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# 1 Prospering in an ageing society

**The ageing of our population is one of the biggest policy challenges facing Australia. It will reduce the relative size of the labour force and cut growth in per capita incomes. At the same time, it will substantially increase demands for health and aged care services. In response, governments need to tackle regulatory, tax and other impediments to increased labour supply. They must also focus on ways to improve efficiency, effectiveness and equity in Australia's health and aged care systems. But fostering higher productivity growth remains the key to future living standards in an ageing society.**

## **Australia's demographic transition**

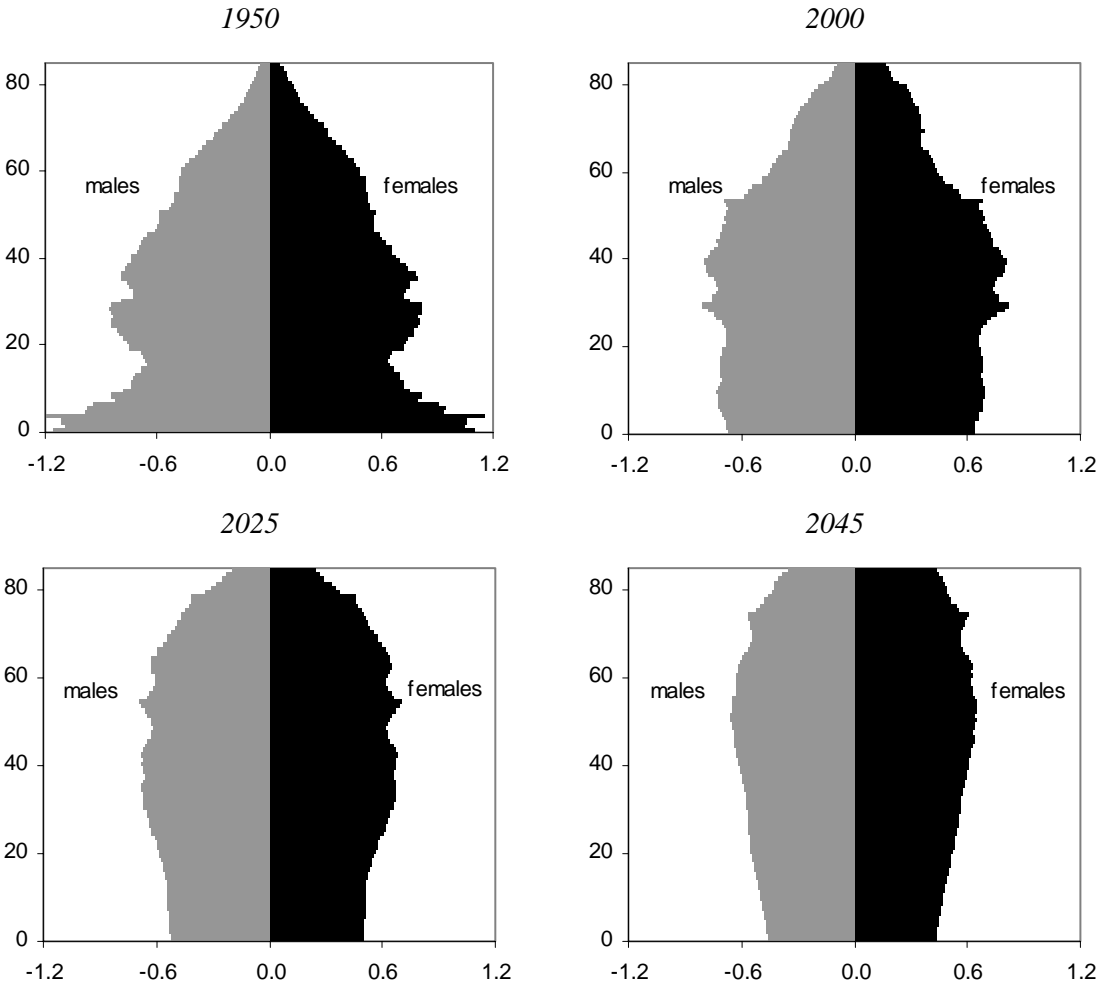
The ageing of Australia's population is becoming a key frame of reference for governments, the media and community groups to assess the adequacy of current policy settings and difficult reform options. Rising incomes, advances in healthcare and less physical work have led to Australians living longer. The average life expectancy at birth of a female born today is 83 years and 77 years for a male, up from 71 and 66 years respectively at the end of World War II. In combination with a long-term decline in fertility rates, this has led to Australia's population structure ageing. Projecting over the next 40 years, Australia's demographic structure will be transformed from a roughly pyramid-shaped distribution — with a wide base of young people and workers — to one resembling a coffin shape (figure 1.1). Other advanced economies face a similar demographic transition and some have moved further than Australia.

The Government's Intergenerational Report of 2002 rightly placed population ageing and its economic and financial impacts, particularly at the Commonwealth level, at centre stage. Two years on, and at the request of the Council of Australian Governments (COAG), the Government has asked the Commission to review the economic effects of ageing across Australia. Its reporting extends to impacts on productivity, economic growth and labour supply, and assesses fiscal impacts on all jurisdictions in Australia.

The broad dimensions of Australia’s demographic future are now reasonably well known. The proportion of people aged 65 and over is likely to double over the next 40 years, reaching 26 per cent of the population by 2044-45. But other aspects of Australia’s demographic transition appear less well understood.

- Ageing could be more profound than indicated by official estimates. Most projection techniques have proved too pessimistic about the prospect for declining mortality at older age groups. On plausible alternative assumptions about changes in life expectancy over the next 40 years, there could be 2.3 million Australians aged 85 years or more and 1.3 million aged 90 years or more, roughly double the ‘standard’ ABS projections for 2044-45.
- The demographic impact will have regional dimensions. Ageing pressures will be more accentuated in Tasmania, South Australia and Western Australia than in other States and Territories, with Tasmania and South Australia having the greatest concentrations of the old (65+) and oldest old (85+) by 2044-45.

**Figure 1.1 The changing age structure of Australia’s population**  
Percentage share of population



Source: PC 2004c.

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- The number of children under 15 years is set to fall in absolute terms (by about ¼ million) but this comes nowhere near providing a fiscal offset for the rise in aged dependency as governments spend much more on old people than the young.

Australia's population structure has been slowly ageing for more than a century, although the consequences will become more evident as increasing numbers of post-WW II baby boomers retire later this decade. However, this should not obscure the personal and wider social benefits entailed. The baby boom effectively delayed population ageing and reduced age dependency until the mid-2030s. The consequent boost to labour supply contributed to higher per capita incomes in Australia from the mid-1960s at a time when there were many policy-related impediments to income growth.

There are no simple demographic 'fixes' to Australia's ageing 'problem'. A significant revival in fertility levels seems unlikely and, even if it happened, the time lag before those children entered the workforce means that any counter to ageing, however slight, would not start to appear until after 2020. Indeed, the short to medium term effect of a sudden increase in fertility would be to worsen the burden on those of workforce age. Moreover, immigration could not offset the ageing process over the long term. Feasible increases in immigration would have a modest effect and at best only temporarily delay the onset of ageing (box 1.1).

