

## Institute of Actuaries of Australia

6 March 2003

Dr Andrew Southcott MP  
Chairman  
Standing Committee on Ageing  
House of Representatives  
Parliament House  
CANBERRA ACT 2600

Dear Dr Southcott,

Inquiry into long term strategies to address the ageing of the Australian population over the next 40 years

Please find enclosed a submission from the Institute of Actuaries to the Inquiry being conducted by your Standing Committee. We were pleased to have the opportunity to meet with you in December last year to discuss a number of public policy issues related to your Inquiry. Thank you also for extending the deadline for receipt of this submission.

The Institute of Actuaries has a commitment contributing to the development of public policy in the public interest and would be interested in having further contact with your Committee as its work progresses.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Chris Lewis".

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President

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Institute of Actuaries of Australia

**Submission to the House of Representatives  
Standing Committee on Ageing**

**INQUIRY INTO LONG TERM STRATEGIES  
TO ADDRESS THE AGEING OF THE AUSTRALIAN  
POPULATION OVER THE NEXT 40 YEARS**

**February 2003**

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## Executive Summary

### Objectives

This response by the IAAust to the House of Representative's Inquiry into Ageing is intended to:

- identify the areas where principles need to be established in order to develop strategies and policies to address issues arising from the ageing of the population;
- suggest a framework which will lead to the development of practical long term strategies and solutions;
- point to areas where action may be taken in the short term to assist in the development of the long term strategies, and;
- indicate areas where members of our profession could add value in assisting the Committee.

### Suggested Framework

We suggest that principles should be developed to give a framework to identify what is required to address the needs of the ageing population. Strategies can then developed to deliver on those requirements. As discussed in the Financing the Ageing paper, the principles should be considered in the light of their impact on:

- The individual,
- The community, and
- The economy.

Areas requiring agreed principles include:

- Concepts of adequacy for provision of retirement incomes, and health and accommodation services for the aged;
- Support structures which are fair and in the best long term interests of Australian society;
- Policies and delivery systems which are financially sustainable, which provide effective outcomes, and which are economically efficient in terms of available resources

## Strategic Choices

Individual strategies for the development of Government policy will depend upon the overall strategic path chosen. In developing strategies to fulfil the agreed principles, there are various issues the Government will need to address. These include:

- Structural issues – including the degree to which the long term costs should be funded in advance or met on a “Pay-As-You-Go” basis, who should fund these costs and whether benefits should be targeted according to needs, or universal;
- High level strategic choices – including the appropriate level of self reliance by individuals and families in providing for their own ageing requirements;
- The ongoing need to maintain a healthy national economy, without which policies to support the aged are likely to fail anyway.

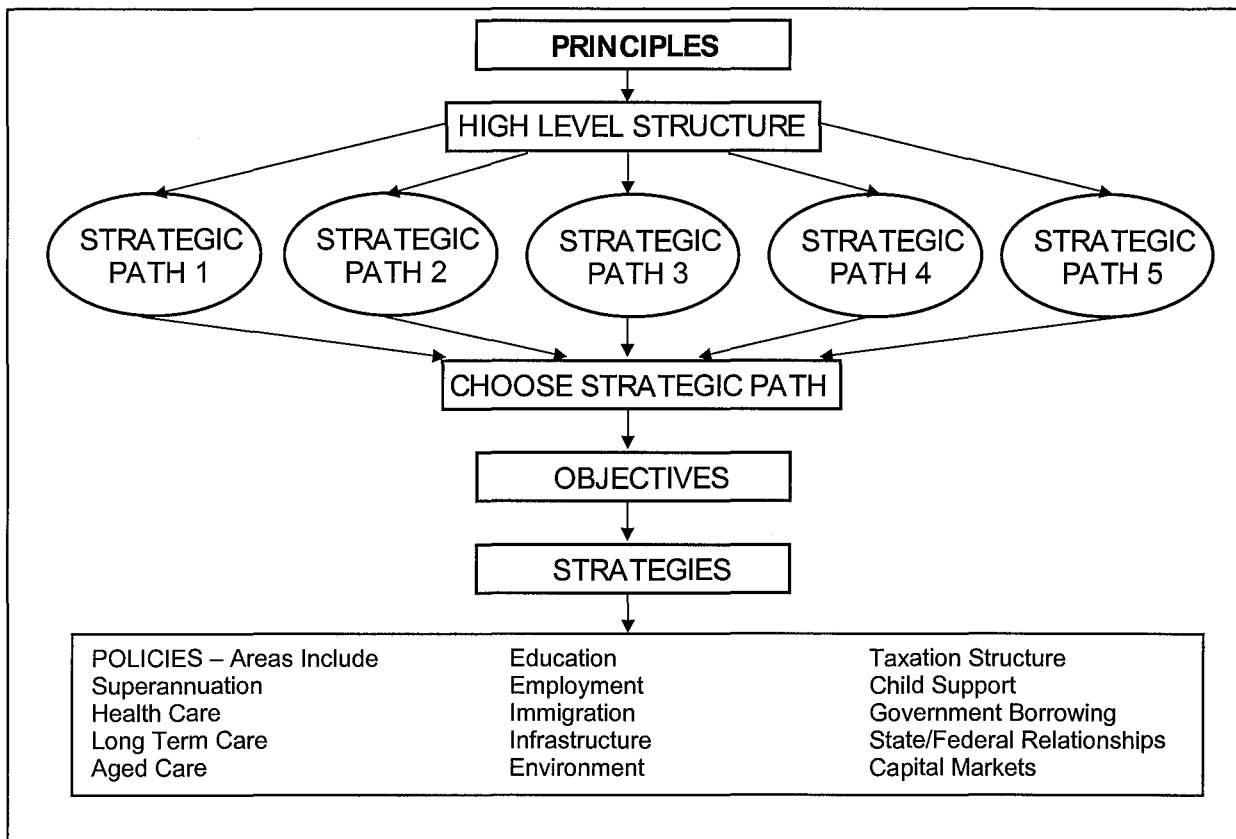
We believe that it is desirable for the Committee to articulate these issues and to make some choices about the strategic direction to deal with them. The benefit of choosing a strategy at this level is that it indicates

