

On January 1, 2017 the age pension will undergo [significant changes](#) . Changes to the assets test, which determine who can receive a pension and how much, [could see 166,000 pensioners receive an increase in their entitlements](#) . But many people will also have their pensions reduced and others will become ineligible entirely.

These headline numbers are just the start, however. Changes to the pension will affect the way people plan and behave – incentivising certain types of homeownership and debt, potentially impacting younger generations.

What are the asset test changes?

The government decides who is eligible to receive the aged pension, and how much they are entitled to, by looking at their assets and income. From January 1, the maximum assets you can own to receive a full pension is being increased, for homeowners and non-homeowners, singles and couples. This will allow a larger group of people to claim a full pension.

For those who don't qualify for the full pension, there are even more changes. For every A\$1000 of assets owned above the threshold the entitlement will reduce by A\$3 per fortnight, [up from A\\$1.50 under the current system](#) . As a result, the threshold to qualify even for the partial pension is being reduced as well.

The increase in the rate that the pension is reduced, as well as the reduction in this top pension threshold, [could result](#) in some 88,000 missing out on the pension entirely, and some 225,000 seeing their pensions reduced.

The [reason given](#) for these changes is that the federal government wants to make the age pension system more equitable. But, even though some will qualify for slightly more age pension, the overall effect will be to cut down on pension spending.

We saw this in an earlier change made in January this year when defined benefit pensioners found their [income test concession was slashed to 10%](#) , reducing their pension entitlements.

Now, this change will reduce the entitlements of “asset rich” pensioners.

Why this could affect behaviour

For people approaching pension age, the latest changes to the asset test has changed their incentives. It is possible that those in pre-retirement phase may now decide to tailor their investments and lifestyle so that they will qualify for some age pension.

Consider this matter in light of what behavioural experts call [prospect theory](#) , which suggests that people place a higher value on what they might lose than what they might gain. In this context, people might be so worried about losing a part of their age pension that they may make decisions that reduce their total income.

This behaviour has already been observed, anecdotally, by many financial advisers, when clients tell them that they want to qualify for age pension regardless of how small the amount might be.

Think of the assets

Overall, if prospect theory holds, the short term incentives of the assets test will see pensioners “use up” their assets to fund their lifestyle choices and gain eligibility for the pension.

This could take the form of any combination of spending more on lifestyle, buying a more expensive home (homes are not included in the asset test), or even giving away assets (assets given away five years or more before pension age are not counted in the asset test). These are all ways of reducing the amount of assessable assets, thereby qualifying for the aged pension.

This incentive will be especially strong for those in the middle or near the upper asset threshold, as they will gain \$3 in pension per fortnight (or \$78 pa) for every \$1,000 of assets they “use up”. Or, in other words, they will achieve a 7.8% pa gain for “using up” \$1000 in assets. This is an almost unheard of return in an age of low rates.

The secondary impact

Changes to the pension asset test will ripple through the economy

Written by The Conversation

The impact of these changes wouldn't stop at running down assets, however. Many pensioners will want to remain at their standard of living and so will likely turn to debt. Some will use the equity in their homes to secure a reverse mortgage. Or, if they do qualify for age pension, they may take a loan from Centrelink. Both of these could result in debt left to an estate, reducing inter-generational transfers.

In addition, it is likely that instead of downsizing to a smaller and more appropriate housing, and thereby releasing surplus funds which then become assessable under the assets test, pensioners are likely to remain longer in their larger homes. This will restrict the supply of established homes for younger people to buy. Hence, demand and supply forces may result in prices for established houses to continue to increase.

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