Incentives To Save More In Superannuation

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Presentation Outline

- Concessionality and Incentives in the accumulation phase
  - One-off investments
- Whole of working life and retirement
  - Consistent Saving using Optimal mix
  - Impact of Abolishing the Surcharge
- Aggregate Superannuation Flows
- Conclusions

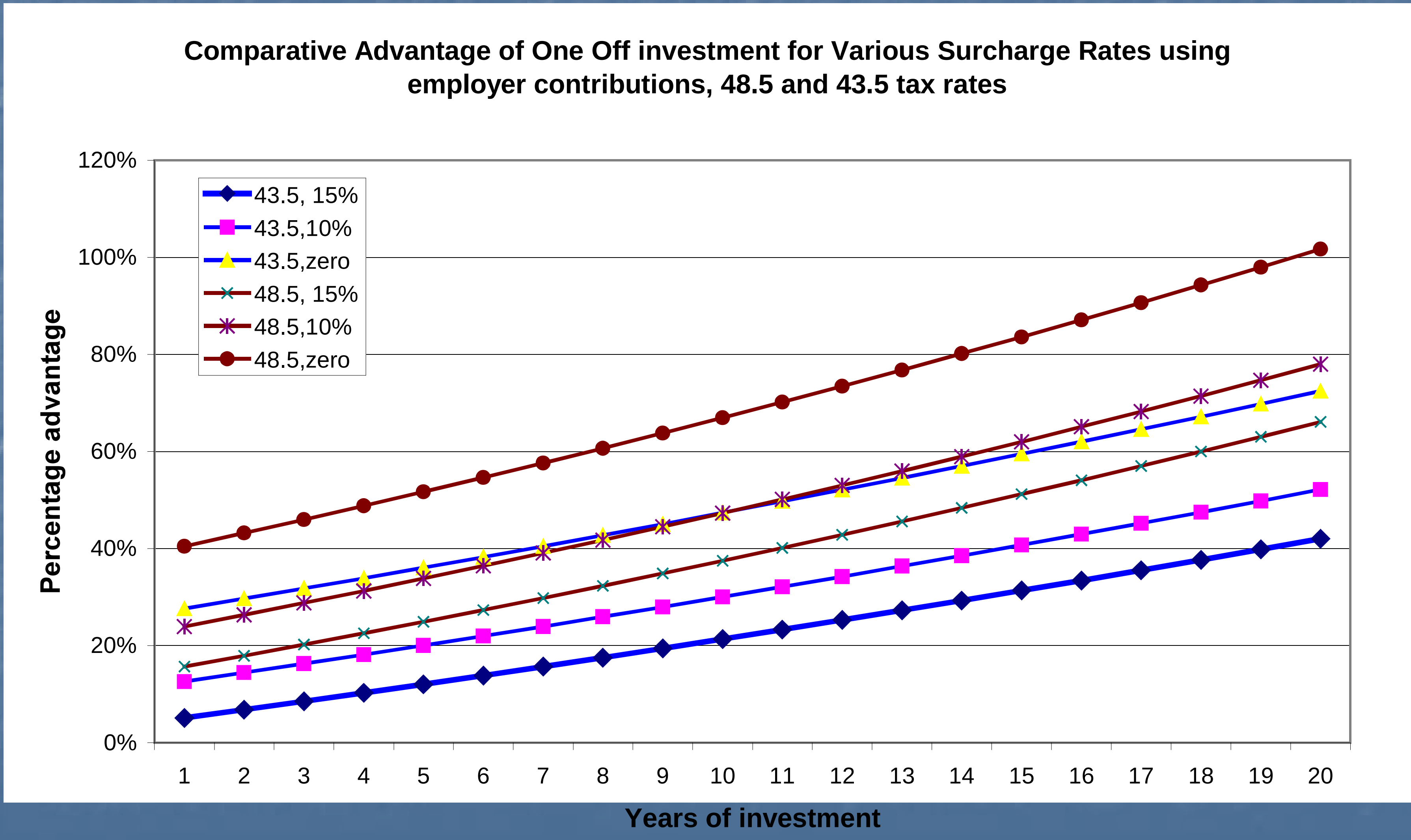
Introduction

- Superannuation system has been growing strongly
  - More than doubled in last 7 years, to around $700bn.
- Taxation arrangements have offered significant incentives for superannuation saving
  - 2004-05 tax expenditure on super estimated at $13.3bn
- Recent Government policies extend the incentives
  - 2004-05 Extension of co-contribution
  - Abolishing superannuation surcharge from July 2005