- a direction for future policies, and
- the degree of change required from the current situation.

It also allows a degree of comparability to be applied to the particular strategies emerging in different areas.

## Development of Strategies

The development of strategies could then follow the process illustrated in the diagram:



Each of the Strategic Paths will have strategies that are likely to impact differently on government finances.

In section 4 we discuss aspects of possible strategies, and their impact on individuals, the community and the economy.

## Policy Options

In section 5 we list some policy issues and illustrate some possible solutions to assess against the structural and strategic choices, especially in the areas of retirement income, health, aged care, and national productivity.

## Issues to be Addressed in the Short Term

In section 6 we draw attention to ways in which some issues usefully can be addressed in the short term. In addressing long term policy issues, in the context of the impact of ageing populations, it is essential to develop a 'Principles Framework' to promote informed debate and provide a useful tool for measuring the effectiveness of policies now and into the future.

## Role of the Actuarial Profession

The actuarial profession has a capacity, an obligation and an interest in contributing to public policy across a range of practice and areas of expertise. Many actuaries work in superannuation and retirement incomes, health, financial planning and related financial services fields. Members of the Institute of Actuaries of Australia (IAAust) are therefore well placed to make a valuable contribution to developing appropriate long-term policies to address the ageing of Australia's population.

Financial analysis of the impact of an ageing population is a core competency of the actuarial profession. The IAAust has been actively involved in work in this area and, in particular, we would draw the Committee's attention to the 1999 position paper entitled "Financing the Ageing – Now is the time to act".

The IAAust's expert taskforces would be prepared to undertake more detailed work for the Committee and would find it helpful to obtain access to the resources of Commonwealth Treasury's RIM Unit. There are a number of alternate scenarios that could be developed for the Committee's consideration. However, full appreciation of the advantages and disadvantages of each option can only be assessed once the complex modelling has been undertaken and analysed.

## Recommendations

The IAAust recommends that the Committee:

- Establish and publish early in its term an interim set of "Ageing Population Principles" which will underlie its recommendations on strategies.
- Ensure that these Principles be established on a bi-partisan basis, to avoid significant future policy changes circumventing the long term actions required.
- Commission financial and other modelling work to investigate alternative strategies and issues. This work should be made public in order to foster an informed debate. Specifically, we recommend that a second Intergenerational Report be commissioned for publication no later than the first year of the next Parliament and that future reports be produced every three years rather than every five years.
- Based on the Principles adopted, identify separately those long term directions that are confirmed, and the topics which remain subject to further public policy debate.

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# 1. Introduction

## 1.1 Overview

We congratulate the Government on releasing the Intergenerational Report 2002-03, and the establishment of the House of Representatives Standing Committee on Ageing. The consequences of the projected ageing of Australia's population are increasingly matters of community concern. By giving the Committee this referral the Commonwealth Government is addressing a serious long term issue for Australia's future.

