1 Overview

Philippa Smith

Life cycles can often be divided into three major stages: childhood, working age, and retirement. As a society we have grown to accept that we should subsidise the young and the old. This is in essence an intergenerational contract—or compact. Society also accepts that it should subsidise other support and services (for example, health and social security for the disadvantaged), and other services and functions that operate in the community's interest—a social compact.

The challenge and question is exactly how this 'balance' between the generations and social compact will or should pan out over the next 30 to 40 years and beyond. With the ageing of our population, just how big will the extra demands be? How will we—should we, plan and manage these needs?

Is the ageing of our demographics a permanent shift or a blip of history?

How will the extra demands be paid for—by government (through increased taxes on those working), by families (through reduced disposable income or hopefully through increased private savings), or by future generations (in the form of debt or increased taxes)? Or will we as a community have to rely on reduced government services?

One thing is for certain—there is no magic pudding. The questions are more ones of what, how, when and who.

The following papers add considerable informed analysis to these questions. As noted by the Institute of Actuaries, this 'is a field that is far from crowded' and the *Intergenerational Report* (IGR) is one of the most welcome innovations in Australian public policy in recent times.

But the IGR should not be treated as the full or final story.

For starters, it looks at only one part of our economy—the government sector and expenditure. It does not cover the likely spending and debt of households or indeed of the state governments. What these papers make increasingly clear is that there is more than one possible solution. Indeed, a variety of solutions will be needed. It would be foolish to think that closure of the problem would be possible through one or two measures alone.

These papers make it increasingly clear that there is more than one possible solution. Indeed, a variety of solutions will be needed. It would be foolish to think that closure of the problem would be possible through one or two measures alone … a reliance on increased productivity down the track is 'dangerously complacent'.

The Treasury paper (Chapter 2) sets out the landscape for the Commonwealth Government expenditure if nothing changes and given the impact between population, workforce participation and productivity. Their conclusion is that a reliance on increased productivity down the track is 'dangerously complacent', especially since the projected increase for productivity and wealth is in fact less than half that achieved by Australians during the period 1950–2001. Relying on likely productivity improvements as our saviour would be similar to looking back to 1950 and saying that at least half the progress in living standards since then could (or ought) comfortably be forgone.

To my mind it is also dangerously complacent to assume, as Treasury does, that the way of tackling increased expectations for retirement incomes is to reduce those expectations. The solution needs to be through increased community awareness and improved savings, supported by government action as appropriate.

The Institute of Actuaries paper argues for the importance of testing the projections through 'what if' scenarios and other 'feedback loops' as a kind of reality check.

For example, they ask can we really assume that PBS costs will rise from less than one-fortieth to one-eighth of Commonwealth spending. In reality, they argue price and budgetary impacts (and the political fallout) would be so great as to force policy change.

The Pharmacy Guild of Australia also picks up on the issue of health costs. They note from international experience that the size of the aged population is not the only determinant of health costs and that the positive side of better health care and healthier older generations (not just the direct costs) needs to be considered. For example, newer drugs may cost more. However, this, they say, is more than offset by other gains, such as lesser frequency of dying, fewer work days lost, and less hospital utilisation.

> The Victorian Treasury argues burgeoning health expenses pose significant fiscal pressures for a state budget. In their view the terms of the implicit 'social contract' cannot be sustained and need to be renegotiated before it is too late.

They argue that 'the appropriate policy responses and control should revisit the public private split, and the implicit public policy and societal choices in the distribution of health care'.

The Victorian Treasury (Chapter 6) warns that it is already feeling the heat of burgeoning health expenses. People aged 65 and over are four times more likely to require hospitalisation and the health costs of the average 75-year-old are about three times those of the average 25-year-old. Community appetite for new technologies and services continues to expand at all ages. The Victorian Treasury notes that this is not a 'bad thing' but poses significant fiscal pressures for a state budget. In their view, the terms of the implicit 'social contract' cannot be sustained and need to be renegotiated before it is too late.

Michael Keating's analysis (Chapter 8) examines the option of increasing labour force participation as a partial solution to the ageing dynamics. His priority focus is for those men aged 55–64. He argues that in the most optimistic scenario an ageing society would not present a problem for another 50 years if the next cohort of men entering their late 50s kept working a little longer and postponed their retirement for as long as the previous generation did.

The problem is currently the lack of jobs for people with 'inappropriate skills' and hence the need for retraining of older workers and lifetime learning strategies. This requires government support and intervention.