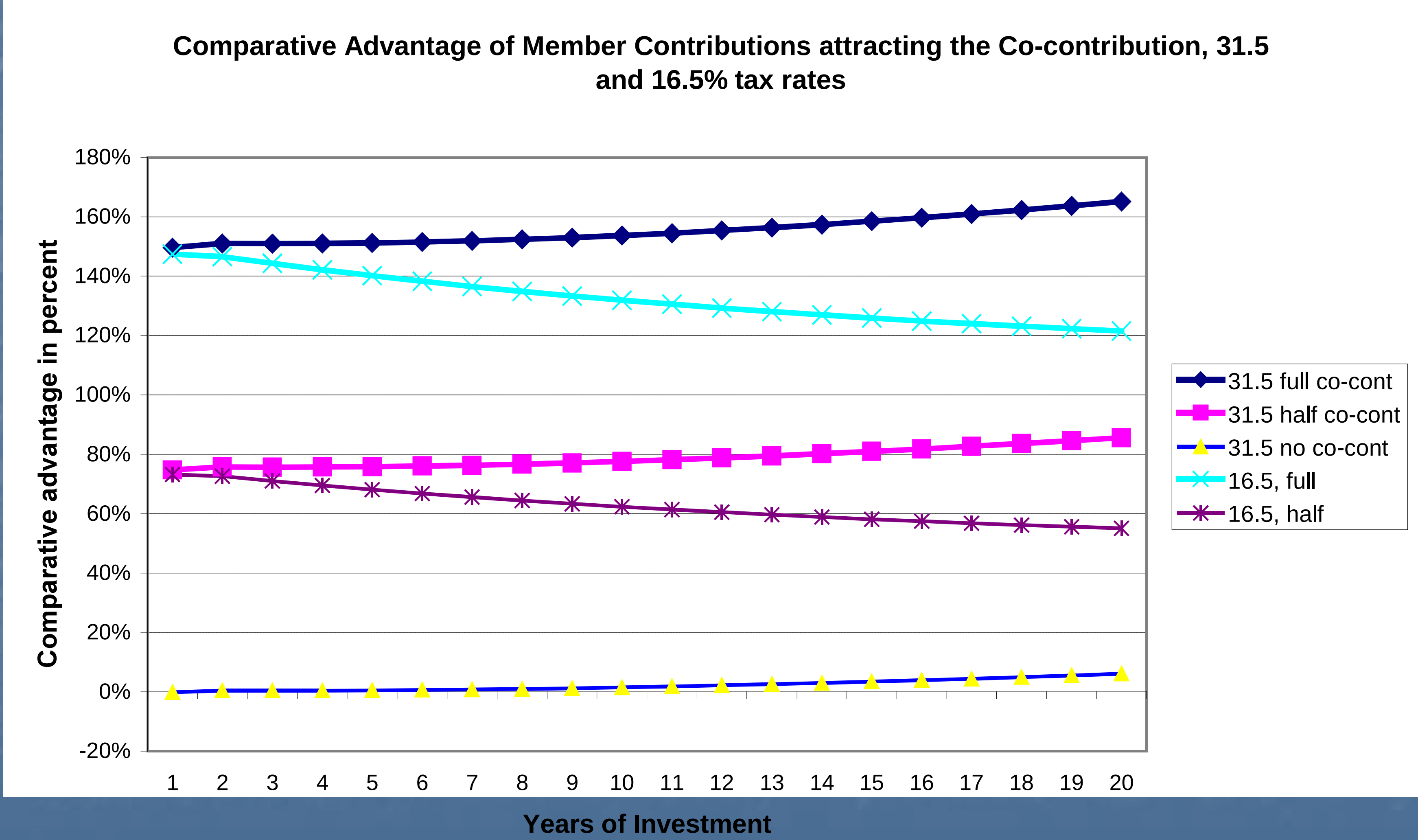
Concessionality and Incentives– Accumulation Phase

