The Ageing Country

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Australia has experienced uninterrupted positive GDP growth for the last twenty-six years,[1] earning its moniker of the Lucky Country. However, an ageing population may threaten this trend in the coming decades: like other industrialised nations, Australia is facing a dramatic demographic shift towards older cohorts. This essay will explore the implications this has for the Australian economy, as well as policy reforms that will ensure its future prosperity.

The rise of global ageing

The post-war baby boom created a pool of productive workers who brought about enormous increases in living standards around the world, including in Australia. However, the subsequent falls in fertility and increases in average life expectancy are causing many countries' age distributions to skew to the right (Figure 1). Projections by the Australian Bureau of Statistics show those sixty-five or older will comprise 25% of the population by the turn of the next century,[2] while the International Monetary Fund has Australia's old-age dependency ratio almost doubling by 2050.[3(p46)] Regardless of the exact proportion, the Australian population is ageing, which has serious consequences for its economy.

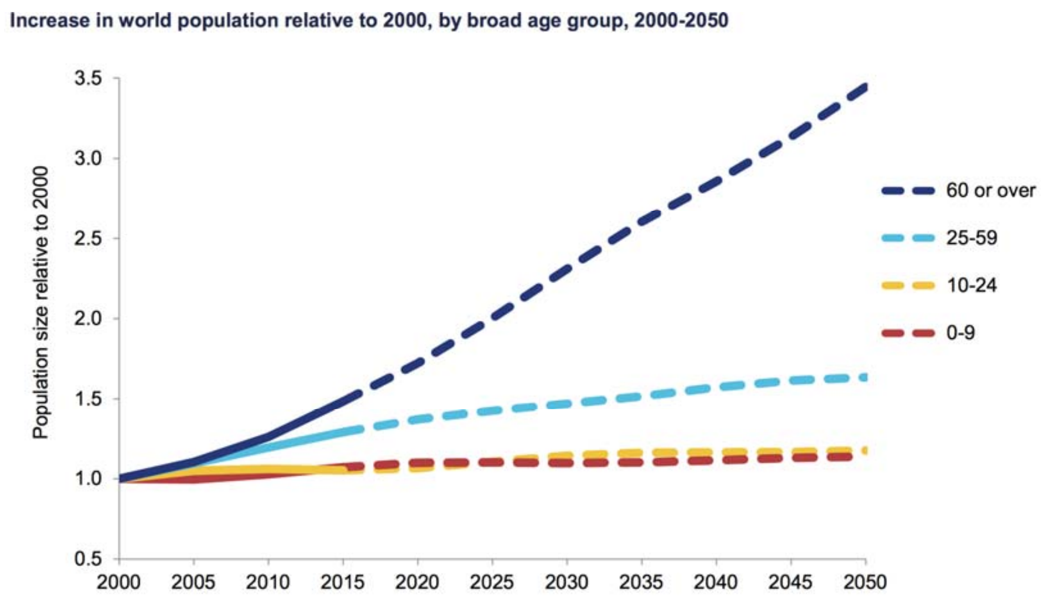

Figure 1: Increase in world population relative to 2000 by age group.[4(p24)]

Ageing and the economy

Population ageing affects the economy in several ways. Those aged sixty-five or older often exit the workforce to retire, lowering the number of workers available to an economy and causing Gross Domestic Product (GDP) per capita growth to slow as fewer workers support a greater number of dependents. Without work income, older Australians use their assets to fund their retirement, reducing national savings. This lower savings level, combined with increases in capital per worker as the workforce shrinks, decreases the returns to capital, which will reduce international capital supply.[5(p61)]

Older populations may also hinder productivity growth. While there is evidence that some sectors' workers become more productive with age, the tendency of those in older cohorts to be more risk-averse may hinder innovation and entrepreneurship, both of which contribute to an economy's productivity.[6]

Ageing also strains governments' budgets. The lower labour force participation rates and consumption rates associated with the elderly reduce tax revenue, while increasing demand for government-provided services, such as healthcare, aged care and the Age Pension. These pressures could cause unsustainable increases in public debt, which would have flow-on effects in financial markets.[5(p9,61)]

However, these results are generally based on extrapolating current and historic data into the future. It is more likely that people will change their behaviour as their future expectations adjust to Australia's demographic realities.[7] Nevertheless, it would be unwise to leave this to chance. There are many policy reforms the Australian Government could enact today in order to ensure the economy is prepared to cope with the burden of population ageing in the future.

Potential policy responses

Australia's potential policy options can be broken down into those aimed at raising economic growth to counteract the negative effects of ageing, and those aimed at addressing the fiscal burden of an older population.