## **Pervasive change in prospect**

Australia's demographic transition is likely to have pervasive social and economic effects. These include not only changes in the types of goods and services demanded, but also national saving and investment; innovation and creativity; family and social networks; community expectations; and, as the median age of voters increases from 43 to 53 years over the next 40 years, political clout.

The two dominating economic impacts, however, will be:

- a significant reduction in the growth of hours worked by the population, with a strong prospect of a slowing in rates of economic growth and per capita income growth; and
- the fiscal pressures on governments arising from increased demand for age-related expenditure in areas such as health and aged care.

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### Box 1.1 **Increased immigration: not a solution to ageing**

Contrary to popular opinion, there is limited scope to reverse or significantly stem the ageing of Australia's population structure through increased immigration.

It is well known that net inflows of migrants have made a significant contribution to the size of Australia's population — nearly a quarter of current Australian residents were born elsewhere. While recognising the difficulty in measuring permanent arrivals and departures accurately, the ABS estimates that net overseas migration has accounted for around half of Australia's population growth in recent years. But can net immigration levels be used to offset an ageing population *structure*?

Net migration largely adds to the working age population of Australia, and thereby helps to lower the aged dependency ratio — the number of people aged 65 years or more relative to the population aged 15 to 64 — in any given year. However, migrants themselves age. The long-term effect of migration on the age structure of the population turns on whether the rate of growth of net migration can be increased sufficiently over time to offset ageing effects.

Net migration of 100 000 people a year (as projected by the ABS) makes a significant difference to population ageing compared to the (unrealistic) assumption of zero future net migration. Commission projections suggest that the aged dependency ratio would be nearly 9 percentage points higher in 2044-45 if there were no further net intake. However, the reductions in aged dependency from extra migration get smaller as the base level of migration gets larger. For example, an increase from 100 000 to 120 000 net migrants a year for 40 years would make only a slight difference to the pace of population ageing — the aged dependency ratio would fall from a projected 44.3 per cent to 43.1 per cent. And even an increase to 150 000 net migrants a year would see the ratio fall by only 3 percentage points.

An ageing population structure could only be avoided by raising the annual net migration intake to about 3.4 per cent of the population, which is around six times its present rate. On this basis, the aged dependency ratio (and share of the population aged 65 or more) would stay roughly constant over the next 40 years — but Australia's population size would be around 114 million by 2044-45, with an annual migrant intake at that time of 3.7 million.

The practical scope for an immigration 'solution' to ageing is also constrained by the increasing world-wide competition for skilled migrants from other countries facing their own ageing problems. Indeed, there is a risk that Australia could lose many of its own skilled people to other countries if income levels do not keep pace.

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## Labour supply: the rear-vision view

The output of goods and services in the Australian economy broadly depends on the number of potential workers in the population, their work involvement and their productivity. These factors have been summarised in the now familiar ‘3Ps’ of population, participation and productivity.

In terms of labour force participation, the Australian economy has benefited from rising rates in recent decades. This is despite declining male participation rates across all the prime working age groups. Women have been the saviours of Australia’s aggregate labour force participation rate over the past 40 years. Female participation rates have risen for all but the youngest and oldest age groups. Fewer children, shorter absences from the workforce after childbirth, greater access to part-time employment and childcare, and changing social attitudes have all played a role.

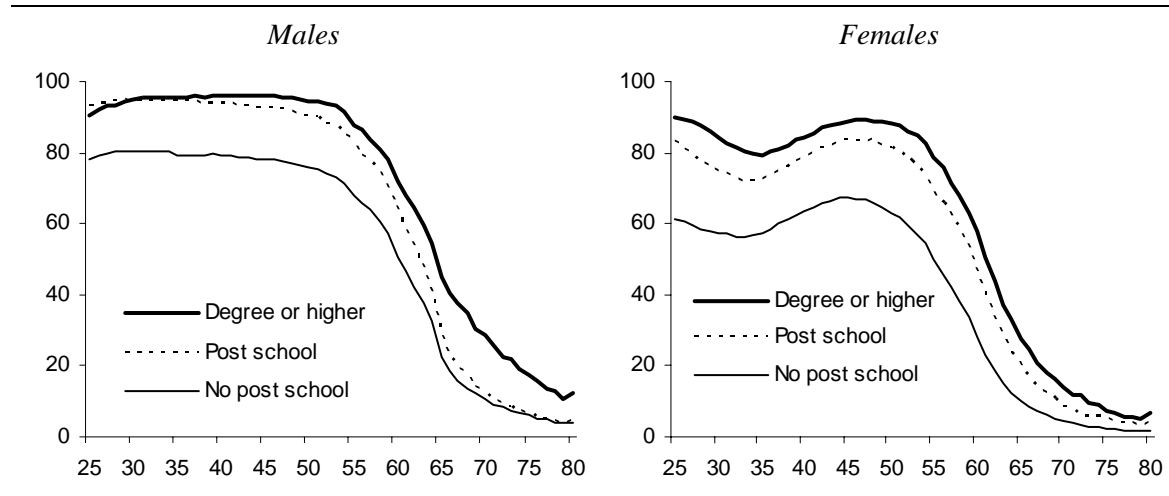
Australia’s effective labour supply — total hours worked per capita — has not increased as much as labour force participation. Average weekly hours worked in the economy have fallen by around 5 per cent over the past two decades. Most of the job growth for women has been in part-time jobs. Women over 25 years old work fewer hours on average than men, whether in full or part time jobs. And males exiting the labour force left full-time jobs. Further, relatively high levels of unemployment also reduced effective labour supply in Australia from the early 1980s until quite recently.

An important counter to these trends has been the rising educational attainment of Australians. Higher educational attainment is associated with higher lifetime attachment to the labour force (figure 1.2). So in addition to raising the productivity potential of individuals, there is an ongoing participation effect.