- Framework follows that developed in Rothman (2000 and 2003)
  - Excel spreadsheets compare one-off investments inside and outside superannuation, using identical investment portfolios
  - Simplified balanced portfolio assumption: 40% fixed interest, 40% fully franked Australian shares, 20% international shares
- All cases assumed to be within age based contribution and RBL limits
- 16.5% ETP tax assumed to be applicable on all additional super saving

One Off Investments in Accumulation Phase



Co-contribution– Accumulation Phase



Whole of Working Life and Retirement

- Analysis uses RIMHYPO to accumulate both super and non-super savings, then rolls over money into retirement phase
  - Includes age pension and all taxation impacts
- 3 cases considered:
  - SG only
  - SG + 3% of pre-tax salary assigned to saving within super (using optimal saving mix)
  - SG saved in super and 3% of pre-tax salary saved outside super, in identical investment portfolio

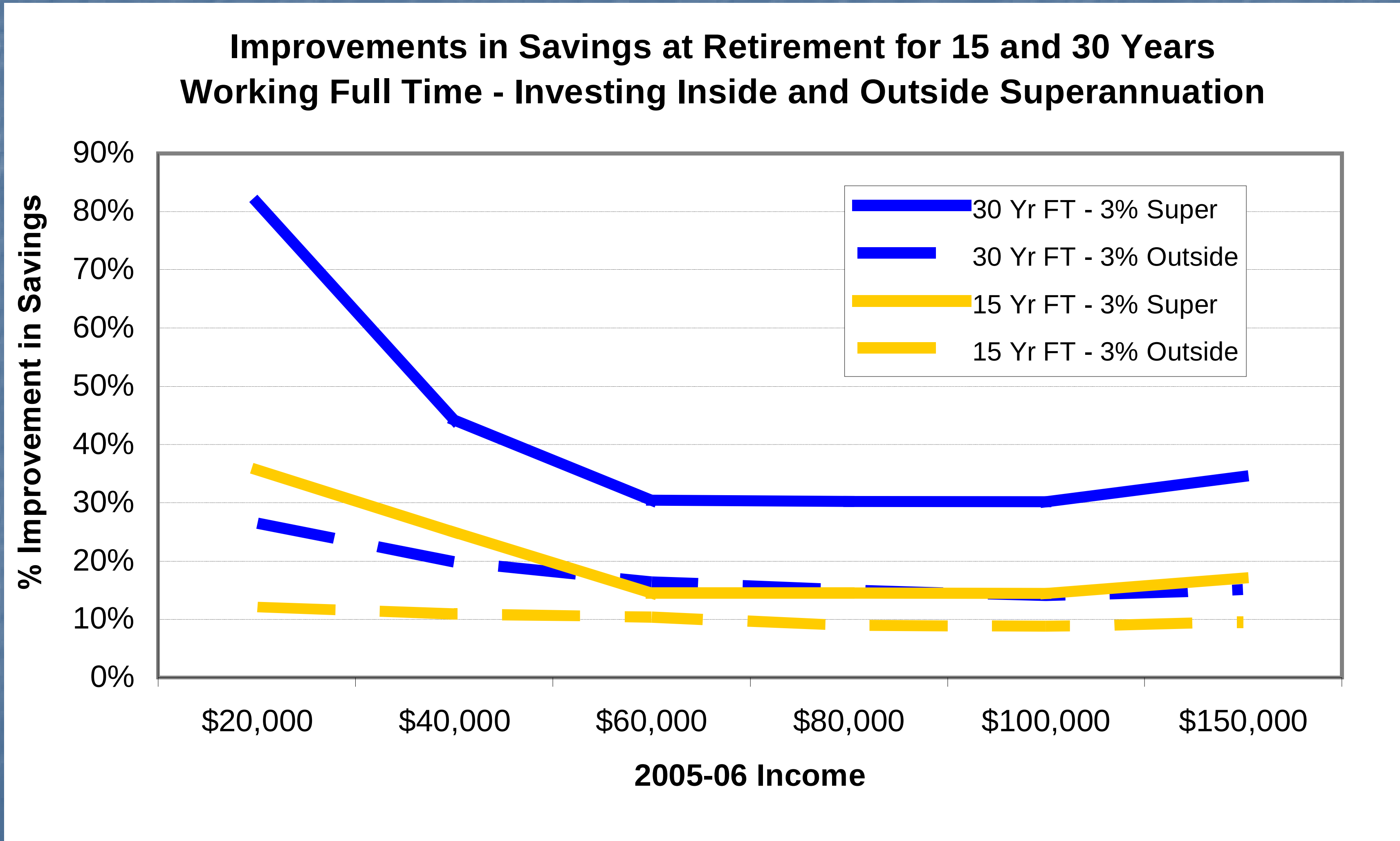
Optimal Saving Decision

- Saving outside super: Assign 3% of pre tax salary to saving outside super, pay income tax on salary and invest available funds in the assumed portfolio.
- The saving decision within super can be more complex:
  - To maximise benefits from an extra 3% saving within super, post-tax member contributions are made until they can no longer receive any additional co-contribution, with any residual saving (to make up the 3%) made using salary sacrifice.
    - If income is $60,000 or higher, all saving is salary sacrifice.
    - For the $20,000 and $40,000 cases, the extended government co-contribution provides a far superior superannuation investment up to the maximum available.

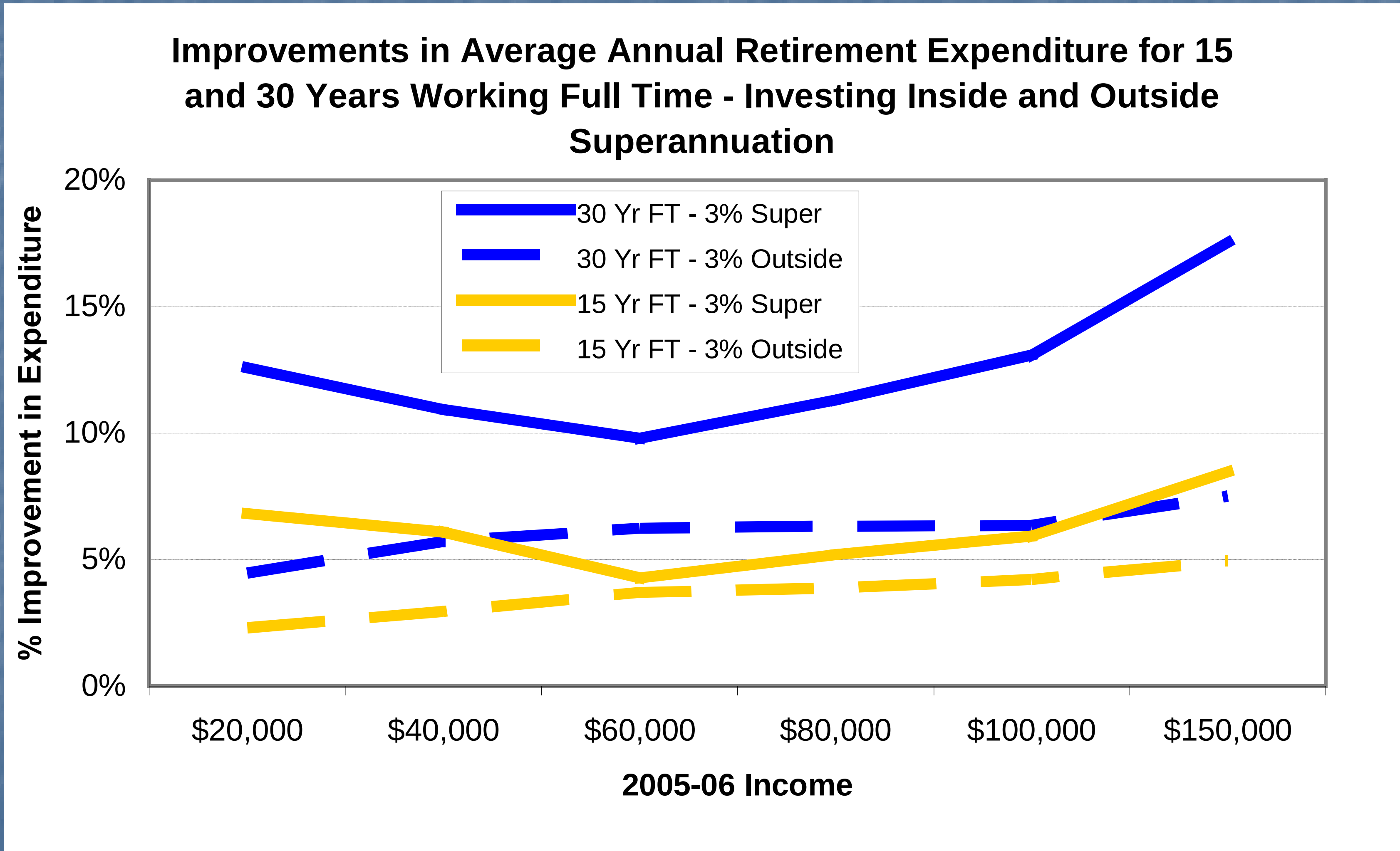
Optimal Saving Decision (continued)