## 1.2 Objectives Outlined in this Submission

The IAAust considers the impact of an ageing population to be an issue of continuing policy importance both in Australia and internationally. Moreover, major elements of such long term issues can be better managed if potential impacts and strategies to deal with them have been identified, analysed and implemented well before they reach crisis point.

This submission highlights potential strategies and policy options which the IAAust considers could beneficially address issues emerging with the ageing of the population.

The IAAust has itself carried out work on the financial impact of Australia's projected demographic changes. This work was best summarised in a paper "Financing the Ageing" published by the Institute in 1999. In this response to the Committee we have drawn on some of the research and conclusions from that paper.

We have also made recent submissions to the Treasurer (in response to the release of the Intergenerational Report) and to the Senate Select Committee on Superannuation (in response to their recent Public Inquiry). Appendix 1 contains abstracts of these responses.

Our objectives in making this submission are:

- To identify the areas where principles need to be established in order to develop strategies and policies to address issues arising from the ageing of the population (section 3);
- To suggest a framework which will lead to practical long term strategies and solutions (sections 4 and 5);
- To point to areas where action may be taken in the short term to assist in the development of long term strategies (section 6);
- To indicate areas where members of our profession could add value in assisting the Committee.

Issues arising from the ageing of the population are an area of core competence for the actuarial profession. We would welcome the opportunity to develop the ideas expressed in this submission further, working with the Committee and other Government and non-government experts in relevant fields.



## 2. Principles

The Committee's terms of reference are to enquire into and report on strategies to address the ageing of the Australian population over the next 40 years. We suggest that the Committee identify the principles to be recognised in setting objectives and developing strategies. The strategies can then be developed to achieve these principles.

In this section we outline our view of principles ("Ageing Population Principles") which could be adopted, and discuss them in the context of various assessment criteria. These criteria are taken from the IAAust's "Financing the Ageing" (1999) paper.

### 2.1 Long Term View

The issues created by population ageing are long term, as highlighted by the Intergenerational Report.

As such, these issues require long term solutions.

We note that Government policies have the power to significantly affect economic and societal outcomes over these long periods. Examples of this from Australia's past are:

- the post-WW2 immigration policies which played a substantial part in Australia's economic and cultural growth during the period 1960-2000; and
- the gradual introduction of "compulsory" superannuation during the 1980s and early 1990s, which years later is expected to lead to substantial improvement in funding for retirement.

### 2.2 "Adequacy" for Individuals and Families

Underpinning the strategies for an ageing population will be a communally accepted notion of "adequacy" for the living standards of the aged in the context of those of the population as a whole.

The "Financing the Ageing" (1999) paper suggested that "the availability of a minimum level of benefits for all aged persons, determined in the context of the economic, social and political conditions, can be considered a requirement within a civilised society. This minimum should not be subject to uncertainty or significant change".

Sustainability of the level of adequacy across generations is an objective for the community, and was one of the reasons for the production of the Intergenerational Report.

We suggest that articulation and endorsement of this "adequacy" level is a task for the Committee. The Senate Select Committee on Superannuation has recently addressed the issue of Standards of Living in Retirement, and the Intergenerational Report highlighted the costs of the community's current expectations.

The IAAust submission on superannuation and standards of living in retirement (June 2002) noted “A 9% [Superannuation Guarantee] SG contribution *alone*, even over a lengthy career, will *not* provide most people with an income in retirement that will meet their expectations”.

We would add that “adequacy” of benefits for the aged should also include provision of a basic minimum level of health, long term and aged care, including immediate treatment of serious conditions.

One of the difficulties of determining adequacy is the wide variation in circumstances of individuals. The Age Pension was established a century ago with a broadly homogenous retirement structure. Males were expected to retire at 65 and females at 60. The majority of retirees came from single income families. Life expectancy at retirement was short. Accordingly, a simple structure could be designed.

There are a number of factors which complicate any analysis of adequacy, including:

- The need to focus on after tax income, rather than gross income;
- The need to recognise changes in expenditure requirements from those before, to those after retirement;
- Variations in family circumstances, including same sex couples;
- Flexible retirement ages between 55 and 70 (soon to be extended to 75);
- Different rules for some sectors of the community (blind people are treated differently to other disabled lives; people receiving benefits from Dept of Veterans Affairs can access them five years before other age pensioners);
- Exclusion of the family home from social security tests means that we have significant numbers of dependent retirees who are income poor but asset rich, but could use their family home to generate income – for example, by purchasing a reverse mortgage;
- Varying ability of those requiring residential aged care to assist in funding – home owners with no partner remaining at home, home owners with a partner remaining at home, non home owners;
- Poor integration of social security and superannuation means that a part or full pension is paid to many wealthier retirees – particularly if they have access to good financial planning advice;
- Poor taxation policy for superannuation actually discourages the efforts of older workers to become self-sufficient in retirement.

