

# InScope

ISSUE 18 • BROUGHT TO YOU BY FINANCIAL WISDOM

## The cost of an ageing population

One of the challenges facing most advanced economies is an ageing population, especially as the baby boomers\* reach retirement age. Australia too is facing this challenge – as the Federal Government's Intergenerational Report (IGR) shows.

The recently released third Intergenerational Report (IGR) forecasts the impact of Australia's ageing population on government finances and the broader economy. In this issue of InScope, the Investment Markets Research team at Colonial First State looks at what the IGR means for Australia.

### Intergenerational Report highlights

- Australia's total population is estimated to pass 35 million by 2050, up from around 22 million today and with annual growth of around 1.2%.
- Those over 65 will represent nearly 25% of the population by 2050, up from just 13% today.
- The number of working aged people relative to retired people will almost halve, from around 5 today to just 2.7 by 2050.
- The cost of the aged pension to the Federal Government is expected to grow from 2.6% of GDP to 2.9% by 2050.
- The cost of spending on health for the government is expected to rise from 4% of GDP to around 7%.
- Real economic growth per person is expected to grow by 1.5% annually over the next 40 years, compared with an average of 1.9% over the past 40 years.

In dealing with the issues of an ageing population, the government is faced with a number of choices which affect the economy more broadly. One possible option is to just accept the costs associated with the ageing population, although this is unlikely. It would require the government to cut services and/or raise taxes – both of which would potentially lower the rate of economic growth and the well being of the average Australian more generally.

The more likely alternative is to continue to prepare the economy for the changes the ageing population will bring. A key focus here is on growing the economy more strongly, to improve its productivity to enable the government, workers and investors to create a greater pool of savings to deal with the costs of ageing.

### Stimulate productivity

A key place to start improving productivity is in education and skills training. This covers not only the school years and basic education levels, but also technical and trade skills and higher education (university) qualifications. A more highly educated workforce is likely to be a more productive workforce. A more productive workforce is likely to be a more highly paid workforce, increasing both the income levels of current workers, but also the revenue raising capabilities of the government.

### Improve infrastructure

Also important to productivity is infrastructure. Better and more efficient roads, public transport options, rail, ports, water, gas and electricity are vitally important parts of helping the economy operate at a higher level of productivity. For some states in Australia, it could be argued that there has been a lack of focus on the provision of quality infrastructure and the cost of this to the economy cannot be ignored. Greater spending on infrastructure, both now and into the future is likely to be a vital part of helping the economy cope with an ageing population.

### Taxation reform

The government review into the taxation system (the Henry Review) is a critical component of this debate. The Henry Review is expected to have outlined to the government a number of reforms and policy goals designed to improve the efficiency, fairness and long term sustainability of the taxation system. As Australia's population ages it will be critical for the taxation system to be able to reward hard work and entrepreneurial behaviour, while also ensuring fairness and strong revenue flow to accommodate required government spending.

\* Baby Boomers are those born between approximately 1946–1962

## Population growth

Another important part of the demographic debate is Australia's population growth rate and the overall population size. In the IGR the government estimated the population would pass 35 million by 2050, a significant increase from the previous estimate of 28.5 million by 2047 and well up on the current population of 22 million.

While adding new people to the population (through both immigration and natural increase) clearly adds to the economic burden of providing the necessities of life, a strongly growing population could be one of the keys to Australia's ability to counter some of the effects of ageing.

The key here is to add to the population via an immigration plan that brings in people who have a higher than average skill level and fall into the lower than average age group. Fortunately, the changing structure of the Australian economy, with more economic resources needed for the mining and private sector capital expenditure sectors of the economy, should encourage just that – more highly skilled and younger workers.

## Participation in the workforce

The goal here is to increase the participation rate of the workforce to ensure that more people in the prime working age groups do actually enter (or remain in) the labour force. Policies will need to be formulated to make it attractive for stay at home parents to re-enter the work force (ie paid parental leave) and for workers approaching the retirement age to stay beyond their 60th or 65th birthdays (ie tax breaks for older workers).

## Sustainable growth

Another key to a productive economy that can meet the challenges of an ageing population is sustainability and especially the way in which the economy deals with the need to reduce carbon emissions. Whatever system the government decides upon in the future, it seems clear that Australia (and other economies around the world) will need to reduce their carbon emissions and this should help provide more sustainable growth for the future.

## Superannuation Guarantee

A key conclusion missing from the IGR is that one of the best ways to deal with the costs of an ageing population is to encourage the current working age population to save more for their own retirement.

This can be done in a number of ways. Firstly, the government could increase the rate of the superannuation guarantee charge (SGC). From the current 9%, there has been some discussion of increasing the SGC to 12% or even 15%. Perhaps one of the best ways to achieve this outcome would be for the government to also share the burden, as was the case in years past, where proposed income tax cuts were applied to superannuation contributions. Once the government's Budget position returns to surplus, this could be a better medium term option for the government, rather than just giving away excess revenue as income tax cuts.

The other way to encourage greater savings by current workers for their retirement is via tax incentives. Currently savings in Australia are taxed in many different ways, depending on their form – such as bank deposits, superannuation and housing. Tax incentives designed to increase savings (versus consumption) could also be very helpful in encouraging current workers to save more for their own retirement. This is likely to be part of the Henry Review which is expected to be released prior to the Federal Budget announcement in May 2010.

## What does this mean for you?

The bottom line for today's workers is that when the time comes for retirement, the ability for the government to provide substantial support is likely to be diminished. With the government expected to need to spend more taxation dollars on aged pensions and health, the ability of future workers to fund the income of those who have retired will likely be diminished.

If you are currently working, think hard about how you can increase your savings and investment returns, in order to provide a greater level of your income in retirement. As always, the value of good financial advice is important.

Speak to us about your financial plan to ensure you have the savings you need to retire comfortably.

### Important information

This general advice has been prepared without taking into account your particular financial needs, circumstances or objectives. This advice is based on Financial Wisdom Limited's understanding of current law as at 29 March 2010 and its continuance unless stated otherwise. While every effort has been made to ensure the accuracy of the information, it is not guaranteed. You should obtain professional advice before acting on the information contained in this publication.

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