Australian Government

Australia's Demographic Challenges

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Introduction

The Australian Government's Intergenerational Report (IGR) projects that over the next 40 years, the proportion of the population aged over 65 years will almost double to around 25 per cent. At the same time, growth in the population of traditional workforce age – 15 to 64 – is expected to slow to almost zero.

This will have a profound effect on the economy and, potentially, on our living standards. The recent stagnation of the Japanese economy has been at least partly driven by its rapidly ageing population, and provides a warning to Australia to start preparing for these issues now.

Over time, the ageing of our population will result in a greater demand for Age Pensions and health and aged care spending. And the need to keep up with changing technology and community expectations of accessing the most advanced diagnostic tests and medical treatments is putting ever increasing demands on health spending. The IGR projects that these pressures will continue.

The IGR puts together all of these major expenditure factors – health, aged care, pensions and education – and projects that spending by the Australian Government will exceed the amount it raises in taxes by around 5 per cent of GDP by 2041-42. To put this into perspective, the 2003-04 forecast is for a surplus of $4.6 billion. A budget deficit of 5 per cent of GDP would mean that for 2003-04 the deficit would be around $40 billion.

The Government's preferred solution to this challenge is to implement policies designed to grow the economy more quickly. A larger economy will provide us with higher incomes, improved living standards and better enable us to meet the costs associated with our ageing population. Further detail on these issues is contained in the Appendix.

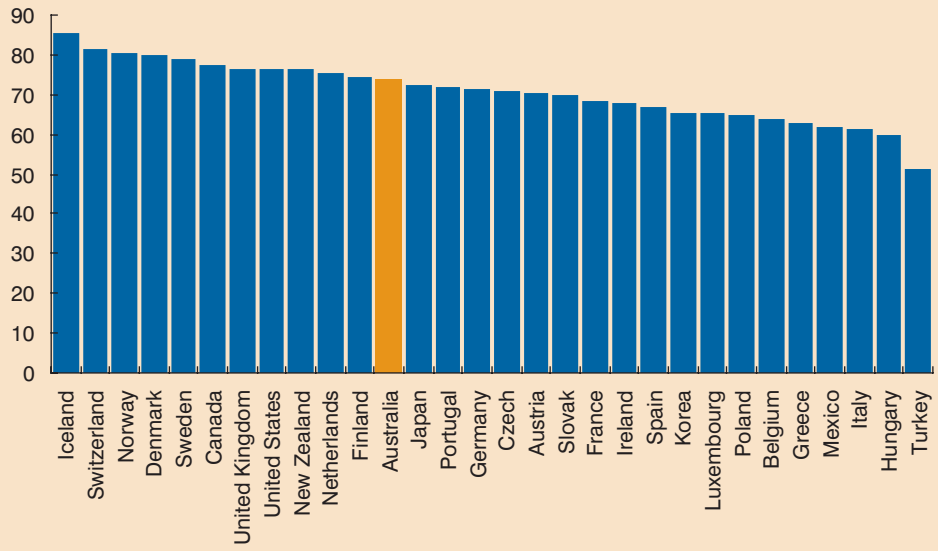
The best way to achieve higher economic growth is via increases in labour force participation and productivity.

Australia has recently enjoyed very strong productivity growth. To maintain this performance into the future we will need to continue with reforms that free-up economic activity, enhance labour market flexibility, strengthen competition, and continue to develop a more innovative and dynamic society. The gains we can make from improving productivity growth are, over the longer term, virtually unlimited. But that is not to say the task will be easy. It will also need to be accompanied by continuing sound fiscal policy and maintaining a low inflation economy.

We also have considerable potential to improve our labour force participation rates. Participating in the workforce makes people wealthier during their lives, and also means that they have higher incomes in retirement. There is also evidence that those who participate are, in general, healthier than those who do not.

Labour force participation rates are influenced by individual choices and respond to incentives and barriers. Amongst OECD countries, Australia's total participation rate ranked twelfth in 2002, suggesting we have significant potential to improve participation both in the short and medium term (Chart 1). For men aged 60 to 64, Australian participation rates ranked fourteenth. Equally, while women's participation has increased over the last 20 years, including for the mature aged, these increases were consistent with the trend across most other OECD countries, and Australia remained in the middle of the OECD for this group.

Chart 1: OECD Total Participation Rates 2002



Significant improvements in participation are possible, and will benefit those who currently are unable to find employment. The government has identified a number of opportunities to improve participation:

- improvements in the capacity for work, through better health and education
- better incentives for work
- improved flexibility in the workplace.

Our recent record of economic reform means that by comparison with other countries, which have even larger problems, Australia is among the countries best placed to deal with an ageing population. The most important thing is that we start to prepare for these changes now. In some cases this will not be easy. We must remember that many of the benefits enjoyed by Australians today are the outcomes of the sacrifices and investments of earlier generations. So too the prosperity of future generations depends upon the decisions we make today.

Equity and fairness across generations – a key building block for increasing the prosperity of nations over time – is particularly important in times of major demographic change, when the risks are higher.

By making wise investments in infrastructure, services and programs, and maintaining prudent fiscal policies we can leave future generations with an ongoing legacy of freedom, social cohesion, opportunity and prosperity.

This document sets out some of the most important issues we will need to think about over the next few years.

Improving the capacity for work

A key aspect of improving participation will be to ensure that all those who wish to participate have the capacity to do so. This will involve ensuring that our education system provides adequate and relevant training to equip our workers with the skills they require. In addition, our health system will need to focus both on preventing illness and injury and, where sickness and injury do occur, assisting Australians to return to health as soon as possible.

Education and Skills – the key to ensuring effective partici pation

Over the last 40 years, Australia has changed dramatically. We have become more educated and skilled, and we have become more flexible, adaptable and better able to use new skills and technologies. Further increasing our skills and educational attainment will be important in improving our productivity and labour force participation. Higher skills and educational levels help in the creation of knowledge, ideas and technological innovation.

As the world around us continues to change rapidly, especially with technological change, efficient and effective post-compulsory education and training systems will become more important. Current and future workers will need to improve and continually update their skill levels.

Skills and educational levels have increased markedly in Australia over time. More young Australians choose to stay at school for longer, attaining higher skill levels. Recent OECD studies confirm Australian students rate highly in international comparisons of reading, scientific and mathematical literacy.

Other Government initiatives include changes to Higher Education which deliver much needed reform, freeing universities to grow in areas of expertise, reducing class sizes and placing the student at the centre of the university experience. Combined with the measures to boost innovation – through the Backing Australia's Future package – this will mean that the higher education sector can continue as an efficient, sustainable and high quality sector. The beneficial effect of this on economic performance will be long term rather than immediate.

In addition, apprenticeship programs have nearly tripled over the last decade, with around 400 000 trainees now compared to around 140 000 in 1995. Similarly, participation in vocational education and

training has grown significantly with ongoing reforms aimed at delivering industry relevant and high quality employment and training outcomes.

