Next up: determining ‘adequacy’

By Tom Garcia | 03/05/2016

The question of what constitutes an “adequate” retirement income has been a thorny issue for as long as superannuation has existed. Getting even two people to agree on what they regard as an adequate or comfortable income is difficult. As one journalist recently noted, it’s a labyrinthine conversation.

How do you define comfort? By whose standards do we judge what is adequate and what is not? Are we talking about having enough money to pay for essentials like aged care and health or do we include overseas holidays?

The adequacy debate is further clouded by the confusion that exists among many Australians about how the Age Pension interacts with super to boost retirement income to levels many people would consider adequate or even comfortable. There is a public misconception that an adequate retirement income is out of reach for those retiring with modest super balances of $100,000 or $200,000. Little wonder that a growing number of older workers are fearful of retiring in poverty.

And then there is the issue of post-retirement income versus actual expenditure. While there has been a lot of focus on the pension payments to retirees, information is surprisingly scarce when it comes to their actual spending habits and the other assets they might own.

AIST – together with our research partner, the Australian Centre of Financial Studies – will shortly release new research into retirement expenditure. Our preliminary findings suggest many retirees are either very cautious about how much they are spending or they are actively saving money on quite modest incomes. But there are wide disparities in expenditure patterns suggesting “adequate” means something very different to a retiree in Sydney versus a retiree in rural South Australia.

Measuring adequacy or setting an adequacy benchmark is much more complex than simply arriving at a number. Internationally, there are several existing benchmarks used by the OECD and the European Union, each with their own unique pros and cons. In the UK, they use a tiered system.

When we define adequacy we inadvertently affect the fairness of the system. For example, an adequacy benchmark based on a percentage of an individual’s working wage might have some driving the latest four wheel drive and leave others by the curbside. Seventy percent of the minimum wage is not very much at all, but 70 percent of an income taxed at the top marginal tax rate seems a good outcome by anyone’s measure.

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Overseas, the European Commission has a dedicated Social Protection Committee tasked with producing an in-depth analysis of the adequacy of European pensions tri-annually. The group don’t just look at how much is enough but also at who is getting it – using the reports as an opportunity to examine issues within the system, such as gender gaps.

With the government now committed to legislating an objective to super, the next logical step will be to resolve the adequacy question. If the goal is to have a framework by which the super system can be measured and assessed, then the objective of super must include a reference to adequacy. Until we get agreement on adequacy we will never know if the system is a success.

Whether this is a number or some other measure, the labyrinthine journey is not over yet.