Reforms aimed at promoting economic growth will be analysed through the '3Ps' framework adopted by the 2015 Intergenerational Report and the Productivity Commission (PC), which decomposes GDP growth into population growth, participation rates and productivity growth.[5, 8] The first aspect is the most straightforward: although Australia's population will continue to grow during the demographic transition, it will grow at a slower rate than in the past.[8(p3)] Increasing it will increase the number of workers available in the future. This can be achieved either through increasing fertility rates or migration levels.

Australia's birth rate is forecast to remain below the replacement level at 1.9 births per woman, but has fluctuated significantly in the recent past.[8(p4)] One option for counteracting this is to encourage reproduction through policies such as baby bonuses and family tax incentives. However, fertility is driven by complex factors and can react slowly and unpredictably to policies. There is also limited empirical evidence that pro-natalist initiatives are effective, making this the least viable area for reform.[9(p14-5)]

The other option is to increase net migration, which is more directly controllable through government quotas. Australia has high migrant inflows by international standards, which it could take advantage of to counterbalance its age distributions, given that migrants are usually younger than residents (Figure 2). Although this would help soften the impact of population ageing, it would not fully counteract it.[10(p55-6)] It is also important to consider the effect of mass migration on social cohesion, and the pressures population growth puts on government services and infrastructure.

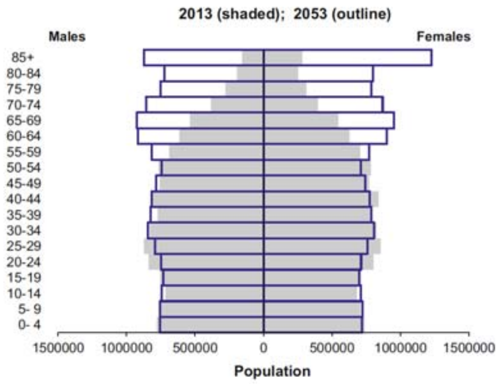

Fig. 4.3 Australian age distributions, 2013 and 2053: zero annual migration assumption. *Source*: Author's calculations

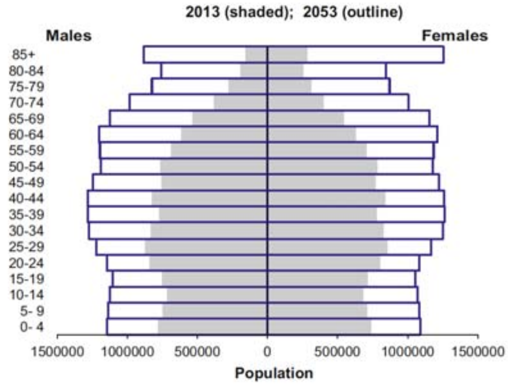

Fig. 4.4 Australian age distributions, 2013 and 2053: 240,000 annual migration assumption. *Source*: Author's calculations

Figure 2: Age distributions with no migration and a net migration level of 240 000, respectively.[10(p54)]

While population reforms offer no permanent solutions, increasing labour force participation does. The literature points to future participation rates being naturally higher than they are now, particularly amongst older cohorts: each generation has been better educated and healthier in old age; jobs are increasingly knowledge-based; flexible working options are more widely available; and women's participation has historically increased.[5(p65,70)] Nevertheless, there are a number of activist government policies that could improve participation.

Based on current trends, Australia's labour force participation rate will drop to 62.4% by 2054-5.[8(p18)] Therefore, a priority for policymakers is to increase the incentives for older workers to remain in the workforce. One such policy that has already been implemented is the raising of the Age Pension eligibility age to sixty-seven by 2023, after it had remained at sixty-five for decades, despite increasing life expectancies and, more importantly, healthy life expectancies – that is, the number of years a person can expect to live without disability.[5(p143,173)] A further improvement would be to formally link the pension age to life expectancy, as in Denmark, and to bring the superannuation preservation age in line with pension eligibility. Otherwise, older Australians have an incentive to retire early, draw down their assets and then access the Age Pension once eligible.[5(p192,201)] However, such changes are unpopular and avoided by policymakers. Given that the proportion of voters aged fifty-plus, and thus directly affected by such reforms, is only going to increase, it is imperative that these changes are enacted now, lest they fall victim to politics.[5(p54)]

Other less controversial options include tax incentives and reduced pension tapering for mature-aged workers. On the demand side, retraining programmes and initiatives like Restart, which offers financial incentives to employers who hire older workers, can improve participation amongst those of retirement age.[5(p177-9), 8(p96)] Addressing poor health outcomes – a key cause of involuntary early retirement – will also help to keep older Australians in the workforce.[5(p131)] The pay-off is huge: if Australia were to match Sweden's participation rates for those sixty-five and older, it would increase its GDP by $69 billion.[11(p6)]

The PC also identified women as a second subgroup whose participation rates could be improved. Despite drastic increases recently, Australia is still outperformed by several countries in the Organisation for Economic Co-operation and Development (OECD), particularly for women of childbearing age. This suggests that better policies are needed to ensure working and having children are not considered mutually exclusive. While changing social norms have bolstered female participation, improving access to affordable childcare and more flexible working options would further increase participation rates.[5(p75-6)] Reaching par with Canada would permanently raise Australia's GDP by $25 billion.[8(p21)]