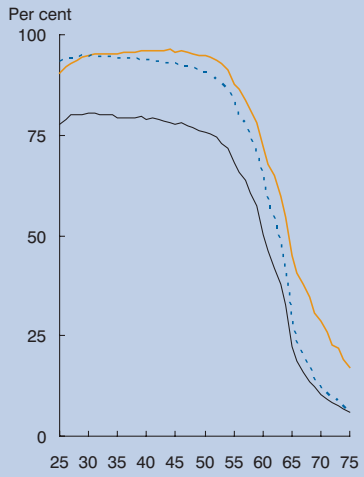
While we have come a long way, we can improve further. For example, an estimated 12 per cent of 15 year old Australian students, and around 20 per cent of the adult population, continue to have very poor literacy skills. Further improvements in education would have widespread benefits. Individuals can derive greater financial and social benefits while society overall benefits from a higher average level of education and skills that lead to greater productivity and economic growth.

The Government has introduced reforms to improve the quality of school education through introducing testing and reporting of literacy and numeracy scores, moving toward common curriculum outcomes and starting ages, and improving the quality of teaching. As well, a key focus of the Australian Government, in conjunction with the States, has been to identify and help 'at risk' teenagers so they stay at school and benefit from schooling or better manage the transition to full-time work.

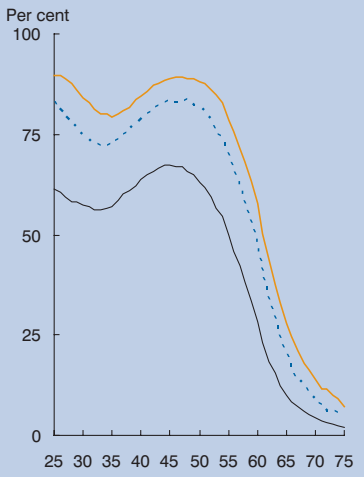
Continued improvement in education and skill levels also encourages labour force participation (Chart 2). Over the past 20 years, unskilled workers have not been as involved in the labour force as their more skilled counterparts. This applies to both men and women. Improving skill levels – particularly for the low skilled – is a key element of improving overall participation levels.

Chart 2: Participation rates by age, educational attainment and sex

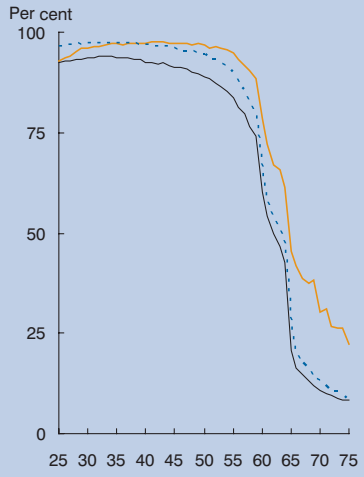
Male participation by age and education 2001



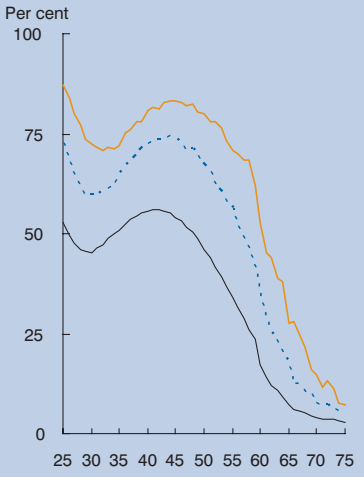
Female participation by age and education 2001



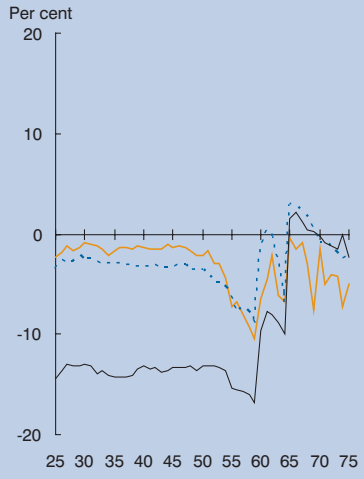
Male participation by age and education 1981



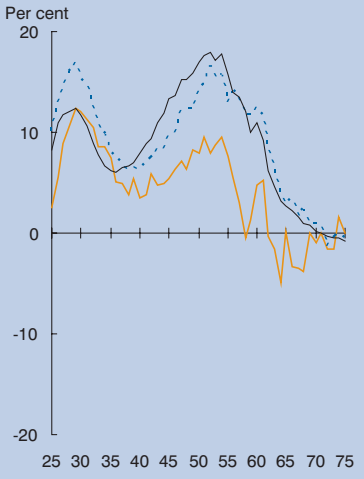
Female participation by age and education 1981



Males percentage point difference 1981 to 2001



Females percentage point difference 1981 to 2001



Degree or higher Post school No post school

Source: Australian Bureau of Statistics, 1981 and 2001 Censuses.

We need to ensure that existing literacy and numeracy programs continue to produce results. How do we help people improve their foundation skills? Linked to this is how transition, counselling, or employment services could better help people in their moves between jobs, into or from education and training, and from full-time caring into employment. We should also encourage younger people to increase their levels of education so they can move more effectively into the workforce and apply remedial efforts to improve the participation rates of the current group of adult workers, particularly the low skilled and mature-aged. Currently training opportunities appear to favour those with already relatively high skills; up-front fees for vocationally oriented courses without access to income-contingent loans make them less attractive to those with lower skill levels.

The Government is currently introducing policies designed to better target and match in a more timely way the skills needs of industry to those of job seekers through improved links between industry, registered training organisations, the broader vocational education and training system and employment services such as Job Network members.

These and other policies aimed at providing higher quality education and training opportunities should make it possible for Australians to build on and improve their skills leading to higher productivity and participation in the labour force, and a more dynamic and flexible society more generally.

Health

Health is important to the well being of all Australians. Healthy people enjoy greater freedom and opportunities to maximise their wellbeing and to participate in society. Healthy Australians are more able to participate in work, sport and family activities. During our working life, good health is an important factor in labour force participation and productivity. Poor health often leads to early retirement, spells out of work, and lost productivity through sickness or injury. Thirty per cent of 50 to 65 year olds who retire in Australia do so because of illness or disability.

Key health conditions affecting Australians are musculo-skeletal conditions, (such as back injury), circulatory diseases (such as heart conditions) and anxiety and depression. These conditions tend to be chronic and worsen over time. Living a healthy lifestyle, including through ensuring we get sufficient physical exercise, effectively managing stress and maintaining a healthy body weight can significantly reduce the occurrence of these common conditions. Physical fitness, for example, can protect against high blood pressure and mild depression, and – alongside ergonomic job design – can help reduce back injury.

A key question for Government is how to best make use of available budget funding to maximise the health of the community, thereby enhancing labour force participation and productivity. Clearly, if we can avoid 'downtime' from illness, we will be better off as a nation. This emphasises the importance of 'value for money' in a health system facing rising costs and an ageing population.

Traditionally governments have focussed health care more on those who have become ill. This has included substantial public provision in areas such as medical practitioner services, hospitals and medications. While these remain important elements of health policy, the role of preventative health deserves further examination. We need to consider the extent to which prevention might help to take some pressure off these elements, enhance the sustainability of the system as a whole, and most importantly bring benefits in terms of improved quality of life, labour force participation and productivity.

With health care resources not being infinite this raises questions as to how and to what extent the focus of the system should be redirected and the importance of individuals adopting healthy lifestyles that support their own wellbeing.

