Actuaries Institute : Colloquy : 12 March 2015

Intergenerational Aspects of Australian Public Policy

The purpose of this Colloquy is to discuss the attached Grattan Institute (GI) papers:-

1. The wealth of generations (December 2014) - "**Wealth Paper**"
2. Balancing budgets : Tough choices we need (November 2013) – "**Budget Paper**"

Much of the focus of Australian actuaries has been either on (or within) individual public policy issues. Consistent with the recent Actuaries Institute 2015-2017 strategy for the Profession, the attached papers lift the current public policy focus to the levels of wealth changes between different age groups and the Commonwealth Government (CG) Budget overall. Both GI papers acknowledge that further work is needed to extend the attached work to the level of the economy overall and job growth in particular. Further background reading is listed at the end of this introduction.

This Colloquy is intended to focus on:-

1. Whether current public policies are so heavily focussed on older Australians that these policies are unfair to younger Australians and will act as a material deterrent to the economy overall and job growth in particular;
2. What changes to current (or new) public policies need to be investigated and prosecuted to return the CG Budget into structural balance; and
3. What options are available to individual actuaries and to the Actuaries Institute to promote the need for necessary changes to public policies.

Public Policy Focuses Currently on Older Australians

While older Australians are generally unaware of it, much of Australia's public policy focus involves the payment of (increasing) government subsidies to older Australians who are not necessarily needy. Page 74 of the GI's Budget Paper states *"Australian welfare policies systemically favour older people over the young, and older people pay less tax and receive more benefits than younger households with similar incomes…….. current arrangements for the Age Pension and superannuation provide significant benefits to those in the middle- and upper-income deciles…".* Examples of public policies which favour older Australians include:-

1. tax free superannuation investment income and drawdowns after age 60;
2. substantially free medical, hospital and pharmaceutical care, community rating of private health insurance, and GST-free health services;
3. recent relaxation of means testing of the Age Pension, and recent increases to pension rates and indexation; and
4. subsidised at-home care for older Australians, as part of the CG's Ageing-in-Place policy.

At the same time as changes to these public policies have resulted in increasing payments to non-needy older Australians, public policies which are applicable to younger Australians have either not been maintained or their anti-young focus has been increased, for example:-

1. public policies which increase the price of residential property have been extended (borrowing by DIY super funds, failure to enforce residential property ownership laws, Ageing-in-Place provisions);
2. increased CG debt will require younger Australians to pay increased future taxes (because older Australians pay relatively low taxes);

3. the quality of Australia's public education and university systems have eroded through underperformance and underpayment of teachers, and by publicly funding poor quality university courses;
4. the CG payment to the unemployed (NewStart) is acknowledged widely as inadequate in amount, and eligibility for payment is tight for those who obtain part-time work;
5. few publicly funded programs exist to assist the school to work/study transition; and
6. younger Australians are being required to pay both the Superannuation Guarantee out of their incomes, and the (substantially means test free) Age Pensions of current older Australians.

By contrast to these 6, CG payments towards the cost of child care have increased over recent years.

Commonwealth Government Budget

The current CG public policy focus on older Australians might be appropriate if CG finances were balanced (both as to deficit and interest payable on debt). The table below is derived from the CG's recent MYEFO and Final Budget Outcome for FY14. All amounts are absolute (ie amounts are not adjusted to reflect projected inflation and projected population growth which are both included in the projected amounts). Data for prior year CG Budgets are in Figure 2.1 of the GI Budget Paper.

$m	FY14 actual	FY15 forecast	FY15/ FY14 % inc	FY16 forecast	FY16/ FY15 % inc	FY17 project	FY17/ FY16 % inc	FY18 project	FY18/ FY17 % inc
Tax Revenue	351,088	361,959	3.1	387,249	7.0	413,821	6.9	440,468	6.4
Less GST	55,517	56,820	2.3	60,390	6.3	63,510	5.2	66,950	5.4
Net Tax Rev	295,571	305,139	3.2	326,859	7.1	350,311	7.2	373,518	6.6
Interest Expense	14,597	16,387	12.3	17,871	9.1	19,239	7.7	19,925	3.6
Non-Int Expense	399,248	406,511	1.8	418,613	3.0	436,858	4.4	455,385	4.2
Net Op Deficit	39,896	37,022	-7.2	24,801	-33.0	15,060	-39.3	2,136	-85.8
NOD as % NTR	13.5	12.1		7.6		4.3		0.6	
Int Exp as % NTR	4.9	5.4		5.5		5.5		5.3	
Int Bear Liab	363,406	425,066	17.0	471,373	10.9	518,647	10.0	542,050	4.5
IBL as % NTR	123	139		144		148		145	
Int as % av IBL		4.2		4.0		3.9		3.8	

The table shows that the CG deficit for FY14 was 13.5% of the CG's FY14 net taxation revenue, and that the projected FY15 deficit is 12.1%. The projected CG interest bearing liabilities at 30 June 2015 are 139% of the CG's projected FY15 net taxation revenue. The table shows that the CG is projecting rapidly reducing deficits after FY15 and up to FY18 caused by tax revenue being projected to increase at materially higher rates (about 7%pa) than expenses (about 3% to 4%pa, note that the 1.8% FY15 rate of non-interest expense increase may be caused by movement of FY13 and FY15 expenses into FY14 for political reasons). Page 80 of the GI Budget Paper comments *"As Figure 11.1 shows, the commitments of the Commonwealth and state governments to reduce spending growth over the forward estimates are extremely ambitious compared to their recent records"*.

