Co-contribution Opportunities for Superannuation Funds and Policy-Makers

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Abstract

This article explores enhancement opportunities for Australian Government co-contributions to superannuation accounts. The article's empirical foundation includes the distributions for variables related to saving, investment and risk perceptions in the 2022 wave of the Household, Income and Labour Dynamics in Australia (HILDA) Survey. As income or wealth increase, there are increases in the probabilities of individuals making additional superannuation contributions, having a saving horizon of at least five years, and being prepared to take more than average investment risks. Four policy changes are suggested in the article, with the potential for superannuation funds to independently implement some of these changes.

JEL CLASSIFICATION
D14; G51; H55; J32

1. Challenges for Retirement Saving and Cost of Living

Australia's retirement income system, consisting of private savings in superannuation and the public age pension, can become substantially more equitable in a cost-effective manner. Tax concessions for Australia's superannuation system go predominantly to higher-income individuals. While the age pension offsets this inequality to some extent, higher-income individuals still receive higher amounts of government support from the retirement income system via tax concessions for superannuation contributions and investment earnings (The Australian Government—the Treasury 2021).

Inequality in support through the retirement income system is also evident with respect to other factors beyond income, such as assets and gender. The gender superannuation gap is likely to be persistent without considerable policy intervention, given that past inequality accumulates with future investment returns (Best and Saba 2021).

While additional contributions from population groups with lower superannuation balances can help to reduce inequality, these groups tend to experience more pressing financial constraints. Recurrent cost-of-living crises, such as the one in 2023, limit the ability of individuals to contribute further to superannuation. Refined support through government co-contributions is one way to reduce inequality for retirement income support.
2. Current Co-contribution Context

The Australian Government has been making co-contributions for low- and middle-income individuals who make extra personal (non-concessional and after tax) superannuation contributions. In the 2023–24 financial year, eligible individuals automatically receive the maximum government co-contribution of $500 when they make personal contributions of $1,000 or more into their superannuation account. Eligibility is mainly based on income. Individuals with income below $43,445 were eligible for the maximum co-contribution of $500 in 2023–24, individuals with income above $58,445 were not eligible for any co-contribution, while individuals with income in between the two thresholds were eligible for a partial co-contribution. The relationship between income and co-contribution eligibility is shown in Figure 1. There is a range of other eligibility criteria, such as having a superannuation balance of less than $1.6 million at the end of the previous financial year and having 10 per cent of total income from employment or business activities (Australian Government—Australian Taxation Office 2023a, 2023b).

Understanding the current context is useful before enhancement suggestions. Government co-contribution payments were around $55.2 million in the September quarter of 2023 (Australian Government—Australian Taxation Office 2023c). These payments benefited 185,090 individuals. The average co-contribution was therefore around $300 per beneficiary. These statistics suggest substantial support. However, it is important to note that the September quarter tends to have higher amounts of co-contributions. For comparison, the June 2023 quarter had around $16.8 million in government co-contributions for 49,123 beneficiaries.

Figure 1 Maximum Co-contribution Payments Per Annum by Income Level for the 2023–24 Financial Year.

3. Issues with the Current Co-contribution Policy

3.1 Income or Assets as Eligibility Conditions

One aspect of the current policy approach is a focus on income thresholds for eligibility. A minor exception is that superannuation balances need to be less than $1.6 million at the end of the previous financial year for co-contribution eligibility (Australian Government—Australian Taxation Office 2023a). However, there would be very few individuals who meet all of the other eligibility conditions while having a superannuation balance of $1.6 million or more.

Assets, as a component of net wealth, may be more important than income for explaining adverse financial outcomes. Assets can accumulate over many years, compared to income which is a temporary flow measure. Empirically, there is a stronger link between net wealth (or its asset components) and financial stress, through households being unable to pay for many consumption items (Best 2022). Figure 2 also provides evidence from the 2022 wave of the Household, Income and Labour Dynamics in Australia (HILDA) Survey for a binary variable identifying overdue bills for any of many consumption aspects. Households in the bottom quintile for net wealth are substantially more likely to have overdue bills compared to the bottom quintile for household income. At the lowest part of the distribution, low-wealth households are more than twice as likely to have unpaid bills, with a gap of over 10 percentage points. Assets, especially financial assets, are also more strongly linked to household investment outcomes like investing in solar panels (Best, Nepal and Saba 2021; Best and Chareunsy 2022).

It is also possible that assets are more important than income in identifying which...
individuals and households face greater constraints for making superannuation contributions. Additional superannuation contributions are probably less likely to be made when households have overdue bills, and this is more closely linked to assets rather than income.

3.2 Breadth of Support

Co-contribution support is limited to those with income below $58,445, based on 2023–24 thresholds. Other middle-income earners with slightly higher income miss out on support. However, Figure 3 shows that the probability of individuals making extra personal superannuation contributions mostly rises across full income and wealth distributions. More gradual phasing of co-contribution eligibility would align with the empirical distributions where middle-income and middle-wealth households are still substantially less likely to make additional superannuation contributions compared to those at the top of the distributions. Figure 3 uses the income distribution and an income-wealth distribution which uses an average of income and wealth percentiles.

One general reason for constrained individuals not making extra superannuation contributions could be a focus on short-term cost of living priorities rather than long-term saving, such as through superannuation. Figure 4 shows that individuals who have greater household wealth are progressively more likely to have longer-term perspectives for saving. Figure 4 gives the probability that individuals consider the period of five years or more as the most important period when planning saving decisions of any kind, which include decisions for superannuation. Individuals who do not consider long-term saving to be important are unlikely to make extra superannuation contributions unless...
there is an extra incentive, such as through a refined co-contribution policy.

