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The Intergenerational Report is not about Intergenerational Equity, but about Fiscal Sustainability

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Budget Paper No. 5, now commonly known as the Intergenerational Report, has rather little to say about "intergenerational equity". Its main focus is on "fiscal sustainability", the long-term balancing of the budget. Fiscal sustainability is a good thing, however, partly because it involves "promoting fairness in distributing public resources between generations of Australians".

The Report's main claim is that sustainability and fairness are threatened by a projected trend in Commonwealth spending, which – beginning in about 15 years' time – will outgrow revenue income, if present policy settings and demographic projections hold steady. All else remaining the same, fiscal deficits will be running at 2 per cent of GDP in 2025 and at 4 per cent in 2035. The increased spending will be mainly on health and aged care and on age pensions. In short, the problem is the costs of later life, for those going into retirement around 2020.

And who are they? They are of course the Baby Boom cohorts, those born between 1945 and 1965. Their costs, it is feared, will have to be borne by their successors, those born after 1965, the members of the Baby Bust cohorts, also known as Generation X. The equity problem, then, is to find a way to make the Babyboomers bear their fair share of those costs.

What is a fair share? This question is not discussed in the Report. A simple answer is that each generation should balance its books – each should exhibit "fiscal sustainability". Thus, the Babyboom's age-related costs should be borne by the Babyboomers themselves. But, the obvious reply to this is, perhaps they have already paid for those costs in their lifetime's taxes. Perhaps they are at present in surplus, and if so, why should they not draw on that surplus in retirement?

This may be a valid reply, but how could we know? But if we can't know, how can we talk about intergenerational equity? The welfare state has never attempted to measure this sort of equity, yet it assumes the existence of a sustainable contract between the generations, each bearing its share of burdens in return for a bundle of social benefits.

In fact, lifetime balance sheets can be constructed – tentatively, of course, and with some conjecture about future taxes and spending – for successive cohorts. The results of my attempts to do this are interesting and run contrary to much popular belief. This analysis shows that we have a problem of intergenerational equity right in front of us, whether or not we will have another one in twenty years' time.

To see my point we need to go back to the founding of the welfare state after the Second World War. At that time, modern societies everywhere chose to invest heavily in the young. The result was twofold: the creation of a welfare state for young families, a 'Youth State', in which child-rearing was massively subsidised; and a massive growth in birth rates, the creation of the Baby Boom. The beneficiaries were the parents of the Baby Boom, members of what we can call the Inter-war Generation, those born between 1920 and 1940.

This was the modern welfare state's original purpose. But around 1970 it did a little-noticed about-face. The Youth State became the Elder State. Supports for children were quietly but steadily withdrawn, so that today they are about one tenth what they were per child in 1950. Expenditure on the elderly became, and remained, the dominant theme. And, after 1970, 'the elderly' just happened to be the Inter-war Generation.

Today we take the Elder State for granted. But to make this new welfare state possible, tax rates had to rise rapidly. The tax burden had to shift onto those raising children, the Baby-boomers. As a result, Baby-boom couples will pay lifetime effective income taxes about three times greater than were paid by their Inter-war counterparts. The Inter-war Generation will in

turn get age pensions worth more than the value (for some, twice the value) of their lifetime effective income taxes. Baby-boom couples will need to work at least ten years longer than their parents, just to make up the difference caused by public policy changes.

Thus we have a scenario not unlike that projected by the Intergenerational Report, with one generation imposing costs on its successor. There are differences. The Report's story is set well off in the future and is therefore somewhat conjectural, whereas my story rests on verifiable evidence. The Report's trends are driven in part by demographics, whereas mine runs counter to the demographics, since in my account a smaller Inter-war Generation imposes its costs on its much larger Baby-boom successor. Even so, if we are concerned with intergenerational equity, current inequities are a good place to start. Let's sort out them first, and worry about the next round of inequities when we get closer to the date.

There is a second set of questions to consider here, much more speculative but worth consideration. What caused the post-war Baby Boom? Why did the fertility rate plummet in the late 1960s, falling today to half its earlier peak? There are no demonstrable answers to these questions. But one obvious conjecture is that the rate followed a trajectory set by the trends in public policy. The Youth State, by deliberate subsidisation, generated lots of youth. The Elder State ramped up the price of raising children, and thereby lowered "demand". The account is crudely economistic, but at least it fits the facts in a rough and ready way. (Not many other theories do even this.)

The point is relevant to the Intergenerational Report's concern with fiscal sustainability after 2020. Today, as it points out, "the aged to working-age ratio (the proportion of people aged over 65 to people of traditional labour force age, 15 to 64) is 19 per cent. This is projected to rise to almost 41 per cent by 2042." This turnaround is largely the result of the Baby-boomer bulge entering retirement and being succeeded by steady-state Baby-bust workforce. The changing demographics of the 1960s and 1970s – the baby boom going bust – have a delayed echo fifty and sixty years later.

But if that delayed echo is at least in part a product of policy, then the Report is dealing with a problem that is partly the product of intergenerational inequities beginning in the 1960s and 1970s. When the Inter-war Generation failed to fulfil its part in the welfare state contract, it triggered long-term repercussions, some demographic, some economic. By taking much more than its fair share, it has set its two successor generations against each other, and both have a reasonable case to plead.

The Intergenerational Report in fact has little claim to that title, since nowhere does it analyse public policies in cohort terms. It therefore completely misses the existence of inequities right here and now. It is also unable to answer the question: Has the Baby-boom Generation paid its way sufficiently to be entitled to the age-related health and pensions benefits that the Report presents as problematic?

My short answer to that question is that there is no clearly right answer to it. If Baby-boomers are entitled to the same benefits as are enjoyed by their predecessors, then the answer is yes. By comparison with the Inter-war Generation, the Baby-boomers (the so-called 'me generation') have been exceedingly fair and responsible. But if the benefits enjoyed by the Inter-war Generation are unsustainable – as they so strikingly are – then to take out the same benefits, even after having paid far higher lifetime taxes, is merely to add to the debts being passed on to successors. Equitability between generations cuts, irreconcilably, in two directions.

There are those who think the idea of intergenerational equity is a red herring, since – they imagine – each generation passes on its gains, ill-gotten or not, at death to its children. So whatever goes wrong in the public policy arena will be corrected via inheritance. This is a

nice idea, but a very unconvincing one. Redistribution at death shifts resources from the very old to the middle aged, not to those who are most in need: young families with children, mortgages and relatively low incomes. It thus reinforces the inequities of the Elder State. And, more importantly, there is no guarantee that the gains will be passed on at all. It is perfectly possible that they are or will be consumed. It may well be true that 'I'm spending my children's inheritance', as the bumper sticker proclaims.

We need a system that is equitable between and sustainable for all generations. But when one generation breaks the implicit contract much else goes awry. There is one somewhat bright aspect to this gloomy story. For whatever reason, Australia has always favoured a lean and mean approach to the welfare state. This frugality has – quite unintentionally – minimised the risk of intergenerational catastrophe. The word might seem exaggerated, but it is not. Australia's problems are serious. Those of the larger, especially the European, welfare states are catastrophic.