The Effect of Population Ageing on the Australian Economy

Year 11 Economics: Group Research Project

**Student Names**

Eric CHEUNG  
Enoch LAU  
Viktor TANEVSKI

**Class Teacher**

Mr Griffith  
Mr Forwood  
Mr Griffith
Introduction:
The Effect of Population Ageing on the Australian Economy

The world’s population has been ageing for centuries, and it should be recognised as a sign of success for society as a whole. Better health and aged care means that more people can look forward to a productive and fulfilling later life. While these growing numbers pose some policy challenges, they also constitute an asset. Elderly Australians embody a wealth of knowledge, experience and understanding, which is valuable in economic as well as human terms. Their contribution to the wellbeing of the nation has the potential to expand if underpinned by appropriate policies.
A. Population Ageing: The Issue

The Ageing of the Population

In 2001, there were 2.4 million Australians aged 65 or older, representing 12.4% of the total population\(^1\) (see Table 1). This is projected to grow to 26.1%, or 6.5 million, by 2051, more than double that of today’s figures. Similarly, from 1901 to 2001, the median age rose from 22.6 years to 35.4, and will increase to 46.0 by the year 2051. These projections show the continual ageing of Australia’s population, the inevitable result of fertility remaining at lower levels over a long period, and longer life expectancy. In Figure 1, the age distribution in 2051 swells around the older age groups.

Based on assumptions of continued low fertility, and continued small declines in mortality, Australia’s population is projected to continue ageing into the next half century.

<table>
<thead>
<tr>
<th>Table 1: Population Projections – National Summary Tables, Australian Social Trends 2002 (ABS)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population aged 0-14</td>
</tr>
<tr>
<td>Population aged 15-64</td>
</tr>
<tr>
<td>Population aged 65 and over</td>
</tr>
<tr>
<td>Population aged 80 and over</td>
</tr>
<tr>
<td>Median age of total population</td>
</tr>
</tbody>
</table>

\(^1\) Projections based on Series II from the Australian Bureau of Statistics (2001), which assumes a fertility rate of 1.6 births per woman and a net immigration of 90,000.
Baby Boom Generation

The large number of babies born between 1946 and 1965 as a result of post-war prosperity are known as the baby boomers, the youngest of which will be of retiring age around 2031. It added a substantial base to the age pyramid of the 1960s. The progress of the post-war baby boom cohort along the Australian age distribution is shown in Figure 2. The baby boomers are on the threshold of greatly increasing the numbers in the retirement ages. In Series II projections (ABS), the highest annual rate of growth for this age group will occur in 2012 when the large cohort born in 1947 turns 65.

Figure 2: Age Distribution of the Population (ABS)
Decline in Fertility
Since the baby boom, fertility rates have declined because:
- Women have chosen to have fewer children in order to follow career paths
- Rising incomes increase the opportunity cost of child rearing, reducing fertility
- There has been an increase in the technology and knowledge of contraceptives
This resulting lack of young people leads to a phenomenon known as ‘structural ageing’ – declining proportions in the younger age groups and the consequent increase in the proportions in older age groups. Falling fertility causes dependency on the working-age population to decrease in the first instance, as child dependency falls; in the longer run, it causes dependency to increase as the larger cohort reaches retirement age (see Figure 3).

Reduction in size of workforce and dependency
A large cohort of workers will move into extended retirement years with a smaller cohort of children entering into the working-age group. Analysis suggests relatively minor direct labour force implications from ageing over the next twenty years. The immediate impact is a rise in the dependency rate – the working-age population supporting a proportionally larger dependent population. The Australian Bureau of Statistics (ABS) predicts an increase in the dependency from 20 percent in 1995 to 25 percent in 2021. This implies that the share of 15-65 year olds in the population falls from 66.7 percent to 64.3 percent. Ceteris paribus, annual growth of per capital output will slow by 0.10 percentage points.
Hence, an ageing population reduces the capacity of working-age adults to finance the optimal level of investment. Indeed, empirical studies confirm that physical investment, as measured in the national accounts, does tend to fall as dependency rates rise.

Mortality and life expectancy
Mortality rates have dropped over the past decades, contributing to the ageing population. This has been caused by medical advances and higher living standards. The ABS has projected that life expectancy will increase 5-7 years by 2051 to 81.1 years for males and 86.3 years for females (Figure 4). Life expectancy rises when age-specific mortality rates decline, as represented by an increase in the probability of the young surviving to working age and/or young adults surviving to old age.