The labour force behaviour of older Australians adds its own dynamic, both negative and positive, to these wider labour supply trends:

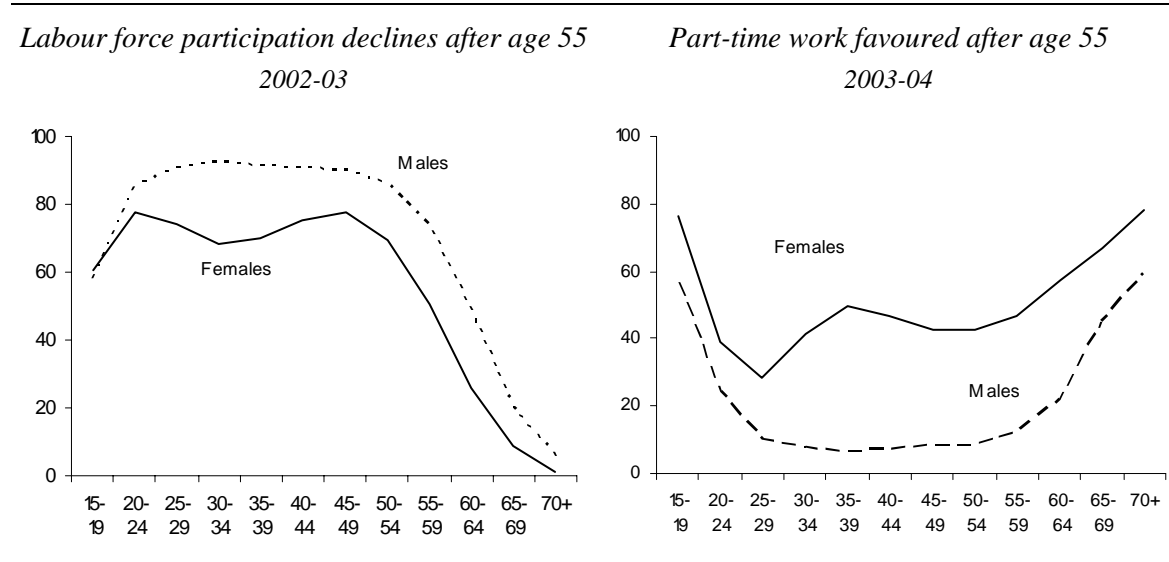
- as people age, on average they participate in the labour force less — engagement falls significantly for those over 55 years and, understandably, is negligible after the age of 70 (figure 1.3); and
- the incidence of part-time work is much higher for older workers (figure 1.3); whereas
- older workers have low unemployment rates, if only because they typically exit the labour force and retire if jobs are hard to find; and
- the higher educational attainment of each successive cohort of the newly aged should help to raise the participation rate for older workers over time to some extent.

**Figure 1.2 Education raises labour force participation**  
 Percentage rates by age and highest educational attainment, 2001



Source: PC 2004c.

**Figure 1.3 Participation in the labour force**  
 Percentage rates by age groups



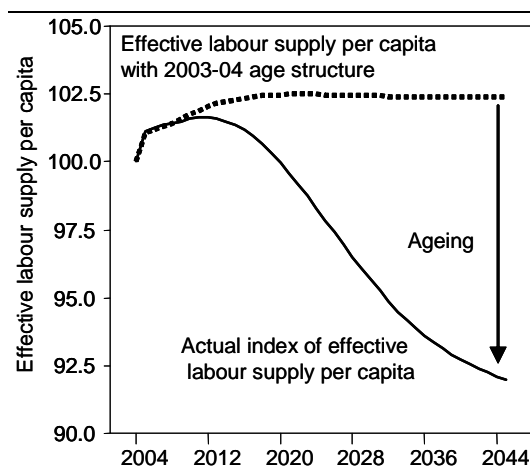
Sources: PC 2004c and ABS Labour Force Survey, unpublished data.

## Labour supply: looking forward

An ageing population structure will therefore have a compounding effect on the potential labour supply in Australia's economy — older people work less hours on average and there will be more of them. Commission projections suggest there will be a decline of about 8 per cent in the hours worked per capita by the total population in the next 40 years (figure 1.4). In the absence of ageing, hours worked per capita would most likely have risen by about 2 per cent. In terms of aggregate labour force participation, the rate will fall to 55.4 per cent, nearly 11 percentage points below where it would be in the absence of ageing.

Figure 1.4 **Ageing and effective labour supply**

Australia 2003-04 to 2044-45

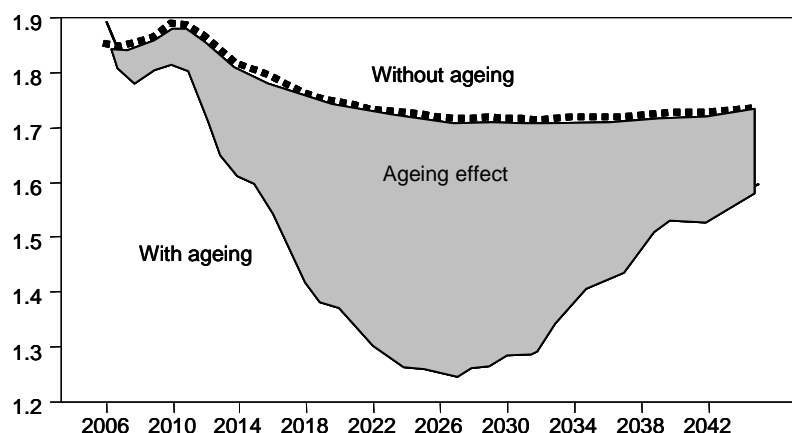


Source: PC 2004c.

Accordingly, although the per capita income and wealth of Australians will most likely continue to grow, the Commission's work confirms the Intergenerational Report's assessment that the potential diminished labour supply available to an ageing Australia will severely constrain that growth. If Australia were to maintain its long-term labour productivity growth rate of 1.75 per cent a year, growth in the real per capita output of the Australian economy would fall steadily over the period to the mid-2020s to nearly 1.25 per cent annually, roughly half its present rate, with a partial recovery in the following 20 years (figure 1.5).

Ageing would create a \$3200 billion dent in cumulative national output from 2003-04 to 2044-45. Even if Australia were to sustain its 'miracle' productivity performance of the 1990s, average annual growth in real GDP per capita would still fall to around 1.6 per cent in the 2020s compared to recent growth of more than 2 per cent a year. Sustaining a high productivity growth is thus one of the challenges inherent in responding to Australia's demographic transition.

**Figure 1.5 Economic growth in Australia — a 40 year projection**  
 Per capita GDP, 2005-06 to 2044-45 (percentage growth rates)



Source: PC 2004c.

## Fiscal impacts on governments

As a share of GDP, government revenues are not as sensitive to ageing as expenditure. At the Commonwealth level, the factors that drive GDP are also the prime determinants of revenue so that, over the long term, the two roughly move in balance. However, some State government revenue streams may decline as a share of GDP. In particular, GST revenue may not grow as fast as GDP because tax-exempt expenditures, such as private health care goods and services, are expected to increase in importance. However, Commission projections suggest that the effect is modest and likely to be offset by growth in other direct sources of State revenue.

At the same time as demography drives down growth in Australia's income and tax base, it will push up age-related public spending demands. Some critical age-related goods and services — substantial expenditures on health and aged care, as well as pensions — are provided by governments. On the other hand, while expenditure pressures in areas such as school education should abate as the share of Australia's population in younger age groups falls, the impact will not be as significant.

In the absence of policy responses, Commission projections show that the fiscal gap opened by ageing will reach around 7 per cent of GDP by 2044-45, with an accumulated value over the 40 years of around \$2200 billion. The bulk of this gap will arise at the Commonwealth level, reflecting its greater funding responsibilities for health and aged care — assuming that its financial transfers to the States and Territories continue to rise with service needs.

