Increasing the Age Pension age – busting the myths

Policy brief

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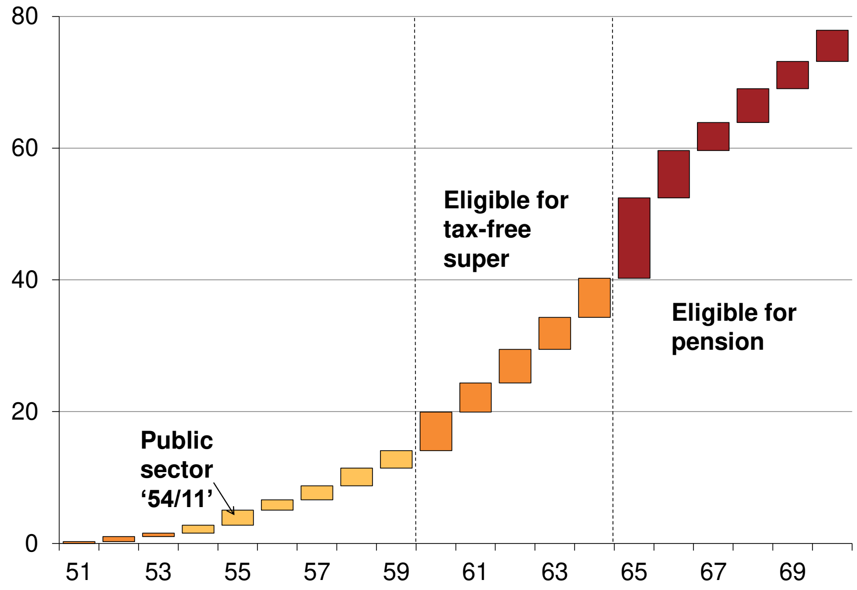
Treasurer Joe Hockey has suggested that if we are 'fair dinkum' about getting the budget back into the black, we need to look at raising the age at which people can qualify for the age pension. He's right, but such a reform will be a lot more effective if we also raise the age at which people can start drawing down their superannuation, as this too affects retirement decisions (Figure 1).

Many will be worried about how this double change might affect them. But most of these worries are unfounded. Given the importance of this reform, more facts are needed.

And facts are vital: this is perhaps the most important single reform for our time. Increasing the age at which you can access the age pension and superannuation is one of the few reforms that is a big positive for both economic growth and the budget.

Figure 1: Impact of eligibility age on retirement

Cumulative per cent of male labour force retiring, by age of retirement

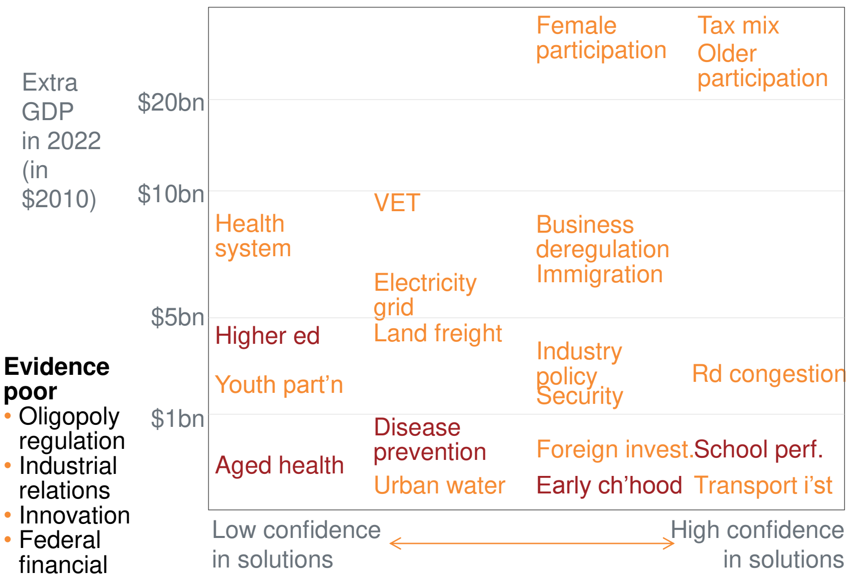


Note: Assumes that differences in labour-force participation rates between cohorts one year apart in age reflect retirement rates.