The variations described above make it difficult to set an appropriate global level of adequacy. In turn, meaningful discussion around the subject of targeting of retirement benefits requires some agreement around the general level of adequacy. Clearly, significant work needs to be done in this area to address the many complex issues.

## 2.3 Community Balance

The ageing population leads to significant shifts in the demographic composition of different segments of the population:

- Older v younger
- Working v retired
- Tax-paying v non- or low-taxpaying

The size of these shifts is significant enough to alter the fiscal balance in areas where currently a social consensus exists.

Implications for government policy include:

- the need to ensure that the treatment of each age group of the population is perceived as “fair” both
  - inter-generationally (ie over their lifetime), and
  - intra-generationally (ie treatment of individuals within that generation);
- the realisation that the issues are not only “financial” but also have a “social” aspect; and
- the need to maintain the social and political cohesiveness of Australian society.

In late 2000, the IAAust facilitated an agreed Framework Principles for the Australian Retirement Incomes System developed by a range of industry groups which provide a useful overview of high level policy objectives (Appendix 3).

Any proposed principles need to be assessed against agreed criteria. The “Financing the Ageing” (1999) paper discussed suitable criteria. Criteria relevant to personal and community consideration are:

- “Confidence” – The policies must provide Australians with a secure confidence that, in all likely circumstances, the expected benefits will be available and provided when needed, in a manner that is consistent with the expectations of all concerned.
- “Transparency” – The policies adopted should be simple and easy to understand which will encourage participation and long term sustainability.
- “Fairness” – The availability of a minimum level of benefits for all aged persons, determined in the context of the economic, social and political conditions, can be considered a requirement within a civilised society. This minimum level should not be subject to uncertainty or significant change. Intergenerational equity is also an important characteristic of a fair system over the long term.
- “Political neutrality and acceptability” – The policies should be acceptable to mainstream Australia and not be subject to regular changes. In addition any transitional arrangements should be acceptable to all major political parties.

- “Independence” – Whether and how far policies should provide an environment where those who are able, are encouraged to be self-reliant and to use their personal resources for the maximum benefit;
- “Provision of family support” – The extent to which policies should recognise and encourage the provision of family and community support;
- “Encouragement of active ageing” – There are widely held views that policies should encourage active ageing so that older Australians are able to maintain their dignity, participate in the labour market as appropriate, maintain responsibility for their financial affairs; while recognising that for some there will come a time when this is not possible, at which stage certainty of provision of appropriate benefits is important. In relation to this point, we note that current Age Pension eligibility rules effectively force most people to either work full time or retire. Not even a part pension is payable to a person of Age Pension age working part time for more than 10 hours per week.

The financial and social consequences of possible changes in the balances within the community are wide ranging. It will be important to identify the full range of factors, influences and consequences in order to provide input to modelling the effects of possible policies addressing the ageing of the population.

## 2.4 Economic Effectiveness and Efficiency

The chosen strategies and policy options will need to be:

- Effective – Policies should achieve what they are meant to, and without unintended side effects;
- Efficient – Policies should make best use of the economic and other resources available to the nation.

Our “Financing the Ageing” (1999) paper suggested that the following six criteria can be used to assess effectiveness and efficiency:

- “Financial sustainability” – over the longer term without the need for additional significant reforms;
- “Efficient use of resources” – (both capital and physical) within the whole economy;
- “Economic growth” – avoiding policies that have a negative effect on growth;
- “Impact on financial capital markets” – avoiding policies which impede efficient operation of markets, cause major short term changes in asset values, or adversely affect market liquidity;
- “Efficient use of human capital” – encouraging employment at older ages, including voluntary employment; while enabling lifestyle choices by older people which are consistent with the views and priorities of Australian society;
- “Incentives for personal behaviour” – policies ought to avoid poverty traps, high marginal tax rates, or any other encouragement to counterproductive behaviours in those affected.

### 3. Implications for Government Financial Policies

The overall health of the Australian economy will inevitably be a factor in the determination of many of the outcomes in policies developed to deal with the ageing of the population. Strategies must therefore be consistent with the broader issues of managing the health of the economy generally.

In this section we discuss those aspects of strategies dealing with the ageing of the population which are likely to have financial consequences for the government.

