say, \$60,000 in personal assets, the cross-over would occur when they have financial assets of around \$250,000. This level of financial assets is becoming increasingly more common as people build up superannuation savings.

The lower the deeming rate on financial assets (at the time of finalising this report, these rates were 3 per cent and 4 per cent), the more stringent is the relative impact of the assets test in its current settings.

Chart 29 Couples, illustrative impact of the income and assets tests

Source: Review modelling.

In summary, the Review's concerns are that the assets test, rather than acting as a backup, can now operate as the primary test for some pensioners with relatively moderate levels of financial assets which would be better assessed under the income test. Instead of this group of pensioners being income tested on the value of their income, their pension is reduced on the basis of the wealth that was generating this income. This means that the income and assets tests are not interacting efficiently and effectively.

These trends and pressures on the assets test parameters were a part of the context of the reduction of the assets test taper rate from \$3.00 to \$1.50 in September 2007.

However, in contrast to the operation of the income test and the treatment of earned income and superannuation, the review considers that it is not possible to develop shorter term reform directions for the interaction of the income and asset test without pre-empting future longer term reform direction, that might be developed by the Australia's Future Tax System Review. The Review notes that the Australia's Future Tax System Review Panel has identified the overall design of the means test as a potential issue in its consultation paper on the retirement income system.

7.5.3 Scope and definitions of income and assets

The definitions of income and assets and the way in which particular items are treated in the means test have consequences for the rate of payment of pensioners. Five specific issues considered here are:

- the assessment of earned income
- the way in which superannuation income is assessed
- the treatment of the family home
- the tax treatment of pensions.

In addition to these specific areas, the Review first considers more generally the definition of income and the role of deeming.

Assessment of income

Various types of income are assessed differently for the purpose of the pension income test. The broad approaches to assessment are shown in Table 7. As illustrated, while in some cases income is simply assessed on the basis of receipts, in other cases it is assessed on a deemed basis. That is, rather than the

actual amount of income a pensioner may obtain from their financial investments, such as bank accounts and shares, a value of income is ‘deemed’ based on the value of the asset and a ‘deeming rate’.

The primary purpose of deeming is to ensure that pensioners utilise their assets effectively, in particular in a historical context where many pensioners held their savings in very low interest bank deposits, and to address the extent to which returns on shares were taken both as dividend income and as capital gains. As noted in the discussion of effective marginal tax rates, where a pensioner obtains a rate of return above these rates the pensioner is income tested on the deemed rate only, and hence the effective tax rate may be well below the nominal rate.

Deeming rates are adjusted to reflect the returns available in the market by the Minister for Families, Housing, Community Services and Indigenous Affairs on the basis of advice from that department. Current deeming rates are 3 per cent for the \$41,000 of financial assets held by a single pensioner or \$68,200 for a couple, and 4 per cent on amounts above this.

Table 7 Assessment of income

Income assessed	Type of income
Amounts earned, derived or received, including from:	Employment (including fringe benefits) (gross amounts) DVA payments and overseas pensions Real estate and businesses including farms (net amounts) Certain remunerative lump sums Boarders and lodgers Some periodical payments by way of gifts or allowances Leave or redundancy payments from an employer
Assessable income is calculated by reducing the annual payments paid from the income stream by an amount that reflects a return of the purchase price.	Income streams with a term of more than five years
The deemed amount from financial assets:	Money in a bank, term deposits, managed investments, listed securities Gold and other bullion Certain income streams (with a term of five years or less) Approved deposit funds, deferred annuities and superfund investments held by people over Age Pension age Loans including those to family trusts and companies Gifts of money or assets over \$10,000 a year or over \$30,000 over five years
Lump-sum amounts apportioned over 52 weeks:	Distribution from a family trust Commission or royalty Profits, for example, distribution from a profit-sharing agreement Grant or scholarship Payments to a professional sports person, for example, endorsement payments Dividend or distribution from a private unlisted company Certain ‘loan’ arrangements where there is no expectation that the loan will be repaid

Earned income and age pensioners

The treatment of earned income was a recurrent theme raised in the consultations. A significant group of pensioners indicated that they were discouraged from taking up employment by the extent to which this would lead to a reduction in their pension payments.

As the analysis in Chapter 2 indicated, continuing employment can be important for the benefits that accrue to individual pensioners (both financial and non-financial), and for the contribution that their participation in the workforce can make to society as a whole.

While these issues have relevance both to age pensioners, and those on working age payments, the focus of the Review's consideration here are on age pensioners. There are three reasons for this.

- Given the conditionality of the working age pensions and the close links between them, the labour market, and other working age payments, including eligibility for working credit, the issues for employment for these groups extend beyond the issue of incentives discussed in this section.
- The need to develop a more effective support for participation by age pensioners as an alternative to the current Pension Bonus Scheme.
- Specific issues around the relative treatment of earned and unearned income which are largely associated with the experience of age pensioners and their other forms of retirement income.

Section 7.6.1 considers the links between Carer Payment and Disability Support Pension and work force participation.

While the effective tax rate on private income in the pension system is not considered excessive when taken as a whole, the nature of employment income is somewhat different to investment income and other savings for two reasons.

The first concerns the direct costs of employment. While one of the purposes of the pension free area in the income test is to cover the costs of work, the free area is a relatively blunt instrument. It is insensitive to the actual costs of work which can vary with the time spent in employment and the level of income derived from it. In addition, to the extent many pensioners have some private investment income, this in effect has already absorbed the free area and if a pensioner commences employment there is no further offset for the additional costs of working.

The second issue relates to the extent to which age pensioners face a trade-off between the time they spend in employment and their leisure time. Because of the trade-off for leisure time, earned income involves an 'opportunity cost' to pensioners that is not associated with other income streams.³⁹

Taking these issues into account, and the importance of employment, the Review considers that there is a case to consider mechanisms that provide a stronger incentive for age pensioners to take up paid work, or to have transitions into retirement that allow for a combination of work and retirement.