Better incentives

Paid work provides us with many benefits. It provides us with the opportunity to satisfy our basic needs. It gives us the opportunity to develop personally, live independently, and interact socially. Paid work also is important in giving us the opportunity to increase our savings for retirement.

Most of us make the decision to join the workforce. However, that decision is influenced by tax arrangements, provision of income support and retirement incomes policies, all of which have an impact on whether we work and how long we work. It is important that government policies do not discourage people from working.

Incentives to work are affected by various elements of the income support system such as the maximum rates of payments, income and assets test structures, eligibility criteria attached to payments and obligations (such as requirements to look for work). Ensuring that the income support system provides an adequate safety net for those in need without providing disincentives to work requires careful balance.

It is equally important that the retirement incomes system does not encourage people to prematurely leave the workforce. For those who leave the workforce prematurely, it can be difficult to find another job. Rules about how and when people can access superannuation can significantly affect retirement decisions.

The issues about work and income support are wide ranging. If people receiving income support must satisfy more participation requirements, they will need additional avenues to help them get a job. How should we involve industry in assisting people off welfare and into work?

While people are in work, what actions can they take to achieve their retirement goals? Is it fair to allow those with some superannuation assets to retire early and then later call on the pension to fund the major part of their retirement?

The Income Support System

Our income support system provides people with assistance during times when they are finding it hard to support themselves. It was set up at a time when full-time work was the norm for men but many groups, such as women and people with disabilities, were not expected to have a job. Today, opportunities and expectations are different. Part-time and casual work is more common. Most women now work before and after having children. Others who worked full-time for most of their lives (such as older men) can have problems getting back into work if they lose their jobs when they are around 45 or 50. And there is a strong trend for skilled males to retire early, well before age pension age.

For most Australians, paid work provides money to live on and raise children during their working years and enjoy a higher standard of living in retirement. It also provides self-esteem and a connection to the community. At certain periods in their lives people

may not be able to take up available opportunities and have to temporarily rely on income support. Others may never be fully self-reliant because of significant disability. Nevertheless, few people in the community are unable to take up paid work at some point in their lives. The income support system needs to encourage paid work, and promote and support people to participate in paid work to the extent they are able.

Around 2.7 million working-age Australians are on income support - over 20 per cent, or one in five of all adults of working age (Chart 3). This has grown by over 17 per cent from 2.3 million in 1996.

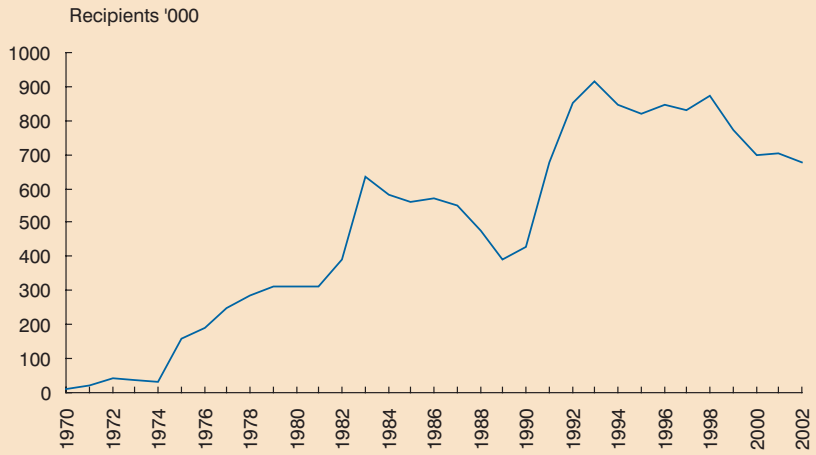
Over 80 per cent of all lone parents receive income support. Many remain on income support for long periods of time. Lone parents who claim social security spend an average of 12 years on one working-age payment or another. Nearly 30 per cent of 50 to 64 year olds receive income support. Very few who claim income support after the age of 50 will ever go off benefits. We have one of the highest rates of growth in the number of disability pensioners among developed countries (650 000 disability pensioners or around 66 per cent more than a decade ago) and one of the lowest rates of employment for disability pensioners and lone parents.

Very few working age people on income support are required to look for work - only around one in six of all working age recipients and one in ten parents in jobless families are required to look for work as a condition for receiving their income support payment. There are now many more people receiving payments with few if any participation requirements, such as Parenting Payment and Disability Support Pension, than are receiving Newstart Allowance (which does have participation requirements). Such a system works against the goal of helping people to join in paid work. In order to maximise the participation of people with diverse capacities and availability for work, a balance of incentives, assistance and requirements is needed.

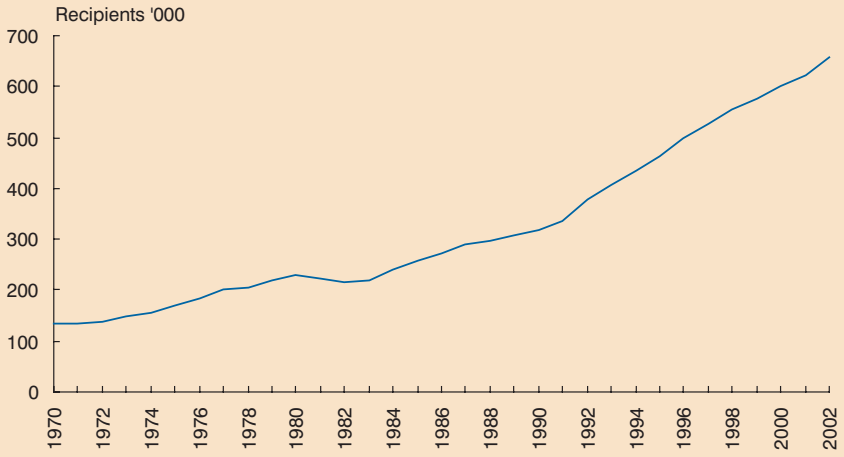
The Government has already taken steps to improve participation outcomes for people on income support. The New Tax System simplified family assistance and improved work incentives for families and individuals. The *Australians Working Together* package announced in the 2001-02 Budget, but only passed by the Senate in 2003, expands and improves employment and other services to help parents, mature aged people and people with a disability get into work. This includes broadening the availability and accessibility of child care assistance for jobless parents who wish to improve their employment prospects.

Chart 3: Growth in Unemployment, DSP and Parenting Payment (single) Recipients

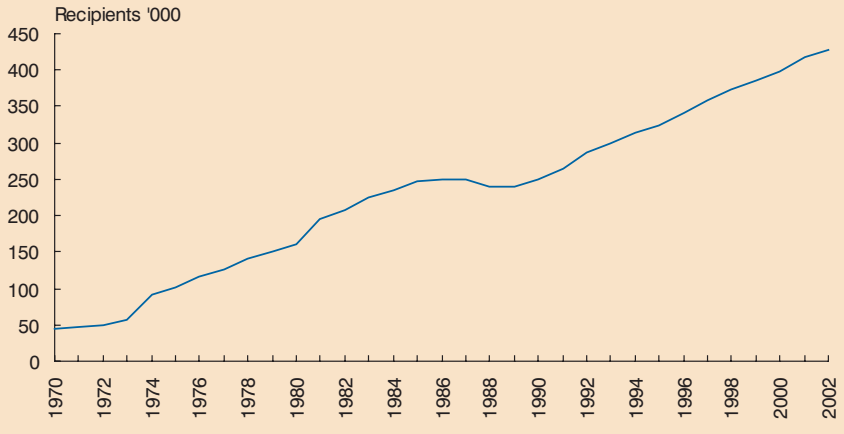
Unemployment benefit recipients



Disability support pension recipients



Parenting payment (single) recipients



Changes announced in the 2003-04 Budget for disability employment service providers will improve employment outcomes and conditions for people with disabilities. The Government also remains committed to changes to the Disability Support Pension announced in the 2002-03 Budget that aim to make sure that the Disability Support Pension remains the appropriate income support payment only for those with little or no capacity for paid work.