These aspects include fundamental structural choices which face any government seeking to manage the financial consequences of an ageing population. While they relate mainly to the provision and funding of the cost of living for the aged, they can also be applied more generally in some areas such as infrastructure, transport, etc. These are not “either/or” choices; instead they give rise to a spectrum of possibilities. These are analysed at length in section 3 of “Financing the Ageing” (1999), and are summarised here for the convenience of the Committee.

We note that government financial reports are increasingly moving to an “accruals” approach with an associated balance sheet, and away from a purely cash basis. This trend improves transparency and proper accounting of the change in liabilities. It will help in managing the implementation of the choices discussed in this section.

#### 3.1 Funding or Pay-As-You-Go (“PAYG”)

##### *Advantages and disadvantages*

A PAYG system relies on outgo (benefits and costs) being supported by income (contributions and taxes) over relatively short time periods. The success of a PAYG system depends on the continuing viability of this balance. An ageing population provides one example where the balance is disturbed; benefits and costs will tend to grow, while contributions and taxes will tend to decrease.

Examples of the key advantages and disadvantages of a PAYG system are:

##### Advantages

- simpler to understand
- provides tax neutrality between generations if the population mix is reasonably stable
- cheaper to administer
- costs can be lower in the early years
- the lack of prescribed “individual contracts” (funded accounts owned by individuals such as occurs with SG superannuation) gives greater flexibility to governments

##### Disadvantages

- inequity between generations when the population mix changes
- threat of political interference
- short term focus, perhaps to the exclusion of long term financial impacts

An Advance Funding system involves the setting aside and consequent investment of funds, in advance of the expected costs. Examples of the advantages and disadvantages of this approach are:

#### Advantages

- long term cost is lower in most circumstances (provided there is a real return on investments)
- more neutral equity between generations
- awareness of the real long term cost
- strong impetus for capital accumulation and efficiency in capital markets
- presence of individual contracts creates greater individual responsibility / understanding

#### Disadvantages

- existence of "individual contracts" reduces government flexibility
- funded benefits must be integrated with any government safety-net benefits
- there are some risks associated with funding:
  - failure to achieve positive real investment returns
  - misallocation of investment funds
  - poor investment decisions
  - fraud
  - potential for future changes to be made which do not reflect the original rationale.

#### ***Particular health and aged care issues***

The advance funding of future health and aged care costs, in particular, raises further issues. Allocating contributions to individual accounts is inefficient in terms of meeting targeted needs, as benefits go to those with the capacity to pay for them, rather than those who need them. Accordingly there needs to be a balance between contributions related to capacity to pay, and distributions which have little relationship to who contributed and how much they paid.

#### ***Implications for capital markets***

Under PAYG on the present population structure the Government receives less contributions and taxes in the early years than if advance funding arrangements were in place. There is thus a background tendency for upward pressure on government borrowing, and hence on interest rates. Under funded schemes the additional contributions are invested and create a background upward pressure on asset values, hence lowering interest rates. These dynamics operate in both fixed interest and equity markets.

#### ***What is the appropriate balance?***

A way to assess the appropriate balance is to consider the Government's "Balance Sheet" over a period of years or decades, asking:

- what is the value of unfunded liabilities (now and in the future)?
- what is the value of the future revenue base (now and in the future)?
- are these mutually supportive?
- to what extent can they be changed?

## 3.2 Targeted or Universal Benefits

**Targeted benefits** – available to those most in need, and usually imply some form of means testing

**Universal benefits** – available to all, and implies no means testing

The issue for the Committee raised in this section is the question of whether the age pension, the provision of health services, and long term and aged care should be provided by the Government in the same manner to all aged Australians, or should some or all of these services be targeted to those in greatest need. We describe this as choice along a spectrum ranging from completely targeted to completely universal benefits.

### **Advantages and disadvantages**

Targeted benefits – advantages

- can provide a higher level of benefit for those in need
- encourages an attitude of self-provision within the higher-paid community
- lower government costs and taxation

Targeted benefits – disadvantages

- disincentives for part-time post retirement work or for pre-retirement saving among the lower-paid community
- growth of a “means test avoidance” industry

Universal benefits – advantages

- encourages higher participation in the labour force
- encourages a higher stock of national savings
- stable and known base of government benefits for individuals and society
- reduced administration costs

Universal benefits – disadvantages

- larger government expenditure, higher taxes
- increased costs when the proportion of aged people rises

### **What is the appropriate balance?**

The choice between targeted and universal benefits depends on the social, economic, and political position of the country. It is inevitable that the answers will change over time, even within one society. However it is equally important to recognise that the answers chosen will have long term social and economic effects.

We suggest that the early establishment of the appropriate principles as discussed in section 3 is especially important in future management of this balance.