Source: Grattan Institute analysis of ABS (2011) Cat no 6530.0

Grattan Institute's *Game-changers* report in 2012 found that raising the pension and super ages to 70 would add $25 billion a year to economic output – almost 2 per cent of GDP -- in the medium term (Figure 2). Undertaking this huge reform to increase economic growth would create more resources to pay for all the things we would like to improve about our lives – not least, improving health care.

Figure 2: Policy reform options to boost economic growth

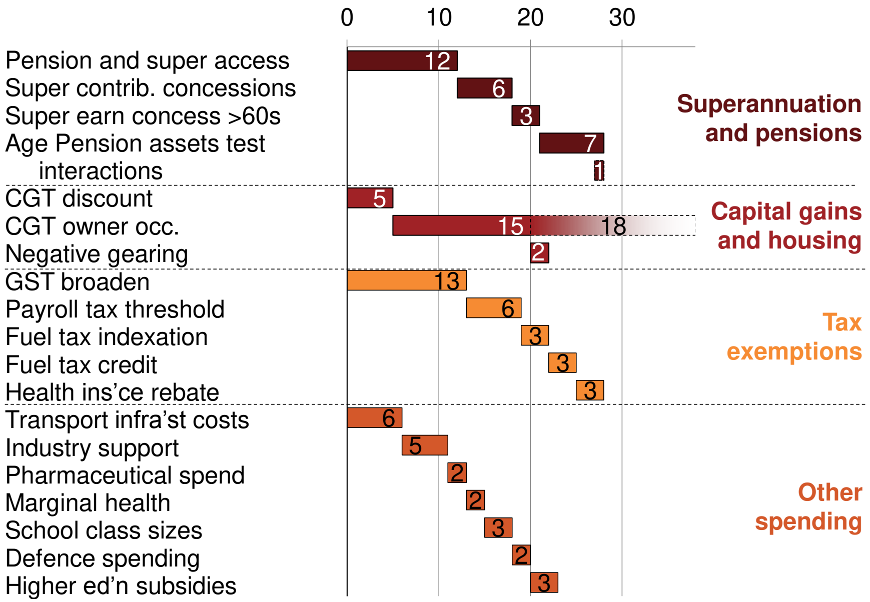


Note: Figures are approximate estimates of annual impact on GDP or budget, at full implementation in ten years, in 2011 dollars. Resolving many of these challenges would have significant non-quantifiable benefits that should also be taken into account.

Source: Grattan Institute (2012) Game-changers: Economic reform priorities for Australia

Raising the pension and super ages would also improve the Commonwealth budget balance by about $12 billion a year over the medium term. It's a double gift for the budget, both increasing income tax receipts and reducing welfare. It has more impact on the budget than any almost any other measure that Grattan Institute could identify in its *Balancing Budgets* report last year. (Figure 3). The only plausible alternatives this big are raising income tax rates by more than 2 per cent across the board, or raising the GST to 12.5 per cent.

Figure 3: Budgetary impact of tough budget choices



Source: Grattan Institute (2013) Balancing budgets: tough choices we need

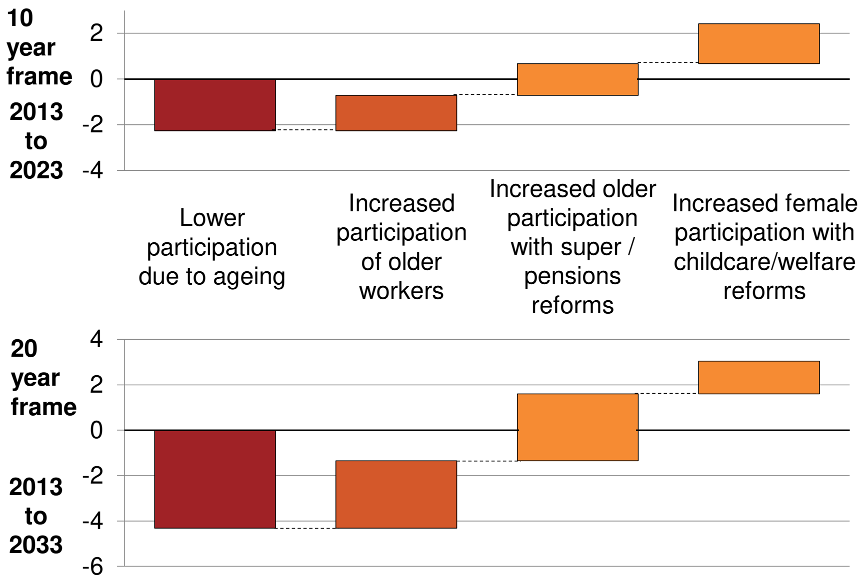
The reform would also have a big impact on budget sustainability. It's much easier to keep budgets in balance with fewer people dependent on government compared to the number working and paying taxes. As the population ages this dependency ratio will increase if nothing else changes. But if pension and super ages increase, dependency ratios could continue to get better for more than 20 years (Figure 4)