3.3 Amount of Support

Other major issues are the amount of support through the co-contribution policy and the amount of personal superannuation contributions which are required to qualify for the maximum government co-contribution. The maximum government co-contribution was $1,000 in 2003–04, before rising to $1,500 for five years, then falling back to $1,000 for three years, and then being $500 since 2012–13 (Australian Government – Australian Taxation Office 2023a). To qualify for the maximum government co-contribution in 2023–24, individuals must make contributions of at least $1,000. Whether these amounts are appropriate are open questions. For some individuals who are eligible for the $500 government co-contribution, the $500 may be more than is necessary to motivate a $1,000 personal contribution, while for others the $500 may be insufficient. More precise policy details could lower unnecessary government spending, which is not providing an additional incentive, freeing up resources for other spending like extra co-contributions in cases where $500 is an insufficient incentive.

4. New Opportunities

4.1 Policy Enhancements

The Australian Government could enhance the current co-contribution policy in many ways. These possibilities include broadening the eligibility to cover more middle-income individuals, making the amounts more precise through greater variation across individuals, raising or lowering amounts based on the impact of individual incentives, and incorporating assets into eligibility conditions to a greater extent. Figure 5 gives an indication of these changes, but the graphical details are
indicative rather than precise, with potential refinements possible through future research.

The orange dash-dot line in Figure 5 shows a flatter slope than the solid black line for the existing policy. This flatter slope can extend eligibility to a broader range of individuals, including middle-income individuals who miss out in the existing policy, while also making payment amounts vary more gradually across the income (or wealth) distribution. The orange horizontal short dash and long dash lines in Figure 5 show the possibility of either raising or lowering the maximum government co-contribution. The amounts could also be set at many other levels. It is also possible to have amounts which vary continuously across broader income ranges, or to have amounts which vary by individual. This last possibility requires an elicitation approach to determine what amount of government co-contribution would incentivise personal superannuation contributions of a given level, as discussed in the next paragraph.

One new opportunity that can pursue more precise targeting of government support is the introduction of new equitable reverse auctions. These have been suggested in the context of household energy investments (Best 2023), and they could also work well for additional superannuation co-contributions. Individuals could bid for extra government co-contributions in a reverse auction, similar to other procurement processes undertaken by governments. To achieve cost-effectiveness, the winning bids would be the lowest. For example, to incentivise personal contributions of $1,000, the winning bids would be the lowest bids for government co-contributions up to a threshold defined by the government. This may involve some individuals only bidding say $100 as the necessary government co-contribution, as opposed to a maximum amount of $500 under the current system. Individuals have an incentive to bid lower amounts, as high bids over a threshold are...
unsuccessful. To achieve equity, sub-auctions could be conducted, such that individuals are competing with others who have similar levels of income and/or wealth. These equitable reverse auctions could either replace the current system, or they could be an additional component on top of the existing system.

4.2 Opportunities for Superannuation Funds

Superannuation funds could run their own co-contribution schemes and/or their own equitable reverse auctions for co-contribution support. Motivation for superannuation funds may include the opportunity to win new members, encourage additional contributions from existing members and play a part in addressing societal inequality. The first two aspects of gaining members and boosting contributions would both contribute to growth in assets under management and the subsequent investment fees for superannuation funds.

Pilot programs could also be trialled with sub-groups of members. For example, a group of low-income female members could be targeted initially. In addition to trialling the approach with a smaller cohort, there is potential to lower the gender superannuation gap slightly with extra co-contributions for low-income female members.

Superannuation funds could also try different default investment arrangements as part of pilot programs. There may be scope to use sustainable investment options as a default, given the substantial and growing interest in sustainable investment by superannuation fund members (Hammerle, Crosby and Best 2021). More aggressive default investment options may be useful, especially for financially constrained individuals who may otherwise feel unable to take on more financial risk. Low- and middle-income

Figure 6 The Smoothed Probability That Individuals Are Willing to Take More Than Average Financial Risk for Saving and Investment, Across Economic Distributions (Individuals Make Their Own Assessment on What Corresponds to Average Financial Risks). Data: HILDA (2023).
individuals are rarely willing to take more than average financial risk for saving and investment as shown in Figure 6, but extra support through additional co-contributions with more aggressive default investment options could play a part in raising the risk and expected return for these individuals.

4.3 Future Advances

Policy-makers have an opportunity to make the Australian retirement income system more equitable with more precise incentives for superannuation co-contributions. This could occur through elicitation of the required incentives for a given level of additional personal superannuation contributions. Greater support for middle-income individuals through extending eligibility, and the potential for larger maximum co-contributions for low-income individuals, could be pursued to lower inequality with respect to the large tax concessions received by high-income earners. Superannuation funds have opportunities to participate through their own co-contribution schemes which have potential to boost assets under management while playing a part in pursuing lower societal inequality. Future research could be valuable with more detailed data that matches income and wealth components with detailed data on the type, timing and amount of personal superannuation contributions at the individual level (rather than limited data such as information on whether any additional contributions are made).

Data Availability Statement

This article uses unit record data from the Household, Income and Labour Dynamics in Australia Survey (HILDA) conducted by the Australian Government Department of Social Services (DSS). Stata code is available on request.

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References