The final way of boosting economic growth is through increasing labour productivity. Labour productivity growth, which can be decomposed into capital deepening and multifactor productivity growth,[5(p107)] has been important historically in improving living standards in Australia, as measured by real national income per person. It will continue to be important in determining future living standards as Australia's terms of trade stagnate (Figure 3). Because of the financing costs associated with increasing capital, multifactor productivity growth is the preferred source of growth, but also the hardest to achieve.[5(p111)]

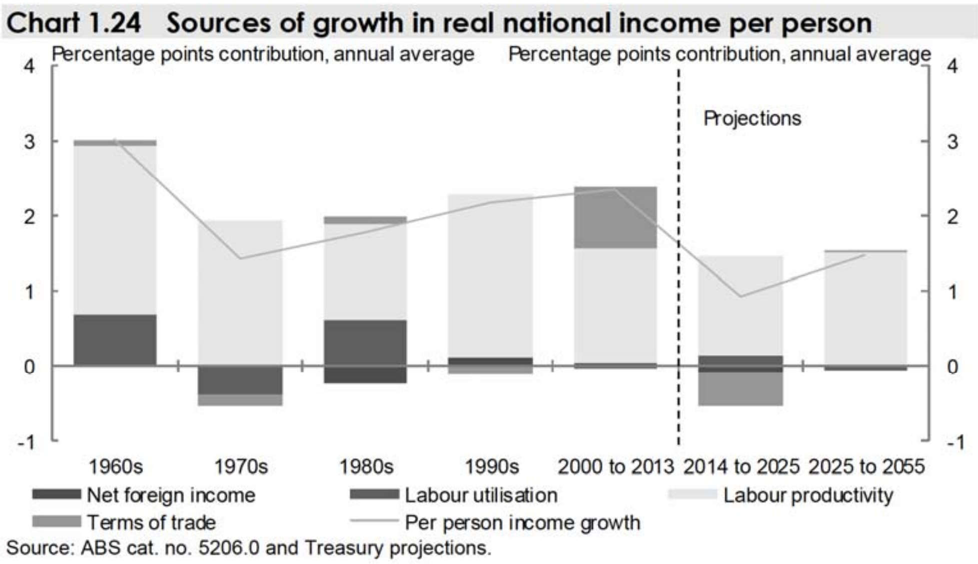

Figure 3: Growth in real income per capita.[8(p33)]

The PC makes regular, detailed recommendations on how to lift Australia's multifactor productivity, many of which remain unimplemented. In addition, commissioned reports have highlighted potential reforms to Australia's problem areas, such as the taxation system and the competition environment.[12]

An OECD report notes that Australia has low research and development investment and research industry linkages, which harms productivity growth. Initiatives such as the National Innovation and Science Agenda are important first steps in remedying this.[13]

These measures designed to bolster participation and productivity are important to prevent falls in living standards as a result of population ageing; however, the effect on Australia's fiscal position is equally important. The consumption patterns of older cohorts mean expenditure on healthcare, aged care and the pension are set to increase, with healthcare comprising an estimated 7% of GDP by 2054-5.[5(p136)] It is therefore important to consider how such increases will be funded in the future.

Borrowing money is not a viable response to structural increases in expenditure, as it simply postpones tax increases or spending cuts. It is also not appropriate to raise income taxes, as this has a distortionary effect on participation rates, particularly amongst women. A better way of funding future outlays would be to shift the tax burden away from incomes, towards wealth and consumption taxes, which are low by international standards.[5(p85,169)]

Reducing expenditure is another option for reducing fiscal pressures. Given the important role of healthcare costs, improving efficiency in this sector may result in significant cost savings. There will be natural decreases in expenditure, such as fewer retirees claiming the full pension, when the superannuation system reaches maturity.[5(p170), 8(p67)]

Another option is accessing the enormous equity in the Australian housing market to reduce government spending. The majority of retirees own their own home and including it in the Age Pension means test would reduce the amount of transfers going to those with large assets. A similar reform involves allowing older Australians to access the equity stored in their homes to make greater user contributions to health and aged care costs. Such deferred payment programmes are already being trialled in other countries, like the United Kingdom.[5(p215-21)] However, this is by far the most contentious policy and appears unlikely in the current political climate.

Conclusion

The effects of Australia’s ageing population are only going to become more pronounced with time. For that reason, it is important to act now to counteract falling workforce participation and the resulting slowdown in GDP per capita growth. While high net migration levels will lessen the impact of population ageing, increasing participation amongst older workers and women, as well as multifactor productivity growth, are immediate policy priorities. With a little initiative from policymakers, Australia will continue to be the Lucky Country for many years to come.

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