The pension age was set in 1908 at 65 for men, when most people didn't expect to live that long, and a 65-year old could expect to live until 77. Today, life expectancy for a 65-year old is 85 (Figure 5). Despite these shifts, the pension age was only changed in 2009, when government legislated to raise the pension age by two years to 67 by 2023. In the 14 years in between, life expectancy is likely to rise by another three years above the pension age.

So this is a pretty obvious reform. And Australia lags many OECD countries (Figure 6).

Figure 4: Changes in participation rates due to demography and policy change

% of total population who participate in workforce

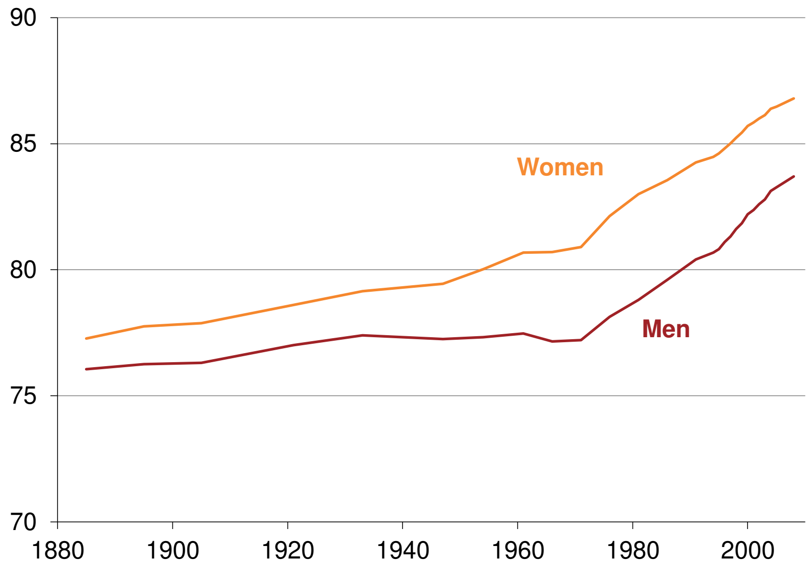


Note: 'lower participation due to ageing' assumes current age-specific participation rate of each age cohort. 'Increased participation of older workers' assumes participation rate of each age cohort continues to increase at 50% of current trends. 'Super / pension reforms' are to lift age of access to pension and superannuation to 70, as specified and modelled in Grattan Institute (2012) Game-changers: Economic reform priorities for Australia. 'Increased female participation with childcare/welfare reforms' assumes reforms to tax, welfare and childcare subsidies, as specified and modelled in the same report.