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In some significant respects, Australia's fiscal outlook with ageing poses fewer risks than in other countries. In particular, Australia has avoided the worst of the pension financing problems besetting many OECD countries (OECD 2003a, p. 69). It has been a leader in such reforms as requiring compulsory superannuation contributions while working, and the concessional taxation of voluntary superannuation and other private savings. These will help reduce to a degree the reliance of Australians on the publicly funded age pension for retirement income. The lesson from this experience — with wider application to other policy challenges posed by ageing — is that early policy action can play a significant role in ameliorating the adverse long-term effects in prospect.

### **Health and aged care costs are the major pressure points**

Older people consume more health services on average than other Australians. For example, expenditures per person in the Pharmaceutical Benefits Scheme are strongly age related — average costs for a male aged 65 to 74 are more than 18 times those for a male aged 15 to 24. Hospital costs follow a similarly steep profile, while Medicare costs also rise with age, though less steeply (figure 1.6). Across health services as a whole, expenditure on those 65 years and over is around four times greater than for those under 65, with the multiple rising to between six to nine times for the very old.

Important as it is, this ageing effect on growth in health expenditure has so far played a relatively minor role in expenditure pressures. Non-demographic factors — in particular, rising demand fuelled by higher incomes and community expectations, together with the emergence and diffusion of new medical technologies — have been the major drivers. Since the mid-1980s, average per capita expenditures (age-adjusted) under the Pharmaceutical Benefits Scheme have grown at a rate nearly 5 percentage points above per capita GDP growth. Other government health expenditure has experienced a premium of around 0.5 percentage points. Such strong underlying demand and technology drivers, when overlaid on an ageing population structure, form a potent cocktail. Moreover, tentative evidence is emerging that medical technologies may be leading to higher health expenditures in older age groups. If true, this would further exacerbate pressures on future health budgets (box 1.2).

Government health and aged care expenditures will bear the brunt of an ageing Australia.

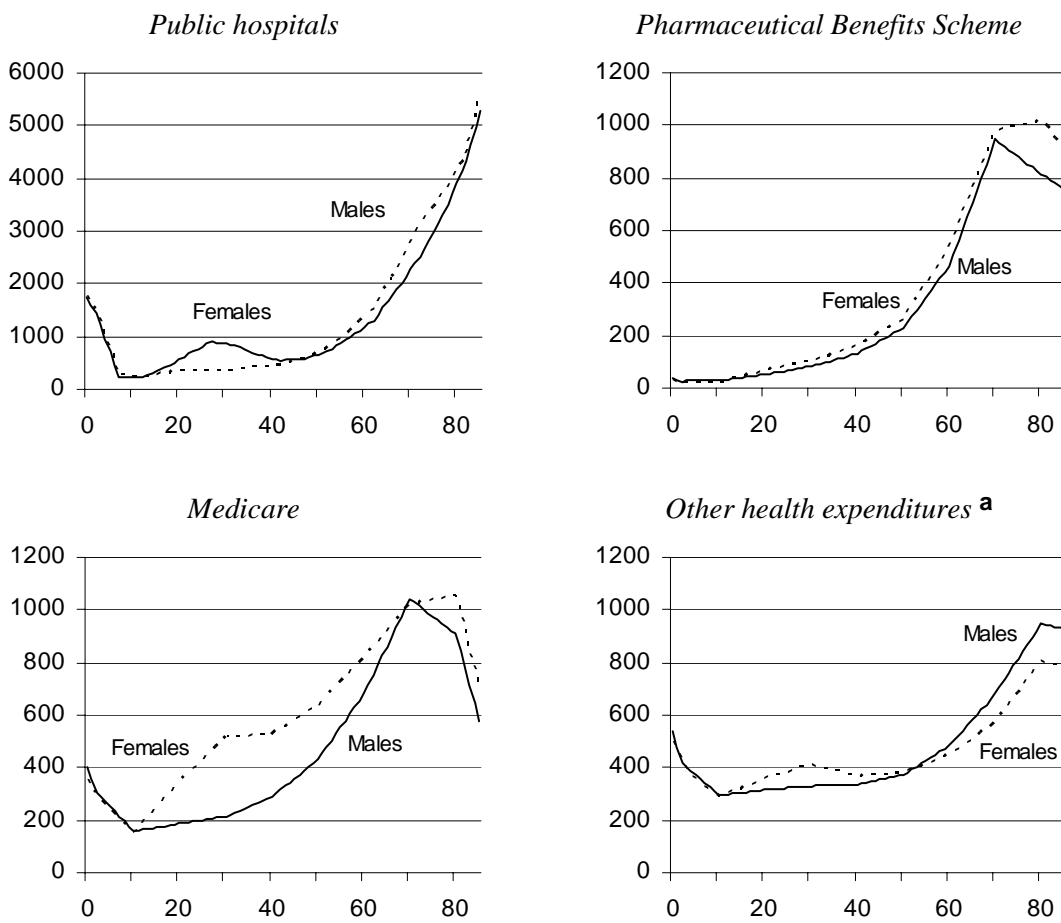
- Commission projections suggest that the ageing of the population will cause health care spending by all governments to be about one third higher than otherwise. This estimate was found to be relatively insensitive to assumptions

about non-demographic cost drivers. In total, government health expenditure in Australia is projected to almost double to around 11 per cent of GDP by 2044-45, with the aged share increasing from around one third to nearly 60 per cent.

- Total government aged care expenditure is projected to more than double, reaching just over 2 per cent of GDP in 2044-45.

**Figure 1.6 Health care costs increase with age**

Government health expenditure per person by age, dollars



<sup>a</sup> Includes other health professionals, aids and appliances, community and public health, dental, ambulance services, research and administration.

Source: PC 2004c.

### Box 1.2 Future health care expenditure: does ageing matter?

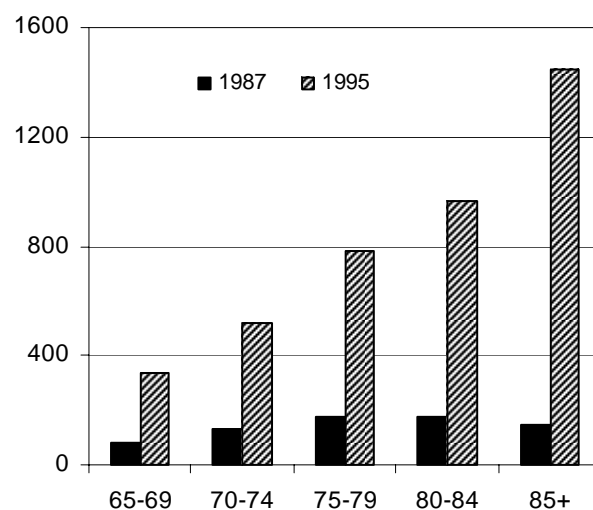
The implications of ageing for future health care costs have been contentious in some circles. Many health economists have seen ageing as a relatively minor influence, arguing that its impact will be swamped by demand and technology effects that are relatively neutral across age groups. They point out that tomorrow's old will be healthier, which could lessen health costs for each cohort, and that hefty end-of-life health costs will simply be deferred as people live longer.