- The first part of such an approach could involve the concessional treatment of at least some earned income (income from work) in the income test.
- The second part relates to the mechanics of the operation of the income test. The current approach is complex and involves 'striking an annual rate' of earnings which is particularly unsuited for responding to the higher degree of variability experienced in earnings-based income for some pensioners who undertake casual or irregular employment.

Such a change would provide a mechanism to replace the Pension Bonus Scheme.

In considering the return from employment for pensioners over Age Pension age, the Review was aware of the need to balance the objective of minimising disincentives for work by these pensioners with equity of treatment between pensioners and ordinary employees. This balance is already markedly in favour of

³⁹ This trade-off is another differentiation between participation incentives for age pensioners, and those on working age payments.

pensioners who receive a higher disposable income for the same level of gross income than working-aged employees. For example, an age pensioner who is in employment and is paid the equivalent of the Federal Minimum Wage would currently have a disposable income of \$627.84 a week. In contrast, a non-pensioner would have disposable income of \$494.44 a week, \$133 a week less.⁴⁰ A more concessional treatment of earned income would exacerbate this. For this reason, the extent of any concessional treatment may need to be capped.

Finding 27: The Review finds that there is a case to provide more effective mechanisms to support age pensioners to maintain or take up paid work if they wish to do so. A concessional treatment of low to moderate levels of income from employment would better deal with the costs of work which are only partially offset in the current means test and be more effective than the current Pension Bonus Scheme.

Definitions of assessable superannuation

The assessment of superannuation income under the income test is complex. Much of this complexity arises from the evolving nature of superannuation in Australia and the complex taxation and other rules applying to it.

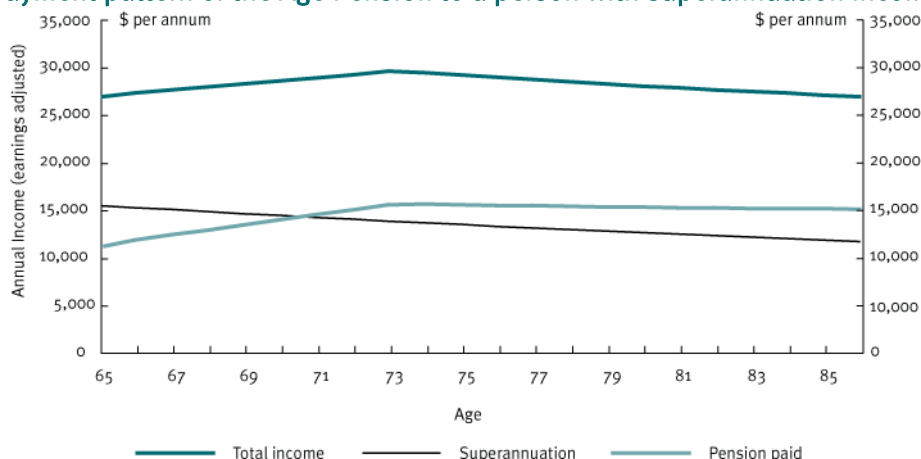
The most common forms in which pensioners take superannuation is as an income stream from an account-based product or as an annuity. In these cases a person is income tested on their 'assessable income', which is equal to the income they obtain less an 'income deduction'. This deduction is equal to the initial value of the superannuation asset divided by a factor which is either the term of the income stream or life expectancy as derived from life tables.⁴¹

While the goal of this approach is to exclude assessing the withdrawal of capital, it has several consequences. The income deduction tends to 'front-load' the concessional treatment and provides a benefit even when individuals only partially use their superannuation over their retirement. That is, while in the initial period of drawing on superannuation a pensioner will largely be drawing on fund earnings, the 'income deduction' is conceptually based on them actually withdrawing capital. In contrast, in later years when they are more likely to be drawing on the capital, the 'income deduction' (which is not indexed) will have reduced in value and a higher proportion of the amount drawn down will be treated as if it were income. Similarly, if a person maintains the capital value of their superannuation, for motives of bequest or to protect against longevity risk, they remain entitled to the 'income deduction' despite the fact that they are not drawing down on the asset. A consequence of these effects is, for example, that a person in receipt of an inflation-indexed annuity will obtain a lower rate of pension in later years as the real value of the 'income deduction' declines, and their assessable income increases. The patterns that result from this and the operation of the assets test on the income of a person receiving a part pension are shown in Chart 30.

In addition to these specific distortions in the rate of pension payment over time, a more general question raised by this treatment of superannuation is the extent to which it introduces distortions in people's choice of assets in retirement. Clearly the treatment is concessional relative to other financial assets.

⁴⁰ In this situation, while the pensioner would receive a net gain of \$84.06 a week of pension income (excluding the value of bonuses) less income tax, a single non-pensioner employee would be paying \$49.34 a week in income tax (including Medicare levy).

⁴¹ The effect of this 'income deduction' can be very significant. For example, in round terms, a man aged 65 with a superannuation asset of \$100,000 could draw from this the equivalent to an inflation-adjusted annuity of around \$7,000 over the following 18 years (the current life expectancy assumed in the pension system is actually 17.7 years). Offset against this would be an amount of \$5,650 ($100,000/17.7$), giving assessable annual income of just \$1,350. Since the first \$3,588 of private income is 'income test free' this means, unless the person had other private income, with this \$7,000 of income from superannuation they would still be entitled to a full pension.

Chart 30 Payment pattern of the Age Pension to a person with superannuation income

Note: Assumes a woman currently retiring with an account-based superannuation balance of \$250,000 which is drawn down on the pattern of a CPI indexed annuity and non-financial assets of \$50,000. Model parameters at Appendix E. Average annual retirement income is given in earnings discounted terms, that is, relative to the income of employed people.

Source: Review modelling.

