

Pensioner Reform Policy Briefing Note

Summary

- Australia is in the midst of an acute worker shortage. New policy solutions are required to fix this problem, given the ongoing pandemic and difficulties with international border arrangements.
- Addressing structural disincentives to pensioners working more hours if they choose to is one such important solution. Leaving their pension intact should they choose to work more hours than the very small limit of earning \$ 480 per fortnight, and then taxing them normally like others in the workforce.
- This solution is win-win-win: it is good for pensioners, who will be given more choice around their working life and the opportunity to lift their standards of living; it is good for businesses and the broader economy, because it will provide immediate relief given the current shortage of workers and allow businesses to better manage skills/knowledge transfer to new workers; and it will be good for government because it addresses a key concern for one of the largest voting cohorts, and will increase income tax revenue.

Background and policy proposal

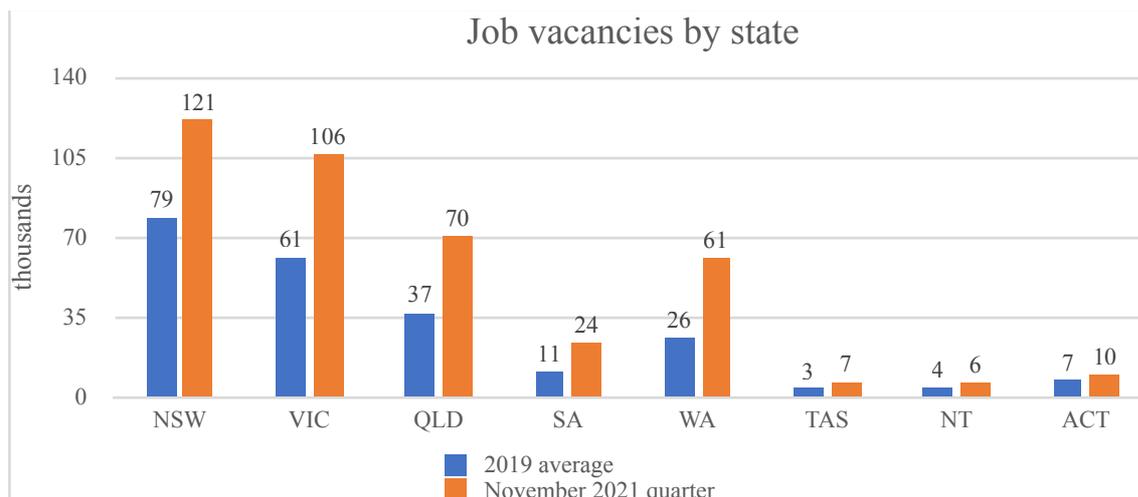
According to data from the Australian Bureau of Statistics, in the November 2021 quarter there was a workforce shortage of close to 400,000 workers, as shown in the chart below.¹



Source: Australian Bureau of Statistics.

This is a historic shortage, and is causing problems for businesses across the country and affecting production and supply chains. Notably, the shortage is affecting all Australian states, as shown in the chart below, which confirms that easing domestic boarder restrictions is not an effective response to state-based shortages.

¹ Australian Bureau of Statistics, "Job Vacancies, Australia, November 2021," January 2022, <https://www.abs.gov.au/statistics/labour/employment-and-unemployment/job-vacancies-australia/nov-2021>.



Source: Australian Bureau of Statistics.

The Commonwealth government has responded to the current workforce shortage by doubling the number of hours international students can work² and waiving the visa application fees for international students and working holiday makers.³ These temporary changes are welcome, but grossly inadequate; the government must do more.

Addressing the current pensioner policy settings is an important path forward. Under the current settings, a single pensioner can earn up to \$480 per fortnight without effecting their pension entitlement. For a pensioner earning \$30 an hour, that is equivalent to one eight-hour day per week.

Once pensioners earn more than \$480 per fortnight, their pension is withdrawn at a rate of 50 cents in the dollar. This is an effective marginal tax rate (EMTR) of 50%, and increases rapidly as income tax thresholds kick in. Pensioners who want to work more face punishing disincentives, and their EMTR can quickly move to 69% and above.