As well, enhancements to Job Network arrangements from July 2003 mean job seekers will receive assistance better tailored to their individual needs, capacities and circumstances, and Job Network providers will be better placed to help parents and people with disabilities find paid work.

Most people today leave unemployment via part-time work. This can lead, over time, to more substantial employment. However, our income support system can be improved to provide better incentives for people to take up part-time work or increase their hours of work. For example, the *Australians Working Together* package included the provision of a working credit which encourages people on income support to take up employment by allowing them to keep more of their income support when they work. All elements of the system, including levels of payments, means tests, participation requirements, labour market assistance and the relationship with the tax and wages systems need to promote, in a balanced way, people's efforts to increase their participation in paid work to the extent possible.

The Government recognises that the income support system needs to be modernised to help achieve the goal of increased participation. Feedback on its consultation paper *Building a Simpler System to Help Jobless Families and Individuals* indicated broad support for reform. The challenge is how to make sure we have an optimal balance between incentives, assistance and obligations that will encourage labour force participation and assist each person to achieve their potential.

Retirement and incentives for early withdrawal from labour market.

Forty years ago, the labour force was dominated by men who started work when they turned 15 or 16 and worked till they retired at 65 on the age pension. Many spent 50 years in the workforce. Superannuation was a benefit provided to a small number of people, mainly managers in medium to large companies and public servants. The introduction of the Superannuation Guarantee has meant that 91 per cent of employees now have some form of superannuation.

Today most students complete high school and a sizeable proportion go onto further study. With people able to access their superannuation at 55 years, many of today's workforce no longer work through to a retirement age of 65. Some full time workers spend as little as 30 years in the workforce, yet life expectancy is increasing rapidly. Women in particular tend to spend less time overall than men in the workforce – primarily due to their caring responsibilities – but generally live longer. As a result, Australians are spending a greater amount of time in retirement – much of it financed either directly throught the tax system (Age Pension) or indirectly through taxation concessions (superannuation).

There is a direct link between the time a person spends in the workforce and their income in retirement. Workforce participation builds Superannuation Guarantee savings and also increases income and with it the ability to make voluntary savings for retirement. A person can also improve their standard of living in retirement by deferring their retirement from the workforce. This increases their superannuation savings and delays the need to drawdown on retirement savings early. The earlier retirees access their superannuation, the lower their ultimate retirement income.

That is why retirement income policies must be effective in improving retirement incomes, have community acceptance and not operate as a disincentive to remaining in the workforce. The ageing of the population also highlights the need for retirement income policy to be fiscally sustainable into the future.

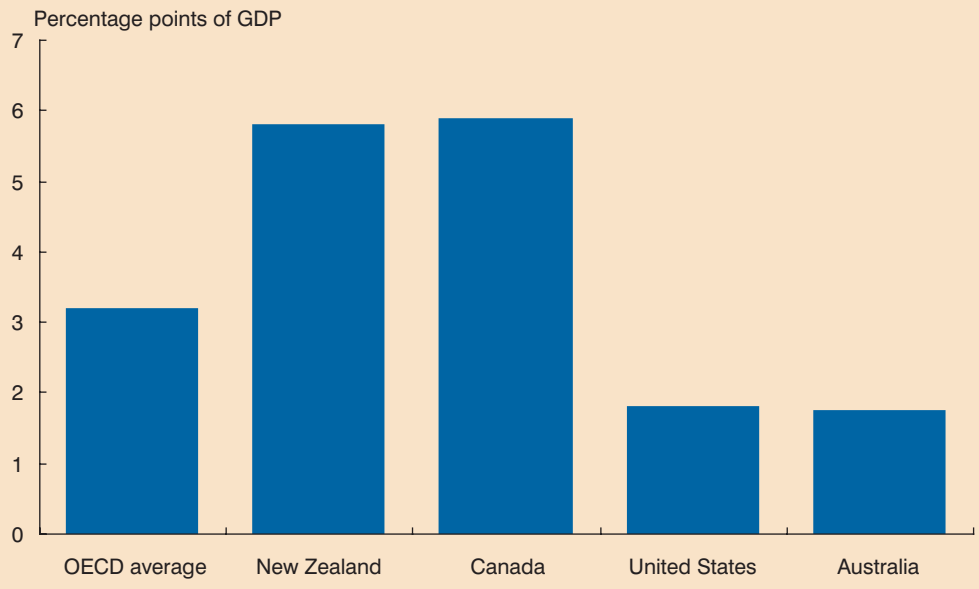
Current retirement income arrangements consist of the publicly funded Age Pension, compulsory employer superannuation contributions, and voluntary superannuation and other private savings supported by tax concessions. This year, taxpayers will provide almost $19 billion to fund Age Pensions and a further $11 billion for superannuation through tax concessions. An additional $6 billion will be spent on income support payments to people aged 55 to 64. Combined, these arrangements provide Australians with higher levels of retirement incomes than before.

Over the next 40 years, Age Pension costs are projected to rise by a manageable 1.7 per cent of GDP. Many other countries are not so lucky (Chart 4).

Countries facing spiralling pension costs have needed to make some important and difficult decisions. Some, including the US and Swiss governments, have increased or are considering increasing the age pension age. The Australian Government is not considering any such change. However, the experience of other countries serves as a reminder of the budget impacts of not securing affordability before it is too late.

The combination of Age Pension, superannuation and associated tax concessions provides a firm base for most people's retirement incomes. Workers with superannuation are projected to have an average potential spending replacement rate of 66 per cent by 2042[1], that is, spending power in retirement that is 66 per cent of that before retirement.

Chart 4: International comparisons of projected increases in spending on age pensions 2000 to 2050



For a person who earns the median wage[2] for 40 years, compulsory superannuation and the age pension would provide a spending replacement rate of 85 per cent – 65 per cent more spending power than is available from the age pension alone. While this would provide a lower income than when a person was working, retirees' day-to-day spending needs typically would be lower. For example, fully retired people do not face work-related expenses such as clothing and transport costs, while the major costs of raising children and paying off the mortgage generally would be in the past. Therefore, a replacement rate of 84 per cent is in the range independent experts consider to be appropriate.

Although old age is inevitable, many people don't think about it until it arrives. Yet a longer lifespan means more time as an older person and more time as a retiree. That is why people need to think about their retirement income goals in advance and determine whether the combination of the Age Pension, compulsory superannuation and other savings will satisfy these goals. Those who want a more comfortable retirement have opportunities to save, including through additional concessionally-taxed superannuation contributions or through postponing retirement.