Early Retirement
Australians tend towards early retirement (55 years) due to social pressures and lifestyle attitudes. There will be fewer taxpayers who will remain to support pensions. There will also have been inadequate savings in their super funds (early retirement means less working years), placing enormous pressure on government welfare. Early retirement, if voluntary, must therefore be funded by the individual.
B. Implications for Consumers and Businesses

Consumers and Individuals

Goods and Services

Older consumers live different lifestyles. They have more time and money than at any other stage of their life and have a less direct role with children. Because they are secure in their home life, they spend less on renovation, furniture, and home electrical items. This consequently affects the wider public in the range of goods and services offered by businesses. The ordinary consumer will also be affected by the reduction in the working population required to produce the goods and services demanded, as the supply of labour decreases.

Paying for Retirement

As individuals live longer, the amount of time in retirement is likely to be longer, which requires a sustainable income base drawn in part from previous savings or supplemented by part-time work to meet a changing expectation of quality of life and standard of living in retirement. However, much tighter means testing by the government of the age pension would force older people to finance a higher proportion of their costs themselves. The accumulation of private assets, such as superannuation, will ensure that adequate retirement incomes, and quality health and aged care services will continue to be affordable in the future. Australians increasingly recognise that they are likely to live longer and that the difference between a basic standard of living in retirement and a comfortable one is largely in our own hands.

Carers

The elderly have traditionally depended on a substantial input of unpaid, informal care, largely provided by family members. With an increase in the number of elderly in the future, more emphasis will be placed on family members to take care while the government’s role is decreasing.

Businesses

Changing Attitudes

Mature age workers play a vital role to play in Australia’s economic future. Research by Access Economics\(^2\) sends a strong signal to Australian employers that they neglect mature age workers at their own peril. It has been estimated that mature age workers can add up to 4% to economic growth if the participation rate for 55-70 year olds increases by only 10%. Older workers are imbued with loyalty to the organisation and have a strong work ethic. In terms of customer service, mature customers are likely to be more comfortable being served by mature age workers. The high cost to business of the loss of older workers is important.

Competence is what counts, yet many organisations judge employees according to age. Unless organisations adjust their thinking on mature workers, market forces may do it for them. The supply of mature workers will grow rapidly in the years ahead, while the supply of younger workers will relatively contract. If companies drop mandatory retirement policies – officially or by default – then the nation gains as a whole.

Changing Demand for Goods and Services

National spending patterns will change with demography. Australian manufacturers must be aware of the power of this new market. Faced with a rapid rise in the spending power of mature consumers businesses will be forced to adapt. For example, can be expected that:

- Carmakers will observe a further swing to small cars and away from family sized cars, raising the incentive for manufacturers to make smaller cars locally
- Bookstores will be favoured over sport stores and music outlets
- Travel agents and airlines will have cater for less backpackers, but more travellers willing to pay a little more for extra comforts
- The construction industry will need to build fewer and smaller new homes, but with higher quality fittings and a greater emphasis on safety and security.

\(^2\) As examined in Population Ageing and Economy 2001 (Access Economics)
C. Implications for Government and its Policy Responses

A greying population, technological leaps in health care and other pressures are set to send the cost of government services soaring by 20 per cent over the next 40 years creating a chasm between spending and tax revenue of $87 billion a year in today’s dollars – Sydney Morning Herald (14th May 2002)

According to a Federal Government report, the number of workers and the level of income tax revenues are predicted to fall from now; pension outlays will increase from the 2010s; health spending will rise from the 2020s, and aged-care demands will increase from the 2030s.

Factors influencing policy

Social values and attitudes influence the respective roles of government, private business and individuals in providing for older Australians. The circumstances of older generations (e.g. labour force participation, level of private income and assets, health status, and availability of family/community support) will influence the level of resources that will be needed for aged care, health, housing and income support. Much of recent government policy has focused on cost reduction as well as shifting costs and responsibility from the public sector to individuals, families, community groups and private business. Briefly, recent reforms to the system of retirement income support include

- Mandatory occupational superannuation for all workers (Superannuation Guarantee) introduced in 1992;
- Tightening of the means test on the age pension
- The introduction of an increase for women’s pension age from 60 to 65

Government Revenue and Expenditure

Australia’s changing age structure has implications for both the level of social expenditure that might be required in the future, and the level of resources that might be available to fund it. As the population aged 65 and over increases in size, associated social expenditures on income support, care and health services can be expected to increase.

However, the potential labour force is projected to grow at a slower rate after 2011; it will be more difficult to generate the level of resources and public support needed to maintain a large aged population with an acceptable standard of living. The working-age population, from which the majority of taxation revenue is raised, made up 67% of Australia's population in 1999. This proportion increases slightly over the first ten years of the projection under all the main series to reach 68% in 2008. It then declines to 65% in 2021 and 59-60% in 2051. Hence, the gap between revenue and spending could increase to 5 percent of the GDP, or $87 billion.

