

# Policy Implications of the Ageing of Australia's Population

**Gary Banks**  
Chairman  
Productivity Commission

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I feel privileged to be able to introduce this first session of what promises to be a stimulating and productive conference. I would like to begin by thanking participants — speakers, discussants and others — for your work and for being here today, especially those of you who have travelled from interstate or overseas.

In this UN designated International Year of Older Persons (which I take to be UN-speak for ‘old people’), it will come as no surprise — least of all to anyone in this room — to hear that the world population is ageing. This is not a new development (demographers tell us it has been going on for centuries) but it is accelerating. What is perhaps less well known is that, while developed country populations are older on average than for developing countries, the latter are ageing even more rapidly: there is convergence at work. So population ageing is both a universal and a perennial phenomenon for the world community — not to mention a source of personal anxiety for some of us ‘older persons’ in this room!

However unwelcome ageing may be to individuals, it should be recognised as a sign of success for society as a whole. Improvements in life expectancy resulting from better health and aged care, mean that more people than ever can look forward to a productive and fulfilling later life. While these growing numbers constitute some policy challenges, they also constitute an asset and an opportunity. 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 nurtured by appropriate policies. In this sense, it seems important for gatherings such as this to consider not only the costs, but also the benefits of population ageing, and how they can be better harnessed.

## Uncertainties ahead

Admittedly, the costs are easier to identify and quantify. This has contributed to the sense of urgency pervading the issue of ageing populations. Countries like Italy, Germany and Japan are already contemplating the prospect of population declines in the next few years, brought on by very low birth rates. In combination with declines in retirement ages and in male labour force participation rates, low population growth has meant that, in most developed countries, net additions to the labour force are trending downwards. This can only accelerate when the ‘baby-boom bulge’ reaches pensionable age.

### *Dependency ratio*

This amounts to a decline in the number of workers relative to non-workers or — to use the jargon — an increase in the ‘dependency ratio’. It has been viewed in some influential quarters — notably international agencies such as the World Bank and OECD — as a cause for concern, because it is primarily through the work of those in employment that a nation’s wealth is created. Further, it is through the goods and services that workers produce, and the income they generate, that governments can afford to provide the safety net to which people in the so-called first world have become accustomed. It is also, ultimately, only because of the efforts of those in employment that our superannuation fund managers can afford to pay us interest on our contributions. So even self-funded retirees are reliant on the work of others for their material welfare, if less visibly.

### *Social expenditure*

By the standards of developed countries, the Australian population is neither very old nor ageing very rapidly. Nonetheless, as noted, the entry into retirement of baby-boomers is only a few years away and will at the very least put pressure on Australia’s social expenditure levels. How *much* pressure, is open to debate, and some of the papers to be discussed today and tomorrow should enlighten us considerably on this point. To give an order of magnitude, one of the Productivity Commission’s predecessors — the Economic Planning Advisory Council (EPAC) — estimated some years ago that expenditure on education, health, employment and welfare/pensions would rise from 21 per cent of

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GDP in 1990 to 24 per cent in 2051 (EPAC 1994). While this is only an increase of 3 percentage points, it must be kept in mind that real GDP will be much higher in 2051 than it is now. In constant dollars per capita, this increase translates into a doubling of the social expenditure 'burden' facing each Australian man, woman and child.

On the positive side, an increase in real GDP also means an increase in the tax base, with the result that taxation may not have to rise too far to meet increased public outlays on pensions, health and aged care. EPAC put the required increase in average taxes at 8 per cent between 1990 and 2051, an increase not dissimilar to historical trends and below international trends (EPAC 1994). Thus, the 'intergenerational warfare' predicted by some, as a result of significantly higher taxes required to finance the retirement of baby boomers, may fail to break out.

However, this does not obviate the need for some hard decisions. In its latest survey of Australia, the OECD suggested that the concurrent increase in pensions and health care outlays would pose a risk to government finances (OECD 1998). Specifically, it estimated that without policy changes, these trends would mean that Australia's budget balance net of interest payments would deteriorate from a surplus of 1.8 per cent of GDP in 2000 to a deficit of 1.4 per cent of GDP in 2030. While acknowledging that this potential deterioration was not as drastic as for many other member countries,<sup>1</sup> the OECD nonetheless called for a number of reforms designed to soften the impact of ageing on public finances. These centre around the need to make people more self-sufficient in the areas of retirement incomes, health care and aged care. I look forward to hearing these important issues debated at this conference.

### *Productivity and growth*

Beyond the most obvious and immediate impact of ageing on the government sector, the wider issue of the implications of ageing for long term economic growth must be considered. As mentioned earlier, the output of goods and services is the real driver of a nation's capacity to 'afford' its aged. No consensus appears to have emerged in the economics profession concerning the impact of ageing on economic growth — although there may not be a consensus here on that statement!

Our knowledge of the impact of ageing on the determinants of economic growth remains fragmented. For instance, life-cycle theory suggests that an older population will dissave relatively more; combined with the greater public dissaving predicted by the OECD, a reduction in the national saving rate looms as a possibility. Simulations carried out by Miles (1999) for the UK and Europe, support this prospect. However, his simulations also point to a rise in the capital-labour ratio, as population ageing and an increased consumption of leisure cause the aggregate labour supply to fall. Thus, a fall in the national saving rate need not equate with a reduction in the amount of physical capital per worker and, hence, labour productivity. This is especially true in an era when foreign capital is more plentiful and mobile than ever before.