Another issue explored by Keating is whether there is a need for greater inducements to keep working, but, as he notes, the opportunity cost of not working is already quite high. The current replacement rate of pensions and retirement incomes is relatively poor and evidence cited by the OECD suggests that there is no clear relationship between this (the replacement rate) and retirement age. In any event, the government has already legislated to increase the preservation age for superannuation to age 60. Other policy options could also be considered, e.g. requirements to take retirement income as a pension rather than as a lump sum. However, the grim reality for many who retire from the workforce prior to age 65 is that they have relatively little superannuation or private savings.

Keating's conclusion is that the primary focus needs to be on the present mismatch between the experience and aptitudes of many older males and the jobs being created. In his view, this mismatch is likely to continue without positive intervention by government. FitzGerald (Chapter 10) also returns to this issue and the importance of removing the rules and anomalies which currently discourage contract, casual and part-time work after retirement.

Louise Rolland (Chapter 7) also examines the shifting profile of labour supply and notes that the contribution of those aged 55 years and over is likely to be more important than increased migration levels. She argues that business might have only six to 12 years to address such issues. While Keating highlighted the skills mismatch faced by this grouping, Rolland notes that they are currently less likely to participate in either formal or informal training.

Ruthven (Chapter 9) looks at the dynamics of the ageing demographics from the viewpoint of attitudes and politics. Different cohorts have different life experiences, expectations and attitudes towards government and society.

Today the babyboomers and Generation Xers are the 'power generation' or cohorts. By 2042 the 'Net Generation' (now aged 2–21 years) will be 41–60 years and will be holding the power.

So what are the implications? In Ruthven's view, the rise of 'Generation X' and the 'Net Generation' will see the rise of a 'get real' attitude. They will be interested in wealth generation, self-reliance and user pays principles, but will also bring society back to a 'we' focus rather than 'me, me' focus.

According to Ruthven, the *Intergenerational Report* of 2001–02 had its greatest contribution in helping focus community debate on the issue of user pays versus inexorable higher taxes.

> The clear conclusion … is that the ageing of the population implies very substantial requirements for increased savings over the medium to longer term so that savings can be drawn upon in the longer term.

Vince FitzGerald (Chapter 10) continues on the theme of who pays. 'From a macroeconomic perspective', he notes, 'it is of secondary importance whether increased savings are private or public'. As he notes, however, politics can intervene in the priorities set (especially where expenditure is public and funded by the taxpayers).

In the private spending and/or user pays model, household savings will still need to increase to cover the increased expenses. Whichever way you cut it the clear conclusion is that the ageing of the population implies very substantial requirements for increased savings over the medium to longer term so that savings can be drawn upon in the longer term.

FitzGerald's analysis of our recent savings performance notes that the shift downwards needs to be discounted further since the acquisition of wealth in the form of owner-occupied housing typically remains locked up and unavailable as a source of finance for daily living expenses until many years after retirement.

On a more optimistic reading, he speculates that the recent 'spending spree' cannot be sustained and the baby boomer cohort may start to accelerate their efforts to save as their horizon to retirement shortens.

The reality between the current level of savings and even minimum expectations of living standards in retirement remains a large one. This gap between actual provision and what is required poses important public policy issues if we are to reduce this gap.

FitzGerald suggests at least five elements to this strategy:

- extended participation in work at older ages
- directly addressing the issue of the current inadequacy of superannuation provisions (and savings)
- improved incentives to save through super and in other forms
- unlocking housing wealth
- ensuring that the balance sheet of Australian governments is grown over the medium to long terms.

'Without some combination of the above types of actions we are drifting towards a future in which many older Australians will be disappointed and resentful about the reduced lifestyle open to them and younger Australians will be equally resentful about high taxes and fiscal priorities biased to the needs of the old. That is not an inevitable future, however,' he says.

Rather than assuming we can reign in expectations or shift costs from the Commonwealth to the states or individuals, we need to ensure that we have more resources available for the future.

Amen to that. There is much that governments, organisations and individuals can do to bring about the best possible outcomes. The papers in this volume better diagnose the problems and challenges that Australia faces.

As outlined, the solutions are not easy and may be multifaceted. As a community we need to shift the public policy focus from the immediate to include the medium and longer-term scenarios. For example, rather than assuming we can reign in expectations or shift costs from the Commonwealth to the states or individuals, we need to ensure that we have more resources available for the future. One of the most effective ways of achieving that is through lifting private and national savings.

Removing or reducing taxes on superannuation contributions would be one of the more effective ways of achieving this. It would also feed directly into improving future retirement incomes. Reform of social security means test rules would also have the potential to lift private savings and labour force participation of mature workers.

The challenges are clear. What is needed is action to lay the foundations for the outcomes Australians need and deserve. Time is running out.