### **3.3 Voluntary or Compulsory**

Another fundamental structural issue for decision is whether participation in any scheme should be mandatory or optional.

In principle there are strong links between the structural issues outlined in this section. For example, mandatory schemes such as the Superannuation Guarantee Contributions usually involve strong public financing support with universal benefits. Otherwise Governments often prefer schemes that incorporate rewards for voluntary participation over enforced membership. The current health insurance arrangements provide an example.

### **3.4 Public or Private Funding**

A very basic design question is that of who is providing any funding. While governments can increase taxes to cover any funding commitments, there are practical and political limitations on the availability of public funds. Closely linked considerations are those of Voluntary versus Compulsory arrangements, and PAYG versus Funded schemes, both discussed earlier in this section. For example, both Compulsory and PAYG systems require a degree of government funding or support as in reality they are difficult to justify in a purely privately-financed environment.

### **3.5 Structural Options**

In our paper "Financing the Ageing" we suggest that the structure of the funding and provision of benefits over the longer term for retirement income, health and aged care, can be broadly grouped into three tiers.

The first tier is funded by the public sector, provides a base level of benefits, is redistributive or targeted, and pay-as-you-go. Key questions with no single answer are "How much?", and "To whom". Should this be a "safety net" for a minority, or benefit for the majority?

The second tier is normally strongly supported by Government and in some cases this means mandatory involvement for those in employment. This tier would normally be funded, with personally identifiable prospective benefits. Key questions, again with no single answer, are "How well integrated with tier 1?", and "What levels of benefit?".

The third tier is a voluntary arrangement where individuals choose to fund their future needs. In some cases there may be limited taxation support or government encouragement for such behaviour. However there would normally be a financial limit placed on any such support. In a free society this tier will always exist, and in fact the only key question is the degree of government support.

The current retirement incomes structure broadly follows this model. However, in the light of the prospective Budget deficits forecast in the Intergenerational Report, the questions raised in the "Financing the Ageing" (1999) paper and outlined above need to be revisited.



### 3.6 Strategic Choices

Combining the chosen Principles with the structural options will require some high level, unifying "strategic paths" to be identified. In section 1.4 we suggested a possible framework for the development of strategies to address the relevant issues. This framework allowed for the consideration of various strategic paths and we now turn our attention to the consideration of some of the available paths.

For the overall area of provision of benefits the range of "strategic paths" that could be followed, broadly falls into 3 classes:

- (i) Requiring More Self Reliance
- (ii) Encouraging More Self Reliance
- (iii) Providing More Reliance on Government.

The benefit of choosing a strategy at this level is that it implies:

- a direction for future policies, and
- the degree of change required from the current situation.

It also allows a degree of comparability to be applied to the particular strategies emerging in different areas. For example, a set of policies:

- which require more individual provision for retirement, and
- simultaneously provide more reliance on government for health

may well be appropriate for the circumstances, but should not be chosen without at least the contrast between the two being examined.

The spectrum of individual strategies to achieve the overall principles can then be identified. An example of different strategic paths, based partly from this framework, is illustrated by examples in the table below:

<b>Strategic Paths and potential policy options or strategies</b>			
<b>Topic</b>	<b>Require more self reliance</b>	<b>Encourage more self reliance</b>	<b>Provide more reliance on government</b>
Health	<ul style="list-style-type: none"> <li>• Reduce subsidies for health care costs</li> </ul>	<ul style="list-style-type: none"> <li>• Increased flexibility for Private Health Insurance</li> <li>• Increase scope for co-payments</li> </ul>	<ul style="list-style-type: none"> <li>• Increase Medicare levy</li> </ul>
Retirement Incomes	<ul style="list-style-type: none"> <li>• Eliminate concept of retirement, and replace it with a focus on inability to work as the basis for any social security benefit entitlements</li> </ul>	<ul style="list-style-type: none"> <li>• Tax concessions for Superannuation</li> <li>• Move to Age Pension as "safety net" only</li> </ul>	<ul style="list-style-type: none"> <li>• Introduce Social Security contributions;</li> <li>• Provide non means tested social security benefits</li> </ul>
General	<ul style="list-style-type: none"> <li>• Include family home and complying income streams in Means Tests</li> </ul>	<ul style="list-style-type: none"> <li>• Tax concessions for all saving</li> <li>• Higher taxes on dis-saving and expenditure</li> <li>• Remove / reduce current incentives to retire early</li> </ul>	<ul style="list-style-type: none"> <li>• Scrap superannuation tax concessions</li> </ul>

## 4. Areas Requiring Long Term Strategies

### 4.1 Establishing an Agenda

In August 2002, the IAAust submitted to the Federal Treasurer a set of comments on the Intergenerational Report and the issues it raises. Arising from our work on that submission we have identified a list of policy areas affected by the ageing of the population over the next 40 years, together with examples of the kinds of strategies that might be investigated.