Nevertheless, the OECD predicts that a slow-down in labour force growth will decrease Australia's rate of economic growth from 2000 onward (OECD 1998). Two factors may help mitigate this outcome. First, some debate still surrounds future changes in attitudes to retirement. Clearly, a reversal of today's trend towards early retirement would alter the outlook on labour force growth. Second, there is the quality of labour to consider. Research carried out by the Commission for this conference suggests that Australia's stock of human capital (adjusted for quality) will be higher in future — as more educated cohorts join the labour force. This is likely to have a positive influence on labour productivity. The precise extent to which this growing human resource will impact on growth is not known, although 'new growth theory' would give it a significant role.

All in all, the wide range of contradictory influences linking population ageing and economic growth makes long term predictions difficult. Once again, we look forward to some of these influences being explored further in today's proceedings.

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<sup>1</sup> Equivalent figures for Japan and Germany are -8.7 and -6.6 per cent respectively (OECD 1998).

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Finally, the natural tendency of economists to bring everything back to GDP per person must be curtailed when considering the effects of ageing. While income per head is obviously an important indicator of wellbeing, it is not the only one. Community wellbeing is and will continue to be influenced by the broader economic and social environment in which we live: thus, the quality and affordability of services such as housing, transport, and education in an ageing Australia must also be examined. As the Commission's work for the Australian governments' review of services demonstrates, performance in such areas depends on both efficiency and effectiveness measures, including equitable access.

It follows from all this that the impact of ageing on the Australian economy, while real and significant, is also likely to be diverse and multi-faceted. In particular the interplay of economic factors, both with each other and with demographic and social factors, makes it hard to restrict the analysis.

## **Why a conference?**

That is why the Commission decided, in collaboration with the Melbourne Institute, to organise this conference. The Commission has recently organised similar gatherings to look at the labour market and at productivity growth, and I hope the results of the next two days will prove equally satisfying.

As on those previous occasions, the goal of this conference is partly to help the Commission do its job better, by exposing it to current knowledge in an important policy area and hence allowing it to incorporate this knowledge into its own research and policy advice to governments. By hosting academic researchers, as well as public and private practitioners, synergies can also be achieved in the exchange of ideas.

We hope the quality of this exchange will be enhanced by the roundtable format for the discussions — despite the relatively large group involved — and by ensuring that all relevant disciplines and sectors were represented today. In this respect, it is pleasing to note the presence in the audience of demographers, planners, health experts, actuaries and representatives of welfare organisations. Such a multi-disciplinary approach, combined with international and Australian expertise, should yield a well-rounded view of the impact and policy implications of ageing.

A perspective of this kind, informed by social as well as economic considerations, is of particular value to both the organisations behind this conference.

The Productivity Commission's fundamental role is to help inform policy choices that will enhance Australia's productivity and living standards over the long term. From experience, the Commission is most able to add value to the policy debate in areas where problems are of a complex or contentious nature, where economic and social dimensions are intertwined, and where there is a potentially high payoff to the Australian community from 'getting it right'. A rigorous analytical approach, informed by extensive public consultations and input, is the best way to shed light on such problems, and thus prepare the way for policy progress.

Examples of such an approach can be found in the Commission's current work program, which includes inquiries into the gambling industries, the regional impact of national competition policy, and the provisions of the Broadcasting Act. In these, as well as in its other inquiries and activities, the Commission takes an economy-wide or community-wide view, and is required to consider the social repercussions of its policy recommendations.

As its name implies, the Melbourne Institute of Applied Economic and Social Research is also concerned with the interplay of economic and social issues. In many ways, the preoccupations of the Institute resemble those of the Commission. We are therefore pleased to have joined forces with the Institute in the organisation of this conference. As a leading research institution, the Melbourne Institute is able to draw on considerable in-house and external academic expertise, domestically as well as internationally. In that, it complements well the Commission's capacity to attract public sector specialists and practitioners in the field.

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## Paving the way for future policy

The confluence of these two streams — academics and practitioners — should be able to produce results that are both intellectually worthwhile and of practical policy use. In respect of the former, a stocktake of our knowledge of the economic impact of ageing — imperfect though it is — is probably overdue at the dawn of a century which will see more elderly people in Australia than ever before.

If the changes brought about by ageing are as dramatic as predicted by some, then it is critical that they be analysed early and comprehensively, so that appropriate policies can be devised within the requisite lead times. The introduction of the Superannuation Guarantee shows that fairly radical measures can be accepted by the community if it is kept informed of what is at stake. If major reforms are likely in the area of aged care or health, for instance, critical issues will have to be identified, priorities set and timeframes determined.

If, conversely, we concluded that ageing-induced changes were unlikely to be greater than have been faced successfully in the past, the current sense of alarm could be alleviated and policy development would obviously involve less urgency.

Either way, I am sure that the work carried out during this two-day conference will make an important contribution to our understanding of the issues. For this reason, the Commission intends to publish the papers and proceedings of the conference, to serve as a durable reference for policy makers and advisers.

## References

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