Source: Grattan Institute (2013) Budget pressures on Australian governments

Figure 5: Life expectancy at 65 years of age

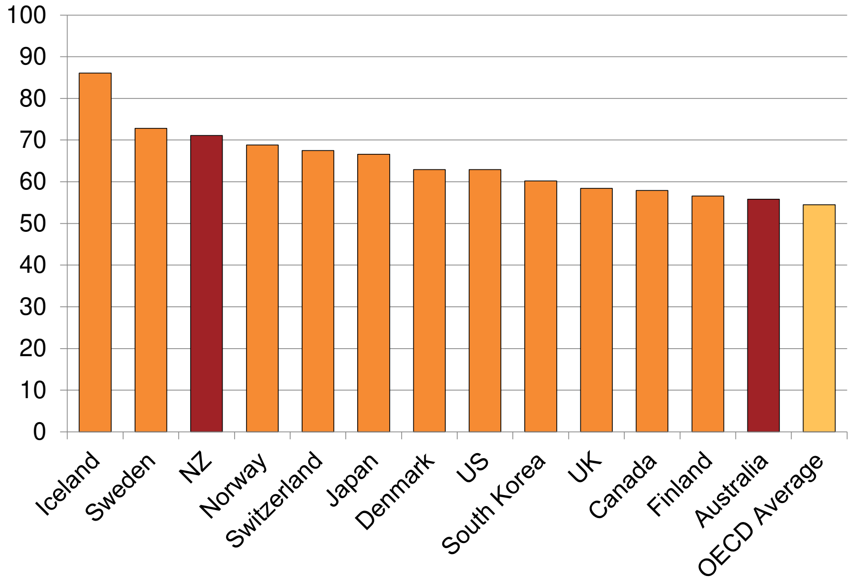
Years



Source: Grattan Institute analysis of ABS (2008) Cat no 3105.0.65.001, Table 7.6

Figure 6: International comparison of workforce participation rates for people aged 55-64

Per cent of cohort

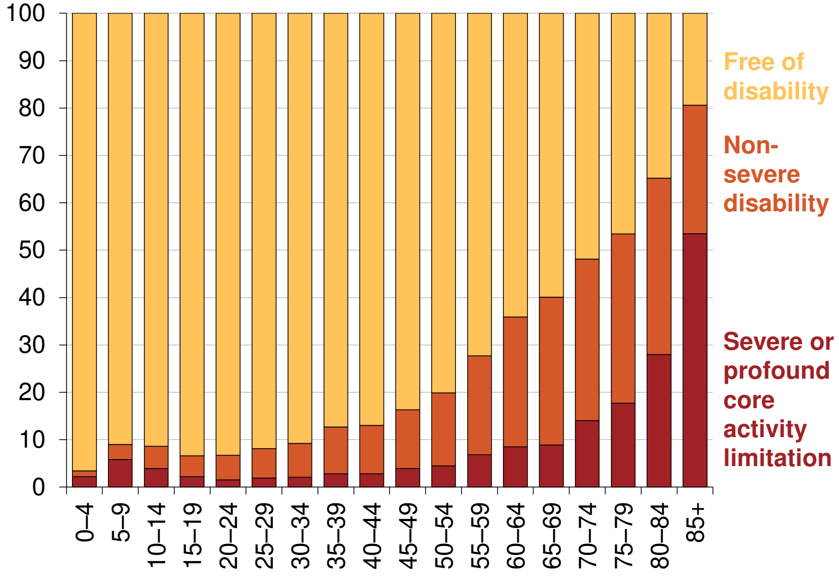


Source: Abhayarantna and Lattimore (2006) Workforce Participation Rates – How Does Australia Compare? Productivity Commission Staff Working Paper.

But reform hasn't happened because of deep community concerns – most of which are based on myths and half-truths. Some are concerned about jobs: people won't be able to work past 65; they won't be able to find a job; or they will take away the jobs of young people.

Some people are concerned about whether older people can work. About 9 per cent of people between 65 and 69 have a severe disability, only slightly more than people between 60 and 64 (Figure 7).

