Possible Impacts of Reducing the Disincentive for Age Pensioners to Increase Paid Employment

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Executive Summary

A cursory glance at publicly available data provided by the Australian Bureau of Statistics (ABS) reveals the exceedingly low labour force participation rate of Aged Pensioners in contrast to those aged 65 years and older. This is at a time when the national and state economies and labour markets are emerging from the impact of COVID, with historically low unemployment (some estimates suggest that there are a job vacancy for every registered unemployed person) and a relatively slow resumption of skilled migrant workers. In short, across all industries and service sectors businesses are clamoring for skilled workers.

The recently elected Albanese Government has established a job summit to consider the national labour market, skills formation, training and retraining, the role of skilled migration, relative wages, technology and automation. The summit follows a recent meeting of Education Ministers that discussed the current teacher shortage.

In this paper we examine a potential policy reform designed to address the current financial disincentive to participation in the labour force faced by those on the Age Pension with a recommendation for change that would be expected to increase the labour force participation rates of Age Pensioners.

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Summary

Australia is currently at full employment but the employment to population ratio of Aged Pensioners of around 4 per cent is well below that of the 32 per cent estimated for the average for those 65 years and older who don't get the Age Pension. Reducing the current disincentive of $0.50 cents of Age Pension being lost for each additional $1 of employment income would be expected to increase the labour force participation rates of Age Pensioners.

This would in turn be expected to lift Australian output and incomes without adding to the current housing shortages compared with further increases to international immigration.

Depending on the policy changes and the behavioral responses of Age Pensioners, the actual cash cost to the Federal Budget could be relatively low and under 1 per cent of the current budgeted cost for Age Pensions in 2022/23.

Labour Market background

The ABS estimates the seasonally adjusted unemployment rate in May 2022 was 3.9 per cent, the lowest since the 1970s, while labour force participation is at record highs overall. It averaged a seasonally adjusted 66.5 per cent in the three months to May 2022, up 0.5 per cent on the three months to March 2020.

The ABS also reported job vacancies nationally in May 2022 were 480,100, over double the levels prior to the pandemic and equivalent to 88 per cent of the number unemployed in that month. The ABS noted 25.7 per cent of the businesses it surveyed reported job vacancies.

International Migration

International immigration is seen by many as a key element in helping to meet current labour force pressures. However, while Permanent and Long-Term arrivals have lifted since COVID related restrictions were eased in November 2021, there appears to be a pent-up demand to leave.

The ABS estimates there were 326,290 permanent and long term arrivals in the six months to April 2022. At an annualised rate, this is historically strong at about 83 per cent of the annual average number of arrivals of around 783,000 in the five years to December 2019.

However, the 251,040 permanent and long-term departures in the six months to April represents an annual rate of around 98 per cent of the annual average number of departures (510,746) in the five years to December 2019.

A consequence is that net Permanent and Long term arrivals in the 6 months to April 2022 were running at an annualised rate of around 150,000. This is well below the annual average net number of 272,228 for 2015 to 2019.

Departures may return to the pre-Pandemic levels but in the meantime to rely on net International immigration to fill the labour force shortages would seem to require a substantially higher rate of Permanent and Long-Term arrivals than the record levels prior to the Pandemic.

Labour Force Participation of Older Australians

One solution is to increase the labour force participation of those age 65 and over. The ABS estimates that as at February 2022, the labour force participation was 15.3 per cent - 19.7 per cent for males and 11.6 per cent for females.

In context, each 1 per cent increase in participation would currently increase the Australian labour force by around 43,000 per annum. Perhaps more importantly, as the 65 and overs are expected to continue to be the fastest growing population group, by 2030 on current ABS population projections, each 1 per cent of labour force participation by this age group would represent around 54,000 people.

What might be the cost of reducing the current Aged Pension Income Test disincentive for those aged 65 and over to increase their labour force participation?

Currently, Age Pensioners earning more than $180 per fortnight from personal sources such as employment and "deemed" income from investments lose $0.50 of Age Pension per fortnight for each $1.00 of income. This is effectively a 50 per cent marginal "tax" rate, although no work-related expenses are deductible against the loss of Age Pension.

For income from employment, a Work Bonus applies that allows up to $300 per fortnight to be earned before the $180 per fortnight gap starts to apply. So, in principle, an Age Pensioner could have employment and other income of up to $480 per fortnight before the $0.50 reduction in Age Pension per $1 of additional personal and "deemed" income applies.

