Intergenerational fairness

Presentation to CEDA Council on Economic Policy
John Daley
Grattan Institute
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Intergenerational fairness

Government budgets are unsustainable: spending on older households is a substantial cause of the problem

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- The dominant pressures on Australian government budgets are increased spending on older households
- Governments are spending more on older households, to pay for increased health services, Age Pensions and aged care
- The increase spending reflects policy choices, not ageing

The wealth of older households is increasing much faster, although some are doing it tough

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Responsible budget repair will disproportionately affect older households with more assets

- Better targeting of age pensions, superannuation, and asset taxation dominate the options for budget repair that are both large and socially responsible
- Reforms would also create incentives for more older workers to work for longer
The Commonwealth’s structural deficits was masked by mining boom and GFC

Commonwealth budget balance per cent of nominal GDP

- Terms of trade
- Cyclical impacts
- Cash balance
- Structural underlying balance

Financial year ending

Note: Cash balance is equal to receipts minus payments, minus Future Fund income, (under 0.25 per cent of GDP)

Source: Budget Pressures 2014
Both revenue and expenditure are worse than longer-run levels

Commonwealth own purpose expenditures and revenues per cent of nominal GDP

Both revenue and expenditure are worse than longer-run levels.

Source: Budget Pressures 2014
Capex has driven increase in State debt

State net debt and operating balance
$2013 bn

Interest and depreciation increased from 7% to 10% of State government revenue

Grattan Institute, *Budget Pressures 2014*
Forecasts of a budget surplus show the triumph of experience over hope

Actual and forecast Commonwealth underlying cash balance per cent of GDP

Financial year ended

Grattan analysis of Commonwealth Budget Papers
Increasing spending on older Australians is the dominant pressure on budgets

Real change in government recurrent expenditure, 2003 to 2014
$2013 bn

Note: Based on analysis of Commonwealth, NSW, Vic, Qld and WA data. Categories that changed by less than $1 billion not shown.
Source: Grattan Institute, Budget Pressures 2014
The net cost of older households to government has jumped in the last 6 years

Average net benefits per household (government payments, less tax)

2010$

<table>
<thead>
<tr>
<th>Year</th>
<th>15-24</th>
<th>25-34</th>
<th>35-44</th>
<th>45-54</th>
<th>55-64</th>
<th>65+</th>
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<tbody>
<tr>
<td>1988-89</td>
<td>-</td>
<td>-</td>
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<td>1993-94</td>
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<td>1998-99</td>
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<td>-</td>
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<tr>
<td>2003-04</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td>2009-10</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: The Wealth of Generations
Governments spend more on older households, due to Health and Age Pension

Government expenditure per household
$ per person, 2009-10

Note: Other in kind includes child care assistance, other social security and welfare benefits, housing benefits and electricity concessions.
Source: The Wealth of Generations
Government spending per person escalates rapidly from pension age

Government spending per person
$ thousands per person, 2011-12

Note: ‘Other’ includes the Disability Support Pension, Parenting Payment, Family Tax Benefit, Disability Support Services (both Australian Government and state and territory), Other social security and welfare payments, Defence and other expenditures and other state and territory expenditures not classified elsewhere
Source: Productivity Commission (2013)
Health spending and cash benefits for over 65s have increased significantly

Change in government benefits per household, 1988-89 to 2009-10

$2010

Source: The Wealth of Generations
Government health spending increased the most for the over 70s

Government health spending per person, $2010

Source: The Wealth of Generations
More, improved, and new services per person

Health inflation > CPI

Population ageing

Population growth and ageing

Rate & eligibility change

Indexation > CPI

Policy choices, not population ageing, drove health and pension spending increases

Real increase in expenditure 2003-2013
($2012 billion)

Source: Grattan Institute, Budget Pressures 2014
Commonwealth government spending on aged care almost doubled in the last 10 years

Commonwealth Government aged care expenditure
2013$b

Note: Financial year ending 30 June, assumed CPI rate of 2.5%.
Source: PBO (unpublished)
Because of super tax concessions, older households pay less income tax than 20 years ago

Change in taxes per household, 1988-89 to 2009-10, 2010$

Because of super tax concessions, older households pay less income tax than 20 years ago.