Increasingly important is the superannuation preservation age. Superannuation receives generous taxation concessions as the preferred retirement savings vehicle. The preservation age aims to ensure that these concessional superannuation benefits cannot be withdrawn before retirement. At the moment, superannuation benefits can be accessed from 55 years – ten years before Age Pension age. This might encourage people to see the preservation age as the appropriate age for retirement. For these reasons it was decided in 1997 that the preservation age will increase to 60 years by 2024.

Preservation rules that allow access to superannuation as a lump sum before Age Pension age also can encourage people to prematurely retire, run down their savings and rely on the Age Pension for their retirement.

Many people over Age Pension age have skills and experience to make them valuable employees. The Government offers incentives for people over Age Pension age to continue working, including the reduction in the Age Pension income test taper rate (introduced as part of the new tax system), Senior Australians Tax Offset and the Pension Bonus Scheme. These policies increase the rewards to people over Age Pension age who wish to keep working and have the capacity to do so.

The challenge is to achieve a balance between continuing provision of a safety net for those in need while maintaining appropriate emphasis on the value of being part of the workforce and incentives for each of us to make sufficient provision for our own retirement.

1 This includes retirement income from the age pension, compulsory superannuation and additional voluntary savings.

2 The median wage is the point where half the wage earners earn more than the amount and half less. It is currently approximately $35,000.

Supporting more flexible work options

With much reduced growth in the working age population in the future, it will be essential that we generate jobs for those who want them – including those who are currently unable to find a job at all, or who are looking to increase the hours that they work. More flexibility will be required, as will conditions conducive to job creation, such as reducing the amount of regulation imposed on those seeking to negotiate mutually beneficial wages and conditions.

The last 40 years have seen significant changes in the ways in which Australians work, with a dramatic increase in the number of women joining the labour force. In 1962 the participation rate for women was just 35 per cent. It is now 55 per cent. This has profound implications for society, with large increases in the number of families where at least one partner juggles a range of responsibilities, such as parenting or caring. It has also opened up whole new industries, including formal and informal childcare.

Yet looking forward even more flexibility will be required. Rising incomes and an ageing workforce will result in more and more people choosing to work part time. We will need to accommodate these preferences. We will also need to ensure that younger Australians, including those currently reliant on income support, are able to find a job. It is important that our system is flexible enough to address these diverse needs and generate jobs for all those who want them.

The issues are important and incorporate both attitudinal and real changes to the way in which we work. For example, should we consider having longer working lives and reducing regulation on employment so employers seek to employ more people? Could we take other action to increase opportunities for mature age workers? How can we encourage mature age workers to take a broader view as to the type of employment that they could undertake? What can employers do to provide greater flexibility and employment opportunities to meet people's needs?

Part-time work

The labour market has become substantially more flexible over the last 40 years. The number of part-time jobs shows this. Forty years ago, around one in ten employees worked part time. Now over a quarter of Australian workers work part time.

Part-time workers often are women and the former non-working parents in both single-parent families and dual-income families. Part time work is also attractive to young people who spend long periods studying and workers who undertake further education and retraining over their working lives.

While some see the strong growth of part-time employment as a welcome improvement in labour market flexibility, others see it as the means by which employers can escape rigidities in the regulation of full-time employment. Surveys suggest some part-time workers want to work more hours, and some full-time workers performing both paid and unpaid overtime may want to work fewer hours. This suggests the labour market is still not flexible enough to allow part-time and full-time workers and employers to arrive at mutually advantageous arrangements.

One important factor which contributes to labour market participation is access to child care. Provision of child care assists parents to balance their work and family responsibilities.

Currently around 540,000 families receive child care assistance in the form of Child Care Benefit through the Government's child care program. The Government has allocated around $8 billion over the four years 2003-04 to 2006-07 to support child care, and recently announced that it will provide an additional $79.5 million over four years for a further 10,000 Outside School Hours Care places, 2,500 Family Day Care places and an expansion of playgroup services.

Australian workplaces, and the Australian workforce, are likely to be very different in the future. There will be a large increase in the number of older workers, and quite possibly, a strong demand for part time or flexible working hours.

What is clear is that government should not distort the system by inadvertently or deliberately hindering people's opportunity to participate in the workforce. People need more options about how long they work, where they work and what hours they work.

Extending people's working life

Forty years ago, once a man reached pension age he could expect to live another 12 years. The pension started at 65, and most men worked almost 50 years – starting when they were around 15 years of age and retiring at age pension age. Today, Australian men and women are spending more time in formal education, and starting work later. We are also retiring earlier, with some often accessing superannuation well before pension age. On top of this, in 2004, the average 65 year old man can expect to live for another 18 years and a 65 year old woman another 21 years. In 40 years' time people could have almost as long in retirement as they have in the workforce.

As we live longer, it will become more important to have flexible arrangements in place for people to make choices about extending their working life, spending longer in retirement and entering the workforce at a later age. This flexibility will become increasingly important. It will allow people to choose what is right for them. Yet some who may want to work longer can face barriers centred on employer and community attitudes, and their own behaviour.

Some employers voice concerns about the potential risks and financial costs of retaining or recruiting older workers because of health and workplace related injury, adaptability and training. Consequently, older workers often are targeted for voluntary retirement or redundancy. Yet research tends to show that the performance of employees declines little with age.

Furthermore, the quality of work in skilled jobs tends to increase with age and experience.

Conversely, older workers sometimes perceive age as the key factor affecting their employability. They can underestimate the opportunities of different kinds of work that they could do, particularly if they have worked in the same occupation or industry for a long time.

Mature-age workers are vital to our workforce and we need to support their ongoing participation. This will be more important as Australians grow older and live longer. Forty years ago, people at a set age faced compulsory retirement; we need to firmly establish a culture of employers judging staff on their merits, and people seeing themselves as having ongoing work opportunities, rather than being locked into a fixed date of retirement. The Government has already legislated to remove any age discrimination that exists in relation to the employment of Federal Government employees, and provides leadership in promoting community understanding of the economic and social imperatives of greater participation by mature age people. The Business Council of Australia has recently issued guidelines aimed at encouraging big business to keep more older Australians in the workforce.

The Prime Minister has asked his Community Business Partnership to suggest practical ways to encourage the private sector to employ more mature workers. The Partnership is expected to report back around the middle of this year.

The Government recognises that mature age job seekers may need extra help to get existing local jobs or jobs in emerging industries and therefore through Job Network offers flexible and tailored assistance to these job seekers. For example, Job Network members have access to a Training Account to provide work related training for eligible mature age job seekers. Training Credits are also available for mature age job seekers who complete a certain number of hours in Work for the Dole or Community Work.

The Transition to Work program offers a range of individual and flexible assistance to help parents, carers or mature age people aged 50 years and over who are looking for paid employment or planning to join or rejoin the workforce after an absence of two or more years. The primary objectives of the Transition to Work program are to provide preparatory assistance to an individual that builds self esteem and addresses confidence issues and improves the individual's prospects of obtaining paid employment through assessment, skills training, support and advice on how to get into the job market.