The Commission has examined the arguments and evidence and concluded that ageing *does* matter. In combination with demand and technology pressures, ageing will place significant additional pressure on future health expenditure for the simple reason that older people can be expected to use many times more health services than other age groups. A doubling in the share of Australia's population over 65 will ensure that any increase in health costs due to demand or technology factors gets amplified. In the context of the current debate, a number of points need emphasis.

- Interpretation of an apparent decline in age-specific disability rates in international data to mean that the old are becoming healthier overlooks the role of effective (but costly) treatments in improving health status and managing chronic conditions which are on the rise. Moreover, while smoking is declining, some public health trends — such as obesity and the associated risks of diabetes type II to kidney, eye and cardiovascular function — could see the prevalence of certain diseases increase amongst the old.
- While health costs are high in the year or two before death, they do not account for most health spending. Even if they did, the expected 60 per cent rise in the death rate between now and 2044-45 will lead to a major increase in *aggregate* health expenditure in Australia.
- With incomes and life expectancy increasing and more senior Australians, there is a rise in community expectations that treatment, even if costly, will be provided at older ages.
- Medical technologies — such as less traumatic surgical techniques and better anaesthesia — have improved the prospects for medical intervention to improve the quality of life for the oldest old. Hip replacements trends for older American women are a sign of this potential for increased expenditure. (Separate to its ageing study, the Commission is currently investigating the impact of advances in medical technology on healthcare expenditure in Australia and is due to report in August 2005.)

#### Hip replacement trends for US women

No. per 100 000 women



Source: Fuchs 1998, p.10

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## Difficult policy choices to face

The impacts of an ageing population structure are unlikely to reach ‘crisis’ proportions. For one thing, under a range of likely scenarios, the per capita income of Australians in the mid-2040s will be nearly double what they are today. Nevertheless, extra demands on government services at a time of potentially slower economic growth will pose some difficult policy choices.

Governments could respond to the increased fiscal demands by gradually increasing the average tax burden. However, if that were the only measure, taxes would need to rise by 23 per cent on average. Higher incomes taxes would risk creating disincentives for increased labour supply, thereby compounding the effects of ageing. And with increasing international competition for labour from other ageing countries, skilled Australians would have incentives to move overseas. Increased resort to other tax bases could risk widening other distortions.

Financing the increased consumption of health and aged care by increasingly accumulating public debt is not a sustainable long-term strategy. It shifts the costs to future generations, and mounting interest payments would eventually cut into the ability to finance age-related and other government expenditures.

The public expenditure burden could be shifted onto individuals through increasing their share of the costs, constraining service quality and/or by rationing access. Progressively shifting more of the cost burden onto those who can afford it needs careful examination, but the policy ground work would need to be well laid out for it to receive community endorsement. And cutting services that would otherwise yield significant benefits to the community is clearly not a desirable strategy.

More promising policy approaches are to be found in ameliorating ageing pressures at their source and in improving the economic wherewithal to deal with them. Two obvious age-related priorities are: tackling artificial impediments to increased labour supply in labour market regulation and the anti-work incentives in Australia’s tax-transfer system; and addressing inefficiencies and service inadequacies in Australia’s health and aged care systems. More generally, policy reforms to raise Australia’s productivity across the board are needed. Failure to take appropriate policy action well before ageing effects accelerate would necessitate significantly greater adjustment challenges later.

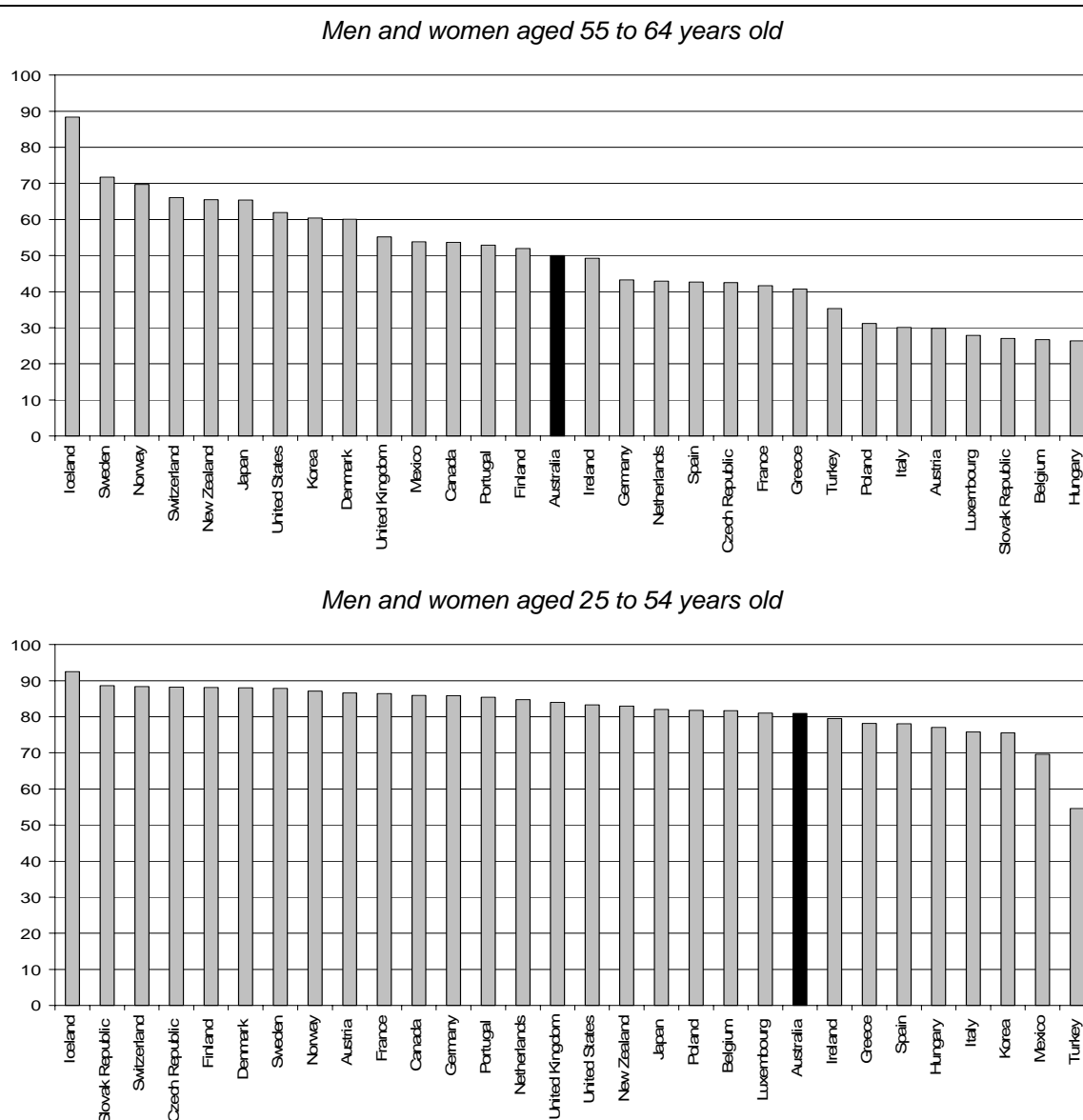
## Reducing impediments to labour supply

Rising incomes expand the choices older Australians have over their mix of work, leisure and volunteering activities, and are an important way for individuals to pursue higher overall wellbeing.