The Review considers that there are strong grounds for changing this approach to remove the inappropriate ‘front-loading’ generated by this treatment, and to reduce any distortions in choices around the form in which assets are held. This would most simply be achieved by treating account-based superannuation in the same way as other financial assets under the income test; that is, assessing these superannuation products under the income test on the basis of income deemed from the current value of the superannuation asset. This approach would also complement any tightening of the income test by increasing the effectiveness of the income test treatment of account based superannuation products.

Finding 28: The Review finds that a deeming approach for account-based superannuation products would remove the current distortion in the pattern of payment of pensions to pensioners with such income and assist in equalising the treatment of superannuation products and other financial assets.

In addressing the treatment of account based superannuation products in the income test, the Review acknowledges that other issues arise in the assessment of a range of retirement income products, including those that may have both an income and an insurance component. In particular, the treatment of specific products can have a considerable bearing on the viability of products developed by the private sector to better assist older Australians to manage risk in their retirement. These issues are also being considered by the Australia’s Future Tax System Review.

Equity in the family home

In consultations, some organisations and individuals raised concerns about the exemption of owner-occupied housing from the assets test.

Some were concerned that this may not be fair or equitable to people who have homes of modest value, or who rent privately or rely on public housing. Others were concerned that the exemption may encourage people to ‘over invest’ in their family home, for example to maximise the rate of pension paid and to maximise the estate they can eventually pass on to their children, or may discourage ‘empty nesters’ and retirees from downsizing to accommodation which is more appropriate to their needs.

In some cases there were suggestions that the means test should be changed so that pensioners with very high value home equity are deemed to generate an assessable income stream from some of this equity.

Balanced against this, the exemption of the principal home from means testing has been a long-term feature of the social security system and home ownership can contribute significantly to the financial security of pensioners by reducing their housing costs in retirement. For many pensioners home ownership is actually used more deliberately as one of the mechanisms for managing longevity risk. The capital value of home ownership also plays a role in the funding of accommodation bonds for certain forms of residential care.

A more specific issue concerns the treatment of equity withdrawal from the principal home. Historically, one of the reasons for excluding owner-occupied housing from means testing has been that equity in the family home was considered to be relatively 'illiquid'. This is less the case today with the emergence of mortgage 'redraw' and equity 'draw-down' products.⁴²

Under the means test, if a reverse equity mortgage is taken as a stream of income, then the amount drawn down is not counted in the income test. If taken as a lump sum, the first \$40,000 is exempt from the assets test for up to 90 days. While these rules apply to any capital amount (for example, a loan), it is possible for pensioners to use their assets test-exempt home equity to draw down a significant income stream that is exempt from means testing.

The emergence of reverse mortgage products is an example of how the products offered by the private sector are evolving to meet changing preferences. However, these changes also raise issues for the pension means test. The first is a direct question of whether or not the treatment is appropriate relative to other assets. The second is the extent to which the settings may inappropriately encourage the use of products, without pensioners fully assessing factors such as the compounding 'negative interest' aspect that can lead to a relatively rapid reduction in equity over time and finally erode security of tenure.

The issue of neutrality of treatment was also raised with regard to a person who downsized their housing—usually cases where a large family home was sold and the person instead bought a smaller unit or apartment that was more appropriate to their needs. While there are transitional arrangements that enable proceeds from the sale of the old dwelling to be protected in the short term to permit the purchase of the new dwelling, where the value of the new dwelling is less than the old, the difference becomes an assessable asset. Pensioners pointed out that this meant that their pensions were reduced, despite no net change in total assets. Effects like this are likely when the assets holdings of a pensioner move between exempt and non-exempt classes. Obviously, while the pension entitlement is reduced, the pensioner has potentially more assets to use to support themselves. This highlights the importance of ensuring that the income and assets tests operate efficiently and effectively and are in balance.

The broader issues that the exemption of the principal base raises, including the question of neutrality in the treatment of assets to ensure efficient allocation, is being considered by the Australia's Future Tax System Review.

Pension taxability

The financial outcomes of pensioners are also affected by how the pension interacts with the broader tax-transfer system. There are some differences in the taxation treatment of age pensioners, and disability support pensioners and of Carer Payment recipients above Age Pension age, and those below this age. While the pensions received by these older pensioners are treated as income for the purposes of income taxation, the pension income of those on Disability Support Pension who are under Age Pension age, and those on Carer Payment where both the carer and the person in receipt of care are under Age Pension age, is non-taxable.

⁴² Industry analysts estimate that there are currently more than 30,000 reverse mortgages in Australia, with an average value of around \$60,000 for each mortgage (Hickey & Ling 2008).

The Review could find no clear rationale for the difference in approach, and could see no compelling reason to continue the tax exemption of pensions paid to working-age pensioners. Pensioners in all categories of pension engage in the workforce and the levels of participation do not seem to warrant this difference. Furthermore, other income support payments for working-aged people are taxable, and similar taxation rebates are provided for both working-aged pensioners and other beneficiaries. This again is an issue that falls more appropriately into the specific focus of the Australia's Future Tax System Review.

7.6 Reform directions—targeting of and eligibility for pensions

A number of other parameters of pension policy directly affect the sustainability of the pension system. Apart from the means test, the most important of these are targeting and eligibility.

7.6.1 Disability Support Pension, Carer Payment and workforce participation

Earlier discussion has noted that both the Disability Support Pension and Carer Payment are conditional payments that take account of a person's current circumstances and their ability to support themselves in the workforce.

Analysis by the Review has, however, indicated that:

- ▶ Notwithstanding strong employment growth over the last 15 years, the number of people in receipt of Disability Support Pension and Carer Payment has increased, and historically levels of receipt tend to increase during periods of labour market downturn.
- ▶ The level of workforce participation of these pensioners while in receipt of these payments is low.
- ▶ When people move off these payments due to a change in their circumstances, a large proportion continue to be in receipt of income support.
- ▶ In addition to the particular disability or caring responsibility that the individuals may have, their low levels of labour market attachment are frequently associated with low levels of individual human capital.

For these reasons, the Review considers that there is a need for a much stronger emphasis in these programs on achieving labour market participation, including:

- ▶ ensuring that eligibility is appropriately targeted
- ▶ providing appropriate incentives and support for workforce participation by those currently on the program.