Source: *The Wealth of Generations*
Intergenerational fairness

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The wealth of older households is increasing much faster, although some are doing it tough

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Responsible budget repair will disproportionately affect older households with more assets

- Better targeting of age pensions, superannuation, and asset taxation dominate the options for budget repair that are both large and socially responsible
- Reforms would also create incentives for more older workers to work for longer
Some households on the Age Pension are struggling

Percent of households under stress

Main source of household income
- Job seeker payment
- Other government payment
- Wages and salaries

Notes: ‘Job seeker payment’ includes Newstart and jobseeker Youth Allowance. ‘Other govt payment’ is dominated by age and disability pensions.

Young households are accumulating less wealth ...

Mean wealth by age of head of household
$ thousands ($2011-12)
... even though household incomes have increased for all age groups

Household wage, business and welfare income before tax, 2012$ 000s

Source: ABS (HES)
Over half of household wealth is in property

Mean wealth by age of head of household
$ thousands ($2011-12)

Source: The Wealth of Generations
Increased wealth for older workers is due to more investment in property and savings

Change in mean wealth per household, 2003-04 to 2011-12
$ thousands ($2011-12)
Falling wealth for younger households was not a result of lower savings

Savings as a proportion of disposable income, per cent

Age of head of household

0% 2% 4% 6% 8% 10% 12% 14% 16%

15 to 24 25 to 34 35 to 44 45 to 54 55 to 64 65+

2003-04 2009-10
Younger cohorts missed out on the windfall of buying a house before 1997

House prices and full-time weekly earnings
Index: 1970 = 100
Changes in household wealth are primarily driven by asset values and deficits

Annual changes in household wealth
2014 $ 000

Age of head of household

Savings Other changes in wealth Inheritance & gifts Change in HECS debt

Future tax impact of annual increase in government debt

Annual changes in private wealth
2004 to 2010

2004 to 2010
2010 to 2014
Historically there have been long periods of little income growth in Australia

Real per capita incomes

$ 2010

Source: Butlin
Younger cohorts in the UK now earn less than their predecessors at the same age

Median gross annual wages in UK

Source: Belfield, C et al, Living standards, Poverty and Inequality in the UK, Institute of Fiscal Studies Report, p.10
The incomes of 24-34 year olds in the US have declined relative to older workers

The graph shows the median incomes in the US from 1947 to 2007, with two lines representing 25-34 year olds and 55-64 year olds. The incomes of 24-34 year olds have generally declined compared to older workers.

Source: Data from US Department of Commerce (2013), US Census Bureau, Historical income tables (table 8).
Wealthy people of a given age tend to receive larger inheritances

Average inheritances if one one received
2002-2012, nominal

Note: Wealth quintiles are based on relative wealth in 2002 and therefore do not include the effect of inheritances received after this time. The HILDA survey asks about payments received from inheritances. It is possible that some respondents did not include housing assets in their estimates.

Source: Grattan Analysis of HILDA (2002); (2012)
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Responsible budget repair will disproportionately affect older households with more assets

• Better targeting of age pensions, superannuation, and asset taxation dominate the options for budget repair that are both large and socially responsible
• Reforms would also create incentives for more older workers to work for longer
There are few options for budget repair that are both large and socially responsible