Health Care Expenditure

The government will have to provide access to high-quality health and aged care services for the elderly. The aging population and soaring cost of new technology and drugs in health could push Commonwealth spending from about $170 billion a year now, to $257 billion in 2042. The potential gap, equal to 5 percent of GDP if taxation remains around its current share of the economy, creates a profound challenge to governments to reshape health and aged-care programs. The painful alternative would be to raise taxes significantly on a shrinking population of younger workers to fund the shortfall.

Furthermore, the rate of disability increased with age to 84% for those older than 85 (Figure 5), indicating increased costs. Likewise, older people’s need for assistance with everyday activities increased with age regardless of whether or not they had a disability – 92% of people aged 85 or more (Figure 6).
In the health area, there is potential for improving the quality of life of the elderly through the lowering of lifestyle risk factors – such as obesity, inactivity, tobacco smoking and alcohol consumption. Prevention would have the benefit of improving the quality of life of the elderly and containing expenditure on health care. Preventative health strategies will give mature age workers the capacity to work past traditional retirement age. An older workforce is inevitable and is therefore a key element of Australia’s economic growth. This could minimise the negative impact of population ageing on other sectors of the community, including health and aged care services.

Under the Coalition’s policies, the total number of operational aged care places will grow from 168,000 to 200,000 by June 2006. This includes 21,000 additional places in aged care homes and 9,000 Community Aged Care packages.

**Pharmaceutical Benefits Scheme (PBS)**

The PBS is a system of subsidised medication for Australians, and is the fastest growing area of health spending. The Intergenerational Report predicts that PBS spending could rise to five times its current level, and suggests that as older people use more medicines, the costs are expected to rise significantly due to the greying population. The PBS could account for 3.4% of the GDP.

The government proposed a bill to increase the charge to consumers, but Labor joined with the Democrats and independent senators to defeat it, leaving the Government with a four-year $1.1 billion hole in the Budget. The proposals would have seen an increase in the costs to the consumer of medicines subsidised through the Scheme, and a tightening up of the pension conditions for the disabled. Senator Patterson has since appealed to the Democrats, Greens and independents to reconsider. The government has warned that it may be forced to reject subsidies for new drugs to restrain the ballooning PBS bill.
Aged Pension

Almost one third of total Social Security portfolio outlay was paid to recipients of the age pension\(^3\), and 74.1% of older income units depended on government cash benefits as the primary source of income\(^4\). This proportion is likely to increase as the number of older people in receipt of an age pension increases. However, the increase will be offset by the increasing number of superannuants and partially funded retirees.

The age pension has always been non-contributory but is means and assets tested. Changes to means and assets tests in the last 20 years have led to a decrease in the proportion of the aged receiving the age pension. However, because of the increased life expectancy leading to an increased retired population, there are concerns about the ability of the pension system to provide adequate financial support for retired people.

The government proposed that the age at which a woman can qualify for an age pension, be increased from 60 years of age to 65 years. This proposal is being implemented progressively, commencing in 1995, by increasing the qualifying age by a quarter of a year per year over a period of 20 years.

The government has also introduced incentives to encourage people to take greater responsibility in providing income for their retirement. Informing people about their superannuation requirements, and introducing compulsory superannuation and the Superannuation Guarantee Charge (SGC), are strategies that the government has implemented. Thus, it has led the government to making it compulsory for private financing (super funds) rather than relying on public financing (aged pension), which would be unaffordable for the government in the future. The aim is to make retired people independent of the age pension one day. Although the age pension will still be available, it will be a safety net complementing superannuation, the main source of retirement income.

Superannuation

Superannuation is at the heart of the retirement plans of millions of Australians. The Superannuation Guarantee Act 1992 (Cth) is seen as a means of reducing the overall cost of age pensions as well as increasing national savings. It was introduced to ensure that most employees receive superannuation support from their employer. Employers must provide a set minimum amount of superannuation for their employees into a superannuation fund or Retirement Savings Account (RSA) that meets Government regulations. If employers do not pay the required amount of superannuation support, they must pay the Superannuation Guarantee Charge to the Australian Taxation Office. The percentage employers have to pay is 8% for the 2000/2001 financial year increasing to 9% in 2002/2003. This increase in the contribution percentage of compulsory superannuation will raise the amount of savings that Australians will have on retirement.

\(^3\) Department of Social Security Annual Report (1997/98)

\(^4\) Income and Expenditure: Economic Resource of Older Australians (ABS)
There is currently around $A500 billion in superannuation funds managed in Australia. By 2005, it is predicted that this will increase to $A600 billion and will continue to grow with prudent management. This will form an increasingly sizeable pool of savings in the Australian economy.