Job Network members also have access to a new Job Seeker Account to purchase a wide range of assistance to help job seekers secure work. The assistance could include, for example, providing a wage subsidy to an employer, purchasing equipment or help with transport costs. Job seekers unemployed for three months, or identified as highly disadvantaged, can access Intensive Support. This provides individually tailored assistance and support to help job seekers address specific barriers to employment and to obtain suitable work.

Today because people are living longer, we recognise it is reasonable for those of Age Pension age to make their own choices about earning additional retirement income. Increased flexibility in the workplace relations system would allow older workers to choose whether to remain in the workforce for longer in part time work as they approach retirement. A flexible workplace relations system will also enable older workers to balance caring responsibilities by allowing employees and employers to negotiate mutually beneficial family friendly work arrangements. This involves increasing employers' awareness of the business case of adopting innovative and flexible arrangements in the workplace.

Tailored wages and conditions

Already an important aspect of flexibility is the ability to tailor wages and conditions to the specific skills and needs of particular individuals and jobs. The Government's agenda of proposed amendments to the *Workplace Relations Act* continue to simplify procedures, increase labour market flexibility and link wages and conditions to productivity improvements. However, the full benefits of reform have not yet been realised. Workplace culture has prevented the new options and flexibilities being fully exploited.

Nevertheless, Australia's labour market has become more flexible through less regulated minimum conditions of employment. The award system has been reduced to 20 allowable award matters. However, areas of overlap and duplication remain, particularly where minimum standards are provided elsewhere in Australian or State Government regulations.

A number of further workplace relations reforms are currently proposed: reform of unfair dismissal laws to minimise their impact on employment, particularly for small business; simplification of procedures for agreement-making; improvements to the remedies and sanctions against unprotected action; improvements to bargaining processes; and improvements to the processes for union right of entry to the workplace. These reforms have been blocked in the Senate.

Wage setting processes also are complicated by cross jurisdictional issues arising from workplace relations issues being covered by State and Australian Government legislation. This can create significant issues for businesses operating in a number of States. Some currently proposed legislation seeks to broaden the federal jurisdiction in workplace relations matters.

Australia's arrangements for the setting of federal award wages, including the minimum wage, are unique in that they are based on a quasi-judicial process. There are different international approaches to setting wages and conditions. Critics have stated that Australia's arrangements do not serve the needs of the low paid in that relatively high award minimum wages make it too expensive for employers to take on low skilled workers.

Legislation is currently proposed that would require the Australian Industrial Relations Commission to consider the needs of the low paid, including their employment needs, the employment prospects of the unemployed, and the capacity for employers to pay when adjusting the award safety net. The legislation seeks to ensure that when setting wages and conditions of employment for low paid and low skilled workers it is at a level that attempts to prevent job losses and reduced employment growth.

Conclusion

Some people argue that we don't need to take steps now to address the ageing of the population. After all, some of these demographic changes have a long way to go before they fully work out.

But just as demographic change takes a long time to take effect, so too does the policy response to the change require a long time to take effect. The people who will be carrying the tax system in 40 years time have already been born. There are long lead times in implementing change in the area of their retirement incomes. To achieve worthwhile change in 30 or 40 years time requires action now.

The longer we leave this action the greater the changes we will need.

We need to act now so we can maintain a prosperous economy and a cohesive society that does not leave an enormous burden on future generations. We cannot expect these problems to fix themselves.

Appendix – the economic implications of an ageing population

The Australian population is ageing

In the past Australia was a relatively youthful country. In 1970-71, 31 per cent of the population was aged 15 years or younger, while by 2001-02 this proportion had dropped to 22 per cent. The proportion of Australia's population aged over 65 years has grown from 8 per cent in 1970-71 to 13 per cent in 2001-02. The IGR projects that over the next 40 years, the proportion of the population over 65 years will almost double to around 25 per cent. At the same time, growth in the population of traditional workforce age is expected to slow to almost zero. This is a permanent change. Barring an unprecedented change in fertility rates, the age structure of the population is likely to stabilise with a far higher proportion of older Australians.

While these overall demographic considerations will drive national outcomes, there will be differences between regions. For example, some regional areas attract retirees and will experience a more rapid ageing of their populations. In others there is migration of many young adults from rural and regional areas to metropolitan areas. In addition, the demographic profile of indigenous Australians is strikingly different. More than half of the indigenous population (57 per cent) are under 25 years of age, compared to 34 per cent for the general population.

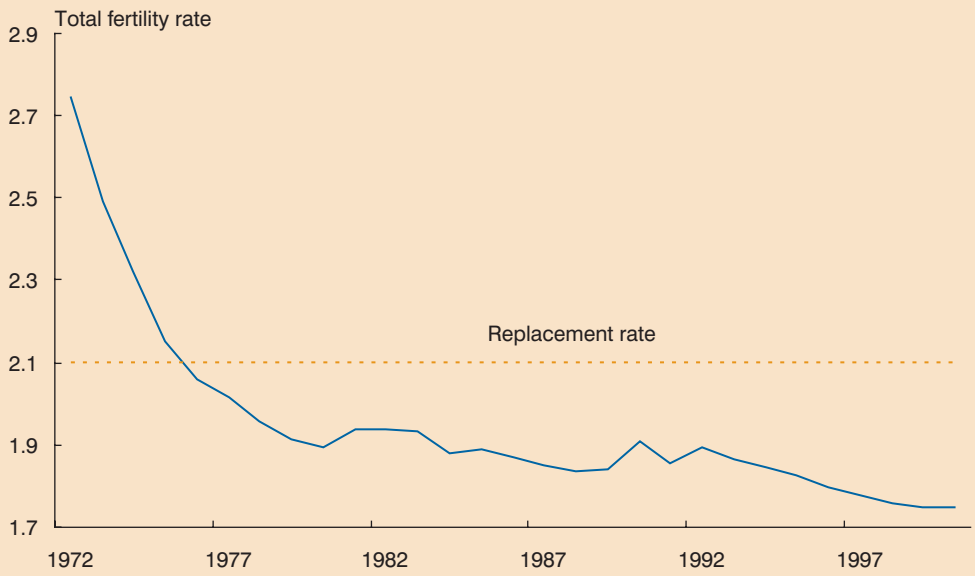
However, these differences do not affect the overall outcome. Between now and 2040 every State and Territory is expected to experience a significant ageing of its population. Ageing is an issue in which everybody has an interest.

Why is the population ageing?

The ageing of the population is caused by two factors. Firstly, Australian families are, on average, having fewer children. Birth rates started declining in the late 1960s, and have been falling ever since (Chart A1). For the last 20 years or so the birth rate has fallen below the replacement rate – meaning that without migration Australia's population would eventually begin to fall.

The decision to have children is certainly an individual one – it is not (and should never be) the role of governments to tell citizens how many children they should have. However, governments can ensure that programs are in place to assist parents in bringing up their children.

Chart A1: Australia's historical fertility rate



The Government has already introduced extensive changes to taxes and benefits to assist families. Analysis has shown that the tax and social security system is neutral in its treatment of dual verses single income families. That is, the balance of the system is about right.

The Government is now looking at how assistance to families may be further improved so that there is maximum choice available to parents in balancing work and family responsibilities. One aspect of this choice is ensuring that employers and employees have the flexibility to reach mutually beneficial working arrangements – including through part time or flexible work.