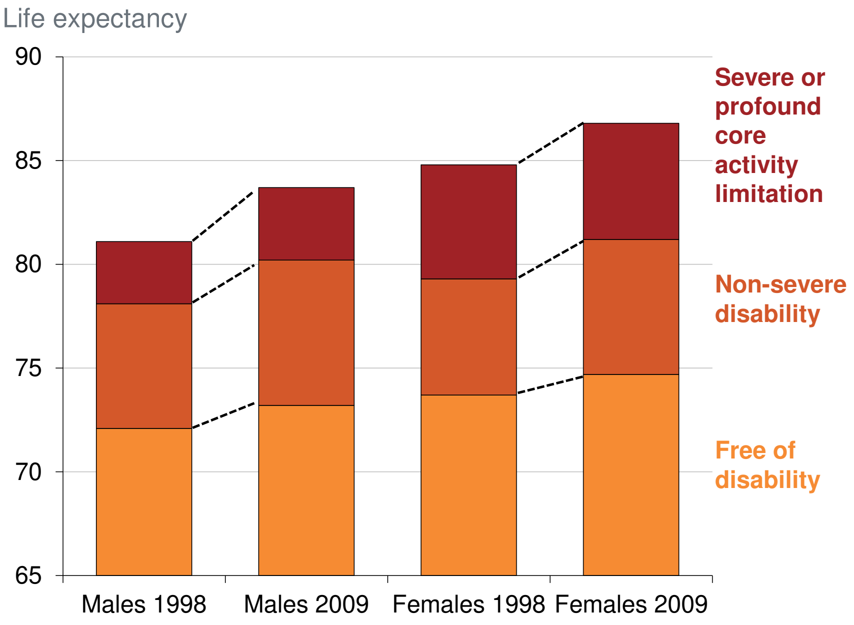
Figure 7: Disability rates by age



Source: AIHW (2012) Changes in life expectancy and disability in Australia 1998 to 2009, Table C4

The existing disability benefit – which pays the same amount as the Age Pension – is aimed at this minority who can't work. There is a good argument that people in this situation should be able to draw on their superannuation. But the average 65-year old Australian can expect to be 74 before they have any disability (Figure 8), is more than capable of working, and has no need to draw down their superannuation.

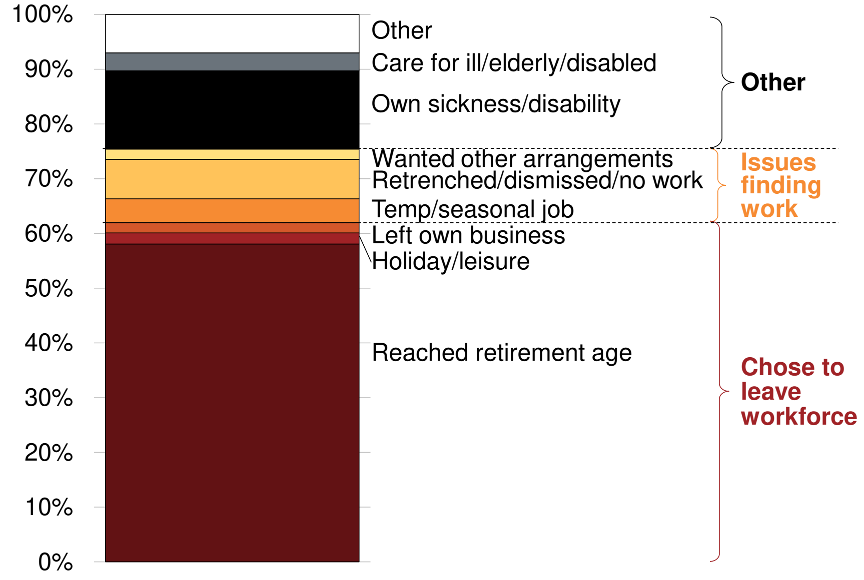
Figure 8: Expected years of life for a 65-year-old by disability status



Source: AIHW (2012) Changes in life expectancy and disability in Australia 1998 to 2009 Table C2

Others worry about whether older people can find work. This too is an issue for a minority. About 11 per cent of people who are retired between 65 and 69 struggle to find work (Figure 9). But the vast majority of people over the age of 65 retired because they 'reached retirement age'. Doubtless we can do more to encourage employers to hire and retain older workers. But most older people who aren't working have chosen not to.

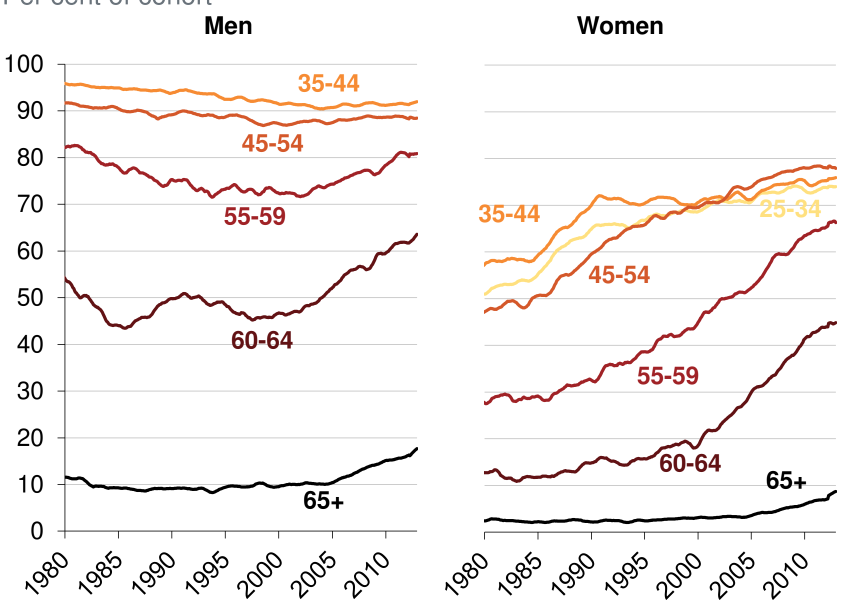
Figure 9: Reasons for retirement given by people who retired between 65 and 69