However, a range of high income OECD countries appear to have significantly higher labour force participation rates than Australia (figure 1.7). The comparative data are suggestive, in particular, of a potential to raise participation levels for 55 to 64 year old Australians.

Figure 1.7 **OECD labour force participation rates 2002**

Per cent



Source: OECD 2004, Statistical Annex Table C.

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Government incentives, not just personal preferences, condition the work choices and expectations of older Australians. They can influence early withdrawal from full-time employment or from the formal labour force altogether. For example:

- Commission estimates indicate that uptake of the disability support pension could explain 95 per cent of the decline in the participation rate of 60 to 64 year old males over the past 25 years in Australia. Almost half of all recipients of the disability support pension are aged 50 or more. This pension has no equivalent to the activity test required to access unemployment benefits and a number of studies have pointed to the role of labour market factors in explaining the growth in numbers of recipients (PC 2004a, p. 81). While the employment prospects for those who have been on disability pensions for a long time are now probably poor — their move into the labour force would increase unemployment more than employment — future cohorts of workers should be encouraged to remain engaged in the labour force and to access Job Network services tailored to their needs. The Australian Government has been seeking legislative approval to tighten disability pension eligibility requirements since 2002.
- Government policies — such as raising the age at which superannuation benefits can be accessed from 55 to 60 years and the progressive removal of access to the aged pension for females aged below 65 — are specifically targeted at discouraging ‘premature’ retirement. The Government’s proposed tax rebate on earned income for those over the age of 55 is similarly intended to encourage mature aged workers to remain in the workforce.

Raising the labour force participation rate of older Australians will only be possible, however, if workplace arrangements are flexible enough to accommodate their work preferences and if wages reflect productivity differentials. Yet ‘non-traditional’ working arrangements most likely to appeal to increasing numbers of older Australians — such as part-time and casual jobs — have been under challenge. For example, there is trade union pressure to convert casual jobs to permanent employment as a matter of right, regulate minimum daily hours and lift casual loadings to a minimum of 25 per cent. Employers will be less willing to take on older workers under such arrangements. Similarly, any extension of industrial awards beyond minimum safety net requirements would be likely to diminish, rather than enhance, job opportunities for an ageing workforce.

Reductions in policy-induced barriers to the employment preferences of older Australians are worthwhile in themselves. But as the Commission’s projections show, focusing just on the over 55s could only have a limited impact on overall labour supply. For example, if the participation rate for males aged 55 years or more could somehow be raised an unprecedented 10 percentage points above the Commission’s projected rate in 2044-45, the participation rate across the whole economy would still only increase by 2 percentage points.

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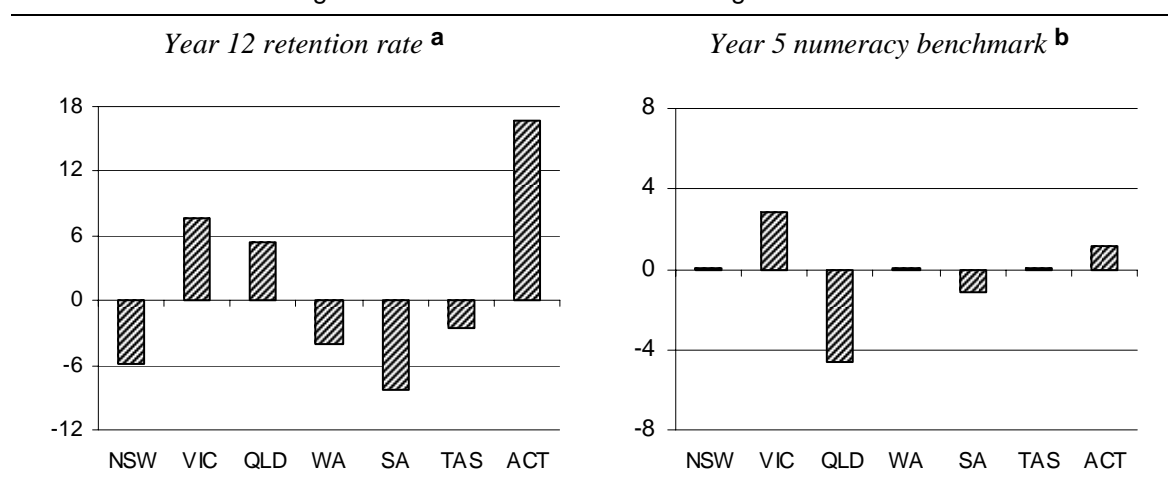
To have a significant pay-off in per capita income levels, participation rates would need to rise across all age groups. For example, if age-specific participation rates in Australia were to rise gradually over the next 20 years and then match the current performance of the top fifth of certain OECD countries, Australia's aggregate participation rate would fall to around 60 per cent by 2044-45, not the 55 per cent otherwise projected. This would mitigate the effects of ageing on participation by around half. Nevertheless, the implied increase in male participation is a big 'ask', requiring rates close to or exceeding historical maximums over the past 25 years.

The core labour reform strategies to raise aggregate participation rates have been identified. In broad terms, these include improving the capacity of people to undertake work, giving them better work incentives and creating more flexible workplace arrangements (Australian Government 2004). Building on past and recent policy initiatives, there is scope to:

- raise the performance of Australia's schools — for which figure 1.8 provides two indicators of variable performance — as well as its higher education and training systems, so that they respond to changing personal and community needs for human capital development and innovation, and to extend people's labour force participation in their older years;
- address the continuing disincentives that arise from high marginal rates of income tax and the high effective marginal tax rates that result from the rapid withdrawal of various income support payments as individuals and family members engage in more work;
- ensure that systems supporting a return to work — such as childcare for working parents, workers' compensation and rehabilitation for injured workers and labour market assistance programs for the unemployed — operate efficiently and effectively, and that no future cohorts of workers are consigned solely to income support programs when there is the possibility of at least some labour force engagement;
- wind back further those labour market regulations which prevent employees and employers reaching mutually beneficial arrangements in their workplaces; and
- explore the interaction between general social safety nets and the regulation of minimum wages and conditions by industrial tribunals in achieving similar social objectives.

Even when implemented, many responses to the challenges posed by an ageing Australia will take time to have an appreciable effect. The pay-off from initiatives to increase school retention rates, for example, is likely to take a decade. Fortunately, however, Australia lags behind many other developed countries in the severity of the onset of ageing. Thus there is a window of opportunity to make beneficial changes to labour supply related policy to ensure that adjustment to the demographic transition is well managed.