To put this in context the $480 fortnightly threshold represents just under 9 hours of paid employment per week at the new Minimum Wage from the recent Fair Work Commission decision to increase the Australian Minimum Wage to $21.38, with the 25 per cent loading for Casual Employment (for a total of $26.725 per hour).

Actual effective maximum hours per week before the effective "tax" rate of 50 per cent on additional earnings cuts in is likely to be lower than nine, however. It could well be under 6.

Older workers are likely to be paid more than the minimum wage and casual loading.

In addition, the income test "deeming" rules on assessable financial assets, (including superannuation) of 0.25 per cent for balances up to $56,400 and 2.25 per cent for that part over $56,400 are likely for many retirees to consume part of the $180 per fortnight on top of the $300 Work Bonus.

In particular, while the specific data is not available, many Age Pensioner are likely to have superannuation balances in excess of $150,000. This is in view of the median superannuation balance at June 2019 reported by the Association of Superannuation Funds of Australia for 1.33 million superannuants aged 65 to 74 was around $190,000[1].

A superannuation balance of $190,000, while allowing access to the maximum Age Pension under the Assets Test and Income Test for single and individual members of a couple, would generate "deemed" assessable income of $2,247 per annum.

At the new hourly Australian Minimum Wage plus casual loading, as noted above, this would "consume" around 1.5 to 2 hours of potential paid employment per week. "Deemed" income on non-superannuation financial assets would consume additional potential paid employment hours

We are not aware of recent studies on the impact of these rules on the willingness of Australian Age Pensioners to enter into or maintain paid employment. It should be noted in this context that eligibility for the Age Pension does not require retirement, i.e. stopping paid employment.

However, some guidance could come from a 2022 report on the USA's National Bureau of Economic Research's International Social Security project. This project started in the mid-1990s and involves 12 major countries. While not specifically addressing the Australian context, it notes:

"Differences in pension generosity, early and normal retirement ages, actuarial adjustment for delayed claiming of benefits, and other provisions can create large differences in the incentive to work at older ages."[2]

Of interest is that the type of calculations required for Australian Age Pensioners as to whether paid employment is worth the effort fortnight by fortnight in view of the rules they face would appear far simpler and straightforward than the actuarial calculations seemingly required of Age Pensioners in many other countries in determining when they should retire.

People retire for many different reasons. The major one is access to superannuation or the Age Pension. Whether they continue to work or return to the workforce will also likely be under various influences.

There does, however, appear to be a significant difference in paid employment participation of Australians 65 years and over depending on whether they are on the Age Pension or not.

The Australian Institute of Health and Welfare reported in November 2021[3], that in April 2021 there were 619,000 people 65 years and older employed in Australia. Around 300,000 of those 65 years and older were employed full time and they were principally Males, at 74 per cent. 319,000 were employed part time. This was broadly split 50:50 between Males and Females. The main types of employment were Professionals, Managers and Clerical and Administration.

In March 2021, 2,554,000 people received the Age Pension. Over two thirds were on the full Age Pension. 32 per cent, or around 817,000, received a part Pension.

According to the AIHW report, 3.6 per cent of Age Pensioners, or around 92,000, declared earnings from employment. Of these, 79 per cent reported earnings of at least $250 per fortnight.

At that time, the labour force participation rate of 65 years and older overall was 14.6 per cent.

The proportion of Age Pensioners reported employed was broadly consistent with the proportion of Age Pensioners employed reported by Dr Jeff Harmer in 2008 at 4.3 per cent[4].

It is possible/likely the labour participation reported by the AIHW for April 2021 was adversely affected by COVID restrictions and so could now be higher.

Assuming, however, the 3.6 per cent is broadly in line with current participation, this implies the Employment to Population ratio of the 1.67 million not on the Age Pension is around 32 per cent. This is calculated as Employment of 527,000 (Total employed of 619,000 65 years and over less 92,000 employed Age Pensioners) divided by the population of 65 and over not receiving the Age Pension (Total population of 4.22 million less 2.55 million Age Pensioners).

There are likely many reasons for this almost 9-fold gap in employment participation. Overseas and local anecdotal experience would suggest, however, at least some impact of the Income Test. Why work if you don't need to or there are non-work related issues reducing the possibility of work and you face an effective loss of Age Pension benefit is 50 per cent?

Cost to the Budget

So, what might be the budgetary cost of a less aggressive benefit loss?