Budgetary impact of tough budget choices
2013$b per year

<table>
<thead>
<tr>
<th>Option</th>
<th>Collateral impact</th>
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</thead>
<tbody>
<tr>
<td>Age Pension assets test</td>
<td>$11b Positive</td>
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<tr>
<td>Negative gearing</td>
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<tr>
<td>Pharmaceutical spend</td>
<td></td>
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<td>Pension and super access</td>
<td>$24b Neutral</td>
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<tr>
<td>CGT discount</td>
<td></td>
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<td>Higher ed subsidies</td>
<td>$12b Mild negative</td>
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<tr>
<td>Defence spending</td>
<td></td>
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<tr>
<td>Cost effective medicine</td>
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<tr>
<td>Super contr concessions</td>
<td>$14b High risk in execution</td>
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<tr>
<td>Super earn concessions</td>
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<td>Fuel tax indexation</td>
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<td>Transport infra costs</td>
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<td>Industry support</td>
<td>$19b Negative</td>
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<td>School class sizes</td>
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<td>GST broaden</td>
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<tr>
<td>Health rebate</td>
<td>$40+b Very negative</td>
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<tr>
<td>Mining royalty</td>
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<td>CGT owner occ</td>
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</tr>
<tr>
<td>Payroll threshold</td>
<td></td>
</tr>
<tr>
<td>Fuel tax credit</td>
<td></td>
</tr>
<tr>
<td>Bracket creep</td>
<td></td>
</tr>
</tbody>
</table>

Source: Grattan Institute, *Balancing Budgets*
Better targeting of age pensions, super, and asset taxation dominate the attractive options

Budgetary impact of tough budget choices

2013 $b per year

- Age Pension assets test
- Negative gearing
- Pharmaceutical spend
- Pension and super access
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- Higher ed subsidies
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- Health rebate
- Mining royalty
- CGT owner occ
- Payroll threshold
- Fuel tax credit
- Bracket creep

Source: Grattan Institute, Balancing Budgets
Pages 32 – 34 have been left intentionally blank
Tax free earnings on super for over 60s mostly benefit rich old people

Income by source for those in their 60s, by income decile, $k yearly

Note: Numbers presented are the income decile averages for each income category for those aged 60-69.
Source: Grattan Institute, *Balancing Budgets: hard choices we need*
The Age Pension could be better targeted

Household net wealth for mature-aged households, $ million

Proportion of mature-aged households receiving government benefits

Benefits received by those receiving government benefits, $/wk

Source: *Balancing budgets*. Note: “mature-aged household is household where oldest occupant is over 65.”
$7 billion a year in Age Pension is paid to households with more than $750k in assets

Age pension expenditures and household wealth
2012-13, $ billion

Source: Balancing budgets
Participation of older age groups and women has trended up for over 15 years

Labour force participation rates (per cent of age cohort)

Grattan Institute, Budget Pressures on Australian governments
Until recently, increases in older age participation outweighed the ageing population.

Contribution to change in participation rate
Percentage points per year

Borland, Labour Market snapshot, December 2013: https://sites.google.com/site/borlandjum/labour-market-snapshots
Older age workforce participation is relatively low in Australia

Adjusted workforce participation rates of 55-64 year olds (%)

Lifting eligibility for Age Pension and tax-free super would increase retirement ages

Cumulative per cent of male labour force retiring by age

<table>
<thead>
<tr>
<th>Age</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>51</td>
<td>0%</td>
</tr>
<tr>
<td>53</td>
<td>0%</td>
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<td>55</td>
<td>0%</td>
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<tr>
<td>65</td>
<td>0%</td>
</tr>
<tr>
<td>67</td>
<td>0%</td>
</tr>
<tr>
<td>69</td>
<td>100%</td>
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</tbody>
</table>

Public sector “54/11”

Eligible for pension

Eligible for tax-free super

Source: Grattan analysis of ABS (2011b) cat no 6530.0
Most older people choose to leave the workforce

Per cent of people retired

Source: ABS (2013) Cat 6238 Table 6.1
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Wealth is dominated by home ownership, but younger people are struggling to buy

Composition of household wealth, 2010

Home ownership rate by age

Source: Grattan analysis of HILDA 2010

Source: Yates (2011a)
Home ownership rates have fallen fastest for young people on low incomes

Percentage point change in home ownership rates, 1981 to 2011

Source: Grattan Institute, Wealth of Generations
Questions

Budget pressures on Australian governments 2014
John Daley and Clasie McGann

November 2013

Balancing budgets
Tough choices we need
John Daley

December 2014

The wealth of generations
John Daley and Danielle Wood