The working credit provides a mechanism to support the work efforts of disability support pensioners, and other income support recipients, who are under Age Pension age by effectively allowing these pensioners to bank unused free areas up to a cap. The working credit in effect softens the initial effect on pensions of income from employment and is primarily designed to encourage initial engagement in the labour market.

Carer Payment

One of the means of ascertaining that a carer is providing full-time care is a cap on the number of hours a carer can be in paid work, currently set at 25 hours a week. While in many cases the level of care that a carer is required to provide leaves little opportunity for employment, this is not always the case, including where the person being cared for may have external activities such as day care and school. In this context the cap operates as a relatively blunt tool.

While for some carers care giving is ongoing, for others the need to provide care may be more short or medium term. In such cases, it is important that the program take account of the future workforce participation of carers in addition to their current activities. Without such support, many ex-carers may fail to make a transition back into employment when their caring responsibilities cease. This is particularly important in light of the analysis presented in the Review's Background Paper, that even when entering into Carer Payment many carers had poor connections with the workforce and tended to move onto other forms of income support if they ceased caring.

Given this, the Review believes further consideration should be given to more robust eligibility criteria which focus on the actual level of care provided, rather than the use of a cap on the number of hours of work. Attention also needs to be given to more actively focus the program on building linkages with labour force participation, either alongside the caring task or to support future transitions into employment.

Disability Support Pension

The Disability Support Pension is part of a continuum of support to people with disability whose capacity to engage in employment can vary widely depending on the nature of the disability.

Under current assessment criteria, to be eligible for the Disability Support Pension a person needs to have a certain level of physical, intellectual or psychiatric impairment that inhibits their ability to work for 15 or more hours a week, or undertake training that would enable them to do so within two years. Moreover, a significant proportion of the current Disability Support Pension population qualified for this payment under earlier criteria that assessed work capacity on the basis of a 30-hour test⁴³, rules that continue to apply for their current period of Disability Support Pension receipt. This creates a strong incentive not to test the labour market. A person with disability, but a lower level of work restriction, who is currently jobless would be eligible for Newstart Allowance. Unlike Disability Support Pension recipients, recipients of Newstart Allowance are subject to mutual obligations including job search.

Many people on Disability Support Pension may have a capacity to undertake some employment, but few do so. Others, while not currently able to work, may have the capacity to undertake other forms of participation, such as study or volunteer work, which would not only have direct benefits but could also enhance their future capacity for employment.

In contrast to the potential of many disability support pensioners, the current approach of the payment is one that is largely conceived around the pension being a passive ongoing source of income. In some cases analysis suggests that the payment is being used by some as a form of early retirement and as an alternative to job search. The Review notes that the current differentials in the level of payment, income test treatment of earned income and mutual obligations between Disability Support Pension and Newstart Allowance create an incentive for people to seek Disability Support Pension even when Newstart Allowance may be more appropriate.

The Review considers that the current passive orientation of Disability Support Pension is inappropriate in terms of both the outcomes for this group of pensioners and national goals of improving participation.

Specific issues that require further consideration in order to achieve such a refocusing are:

- ▶ improved assessment procedures to ensure that people are not inappropriately placed on Disability Support Pension

⁴³ Prior to the Disability Support Pension changes in 2006, assessment was based on an individual's inability to work 30 hours or more a week. Under current assessment rules an individual must be unable to work 15 or more hours a week.

- stronger support for the employment of disability support pensioners and other people with disability including addressing service issues raised in Chapter 6
- a more proactive approach to the current population of disability support pensioners, in particular those with higher work capacities than the current eligibility cut-out.

Finding 29: The Review finds that the Carer Payment and Disability Support Pension should more actively address questions of workforce participation. This focus needs to be effectively integrated into initial eligibility, policies to promote participation while people are on the payments and in ensuring that, where they have the capacity to support themselves and are no longer eligible for the pension, they can successfully establish or re-establish themselves in the workforce.

7.6.2 Age of eligibility for Age Pension

The age of eligibility for men for the Age Pension has been 65 years since the inception of the pension in 1909. The age for women, which was initially set at 65 years and then reduced to 60 years, is, following a decision in 1994, being raised again to 65 years. The current age of eligibility for women is 63.5 years and will reach 65 years in 2014.

In the light of its terms of reference and the need to ensure the long-term sustainability of the pension system, the Review considers there is a need to assess whether these ages continue to be appropriate.

The demographic context

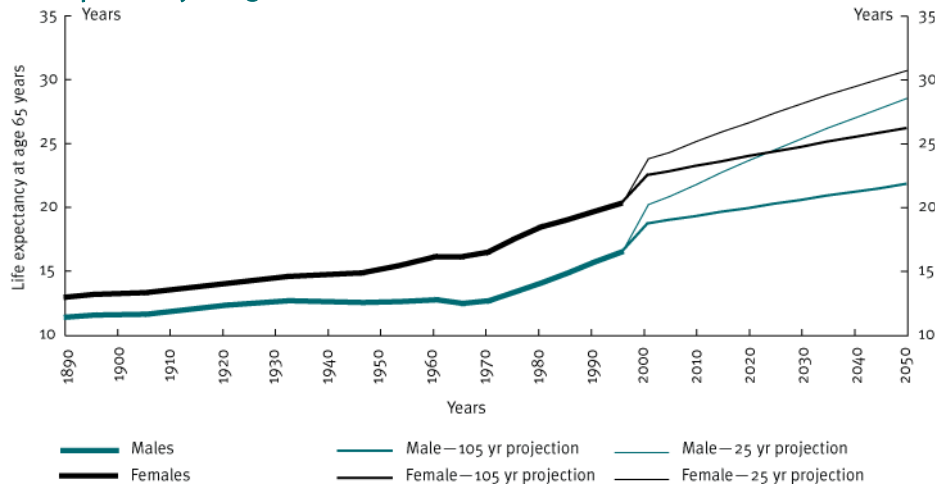
As detailed in Chapter 2, Australia is facing a major demographic challenge.

