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Australia is ageing, but is lifting the retirement age inevitable?

November 25, 2013 2.04pm AEDT

Author

Rafal Chomik
Senior Research Fellow, ARC Centre of Excellence in Population Ageing Research, Australian School of Business, UNSW

Dealing with an ageing population and workforce has been a concern for some years, with Tony Abbott promising changes to make it easier for older workers to find employment. AAP/Paul Miller

The Federal Government only took a few hours to quash suggestions made by the Productivity Commission on Friday to lift the retirement age.

But while the Commission's report is based on research that's new, calls to address the economic impact of population ageing are not.

The issues were first raised in Parliament as far back as 1986. And the numbers suggest that Australians will need to work longer and access savings locked up in home equity to deal with an ageing population.

The numbers

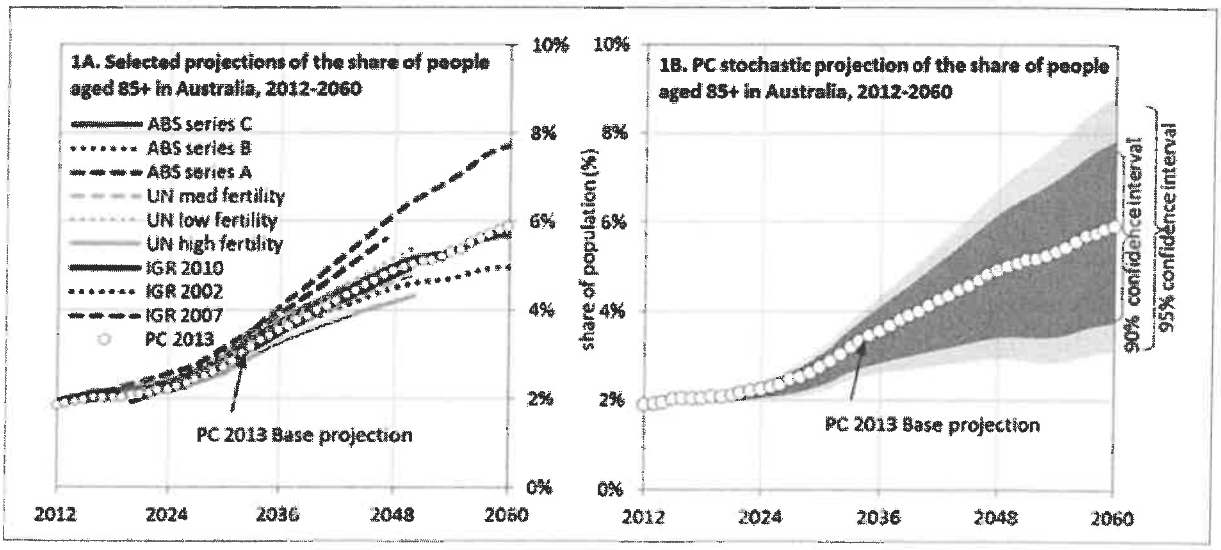
The projected scale and speed of population ageing differs according to the agency releasing them, the scenarios offered, and the year of release (see figure 1A below). This is not unusual given the uncertainty of the underlying assumptions – fertility, mortality, and migration.

Many of the demographic projections by the Commission are similar to what has been seen in the past. The report points out that life expectancy may be often under-estimated. It expects females born in 2012 to live to over 94 years on average, higher than the more often quoted calculation based on unadjusted life tables.

But it would be unfair to say that Australian Bureau of Statistics projections are necessarily "misleading", as has been claimed. The ABS also publishes a series of figures using higher life expectancy.

What's new is that the Commission has backed up its figures by looking at the historical variance of the key demographic assumptions and used these to calculate the likely range around some of its projections (figure 1B).

It helps us understand the risks better, is increasingly used elsewhere, and has been previously called for in relation to Treasury's projections.



