

# Sustainability of australia's retirement income system



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## **Introduction**

Australia's retirement income arrangements are well known around the world. Meanwhile people would like to know more about the sustainability of Australia's retirement income system because they may wonder whether or not it will be still on the top in 50 years or even more. George P Rothman (2012) conducted a study about the impact on projected long term costs of Australia's retirement income arrangements. This research aimed to extend and update previous work on sustainability studies and also presented a long term projection of tax expenditures on the retirement income system. The paper reveals that Australia's retirement income system still retains positive position in the long run although the age and service pension costs are going to increase mainly due to demographic trends and pension policy settings in the future, and indeed, age pension outlay and superannuation tax expenditures influence on the government's fiscal balance. Generally speaking the model (RIMGROUP) of this study is appropriate, the analytical framework is clear and the research question is addressed thoroughly. However, in my opinion, to some extent, there are several shortages of the model, imperfect description of assumptions and an additional background which should be introduced before analysis.

## **Summary**

### **Background:**

Some backgrounds about this issue are useful for giving us a basic understanding of Australia's retirement income systems, explaining the

improvements of this article from previous studies, presenting the introduction of the model and describing base results used in later analysis.

Firstly, the article gives some basic understanding about Australia's retirement income system. It was proved by the third Mercer global pension index in 2011 that Australia was ranked at the second place in the world's best pension systems and it also got the second highest score in the sustainability survey. Currently it is one of the best retirement systems in the world. The type of pension scheme in most developed countries is unfunded hence unsustainable especially when growth rate in retired population is bigger than the growth rate in working population.

Secondly, the article mentions that, from the result of previous studies, the main reasons for the rise of future age and service pension payments being less than the result from purely demographic changes are that the eligibility age of age and service pension has been increasing and retirees have been being wealthier gradually due to Australia's superannuation arrangements. Based on previous studies and current policy settings, the author listed the key parameters, assumptions and policies used in this paper.

Thirdly, Rothman introduced the model used in this paper is called RIMGROUP model, as the author saying, "*it is a comprehensive cohort projection model of the Australia's population.*"

The appropriateness of the model is addressed since the version of RIMGROUP used in this study incorporates recent and relative changes to superannuation and age pensions. For example, the retirement savings will

be improved due to the rise of superannuation guarantee and the eligibility age of age and service pension will increase gradually and etc.

The last thing is giving some key results of the base case analysis which would be used in later analysis. Based on previous studies, we can know that retirees have been being wealthier and have an increasing income. As the result of that, the partial pension will be the majority of the age and service pension in the future, which is the basic picture.

### **Analysis of arguments:**

Based on previous studies, by using the RIMGROUP model, the author tended to extend and update the work to find the impact on projected long term costs of Australia's retirement arrangements. The pension costs are measured as percentage points of GDP . this paper finds that even though the projected pension costs are indeed rising, Australia is still in a strong position in the area of the sustainability of its retirement income system compared with almost any other country in the world. Furthermore, the paper also finds that the tax expenditure have impact on government's fiscal balance.

There are too many parameters and policies to be considered. Thus, for convenience, the author classified all the factors into three groups: demographic, pension policy setting and related parameters and others variables.

In the first group, the demographic, greater longevity and lower migration add the projected cost of the age pension whereas the higher participation in the labor force and higher migration has the contrary impact on GDP.

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The second group, pension policy setting and related parameters, considers 5 scenarios. The level of the age pension increased by 10% and the variation indexed the thresholds by wages do significant positive impact on the increase in projected age pension cost. However, the rise of pension cost is less than 0.5% of GDP. The asset test would be more dominant in deciding the amount paid to partial pensioners than the income test so that the impact on GDP of income taper is very tiny.

The last group considers other variations including contributions, investment returns, productivities and behaviors. The changes on pension payments is quite small when improving the contribution rate from 9% to 12% due to the assumption of RIMGROUP, which is remaining the total employee remuneration by adjusting wages. The Low Income Superannuation Contribution and High Income Superannuation Equity Measure do seldom impact on the pension costs in the long run. However, the investment return impact on the pension costs significantly. Behaviors here mean retirement savings dissipated and indeed it increases the pension costs over time but not too much. The last factor is productivity which impacts on the pension costs insignificantly by impacting wages level.

The other part of the analysis of this article is about the long term projection of tax expenditures on Australia's retirement system, where is a rare area for research especially the long term projection. The author got a conclusion that government's fiscal balance is in relation to both age pension outlay and superannuation tax expenditures.