- Eg. An eligible person with an income of $40,000 can currently contribute $600 to receive a maximum Government co-contribution of $900. This level of member contribution nominally represents 1.5% of gross salary, but, being a post tax amount, requires 2.19% of pre-tax salary. The remaining 0.81% of salary is assumed to be saved via salary sacrifice.
- The analysis assumes that the member reassesses his savings mix every 5 years.

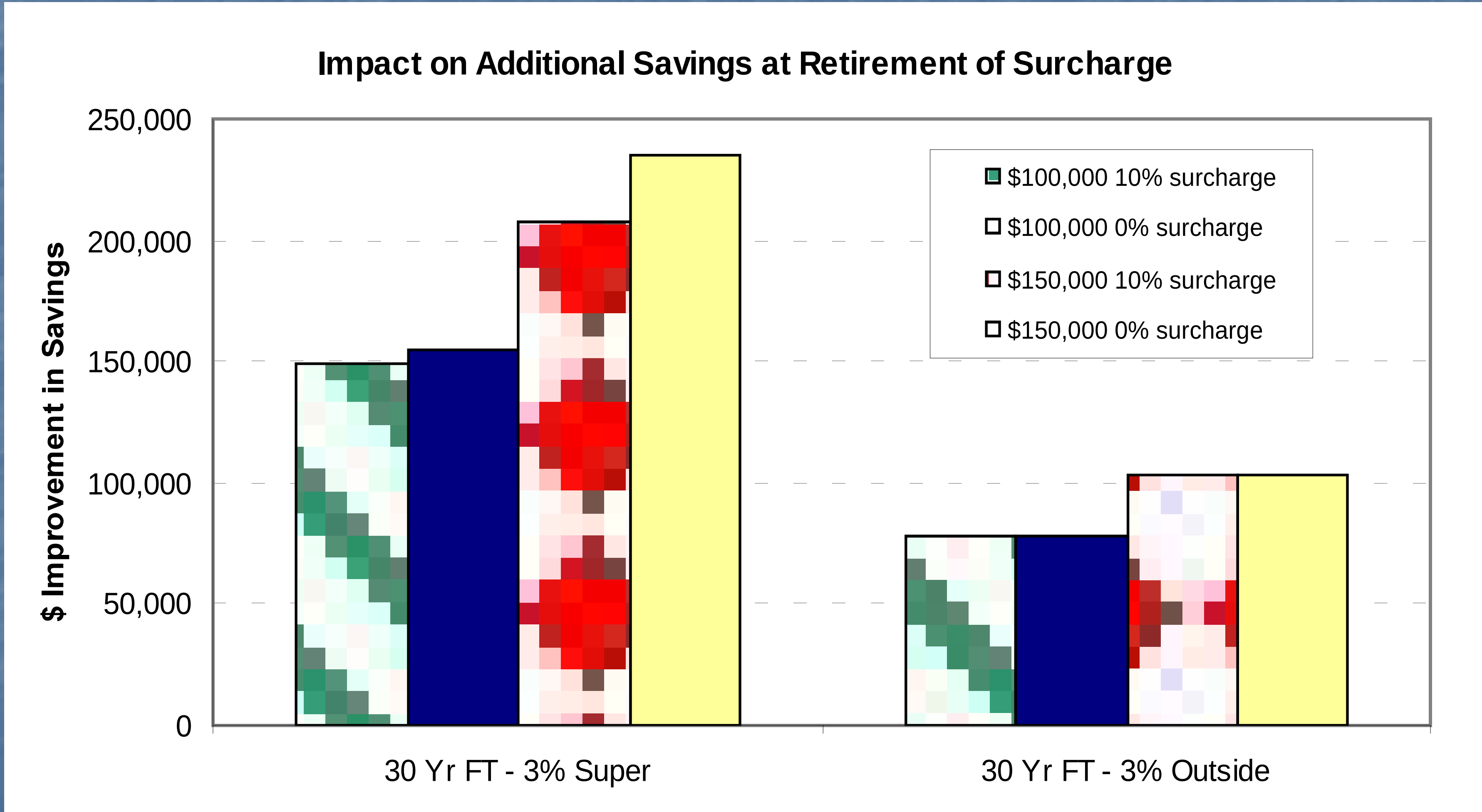
Concessionality – Whole Of Life



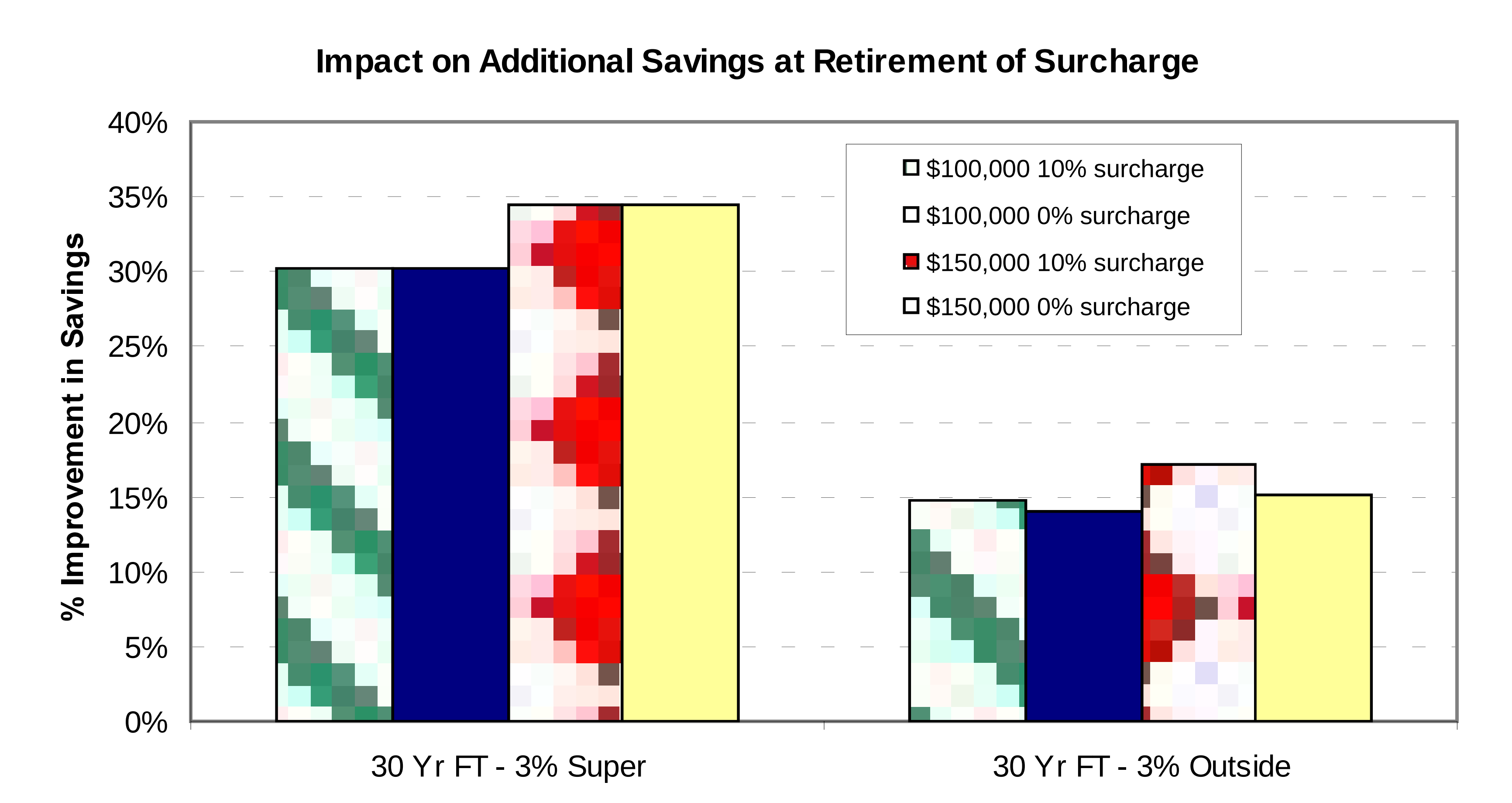
Concessionality – Whole Of Life



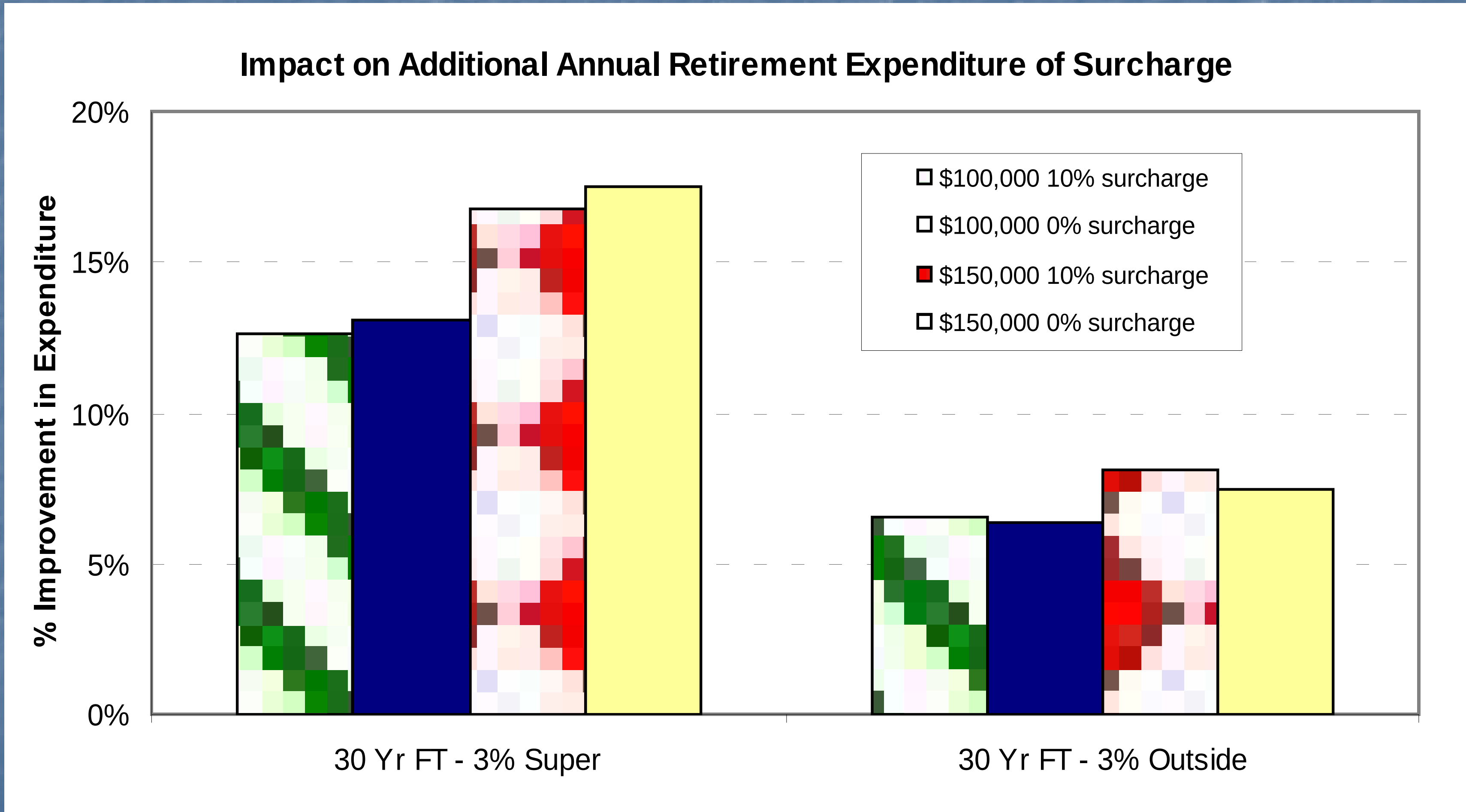
Impact of Abolishing Surcharge -$ improvement