There would be various options but they would fall into two main categories of:

1. Reducing the current loss of $0.50 of Age Pension per $1 of employment income. This could include having a zero loss from employment income as is the case in several other countries where there is no income test; or
2. Expanding the amount of employment income available before Age Pension is reduced, e.g. increasing the Work Bonus amount or providing an employment income rebate.

The simplest and quickest option may be under 2. To allow an additional $500 per fortnight, or up to $800 per fortnight or $20,800 per annum of Pension Work Bonus per Age Pensioner. Including the $180 per fortnight of general Income Test gap, this is about 37 hours per fortnight at the new Minimum Wage and casual loading but actually probably less actual hours taking into account likely average wages being higher than the Minimum Wage plus loading and the likely impact from deemed income.

Assume the number of Age Pensioners accessing this to the maximum moves from the currently estimated 3.6 per cent of Age Pensioners employed to 10%. Specifically, for the sake of estimating the impact:

1. The current 92,000 Age Pensioners working part time add an average of 19 hours per fortnight. (From the AIHW Report, a substantial proportion of part time employed Age Pensioners would seem to earn

less than the maximum allowed under the $300 per fortnight Work Bonus. According to the AIHW, 21 per cent of employed Age Pensioners report earning less than $250 per fortnight.); and

2. An additional 164,000 (6.4 per cent of the 2,554,000 Age Pensioners) not now working enter the workforce to work up to 37 hours per fortnight. (This would be the equivalent of about 4 per cent of the current part time workforce in Australia)

Working on the assumption that under the current rules a single Age Pensioner can have personal and deemed income of up to $180 per fortnight and $300 of employment income without affecting the Age Pension, this additional employment income of $500 per fortnight on average would currently lead to a reduction in Age Pension of $250 per fortnight.

According to the AIHW Report, of the 92,000 Age Pensioners reporting employment earnings, 21 per cent or 19,300 reported less than $250 per fortnight. Assume another 5 per cent or 4,600 earn between $250 and the upper limit of $300 per fortnight. That leaves an estimated 68,000 reporting earnings of $300 or more per fortnight.

Giving them an additional $500 of Work Bonus and assuming they all currently are earning $980 per fortnight ($180 per fortnight of personal and deemed income plus $300 current Work Bonus plus $500 of additional Work Bonus) would see them collectively receiving an additional $250 per fortnight of Age Pension or $442 million per annum in total as a maximum.

This would be an additional amount of Age Pension to be paid but is likely to be less than actually paid as it assumes all of the 68,000 are earning $980 per fortnight. It is the equivalent of 0.8 per cent of the $54,153 million budgeted to be paid as *Support to Seniors* in 2022/23[5].

On the calculations for behaviour changing so more hours are worked by those Age Pensioners currently working or decide to enter the workforce, it is estimated there would be some $1,222 million of Age Pension not reduced. This component is not an additional cash cost and only arises if the total hours worked by Age Pensioners actually increases

The total of $1,664 million represents around 3.1 per cent of the 2022/23 budgeted *Support for Seniors* but would likely be an overestimate.

The question then arises as to whether this is worth incurring for the likely benefits of increased workforce participation by Age Pensioners.

An Addendum

A recent article in the Sydney Morning Herald[1] noted that pensioners in New Zealand can work without it affecting their income 'and 25 per cent of them earned income from paid work, compared to 3 per cent in Australia. They further noted that the previous government had been provided with a briefing that "found an extra 445,000 people could enter the workforce if tax on pensioners' earnings were cut."

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[1] The Australian Financial Review, March 18 2022, How your super balance compares with people your age.
[2] Social Security and Retirement Around the World: Lessons from a Long-Term Collaboration, Courtney Coil et al, Documento de Trabajo 2022/02, p2
[3] Age Pension, Australian Institute of Health and Welfare (2021) AIHW, Australian Government (website)
[4] Pension Review Background Paper, Dr Jeff Harmer, (Department of Families, Housing, Community Services and Indigenous Affairs, Commonwealth of Australia, 2008) p48
[5] Budget Strategy and Outlook 2022-23, Paper No 1, Statement 5, (Commonwealth of Australia 2022) p55
[5] SMH August1, 2022 Farmers urge tax break for pensioners to unleash grey army of fruit pickers"

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https://www.smh.com.au/politics/federal/end-to-income-test-would-deliver-grey-army-of-workers-seniors-20220209-p59uzt.html