## Evaluation

### **Aims achieved:**

The main purpose of this article written by Rothman is to test the sustainability of Australia's retirement system by modelling using RIMGROUP model. At first, the author argued that the increase of projected pension costs will not increase significantly if the retirement system is sustainable. Furthermore, the author presented the projected pension costs as the percentage of GDP, which means that the projected pension costs will rise largely if the change of percentage of GDP is positive and significant, similarly, the projected pension costs will not change too much if the change of percentage of GDP is quite small or even negative. Thus the author aimed at testing the sustainability by observing the changes of percentage points of GDP and the observing variables for the analysis are correct. Throughout the article, the change of the percentage GDP is the core observing variable. From my point of view, it is an effective observing variable not only because it is indeed in relation to the sustainability, but because it is easy to observe whether the costs are increasing or not, and it can show the trend of the change of costs clearly as well.

Rothman attempted to do two things to test the sustainability. One is reviewing the impact on long term projection pension costs of key parameters selected, and the other thing is observing the impact on retirement system of tax expenditures. The results from the two parts give a consistent answer that is Australia's retirement system is sustainable. In a great extent, the author achieved the goal, gave audiences an exact and

reliable answer, and also made a contribution to the research of Australia' retirement system development.

### **Assumptions founded:**

Lots of assumptions are founded in this article. They are come up with analyses and appear in different locations instead of being listed together at the beginning. From my point of view, it is better for understanding by presenting the assumptions with a specific analysis in different paragraphs.

Some of them are appropriate. For example, when discussing the reasons for the impact on the pension payment being moderate, an assumption is come up

“ As the Superannuation Guarantee increase, wages, rather than profits, are adjusted so that total employee remuneration in a given year is unchanged.”

This is an appropriate and necessary assumption because different remuneration approaches will result in different potential flow-on effects for an employer.

However, some other assumptions are unrealistic. For instance, when analyzing the impact on pension costs of the level of the age pension, the RIMGROUP model assumes that only full year changes in age are accepted whereas the changes in the reality is more gradual.

### **Model strengths and limitations:**

The model used for analysis in this article is called RIMGROUP model and I have introduced in the summary above. RIMGROUP model developed by the Australian Treasury, for analyzing the future impact of superannuation and <https://assignbuster.com/sustainability-of-australias-retirement-income-system/>

other policy changes (Bacon, 1999)æ ¼å¼. Thus it is very suitable for analyzing the sustainability problem. Furthermore, it is easy and facile to alter parameters and assumptions in this model. However, there are some limitations lying in the model as well. Except what the author mentioned in attachment, what I can see is that because the model is very large , it does not consider the inner linkages between every parameters and factors, which may raise conflicts or impacts on final results.

### **Conclusions supported:**

Some results and conclusions can be supported by other research. One of the results of this article is that high participation of labor force have positive impact on sustainability, which can be supported by an article called “ Policy Forum: Saving for Retirement, The Fairness and Future of Australia’s Retirement Income System” (David M. Knox, Mercer (Australia) Pty Ltd, 2010): æ ¼å¼

“ The report also recommended that Australia should focus on increasing its labor force participation rate among older workers and introduce a mechanism that would link the eligibility age for the age pension with increasing life expectancies. Both these changes would improve the long-term sustainability of the Australian retirement income system.”

From this point of view, this article gives us a specific data and reliable evidence to explain that Australia’s retirement income system is sustainable.

### **Writing style& text structure:**

The organizing principle of this article is normal, which contains coming up with the problem ( i. e. whether or not Australia’s retirement income system

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is sustainable?) , then solving the problem by using RIMGROUP model and analyzing the results of the model, finally drawing some conclusions based on analyses above. Both the whole article and the analysis part, the text structures are very clear and easy to read for both expert and non-expert audiences.

**Something omitted:**

What the author fails to mention is that the three “ pillars” of Australia’s retirement income system. They consist of the safety net, the mandatory consumption smoothing and the voluntary retirement saving, which make great contribution to the sustainability of Australia’s retirement income system. The retirement income system of Australia is very different from that of the other countries because the unfunded pension scheme is usual in the most other developed countries while the typical structure of that in Australia is based on “ three pillars” which contains both unfunded and funded pension schemes. Thus, in my opinion the three “ pillars” should have been mentioned and compared with the systems of other developed countries in the background.

**Conclusion**

This critical review has evaluated the article “ Modelling the Sustainability of Australia’s Retirement Income System” by George P Rothman. The arguments in the article show the extent of aims are achieved, the appropriation and shortage of the assumptions, the strengths and limitations of the model, the support for some conclusions, the normal writing style and clear text structure, and the three “ pillars” are omitted.