According to the most recent data available from the Department of Social Services, in September 2021 there were 74,669 Age Pension recipients who had earnings from employment. This is just 2.9% of the 2.57 million Age Pension recipients.⁴

In other words, 97.1% of Age Pension recipients in Australia do not work.

The degree to which pensioners participate in the workforce is driven primarily by the government's policy settings, or for some, medical choices, and advanced years.

² Joshua Boscaini, Erwin Renaldi and Natasya Salim, "International students allowed to work more hours to help ease COVID worker shortage," ABC News, 13 January 2022, <https://www.abc.net.au/news/2022-01-13/international-students-allowed-to-work-more-hours/100753802>.

³ Tom Stayner, "Visa charges to be waived for international students and working holiday makers," SBS News, 19 January 2022, <https://www.sbs.com.au/news/visa-charges-to-be-waived-for-international-students-and-working-holiday-makers/c28d2cb6-a379-4ad9-9540-db0a6f91b1f9>.

⁴ Department of Social Services, "DSS Payment Demographic Data," September 2021, <https://data.gov.au/data/dataset/dss-payment-demographic-data>.

To provide international context, in New Zealand pensioners do not face high EMTRs if they choose to work. They simply pay income tax on those earnings. As a result, according to data from the OECD, the labour force participation rate in New Zealand is 24.8%. Similarly, the comparable participation rate is 35.3% in South Korea and 25.5% in Japan.⁵

According to the Australian Bureau of Statistics, there are 4.2 million Australians aged 65 and over.⁶ If Australia were to match New Zealand's labour force participation rate among this population, there would be an additional 445,000 workers.

Unlocking this potential workforce is vital during the current worker shortage. Aside from the evident, benefits of alleviating the worker shortage, a Deloitte Access Economics report released in 2012 found that increasing workforce participation among older Australians would have benefits in the longer term.

The Deloitte report found that if Australia were to achieve a 3-percentage point increase in mature age participation over and above that currently, annual economic output would be \$33.0 billion, or 1.6%, larger. A 5-percentage point increase would lead to a \$47.9 billion, or 2.4%, boost to GDP.

Adjusted for inflation, the latter is equivalent to about \$60 billion today.

The current pensioner incomes test assessment along with the complexities of different pension rates, an assets test threshold, an incomes test threshold, marginal tax rates, special taxation rebates (SAPTO) and pension penalty rates act as a disincentive to many Australians who may otherwise continue working and contributing to Australia's prosperity and helping to address Australia's critical worker shortage.

Addressing the current unfair and onerous Age Pension arrangements should be a top priority for the government.

It should be noted that this reform aligns with the government's commitment to reduce reliance on net overseas migration as the 'one-size-fits-all' solution to problems in the workforce. Historically, Australia has relied on immigration, overseas students and backpacker holiday makers on working visas to fill employment gaps. The current pandemic has put a stop to the flow of international workers and there is uncertainty when this may be resolved.

The 2021-22 Federal Budget target inbound migration figure is 160,000, down from 190,000 from 2018-19 onwards. This reflects an existing Commonwealth commitment to achieving better employment participation outcomes from existing Australians and is also intended to

⁵ OECD, "Labour force participation rate," OECD Data, <https://data.oecd.org/emp/labour-force-participation-rate.htm>.

⁶ Australian Bureau of Statistics, "National, state and territory population, June 2021," December 2021, <https://www.abs.gov.au/statistics/people/population/national-state-and-territory-population/jun-2021>.

reduce pressure on urban infrastructure associated with larger inbound migration targets. The pension reform policy outlined here is consistent with this commitment.

Recommendations

Simplify the pension system and provide Age Pension recipients with the choice of undertaking additional work if they choose and without prohibitive EMTRs.

- 1) No change to the Assets Test.
- 2) Maintain marginal income tax rates.
- 3) Work income isn't assessable for the pension.
- 4) Other unearned income thresholds (\$180 per fortnight) remain the same.
- 5) Consider Age Pension recipients' income tax as return of pension. (In simple terms this should mean a married pensioner will have paid tax roughly the equivalent of their pension once their salary and pension exceed \$80,000 pa. A single pensioner will have repaid their pension in full if they earn \$100k pa. Working pensioners will effectively pay for their pension through income tax.)
- 6) The government could introduce this reform on a minimum 4-year trial basis to assess its effects, including on the Budget.