We recommends that the Committee's agenda include exploration of each of these issues in order to produce a balanced set of strategies.

### 4.2 Superannuation

- Redefine the pension age to allow for changes in longevity, work practices and the needs of the community.
- Ensure that the combined benefits from the compulsory and voluntary elements of the superannuation system are such that the majority of those now entering the workforce under age 25 will retire independent of the age pension and those now in the workforce maximise their independence from the age pension.
- Require the majority of superannuation benefits to be payable as income streams.
- Adjust the means testing of social security benefits to encourage people to continue in paid employment, on a full-time or part-time basis.
- Target the full age pension to a limited target proportion of the population, say 25% of those reaching Age Pension age.

An example of the long term nature of the problems and solutions is illustrated by the different forms of indexation of social security benefits. Some are CPI-related (for example, unemployment benefits), whereas others are linked to wages (for example, Age pensions). In the short term, a continuation of the current CPI linkage is workable; but in the longer term, an increasing gap between CPI-adjusted benefits and average wage or GDP-related incomes, is likely to prove unsustainable.

The Financing the Ageing paper puts forward two options designed to achieve at least some of the aims outlined above. These options are noted below, but are discussed more fully in that paper. Appendix 2 gives a summary of how these options meet the various assessment criteria. The options are:

- Remove the means test on the age pension, and replace it with an income tax surcharge on aged pensioners, at higher income levels. Also increase the tax on larger superannuation benefits, to encourage benefits to be taken as income.

- Introduce a means test at a single point in time. This would have an automatic link to superannuation benefits, to ensure integration of the age pension and superannuation. There would be some right of review at a later time in case of hardship.

### 4.3 Health Care

- Establish a definition of an agreed basic level of health care, and immediate treatment of serious conditions for all
- Support the implementation of an agreed basic level of health care and ensure sufficient Government funding to meet this need.
- Reduce the existing constraints on Private Health Insurance product design and pricing, to permit more innovative products.
- Increase the range and amounts of co-payments for both health products and medical and hospital treatment for non-life threatening ailments.
- Facilitate the development of resource allocation and assessment mechanisms to ensure equitable distribution of funding for health services and to remove the current discontinuities in the health funding system.

The Financing the Ageing paper also puts forward two options to address perceived weaknesses in the health care area. These are noted below, with full discussion in the original paper. A summary of how these options meet the assessment criteria is set out in Appendix 2. The options are:

- Establishing individual medical savings accounts, backed up with catastrophe insurance.
- Moving to funded lifetime community rated health insurance, to supplement Medicare.

Actuaries were instrumental in providing advice to Government regarding the introduction of funded lifetime community rated health insurance.

### 4.4 Long Term Care

- Establish a definition for an agreed basic level of long term care and provide sufficient Government funding to ensure this level of care for people with long term disabilities.
- Provide sufficient Government funding for research into possible improvements in services and/or facilities, for those requiring long term care.
- Facilitate the development of assessment mechanisms to ensure equitable distribution of funding for long term care services.
- Partner with accident compensation authorities and insurers to develop more comprehensive long term care funding models.

- Reduce existing constraints on Private Health Insurance product design and pricing to permit more innovative products to capture private funding for long term care.

## 4.5 Aged Care

- Adjust the entry to Government-supported residential aged care so that it is both means tested and needs tested.
- Revise the minimum standards of care and lifestyle programmes in residential aged care, and the level of required supervision .
- Ensure that the vast majority of those requiring residential aged care are able to obtain it within a reasonable distance of their home.
- Encourage the pre-funding of residential aged care with tax relief– possibly through the use of superannuation related products or through the relaxation of Private Health Insurance product design constraints.
- Facilitate the development of resource allocation and assessment mechanism to ensure equitable distribution of funding for aged care services.

Again we refer to the Financing the Ageing paper for two options to address aged care issues. These are noted below with discussion in the original paper, and assessment criteria rating in Appendix 2:

- A Government run and pre-funded scheme.
- A privately run, pre-funded scheme to give an 'opting out' alternative to the Government scheme.