**Figure 1.8 Variability in Australia's schools**  
Percentage variation from the national average



**a** Apparent retention rates of full-time secondary students from years 10 to 12, all schools, 2002. Retention rates can be affected by State-specific factors which limit comparability. Exclusion of part-time students has particular implications for South Australia and Tasmania. **b** Variation from the national upper or lower bound estimate (as appropriate) in the proportion of Year 5 students achieving the numeracy benchmark, 2001. **Note:** The caveats that jurisdictions attach to the data and the confidence intervals for numeracy benchmarks are reported in SCRGSP (2004, pp. 3.36-3.46). The Northern Territory is included in national averages but not separately identified here because of the size of its indigenous population and other features.

Source: Derived from SCRGSP 2004, tables 3A.32 and 3.11.

## Better health and aged care systems

Australia's health and aged care systems are not well placed to respond to the growing demands of an ageing population. Against international indicators such as life expectancy and health care expenditure per capita and as a percentage of GDP, Australia's health system appears relatively cost effective. However, both the health and aged care systems are under pressure.

- The health status of indigenous Australians, the relatively poor health outcomes of other Australians living in rural and remote areas and growing concerns about access to public hospitals, general practitioners and residential aged care services, even in metropolitan areas, indicate significant unmet needs.
- Further shortages in some key workforce areas such as nurses, general practitioners and some medical specialties are likely to add to pressures on access and service quality in the future. In recognition of such issues, COAG (2004) recently called for a review of health workforce issues, including supply and demand pressures over the next 10 years.
- There is potential for Australian hospitals to improve overall safety and quality of care for patients. Around 4500 preventable deaths are 'conservatively' estimated to occur in hospitals each year as a result of mistakes and

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inappropriate procedures (Richardson 2003). Health outcomes would improve if more hospitals could match the safety and quality-of-care performance of the best achievers (ACHS 2003 and SCRGSP 2004).

- Considerable variations in service performance across jurisdictions for the same service, whether for the general population or the aged, are indicative of the potential for raising performance (figure 1.9).

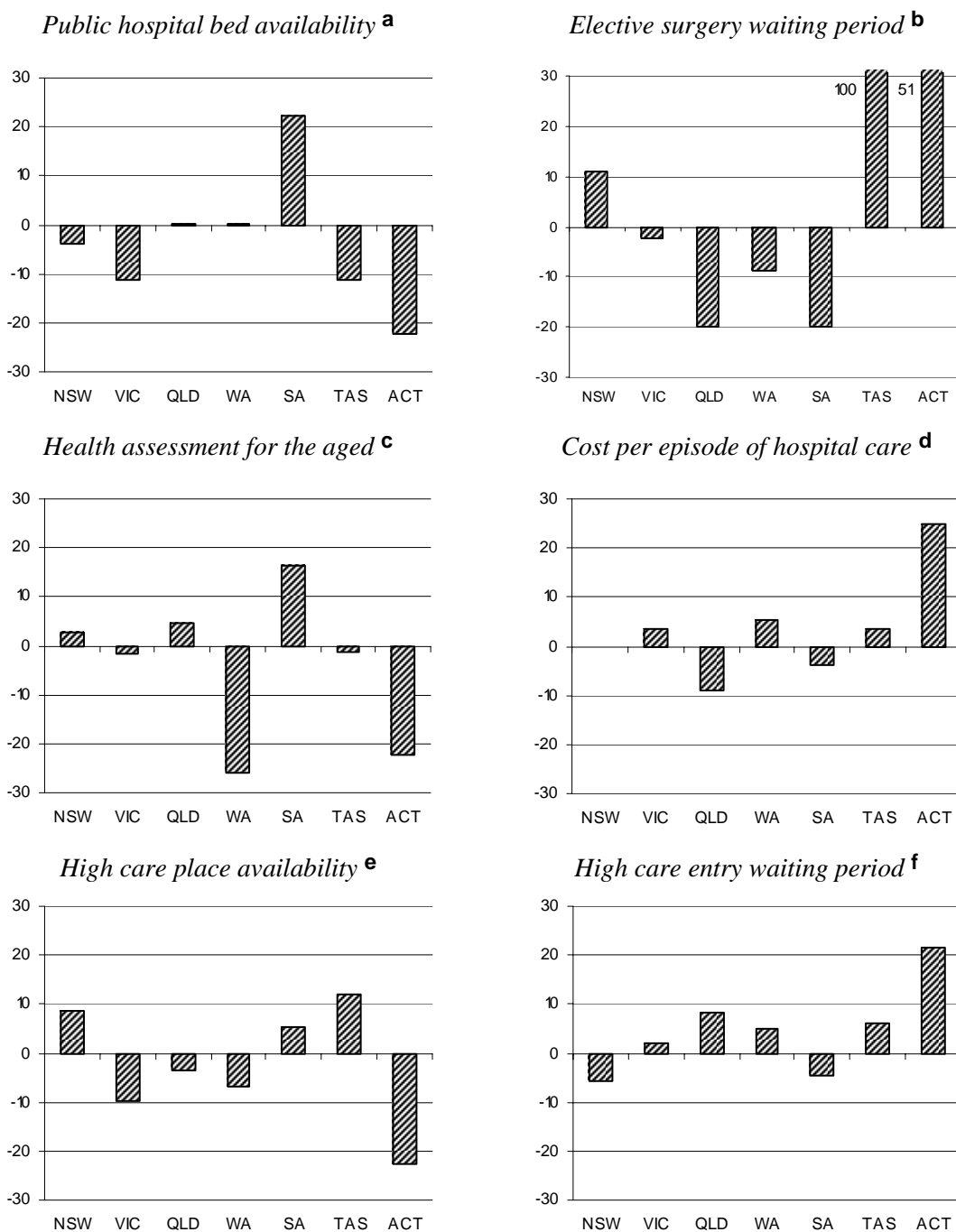
Australia's aged care system is also characterised by a range of problems. These include: unduly limited access for those assessed as requiring care, including to high-level residential and dementia-specific care; inequities in charges/fees between low and high level residential care and between residential and other forms of aged care services; inconsistencies and inappropriate incentives in funding and delivery; regulatory provisions which constrain service choices; and concerns about financial sustainability (PC 2003a).

A reform program for residential aged care services has recently been mapped out by the Hogan Review (2004) and the Australian Government has agreed to adopt most of its shorter term recommendations. Consideration of its longer term options — in particular, giving greater emphasis to self reliance in meeting the cost of aged care and the associated development of more relevant tax and asset arrangements governing the sale of the family home — will prove controversial and any such reforms will require a change from current expectations. But this seems unavoidable if the community's future needs for quality residential aged care are to be met efficiently, effectively and equitably.