With lower fertility rates and increasing life expectancy, the demographic profile of the nation is changing and the balance between the working-age population and others, including the retired, will shift dramatically.

Increased life expectancy will markedly lift the time that people spend in retirement. While in the 1900s, as shown in Chart 31, a man retiring at age 65 would have expected to spend 11 years in retirement, by 2050 this will have increased to 22 years, or, depending on ongoing improvements in health care,⁴⁴ may be as high as 28 years. Similar changes are forecast for women.

On a more contemporary basis, while a current male pensioner who, for example, retired in 1996 at the age of 65 years could have anticipated living until he was 81 years old, a man retiring at this age in 2050 can anticipate living until he is 87 to 93 years old. For women the increase is from age 85 to between age 91 and age 96.

⁴⁴ A key issue in estimating and projecting life expectancy of any current or future population is the impact of current population health and health behaviours and future health care on mortality. The chart contains three series provided by the Australian Government Actuary. For the period to 1995–97, the data are actual life expectancy, or estimated life expectancy based on current age-specific mortality. For the estimates beyond this point two series are available. The first, the 105-year projection, forecasts future mortality based on the rate of improvement in mortality over the past 105 years. The second assumes that the much more rapid improvement in mortality recorded over the past 25 years will continue.

Chart 31 Life expectancy at age 65

Source: Australian Government Actuary 2009.

At the same time:

- There has been a trend towards early retirement and withdrawal from the workforce.
- Increasing levels of educational participation, including time spent in higher education, has delayed entry into the workforce.

As a consequence, the actual proportion of people's pre-retirement age spent in employment is reducing, and the time they spend in their retirement has increased dramatically. This has very significant implications for the retirement income system as a whole and for the Age Pension in particular.

For the pension system, it will result in increasing numbers of pensioners with life expectancies double or higher than was the case when the Age Pension age was originally set. The increase in life expectancy, especially if the higher projections are realised, will mean that superannuation savings will have to be spread more thinly to provide income for a longer period of retirement (and in all likelihood significantly increase the role of the Age Pension in meeting the longevity risk of these savings not 'making the distance').

It can also be expected that there will be pressure for an increase in the relative level of resources available to this group:

- There are increasing expectations of higher living standards, to be sustained over longer, and in many cases healthier and more active, periods of retirement.
- While some of the increase will be spent in good health, it is also likely that many in this older population will have significant health and related care needs, potentially over a longer period of their lives than today. This will bring with it a marked increase in demand for spending on health and related services.

As discussed in Chapter 2, Treasury forecasts in the *Intergenerational Report 2007* indicate that the cost of an increasing number of pensioners and a growing life expectancy (while maintaining current pension settings) and increased age and health care costs will result in a rise in spending from 13.1 per cent of GDP to 18.2 per cent by 2046–47.

A change in the Age Pension age?

As discussed in Chapter 2, the Review considers that the long-term sustainability of the financing burden of the Age Pension is a serious issue. As well as the budgetary aspect, there are important questions concerning the societal support for the retirement system and the Age Pension. Without fundamental action such as a change in the Age Pension age, it is highly likely that there will be very strong pressure to restrain the value of the pension so as to minimise the growth in expenditure. This would in turn undermine the adequacy of future pension payments. More significantly, it is possible that the increasing funding burden may engender a reduced commitment of future workers to the support of the pension system.

In this context an increase in the Age Pension age is an option that needs to be seriously considered.

Specific benefits include:

- ▶ An increase in the Age Pension age, and in the age of retirement, would partially redress the increasing dependency rate and concerns about a largely static workforce. Longer periods in employment would contribute to national levels of production and the tax base. For industry, it would provide extended access to an experienced workforce.
- ▶ An increase would also enable individuals to experience the higher standards of living that are associated with employment for a longer period. It will boost their standard of living in retirement by reducing the span of time over which they draw down on their savings, including superannuation. It will also enable them to accumulate such savings over a longer period.
- ▶ A reduction in demand on the Age Pension.

At the same time:

- ▶ An increase in the Age Pension age represents a major cultural change and would require a substantial change in people's expectations around their working lives.
- ▶ A large proportion of people retire prior to the Age Pension age and a change in the age itself will not necessarily result in higher levels of participation.
- ▶ Although average life expectancy is increasing, the actual pattern of mortality will mean that for some an increase in the Age Pension age may mean that they will not live long enough to retire, or will only have a short period in retirement.

On balance, the Review considers that the force of argument is clearly in favour of a modest rise in the age of eligibility for the Age Pension. In considering the magnitude of any increase the Review noted that taking account of the increase of some five to seven years in both male and female life expectancy between the 1970s and the early 2000s, and projected increases on a further three to seven years by 2050, suggests a total increase over this period of some nine to fifteen years.⁴⁵ In this context the Review considered that an increase in the Age Pension age of some two to four years would represent a reasonable balance in the distribution of this between work and retirement.

⁴⁵ Using 'current' mortality life expectancy at age 65 is estimated to have increased between 1970-72 and 2000-02 by 5.33 years for men and 5.06 years for women. Using the 105 year trend in mortality suggests an increase of 6.08 years and 6.16 years respectively, with these rising to 7.68 years and 7.56 years if the 25 year trend continues. The 105 year trend series suggests a further gain of 3.09 years for men and 3.67 years for women between 2001 and 2050. The 25 year trend series estimates the increases at 8.32 years and 6.88 years. Over the period from 1971 to 2050 this suggests an increase in life expectancy for men at age 65 at between 9.17 and 16.0 years and for women between 9.83 years and 14.44 years.

If these changes were built on the existing schedule for changing the Age Pension age for women, a pension age of 67 years would be reached in 2021, 68 years in 2025 or 69 years in 2029. It would be appropriate to consider the actual scheduling of any change in the context of changes to the broader retirement income system.