Impact of Abolishing Surcharge- Per Cent Improvement at Retirement



Impact of Abolishing Surcharge- Per Cent Improvement in Retirement Spending



Summary of Impact of Abolishing the Surcharge

- The level of concessionality improves significantly
  - Saving within super becomes more attractive, both in an absolutely and relatively, as compared to investment outside super.
- Note how the removal of the surcharge impacts upon the percentage improvements available via saving outside the superannuation system:
  - Removal of the surcharge does not impact upon the additional dollar value of saving outside super
  - However, the removal of surcharge does lead to an increase in the SG accumulated benefit (which is the base)
  - So the fixed dollar benefit of saving outside super has a lower proportional impact.

Aggregate Superannuation Flows

- The two key recent policies, when fully implemented, directly add around $2 billion dollars pa of government money to the super system.
- Abolishing the surcharge is likely to lead to large increases in super saving for those affected
  - Possibly $1bn+ annually, with most of this flow switched from other savings vehicles.
- Co-contribution likely to lead to large increases in super saving for low and middle income earners
  - But with a much lower offset from other saving
- Likely increase in annual super flows of around $3.5bn
  - This increases contribution flows by about 10%
  - Most of this flow will be a net addition to private saving.

Conclusions (1)

- Both consistent and one-off saving in superannuation is very worthwhile over a wide range of income levels.
  - Importantly, we find that the system is broadly equitable and treats low to middle income earners well.
- Following the recent changes the system is projected to deliver very good projected outcomes to those prepared to save even moderate amounts above SG.
- For the $40,000 case 3% consistent (optimal) saving within superannuation over a 30 year working life, leads to 44% more private accumulation at retirement than from the SG alone.
  - Saving the equivalent amount outside superannuation gives a 20% higher accumulation.

Conclusions (2)

- For the $40,000 case using superannuation, the person's retirement spending rises by about 11%.
  - His projected spending replacement rate in retirement rises significantly from 72% to 82%.
- The comparable figures for the $150,000 case are 35% more at retirement using super vis a vis 15% outside.
  - There is 18% increase in retirement spending and the projected replacement rate in retirement rises from 38% to 46%.
- These strong incentives to save more also have significant aggregate impacts.
  - Likely to be around 10% additional flow into superannuation.
  - Most of this flow will be a net addition to private saving.