Source: Grattan Institute analysis of ABS (2013) Cat no 6238, Table 6.1

Some people worry that if older people work for longer, there will be fewer jobs for young people. This is known as the 'lump of labour fallacy' – the belief that there are only a fixed number of jobs to go round in any economy. The history of the 20th century shows how wrong it is. Massive increases in women's workforce participation didn't put millions of young people out of work. Nor did the substantial increase in older workforce participation in Australia over the last decade (Figure 10). We now know that in the medium run, if more people work, more is produced, and living standards rise.

Figure 10: Age-specific labour force participation rates over time



Source: Grattan Institute analysis of ABS (2012) Cat no 6291.0.55.001

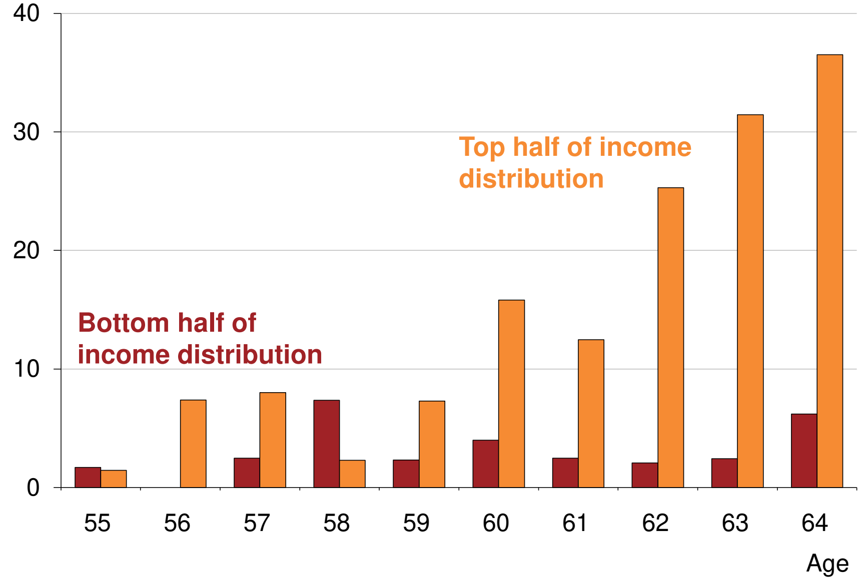
Another concern is that raising pension and superannuation ages will mean that older people volunteer less, or are less able to look after their grandchildren. Yet Grattan Institute analysis of ABS surveys and the Census shows that employment has no impact on volunteering levels. Nor is it likely to affect grandparenting. Nearly one in five Australians aged between 65 and 69 voluntarily look after children in an average fortnight. It's almost exactly the same percentage whether or not they have a job.

It is vital that any increase in pension age be matched by an increase in the age of access to superannuation. The Harmer review found that a third of all superannuation balances are drawn down *before* people qualify for the Age Pension. We provide lavish tax concessions for superannuation on the basis that government will then pay less for age pensions. But if the super is spent before Age Pension age, the concessions do nothing to reduce government liabilities.

Drawing down on superannuation before age pension age really only benefits the well-off. The vast majority of those who draw on their superannuation before 65 are in the top half of income earners (Figure 11). Only about 5 per cent of people in the bottom half of income earners draw down their superannuation early – they have little choice but to work to age pension age. Wealthy people who save enough to retire early should be able to do so. But they shouldn't get a tax break to help.