The impact of these changes would be marked. It is estimated that, for example, a three-year increase in the retirement age would have a similar effect as an increase of 2 per cent in the Superannuation Guarantee on the income replacement rates in retirement.

Challenges

Achieving these gains would, however, require much more than a simple change in the Age Pension age. There would also be a need for a broader package of measures and policies to support this shift, both removing incentives to earlier retirement and providing support for those who need it to enable them to maintain employment.

Central to this could be alignment of the preservation age with the Age Pension age. The Australia's Future Tax System Review Panel is examining this and other issues impacting on participation as part of its broader review of the retirement income system. It will also be important that income support payments for people of working age, including the Disability Support Pension and Carer Payment, have a strong orientation towards supporting active participation, and that attention is paid to the training and retraining needs of older workers.

Achieving these changes will also involve a shift in expectations. Many people may build their expectations of their retirement age relatively early in their working lives, and so change will have long lead times.

Finding 30: The Review finds that there is a case for a phased increase in the Age Pension age starting from 2014, when the Age Pension age for women will be the same as for men. Such a policy would improve retirement outcomes and support Australia's capacity to address the impact of population ageing. It would reflect the strong increases in life expectancy the nation has experienced, which are expected to continue. Any reform would need to be part of a coordinated approach to retirement, including bringing the settings of the superannuation system into line with the Age Pension age.

Appendix A: Number of pensioners

Recipients of pension payments and concessions, 2008

Payments	Male	Female	Total
Age Pension	882,700	1,187,600	2,070,300
Disability Support Pension	417,200	325,500	742,700
Carer Payment	43,500	92,300	135,800
Wife Pension	0	29,600	29,600
Widow B Pension	0	700	700
Bereavement Allowance	100	500	600
DVA Service Pension	103,900	92,200	196,100
DVA Income Support Supplement	100	81,400	81,500
Total	1,447,500	1,809,800	3,257,300
Commonwealth Seniors Health Card	135,900	148,400	284,300
Low-Income Health Care Card	166,000	199,500	365,500
DVA Disability Pension and War Widow	na	na	261,700

Note: Age Pension numbers include DVA Age Pensioners (around 5,900). In addition there were 443,800 Carer Allowance recipients at December 2008.

na = not available

Sources: Pension customer numbers derived from Centrelink administrative database, fortnight ending 5 December 2008. DVA customer data is at 2 January 2009 and will be published in the upcoming DVA Pensioner Summary Statistics series. Commonwealth Seniors Health Card and Low-Income Health Care Card customer numbers derived from the Centrelink administrative database, fortnight ending 19 December 2008.

Appendix B: Pension payments as at 1 January 2009

Rates	Income test	Assets test
Pensions—including Age Pension, Disability Support Pension, Carer Payment, Wife Pension, Widow B Pension, Bereavement Allowance and DVA Service Pension		
<p>Single: \$562.10 pf Partnered: \$469.50 (each) pf</p> <p>Single disability support pensioner under 21, no children (Youth Allowance plus Youth Disability Supplement of \$105.10 pf, total cannot exceed adult disability support pensioner rate):</p> <p><18, at home: \$308.40 pf 18–20, at home: \$349.50 pf 16–20 independent: \$476.50 pf Member of a couple: \$469.50 pf</p> <p>Rates are adjusted each March and September in line with increases in the CPI. Single adult pension rates are also benchmarked against 25 per cent of Male Total Average Weekly Earnings, with a proportional flow-on to partnered rates.</p> <p>Pensions are taxable, except for Disability Support Pension and Invalidity Service Pension paid to people under Age Pension age, and Carer Payment and Wife Pension spouse where the person being cared for or the spouse is receiving a non-taxable pension.</p>	<p>Free area:</p> <p>Single \$138 pf (\$3,588 pa)</p> <p>Couple \$240 pf (\$6,240 pa) plus \$24.60 per additional child pf</p> <p>Taper:</p> <p>Singles: 40 per cent of income above free area</p> <p>Couples: 20 per cent of combined income above free area for each member of couple</p> <p>Cut-out:</p> <p>Single \$1,558.25 pf (\$40,514.50 pa)</p> <p>Couple \$2,602.50 pf combined (\$67,665 pa)</p> <p>Working Credit available if aged under Age Pension age.</p> <p>Income test does not apply to a permanently blind person receiving Age, Service or Disability Support Pension.</p> <p>Some income types are subject to different arrangements (for example, compensation payments may be deducted directly from the rate otherwise payable).</p>	<p>Home owners for full pension:</p> <p>Single: \$171,750 Partnered (combined): \$243,500</p> <p>Non-home owners for full pension:</p> <p>Single: \$296,250 Partnered (combined): \$368,000</p> <p>Assets over the limit reduce pensions by \$1.50 a fortnight for every \$1,000 above the threshold (single and couple combined).</p> <p>Home owners for part pension:</p> <p>Single: \$550,500 Partnered (combined): \$873,500</p> <p>Non-home owners for part pension:</p> <p>Single: \$675,000 Partnered (combined): \$998,000</p> <p>(Amounts are higher if receiving Rent Assistance or separated due to illness.)</p> <p>Assets test does not apply to a permanently blind person receiving Age, Service or Disability Support Pension.</p>

Note: pf = per fortnight; pa = per annum

Appendix C: Supplementary entitlements available in the income support system, January 2009