Current low interest rates mean that the forecast CG interest expense for FY15 ($16 billion) is 5.4% of FY15 Net Taxation Revenue. Using a long term interest rate (consistent with the Reserve Bank's 2% to 3%pa price inflation target) of say 5%pa, CG interest bearing liabilities of 200% of CG net taxation revenue would result in annual CG interest payments equal to 10% of CG net taxation revenue ($31bn pa in FY15$), a $15 billion increase from the projected FY15 amount which additional amount would absolutely require CG tax increases and/or benefit reductions in the short term. The table shows that this level of interest bearing liabilities and annual interest expense could be reached if the current rate of increase in interest bearing liabilities was continued for the next 5 years and interest rates returned to long term levels (as might be expected over this period).

The question arises as to what changes to public policies would be appropriate if these CG forecasts prove optimistic for either political (Senate or media) or economic reasons. The GI Budget Paper examines many alternatives for CG budget repair (see list on page 6 and tabular summary on page 25), and sets out the GI's estimates of budget effects and "other impacts" from the various changes to public policy. The GI's "other impacts" are social, distributional (ie between income rankings) and economic, and do not include age group related impacts specifically. Chapter 5 of the GI Budget Paper sets out a potential Reform Package (see page 26), focussed on Superannuation and Age Pensions, which are covered in detail in Chapter 6.

Page 10 of the GI Budget Paper states "*The largest threat to future budgets is the sustained pressure on health expenditure. Over the last decade, health has been responsible for most of the spending increases above GDP, for both Commonwealth and state governments (Figure 2.6).*" Despite the identification of this "largest threat", the GI Budget Paper presents few suggestions to limit the growth of health care spending by governments. The health components of CG Expenses in the Table above increase by only 3% to 4%pa in nominal terms, which compares with the average 3.9%pa per person real increase in total health expenditure over the 9 years to 30 June 2012, indicating that the CG is projecting that its payments will constitute a reducing proportion of total health care spending in future, consistent with the outcome for FY13 when CG expenditure reduced by an approximate 4% in real per person terms (AIHW, Health Expenditure Australia 2012-2013).

Page 10 of the Actuaries Institute (AI) Green Paper (see references) comments "*per capita health expenditure is growing faster in the older age groups, which will exacerbate the health expenditure effects of population ageing",* and also page 12 *"working age people bear most of the cost of health care, despite using a relatively small share of health services"*. Chapter 6 of the AI paper considers potential funding related alternatives to address these problems, references the recent major reforms to the funding of aged care which introduce user fees subject to lifetime caps, and asks the question *"could this work in Health?"*. The Green Paper concludes that change *"may mean taxes and a social welfare approach, rather than driving more individually-funded health care and out-of-pocket costs".*

Effects of Current Public Policies on Wealth of Different Age Groups

Much of the public policy focus on older Australians has either been introduced since the early 2000s, or has increased due to changes which have occurred over this period. The question arises as to whether there has as yet been any effect on Australians from these policies. The GI's Wealth Paper analyses changes in wealth for different age groups over the period FY04 to FY12, and concludes on page 12 "*The wealth of the median household over 55 grew strongly (more than 2 per cent annual growth), stagnated for households aged 35-44 (0.3 per cent annual growth) and declined for those aged 25-34 (minus 2.7 per cent growth)".* While there are significant limitations in the scope of the GI Wealth Paper (eg time specific, wealth not net income), the GI's Wealth Paper does identify material wealth shift and wealth concentration.

Beyond the current CG budget need for public policy change, the future health of the Australian economy generally and jobs growth in particular may require a change in public policy focus away from older Australians with means.

Making Public Policy Change

If changes are to be made to public policies, it is difficult to escape the following conclusions:-

1. means testing of the Age Pension needs to be tightened materially (without reducing payments to older Australians with few means);
2. unencumbered home ownership by older Australians is an important component of achieving satisfactory retirement income, and therefore needs to be encouraged by public policies which ensure affordability of residential property for younger Australians; and
3. mechanisms need to be introduced to require older Australians with means to use their superannuation (and other financial assets) towards reducing the extent of government payment of their health care costs.

Options for Promotion of Public Policy Change

The November 2014 Canberra meeting of "Senior Actuaries" held a discussion entitled "The Future of Australia", based on notes prepared by Barry Amond (a Past President). Barry's notes ended "*I am enthusiastic about the future of Australia. As in the past, our success might well depend on entrepreneurs taking risks*". The discussion at the meeting highlighted the need for public policies to ensure that younger Australians continue to be in the position to be entrepreneurs and to take risks (as has been the case in earlier decades), and the extent of the public policy advantage of older Australians with means currently. The need for older actuaries to advocate for appropriate public policy change among their older friends, their communities and within the AI was discussed.

Older and more senior actuaries are well placed to advocate for reductions in spending on older age Australians with means. Younger actuaries generally are not well placed for such advocacy, both for career related and "perceived self-interest" reasons. Beyond advocacy, older Australians (including older actuaries) can provide practical assistance to younger Australians within their families, their communities, and by mentoring younger Australians (including younger actuaries).

It is clear that meaningful reductions to welfare programs covering older Australians with means will not occur at the initiative of any CG unless the CG budget reaches a position of stress (as outlined above). Meaningful reductions will occur earlier only if older Australians with means generally come to understand the extent of their current advantage, and a balanced message can be delivered to the community by the many advocacy groups which cover older Australians, and the retirement incomes and health care industries generally.

Individual actuaries and the AI can have a role in ensuring that appropriate changes are developed and then communicated. Australia's continued economic wellbeing may depend on appropriate changes being implemented progressively over the next few years.

Rob Paton – 21 January 2015

References

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