Figure 11: Use of superannuation before retirement, by income level

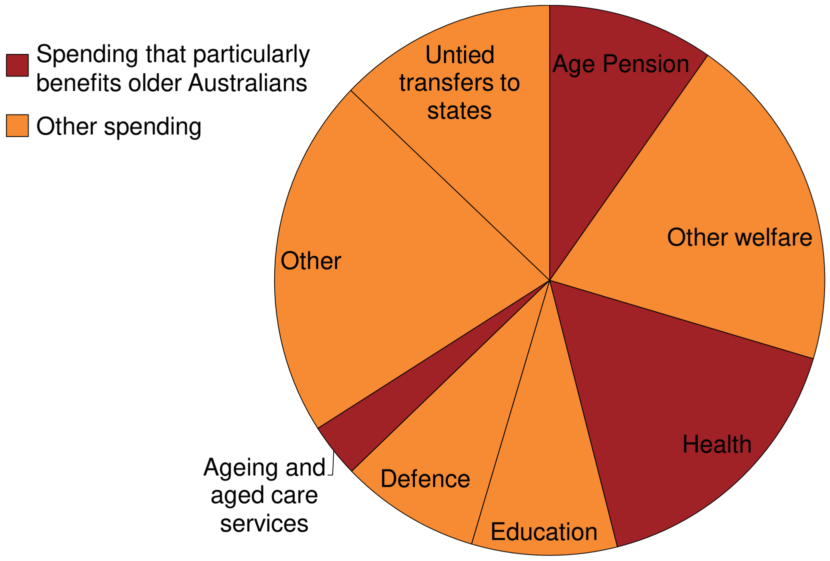
Proportion of age cohort receiving some superannuation payment



Source: Grattan Institute analysis of ABS (2011) Cat no 6503.0

Ironically, those who object most vociferously to increasing retirement ages are often retired already. Yet these people would benefit most. Those who are already retired are hoping that government will continue to pay for their pensions and healthcare. Age pensions already consume almost 10 per cent of the Commonwealth budget – the largest single line item (Figure 12). Pressures on these outlays – as well as rising health and aged care spending -- are likely to increase as the population ages and modern medicine finds more ways to keep us healthy for longer.

Figure 12: Commonwealth government expenditure, 2012-13

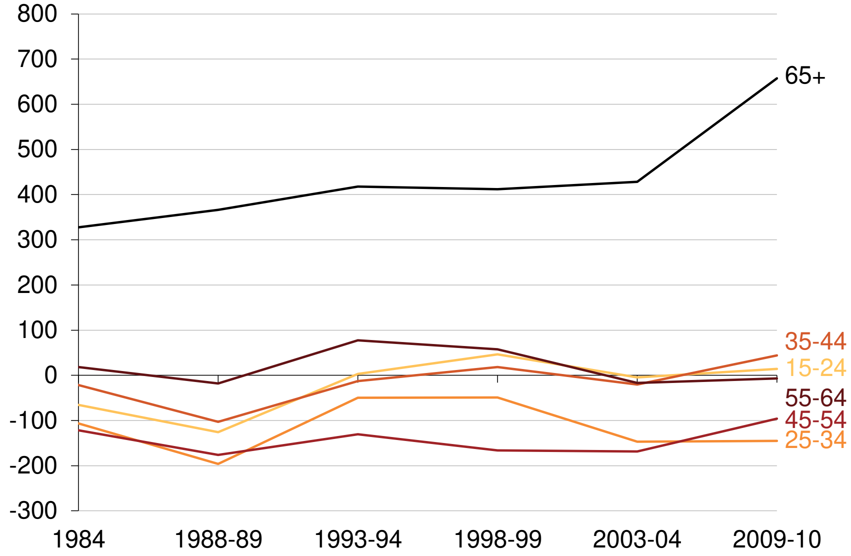


Source: Grattan Institute analysis of Commonwealth budget papers 2012-13

The net benefit transferred to older households through the budget has increased significantly over the last 5 years. It will be easier to resist the temptation to cut back if pension and superannuation ages increase, and governments have more money to spend.

Figure 13: Average net benefits from government (transfers minus taxes) by age of reference person

2009-10$ per week



Note: 65+ bracket in 2003-04 and 2009-10 is a weighted average of 54-74 and 75+ age brackets reported

Source: Grattan Institute analysis of ABS (various years) Cat no 6537.0

Increasing the age at which you qualify for age pension and superannuation is the most important economic and budgetary reform of our time. It is indeed a litmus test of whether the government is 'fair dinkum' about the Australia's future.