Benefit	Rate	Frequency	Availability	Comment
Rent Assistance (RA)	\$110.20 single \$103.80 per couple \$73.47 sharer	Fortnightly	Payable to eligible income support recipients, or those receiving more than the base rate of Family Tax Benefit Part A, who pay rent above the applicable rent threshold. The rent threshold is \$98.00 a fortnight for singles and \$159.60 a fortnight for couples.	RA is an increase in the amount of pension, allowance or Family Tax Benefit. RA is reduced by the means test rules applying to the primary payment. Disability Support Pension and Carer Payment not subject to the sharers rate.
Pharmaceutical Allowance (PhA)	\$6.00 single \$3.00 each member of a couple	Fortnightly	PhA is not paid on its own. It is paid as a component of applicable income support payments.	PhA is added to the primary rate of payment. If, after applying the payment's income and assets tests, a person is entitled to any amount of payment, they receive the full PhA amount.
Telephone Allowance	\$23.00 lower rate \$34.60 higher rate for Age Pension age recipients who are home internet subscribers The amount is shared between members of a couple.	Quarterly	Paid to pensioners and certain allowees.	Full amount if eligible on the 'test day'.
Utilities Allowance	\$128.50 The amount is shared between members of a couple.	Quarterly	Paid to pensioners and certain allowees.	Full amount if eligible on the 'test-day'.
Mobility Allowance	\$79.30 \$111.00 higher rate for Disability Support Pension, Parenting Payment, Newstart Allowance and Youth Allowance	Fortnightly	Assists with transport costs for people with disability who are unable to use public transport without substantial assistance.	No means tests apply (but recipients need to qualify for a primary payment).
Remote Area Allowance	\$18.20 single \$15.60 each member of a couple Plus \$7.30 for each dependant	Fortnightly	Must be receiving an income support payment and be physically present in a remote area.	No means tests apply (but recipients need to qualify for a primary payment).
Carer Allowance	\$105.10	Fortnightly	For carers of a person with a disability (child or adult). Eligibility determined by the level of disability and care required by the care receiver.	No means test apply. An additional \$1,000 a year is paid on 1 July for each child (under 16 years) being cared for.
Child Disability Assistance Payment	\$1,000	Annually	Per child under 16 years for whom a Carer Allowance is paid.	Full amount if paid Carer Allowance (child) on 1 July.

Benefit	Rate	Frequency	Availability	Comment
Pensioner Education Supplement	\$62.40 or \$31.20 The rate depends on study load and the person's income support payment.	Fortnightly	Available to workforce-age income support recipients.	No means tests apply.
Crisis Payment	One week's payment	One-off	Available to income support recipients in severe financial hardship.	Must claim within seven days after the event that led to the crisis.
Education Entry Payment (EdEP)	\$208	Annually	Generally, available to recipients of Pensioner Education Supplement.	Only one EdEP payment per calendar year. EdEP is a taxable payment.
Work for the Dole Supplement	\$20.80	Fortnightly	Available to Newstart Allowance and Youth Allowance recipients participating in Work for the Dole.	
Language, Literacy and Numeracy Supplement	\$20.80	Fortnightly	Available to some income support recipients participating in Work for the Dole.	
Pension Bonus Scheme	Rate depends on length of deferral of Age Pension and rate of Age Pension. Maximum amounts: \$34,344.30 single \$28,686.50 each member of a couple	One-off	Available to those who defer receipt of Age Pension and continue to work.	Non-taxable
Pension Bonus Bereavement Payment	Maximum amounts: \$34,344.30 single \$28,686.50 each member of a couple	One-off	Available to the surviving partner of a deceased Pension Bonus Scheme member who did not claim the bonus before their death.	Non-taxable
Pensioner Concession Card	Value varies depending on usage.		Automatically issued to all social security pensioners.	No means tests apply. Allows access to specific services at concessional rates.
Health Care Card	Value varies depending on usage.		Issued to people who receive certain social security benefits, low income earners and selected other groups (e.g. foster children) to assist with certain health costs.	
Benefits available to self-funded retirees				
Commonwealth Seniors Health Card (CSHC)	Value varies depending on usage.		For self-funded retirees who have annual income less than \$50,000 (single) and \$80,000 (couples).	
Telephone Allowance	\$23.00 lower rate \$34.60 higher rate for those who are home internet subscribers The amount is shared between members of a couple.	Quarterly		Full amount if eligible on the 'test day'.
Seniors Concession Allowance	\$128.50 each for CSHC holder	Quarterly	Paid to CSHC holders.	

Appendix D: One-off lump-sum payments provided since 2004–05

Payment to older Australians and pensioners (\$ million)	
2008 Economic Security Strategy	
Pension lump-sum payment	
\$1,400 to singles (\$2,100 to couples) in receipt of Age Pension, DVA Service Pension, and Income Support Supplement pensions, Disability Support Pension, Carer Payment, Widow B Pension, Wife Pension, DVA Gold Card holders eligible for Seniors Concession Allowance, Widow Allowance, Partner Allowance, Bereavement Allowance, Commonwealth Seniors Health Card holders and people over Age Pension age who received Parenting Payment, Austudy, Special Benefit or ABSTUDY Living Allowance.	4,370.0
2008–09 Budget	
Seniors Bonus	
\$500 to individuals in receipt of Age Pension, DVA pensions, Widow B Pension, Wife Pension, Mature Age Allowance, Widow Allowance, Partner Allowance and Seniors Concession Allowance.	1,375.0
2007–08 Budget	
Seniors bonus payment	
\$500 to individuals of Age Pension or veterans' pension age receiving Utilities Allowance or Seniors Concession Allowance, Mature Age Allowance, Widow Allowance and Partner Allowance.	1,311.3
2006–07 Budget	
Older Australians one-off bonus	
\$102.80 to each household with a person of age or service pension age eligible for income support. Paid to recipients of Mature Age Allowance, Partner Allowance and Widow Allowance (groups newly eligible for Utilities Allowance). \$102.80 for each recipient of Seniors Concession Allowance.	200.5
Payment to carers (\$ million)	
2008 Economic Security Strategy	
\$1,000 to Carer Allowance recipients for each eligible person in their care.	370.0
2008–09 Budget	
\$1,000 to Carer Payment recipients. \$600 to Carer Allowance recipients for each eligible person in their care.	428.1
2007–08 Budget	
\$1,000 to Carer Payment recipients. \$600 to Carer Allowance recipients for each eligible person in their care. Carer Allowance recipients in receipt of Wife Pension or DVA partner service pension also receive both payments.	394.2
2006–07 Budget	
\$1,000 to Carer Payment recipients. \$600 to Carer Allowance recipients for each eligible person in their care. Carer Allowance recipients in receipt of Wife Pension or DVA partner service pension also receive both payments.	358.0
2005–06 Budget	
\$1,000 to Carer Payment recipients. \$600 to Carer Allowance recipients for each eligible person in their care.	316.9
2004–05 Budget	
\$1,000 to Carer Payment recipients. \$600 to Carer Allowance recipients.	255.0

Appendix E: Superannuation modelling

The modelling of superannuation presented in this report was undertaken by the Review. Unless otherwise stated, the results are for a person retiring after a full employment lifetime working under the Superannuation Guarantee.