The second factor contributing to the ageing population is that we are living longer. For example, in 1960 life expectancy for males at birth was around 68 years. Today it is 78 years, and in 2042 the IGR projects it to be around 83 years. Similar increases in life expectancy have occurred for females.

With fewer babies being born, and more people living longer, it is inevitable that the population will get progressively older.

Immigration

Some have argued that immigration levels can be increased to address population ageing.

Because migrants are predominantly of workforce age, migration will assist in keeping up workforce growth. Moreover, if they are skilled they will raise general skill levels and productivity.

This is in fact happening. The Government recognises that the greatest gains to Australia come from young skilled migrants, and has shifted the balance of Australia's Migration Program from less than 30 per cent skilled in 1995-96 to more than double that proportion in 2002-03.

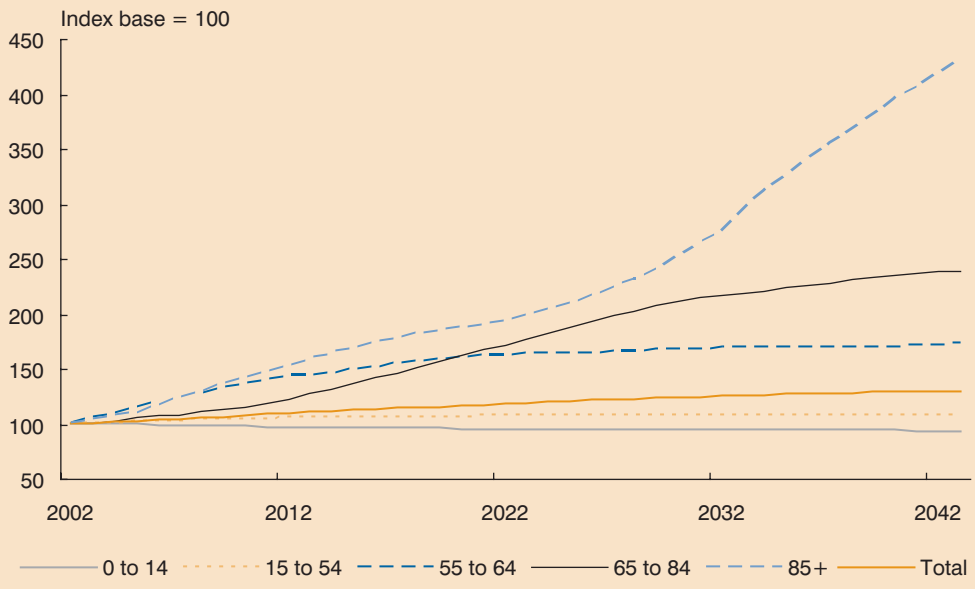
But increased migration cannot prevent our population from ageing. This is because migrants who come to Australia will age along with the rest of the population. To maintain Australia's existing age structure through immigration would require increases in immigration every year – and the increases would need to become progressively larger and larger to take account of the ageing of the migrants themselves. While there are undoubted benefits in maintaining net overseas migration, migration cannot stop the ageing of our population.

Should we be concerned that the population is ageing?

Yes – the decisions that we take today will affect our children and their children. Our society will look quite different to what it does today. Quite simply, there will be many more older Australians than there are today. The number of Australians aged 65 and over is expected to increase rapidly, from around 2.5 million in 2002 to 6.2 million in 2042. That is, from around 13 per cent of the population to around 25 per cent. For Australians aged 85 and over, the growth is even more rapid, from around 300,000 in 2002 to 1.1 million in 2042 (Chart A2).

At the same time, growth in the number of people of workforce age is expected to fall from around 1.2 per cent per annum over the last decade to almost zero in forty years' time. In 2002 there were more than five people of working age to support every person aged over 65. By 2042, there will only be 2.5 people of working age supporting each person aged over 65.

Chart A2: Population Growth Indices by age group

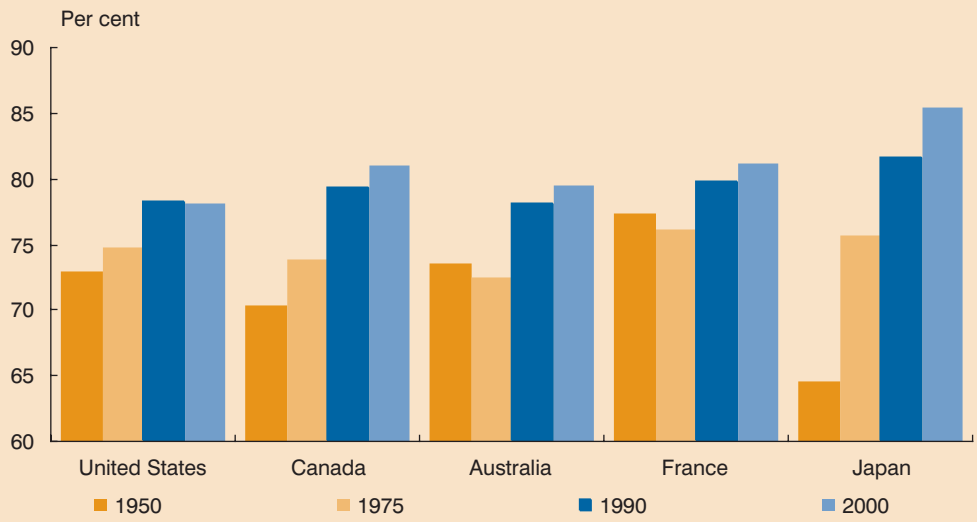


The experience of other countries

Falling birth rates are not unique to Australia. In fact, birth rates have been falling in all the advanced industrial countries – and many are currently lower than Australia's. Low birth rates largely reflect increased choices available to women, including access to birth control, access to education and employment, and higher living standards.

Chart A3 below shows how the proportion of the population aged over 15 has changed in Australia, the United States, Canada, France and Japan. This ratio has generally risen over time in each country.

Chart A3: Proportion of Population Aged Over 15

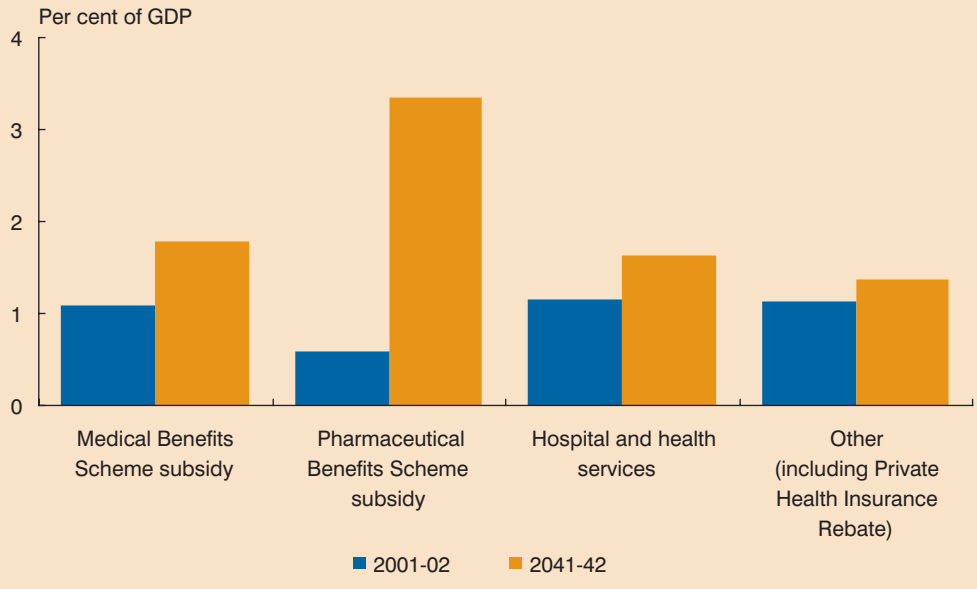


Data Source: *World Population Prospects Database,* United Nations Population Division

The policy challenge

Over time, the ageing of the population will result in a greater demand for Age Pensions and health and aged care spending. Already the need to keep up with changing technology and community expectations of accessing the most advanced diagnostic tests and treatments are increasing demands on health spending. The IGR projects that these pressures will continue.