The Federal Government has a Better Superannuation System set of policies, designed to instil confidence in the superannuation system:

- Encouraging early savings for children by allowing superannuation contributions up to $1,000 per annum to be made on behalf of children
- Recognising those who wish to continue working beyond 70 by increasing from 70 to 75 the age up to which working members of superannuation funds can make personal superannuation contributions
- Providing members of superannuation funds with greater control over which fund their superannuation benefits are in by providing choice of superannuation and portability
- Increasing fairness for employees by requiring contributions to be made by employers on behalf of their employees at least quarterly

“We already provide significant concessions for superannuation; it’s taxed at a concessional rate to income which is worth about $9.5 billion a year,” said Costello. “There are no current proposals to change it.”

Retirement

Mature age employment has been promoted by the government. It has promoted the value of mature age workers, and alerted employers to the benefits of workforce participation by implementing working arrangements that are more flexible. Governments need to ensure that there are no structural disincentives to later retirement, as well as adequate incentives for individual savings and later retirement. The myths that mature age workers take more sick leave, are slow to learn new ideas, or are not computer literate, have been exposed as false. Indeed, evidence shows that productivity declines little with age, that quality of work is maintained or is improved, and that loyalty, work ethic and reliability is high among older workers. The Australian Government has taken the lead in the area of mature age employment by amending legislation. For example,

- The compulsory retirement age in the Federal Public Service has been abolished
- The Workplace Relations Act 1996 (Cth) prevents the inclusion of age limits in Certified Agreements between employers and employees
- A Pension Bonus Scheme has been established to provide an incentive to encourage older workers to defer claiming the Age Pension, and instead remain in the workforce for up to five years (receiving a lump sum payment at the end)
- Action has commenced to remove the “statutory senility” provisions from Corporations Law requiring company directors to demonstrate competency on reaching a certain age.

Immigration

High levels of immigration after WWII, combined with high fertility, contributed to a more youthful society. Since immigrants have a younger age profile than the general population, the initial effect of migrant intake is to delay the ageing process, but this effect is relatively small over the long term. For example, if net immigration were assumed to be zero from 1999-2051, the projected median age in 2051 would be 47 years instead of 44 years.

Regulations

Governments can create a multitude of thresholds by means of legislation – for instance, anti-discrimination legislation can outlaw age-specific recruitment. However, this type of legislative intervention is not costless. Designing wheelchair access in a new shopping centre may involve little marginal expenditure, but retrofitting the same into a 1950s factory would likely be enormously expensive. Using all means possible to increase the social and economic choice of older people would be uneconomic, and would impinge in some cases on the choices available to the non-elderly.

“Everybody wants a slice of super” Sydney Morning Herald (12th July 2002)
Government Reaction and Response

A House of Representatives Committee on Ageing is to look at long-term strategies to address the anticipated ageing of the Australian population. The Intergenerational Report was delivered along with this year’s Budget. It is a report showing the government’s projected fiscal position over the next 40 years. It highlighted the fact that the ageing of the Australian population would produce a gradual increase in the budget deficit, to the extent that it would represent over 4% of GDP by the year 2042. The changes to the PBS were the main measure announced to reduce this long-term expenditure gap. It has also commissioned many studies by Access Economics and the Productivity Commission to examine the effects on the economy. In addition, it has created an Aged Care portfolio to address this issue.

Treasurer Costello said that a baby boom would worsen the economic effects of the aging population for a generation⁶. Spending on policies like paid maternity leave could actually have a “negative effect”. Mr Costello said governments should look at ways to encourage older people to keep working and entice people on benefits to work at least part-time. A boost to the fertility rate would see more dependents with fewer people in the workforce supporting them. For a period, there would be more children and fewer women in the workforce, as they left their jobs to have and to care for their offspring. “It has a negative effect for around 30 years before you get the pay-off.” Mr Costello stressed that Australia’s economic growth and its budget was under threat as the ageing population left fewer workers and taxpayers supporting more retirees.

The Prime Minster encouraged Australians to remain in the workforce until their mid-60s as a way of tackling the country’s aging population. The policy direction of the Federal Government over the next two years has a strong emphasis on the dual social issues of balancing work and family commitments, and caring for an ageing population.

Conclusion

Population is a pressing issue for Australia that must be closely examine by Government, Business and Individuals. There are anticipated costs associated with care and income support; an ageing Australia requires government to understand the work with older people, the aged care industry and the community to ensure that the needs of the older population are met. However, it is important to consider not only the costs, but also the benefits of population ageing. In economic terms, an ageing population demands an increase for services, creating stimulus. Mature aged workers and the purchasing power of a healthier older population can make significant contributions to the Australian economy. Continued economic growth is the key to positive outcomes for Australia as it begins the twenty-first century.

⁶ “Costello cool on a baby boom” Sydney Morning Herald (7th August 2002)
Bibliography


Gittins, R. (3-4 August 2002). Young workers will catch a turning tide. The Sydney Morning Herald, p.44.