Key assumptions are:

- ▶ a person receives a 9 per cent Superannuation Guarantee payment that accumulates and is taken as a CPI indexed annuity over their post-retirement period
- ▶ they have no other income-producing or assets tested assets
- ▶ the life expectancy of a man is 88 years and a woman 91 years; these are based on the expected life expectancy of people aged 60 in 2042
- ▶ in the model used, all taxation and income support parameters, as well as wages, are indexed by the product of price change and productivity growth
- ▶ points in the earnings distribution have been derived from the ABS 2005–06 Survey of Income and Housing (ABS 2007), based on the distribution of full-time adult earnings. It is assumed that the person earns at this rate (subject to shaping as discussed below) across their working life.

The employment pattern used to produce the results used in this report is one in which a person, from the age of 18 years, works a total of 40 years full-time and two years part-time and has two years not in the workforce.

The earnings rate is also slightly shaped over the person's working life, rising from 65 per cent of the designated rate at age 18 to 100 per cent by age 30, and then declining from 100 per cent at age 55 to 86.5 per cent at age 64.

The replacement rates are based on the average income of individuals over their entire retirement relative to the net incomes they received in the last 10 years of employment prior to retirement.

Key parameters used in the model are CPI 3 per cent, productivity 1 per cent, super earning rate (accumulation) 7 per cent, super earning rate (annuity) 6.5 per cent.

Appendix F: Data sources and notes

The Pension Review has drawn on many data sources for information. These include data and information gathered from Pension Review consultations, written submissions and focus groups, internal FaHCSIA research and administrative data, data from other government departments and various surveys. Wherever possible this report aims to ensure consistency across tables and charts and for administrative data supplied. However, diversity among data sources means that not all figures and definitions are the same throughout the report and that time periods identified in analysis may also vary. This appendix outlines the main data sources used throughout the report.

Administrative data

The Review draws extensively on administrative data collections within FaHCSIA as well as data from Department of Education, Employment and Workplace Relations, the Department of Veterans' Affairs, and the Department of Health and Ageing.

These collections include both official statistics, including those published in annual reports and statistical publications, and internal analytical and research collections.

Administrative data collections only contain sufficient data to administer payments, and as such at times only limited data are available on the specific characteristics and circumstances or total resources available to income support recipients.

Data from the consultations

The Review received over 1,800 written submissions, conducted a series of public forums and held focus groups with pension recipients throughout Australia as part of the consultation process. Information and data collected from the consultations has been used to inform the review process and is cited throughout the report.

Payment data

Payment rate data have been drawn from:

A Guide to social security law, which is available at: <www.fahcsia.gov.au/guides_acts/ssg/ssg-rn.html> (this also has historical rates).

A guide to Australian Government payments, a Centrelink publication which is available at: <www.centrelink.gov.au/internet/internet.nsf/publications/co029.htm>.

Payment rate data in the report are generally for the period 1 January to 19 March 2009.

Internal models have also been used in payment calculations.

Survey data

Survey data are usually much broader in nature than administrative data. A number of household surveys are used throughout the report. There are some limitations that should be noted when considering survey data, including:

- ▶ As the surveys are sample surveys, estimates derived from them are subject to sampling error. This can mean that estimates for small populations cannot be derived accurately and that not all apparent differences between estimates, say for different population groups, are meaningful.

- ▶ Reliance on self-reporting may lead to inaccuracies. For example, many income support recipients do not know the name of the payment they receive or refer to it by a common or former name, or confuse payments where names are similar, such as Carer Allowance and Carer Payment.
- ▶ Household income is not always reported accurately, particularly at the bottom and the top of the income distribution
- ▶ Expenditure data are often collected over a relatively brief period and the actual spending of a household over this period may not be typical.

Definitions in surveys often differ from those used for income support payment purposes.

The main surveys used in this report are:

- ▶ The ABS Survey of Income and Housing, which collects extensive information on the characteristics, income and wealth of households. The survey is conducted every two years.
- ▶ The ABS Household Expenditure Survey, which is similar to the Survey of Income and Housing. The Household Expenditure Survey collects data on household expenditures and financial stress. This survey is used by the ABS as the basis of weighting the CPI and ALCI.
- ▶ Average Weekly Earnings. This is an employer based survey conducted quarterly. As data are collected in an aggregate form only average earnings can be derived.
- ▶ The ABS Survey of Employee Earnings and Hours, which provides statistics on the composition and distribution of wage and salary earners' income, the hours they are paid for and whether their pay is set through awards, collective or individual agreements, or contracts. The survey is conducted every two years.
- ▶ The ABS Survey of Disability, Ageing and Carers, which provides detailed data on people's experience of ageing, disability and caring. The survey collects information on people aged 60 and over, people with disability and their carers. This survey provides information on the needs of these groups, the extent to which they are met, and the characteristics of those with unmet needs. The survey also provides information on participation in economic and community activities. Previously the survey was conducted every five years, but it is currently moving to a six-year cycle.
- ▶ The Household, Income and Labour Dynamics in Australia (HILDA) survey, which is a longitudinal survey conducted by the Melbourne Institute of Applied Economic and Social Research on behalf of FaHCSIA. HILDA is a household-based panel survey that collects information about subjective wellbeing, labour market and family dynamics. The survey began in 2001.

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