Chart A4: Projected growth in components of Commonwealth health spending



Spending on health and aged care accounts for much of the projected rise in Commonwealth government spending over the next four decades (Chart A4).

The Commonwealth is the primary funder of health and aged care services in Australia. It funds Medicare, which incorporates the Medical Benefits Scheme; the Pharmaceutical Benefits Scheme (PBS), which subsidises selected pharmaceuticals; and the Private Health Insurance Rebate. It also contributes to State funding of public hospital services and provides funding to non-government organisations for services such as residential aged care, community care and indigenous health care. Over the past three decades, Commonwealth health spending has more than doubled, to 4.0 per cent of GDP in 2001-02. In recent years, spending on the PBS has been the fastest growing component. In the decade to 2000-01 PBS spending as a percentage of GDP more than doubled.

Although population growth and ageing affect health spending, these factors account for only around one-third of the recent growth. Much of the growth has come from the demand for new technology and treatments. Australians now expect to access more expensive diagnostic procedures and new (and more expensive) medications listed on the PBS. Unless addressed, these trends are likely to continue to drive health spending over the next four decades, pushing up Commonwealth health spending from 4.0 in 2001-02 to 8.1 per cent of GDP in 2041-42.

Payments to individuals include Age and Service Pensions, unemployment allowances, Disability Support Pension, Parenting Payment and family payments. They account for about a third of Commonwealth spending. The number of people receiving social safety net payments has been rising significantly and is a key driver of rising spending on these payments.

Commonwealth government spending on education and training accounts for 7 per cent of all Commonwealth spending, with around half of this allocated to government and non-government schools, and around a third to higher education institutions.

In recent years, demands for a more skilled labour force and the desire for education have increased, driving up the rate of participation in the university sector, and in vocational education and training. At the same time, the proportion of the population in the principal age group for education (5 to 24 years) has fallen from 36 per cent in 1972 to 28 per cent in 2002.

Overall, Commonwealth spending on education and training, while continuing to grow at a solid rate, is likely to decline as a share of GDP over the next four decades, from 1.8 per cent of GDP in 2001-02 to 1.6 per cent of GDP by 2041-42.

What does all this mean?

The IGR projects that spending by the Government will exceed the amount it raises in taxes by around 5 per cent of GDP by 2041-42. To put this into perspective, if we had a budget deficit of 5 per cent of GDP today, then we have a deficit of around $40 billion instead of the forecast surplus of $4.6 billion.

So what are the choices?

Choice 1.

We could elect to do nothing now, and raise taxes in the future to cover budget deficits as they occur.

Some argue in favour of this position, noting that in 40 years average incomes will be substantially higher than they are today due to continuing economic growth. They argue a richer society will be able to afford higher taxes.

While society will be richer, we need to think carefully before condemning our children to higher taxes.

We are not talking about a minor tax increase. The projected tax-expenditure gap is 5 per cent of GDP. To put this into perspective, the GST currently raises $32.4 billion or 4 per cent of GDP. Personal income tax raises $94.7 billion or just under 12 per cent of GDP. A tax increase of 5 per cent of GDP would require an increase in personal income tax collections of over 40 per cent.

Increasing international competition for skilled people – such as entrepreneurs and managers, scientists, teachers, nurses, lawyers and accountants – would make retaining skilled people in Australia even more difficult than it is today. Higher tax rates could simply encourage our best and brightest to head overseas.

In addition, living standards elsewhere are likely to continue to grow in the future – the United States in particular. A slowing in Australia's per capita GDP growth would represent a substantial decline in relative living standards. Ongoing improvements in transport and communications technologies are likely to make relative differences in wealth all the more obvious.

This is not the sort of Australia we should aspire to leave to our children.

Choice 2.

An alternative approach would be to cut future government expenditure by around 5 per cent of GDP.

Without doubt we will need to be very careful about government spending priorities in the future. But again, the dimensions of such spending cuts are enormous. For example, the sorts of expenditure cuts required to achieve a 5 per cent reduction of GDP could include:

- the entire amount allocated to health
- over half the social security and welfare budget.

Clearly neither of these options could ever seriously be contemplated.

However, this does not mean that the Government will not need to become increasingly careful about where it spends taxpayers' money.

The Government already has taken some steps to try to moderate some growth in health and income support expenditure. However, these decisions - on Pharmaceutical Benefit Scheme co-payments and 'ability to work' requirements for people on the Disability Support Pension – have been blocked in the Senate.

In the circumstances, clearly future demands for health and welfare spending from an ageing population will increasingly reduce the capacity of government to increase spending in other areas. Moreover, those future demands will seriously restrict the Government's ability to respond to new priorities as they emerge. Significantly, the Government will have to be careful about taking on new expenditure priorities in the future, particularly in areas that are highly sensitive to the effects of the ageing of the population.

In this regard, the Government also will need to reassure itself that all its ongoing expenditures are still relevant to its current set of priorities and objectives; and importantly that all current services and benefits should continue to be directed to the appropriate elements within the community.

Choice 3.

We could run deficits and hence increase debt.

This is not a sustainable or responsible solution, as it merely passes the problem on to our children's children. Interest payments on debt would grow at an ever-increasing rate, reducing the money available to pay for pensions and health care. Eventually our descendants have to start to pay off the debt – further reducing the scope for government provision of essential services.

This option – while it avoids some of the hard decisions now – would leave a legacy of economic disadvantage to our children's children, and is not one that any responsible Australian should be prepared to contemplate.

Choice 4.

The best approach is to look for ways to increase the size of the economy so that we all have higher incomes and are better able to meet the costs associated with our ageing population.

The way to increase the size of the economy is to grow at a faster rate. The key ways to improve economic growth are through increases in labour force participation and productivity.

The Government is seeking comments from interested parties by Friday 14 May 2004. The comments should be forwarded to the following address:

Australia's Demographic Challenges
Social Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email address: demographics@treasury.gov.au

Copies of this publication are available from the Website:
http://demographics.treasury.gov.au

It will be assumed that submissions are not confidential and will be publicly available unless the contrary is indicated when the submission is made. However, if an application is made pursuant to the freedom of information legislation for access to a submission in respect of which a claim of confidentiality has been made, the principles of that legislation will apply.