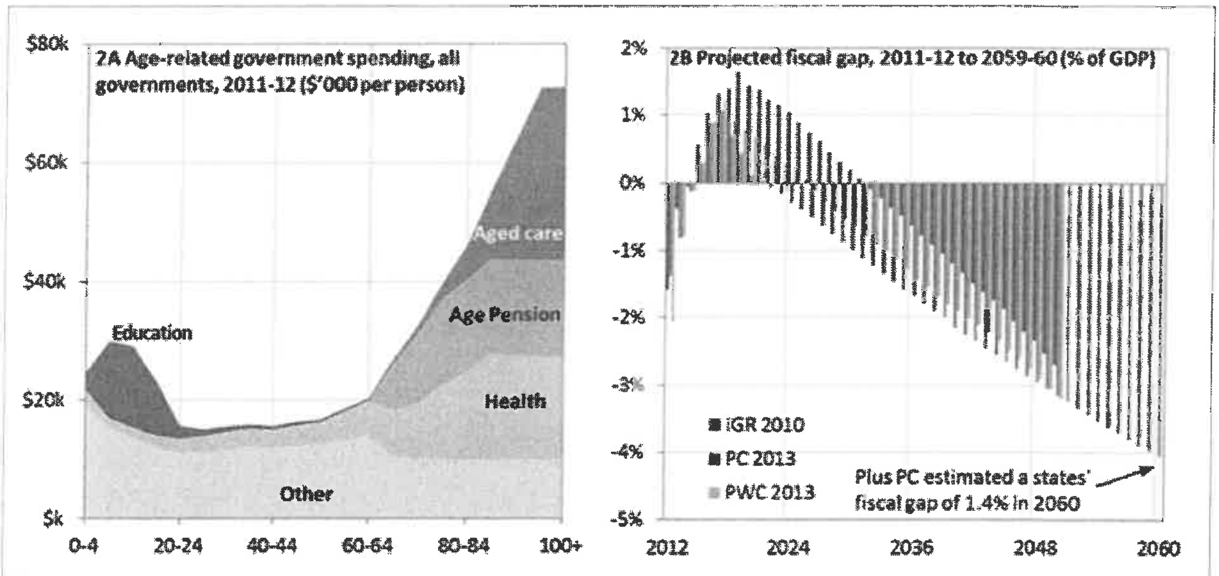
We will see substantial ageing for any realistic combination of fertility, life expectancy, and migration. Australian Treasury, UN, ABS, Productivity Commission.

There are also new projections of the impact on the labour market, income growth, age-related expenditure and the budget. More older people overall means the total labour force participation rate is expected to fall between 2012 and 2060 from 65% to 60%.

Combine the lower participation rates with declining terms of trade and lower productivity growth and it spells lower rates of income growth than Australians are used to. On top of this, there will be more pressure on public spending, which is geared toward older people through the health, pensions, and aged care systems (figure 2A).

The report also updates the Treasury's Intergenerational Report 2010 projections of the resulting budget deficits: 3.2% of GDP in 2050 and 4.1% in 2060 – higher still if states pass on some of their fiscal pressure to the government. The findings are similar to those published in a PwC report, but higher than the Government's estimate of 2.75% in 2050 (figure 2B).

The Treasury assumed that growth in the short- to medium-term expenditure could be capped. The Commission seemed think this was not credible without substantial reforms.



More older people implies more budget deficits in the future. Productivity Commission, Treasury, PricewaterhouseCoopers.

The proposed response

Faced with the fiscal challenges of population ageing, a society has a number of options. It might try to increase migration (migrants tend to be younger, but increasingly less so); raise fertility levels; sell state assets; borrow; compromise the standard of living of older people by reducing their benefits; compromise that of younger people by raising their taxes; transfer more resources between now and the future (through either public or private savings); or work longer or more efficiently.

Some of these options are already being applied but each deserves a considered public conversation. The Commission did not make any recommendations but suggested three areas for reform: working longer by delaying the pension age; accessing private savings in the form home equity; and improving the efficiency of the health sector.

They suggest increasing the eligibility age for the age pension once it reaches 67 in 2023 and indexing it to life expectancy or healthy life expectancy. This is based on the rationale that the eligibility age serves as a financial incentive and signal to exit the labour force early, even if most people in their late 60s are "neither infirm nor inept".

One advantage of indexation is that it can take the variability of politics out of the matter.

It will very likely go up in future, but perhaps at shorter notice. The gradual increase to women's pension age in 1996 started within two years of the legislation passing; the increase toward age 67 is starting in 2015, six years after it was announced.

Developing products that release equity in the homes of older Australians sounds promising and there is plenty of new research about structuring such products. But any solution would need to include rethinking the extent to which housing is used to shelter assets from the Age Pension and aged care means tests.

The report also considers the efficiency of healthcare, which is the largest area of age-related expenditure. Australia usually scores well on the overall efficiency of the system. But there is scope to improve cost effectiveness. For example, we spend less of health expenditure on prevention and rehabilitation than the OECD average.

All three such assessments of long-term sustainability of government policies conducted by the Treasury since 2002 showed that policies as they stand are not sustainable. The next update is due in 2015. Time will tell if the Commission's assessment will galvanise constructive debate and action.

Retirement Ageing workforce age pension