Governments have attempted piecemeal reforms in health care, but have yet to come to grips with the deep-seated structural problems arising from fragmentation of responsibility and lack of coordination across services. Three areas stand out in particular: the interface between public and private hospital services; hospital-based services versus health care provided in the community, such as general practice; and the interface between health care and other community services, including aged care. Apart from the direct efficiency costs, the divided responsibility for service provision between the Commonwealth and States creates considerable incentive for cost, risk and blame shifting. 'Bed blocking' — whereby elderly patients prevent multiple use of acute care hospital beds while waiting for a nursing home placement — is one example of dysfunction. As a former head of the Victorian Health Department observed:

The surprising thing is that Australian healthcare, operating under such compromised arrangements, manages to be as good as it is. (Paterson 2002)

**Figure 1.9 Variability in Australia's health and aged care systems**  
 Percentage variation from the national average



**a** Available public hospital beds per 1000 people, 2001-02. **b** Proportion of patients waiting more than a year for elective surgery in public hospitals, 2001-02. **c** Proportion of the aged population (75 and over, indigenous people 55 and over) receiving a voluntary health assessment, 2002-03. **d** Total recurrent cost per casemix-adjusted separation, selected public hospitals, 2001-02. **e** Operational high care places per 1000 people aged 70 years and over, 30 June 2003. **f** Proportion of people entering high residential care within three months of their ACAT assessment, 2002-03. **Note:** The caveats that jurisdictions attach to the data are reported in SCRGSP (2004). The Northern Territory is included in national averages but not separately identified here because of the size of its indigenous population and other features.

Source: Derived from SCRGSP 2004, tables 9A.6, 9A.18, 10A.20, 9A.4, 12A.10 and 12A.37.

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Systemic health care reform in Australia has so far proved to be nearly intractable. A number of possible strategies has been identified (box 1.3). But thorough public evaluation of such strategies has been lacking.

Without broader agreement on the causes of underperformance and possible solutions, making headway will remain difficult. As a first step, the Commission has proposed that COAG initiate an independent national public review of Australia's health system as a whole. The review should encompass all aspects of the system, but with particular emphasis on:

**Box 1.3 Different paths to health care reform in Australia**

There has been a range of proposals in recent years for health care reform in Australia. Some have involved more ambitious or large scale changes than others. These were canvassed in the Commission's Discussion Draft, *Review of National Competition Policy Reforms*, and categorised as follows:

- 'Incremental', but nonetheless significant, changes could be made in both the public and private sectors, while maintaining the existing roles and responsibilities of the various levels of government and in the context of current funding arrangements.
  - Examples could include: reducing the scope for cost shifting, improving service integration, addressing shortages in the health care workforce, addressing shortcomings in private health insurance arrangements, and facilitating choice by providing improved information to patients.
- Major changes could be made to roles, responsibilities and funding arrangements. Possible options include:
  - The Australian Government assuming funding and delivery responsibility for public hospital services.
  - The States assuming responsibility for a greater range of health services, for example, after-hours GP clinics.
  - Allowing, or obliging, those people who can afford adequate private health insurance to opt out of the public system.
  - Introducing 'managed competition' whereby 'budget holders' (or competing third party payers) would purchase health care services from competing providers on behalf of their client populations. There are various possibilities in this regard:
    - : Richard Scotton, for example, has proposed a scheme involving three main elements: the amalgamation of existing health programs; the specification of clear and separate roles for governments; and the integration of private sector funding and service provision into a national program (PC 2002b, p. xiv).
    - : A somewhat different, but related approach, would involve pooling of federal and state funds, with responsibility for service provision devolved to regional health authorities that would purchase the full range of health services for their residents.

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- health financing issues (including federal/state responsibilities and their implications);
  - coordination of care (including with aged care);
  - the interface between private and public services; and
  - information management in health care (such as transferable patient records and use of information in quality assurance).

Recommendations from such a review — akin to the review by the Hilmer Committee that preceded the national competition policy — could be used by COAG to develop an agreed coordinated reform framework and program, and an implementation timetable to drive the reform process.

The efficiencies arising from such a cooperative national reform program could be directed to enhancing service quality and accessibility and help to address the burgeoning fiscal pressures that will otherwise result from Australia's ageing population.

## **Wider reforms to promote productivity**

Although an ageing population structure is probably Australia's biggest foreseeable policy challenge, it is not the only one. There is pressure both domestically and internationally to improve environmental outcomes and the sustainability of resource use, whether through rectifying land degradation and salinity, reducing greenhouse gas emissions, conserving biodiversity or enhancing environmental amenity. And the growing emphasis on bilateral and regional trade agreements in place of multilateral trade reform adds to the ongoing challenges to Australia's economic performance as the world's economies becoming increasingly integrated.

In the future, even more than in the past, productivity growth will be the prime determinant of the living standards of Australians given ageing and other pressures. Over a 40 year period, the power of compounding means that even a seemingly small lift in annual productivity growth eventually has big effects. For example, if Australia were able to match the 1990s labour productivity growth rate of 2.05 per cent after 2003-04, rather than the long-term average of 1.75 per cent, Australians would cumulatively have \$3900 billion more income by 2044-45 — a sizeable buffer against ageing costs. General productivity growth thus has a key role to play in easing the fiscal pressures associated with ageing, even if the higher real wages and expectations about service levels that come with it bring fiscal pressures of their own.

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Productivity growth was the mainspring of Australia's economic performance in the 1990s. During the last completed growth cycle, multifactor productivity — a measure of the efficiency of both labour and capital use — grew at more than double the rate in the previous cycle. Australian households benefited from the equivalent of an additional \$7000 income, on average, by the end of the 1990s. Notwithstanding the difficulties in establishing causality, a range of indicators confirm that structural reforms, including national competition policy, have been the principal contributors to that surge in productivity and income.

As more recent experience shows, however, sustaining high productivity growth can be difficult. Annual multifactor productivity growth averaged only 1 per cent in the five years to 2003-04 compared to twice this rate in the 1993-94 to 1998-99 growth cycle. Short-term influences, such as drought, have adversely affected Australia's productivity performance in the latest incomplete cycle, but the disparity with the earlier period illustrates the challenges.

COAG's review of national competition policy in 2005 provides an opportunity to build on past efforts and commit to a new and enlarged productivity-enhancing reform agenda for Australia.

The Commission's current inquiry on national competition policy reforms is intended to inform that review. In addition to assessing the substantial net benefits of reforms to date, the Commission has identified areas where the national coordination of reform would offer a high pay-off to the community compared with individual jurisdictions acting independently. These encompass important areas of Australia's economic infrastructure — energy, water and freight and passenger transport — as well as natural resource management and, as noted above, the health care system. Continuing reforms in other human services areas — such as education training and aged care — as well as in labour market and tax policy, are also crucial to Australia's future prosperity, but appear in less need of national coordination at this stage.

Implementation of a broad-based reform effort would play a central role in helping to maintain and enhance the living standards of Australians in the face of population ageing and the other major challenges ahead. Even though there are some uncertainties about the precise demographic transition over the next 40 years, the risks to our future prosperity from an ageing population are relatively clear. The lead times involved in achieving necessary reforms, and seeing a pay-off from them, add to the importance of taking action sooner rather than later.