## 4.6 Immigration

- Consider the development of a suitable long-term immigration policy, taking into account its effect on the demography and the outcomes associated with the population ageing .
- Examine the extent to which the immigration policy should have the support of the States and the community generally.
- Examine any relevant lessons from Australia's post-war immigration policies, specifically the degree to which these demonstrate that control or substantial influence over demographic outcomes has been achieved in the past

## 4.7 Child Support

- Consider the level of provision of, and subsidy for, preschool child care and kindergarten places, having regard to the needs of parents, employers, the children and the community generally.

- Examine the possible effects on the fertility rate from the provision of additional child support. Alternative ways of providing this should also be considered – e.g. child allowance, tax relief for costs, baby bonuses.

## 4.8 Employment and Education Policies

- Continue to recognise the positive social and economic benefits of minimising unemployment.
- The balance between policies to minimise unemployment and policies to minimise labour shortage will change over the projection period. The Government could consider bringing forward the timing of essential public works as a means to reduce short term unemployment and ease long term labour shortages. In some cases, the tax revenue generated and social security costs saved (including the value of fringe benefits) could come close to the additional wage and other outlays.
- To maintain the required skills in the community, there must be continual review on how education media, methods and processes will satisfy future needs of employers.
- The potential impact from immigration and child support policies need to be taken into account in establishing Government employment policy.
- Immediate growth in GDP may be achieved by encouraging more over-55 year olds to continue working. Such encouragement could include:
  - (1) extending the minimum age for access to private pension benefits,
  - (2) reviewing public service and private sector recruitment policies in relation to this age group

## 4.9 Treatment of the Home

This is a sensitive and important issue. There are strong arguments to allow any means testing to exclude the family home. But this often fails the 'efficient use of assets' criteria. There are many anecdotes of people in receipt of the full age pension, while living in a multi-million dollar home.

Questions that arise are:

- Should other taxpayers be expected to support such asset rich members of the community?
- Should people be expected to move out of the family home and neighbourhood they have lived in for most of their lives?
- Should people be able to draw the age pension at the expense of taxpayers, while eventually passing on very valuable assets to their children?

Perhaps a reasonable approach might address the issue by:

- Encouraging a reverse mortgage industry,
- Assuming a level of income consistent with a reverse mortgage in the means test, and
- Capping the value of the family home to a reasonable level for social security payments.

## **4.10 Infrastructure and Environment**

Consider the effect on infrastructure needs and the environment of:

- Demographic change, and
- Immigration policy.

Australia is facing some major issues in terms of the long term provision of community infrastructure. Much of the focus on these issues tends to be at the State level, with little recognition of the extent of infrastructure that is delivered by local government and the subsequent funding levels. There is also a tendency to focus on current service provision rather than on funding of capital, for both new works and for depreciation of assets.

## **4.11 Taxation Base And Structure**

- A suitable balance between sources of taxation needs to be maintained, having regard to fairness and ease of collection. This particularly applies to taxation of income which is currently progressive, and the taxation of expenditure which is not substantially progressive. The effect of demographic changes on this balance needs to be investigated, and the outcomes managed.
- The Australian tax structure should have regard to other structures internationally, and current and potential double taxation agreements, to avoid loss of business investment and highly productive individuals.

## **4.12 Government Borrowing**

- Currently, "budget surpluses" are the focus of all levels of Government. In determining future strategy, it may be worthwhile considering the use of borrowing to fund some capital expenditure.
- Outstanding Commonwealth Government debt is forecast to fall below \$50b within a short period. Market participants have suggested that this may undermine the current highly liquid market. This could have undesirable consequences to the extent that the Commonwealth Bonds provide a significant yardstick in maintaining a robust corporate lending market.

- Superannuation Funds are forecast to continue to grow rapidly. Consideration needs to be given to the possible impact of a limited Commonwealth Bond market on Trustees' desired investment strategies.
- The potential for further privatisation of Government businesses will also impact the forecast Government debt position.
- Another form of government debt is the Unfunded Liabilities of public sector superannuation schemes and the commitment to pay age pensions to retirees.

#### **4.13 State And Federal Relationships**

- As the main tax collector, the Federal Government is continually reviewing ways to allocate money to the States, which are committed to providing a large range of services.
- Decisions on Federal funding for State public works programmes need to take into account offsetting benefits to the Commonwealth Government in terms of Social Security costs saved and tax revenue generated.
- Financial modelling done for the InterGenerational Report could be extended to include the impact of State Government policy changes, and the funding of these policies.

#### **4.14 Other**

- Capital markets and financial instruments or products are the means by which consumption is deferred to a future time. The extent to which these are affected by ageing population policies should be established.
- Australia exists in an increasingly globally organised world. Over the next 40 years it is unlikely that ageing population strategies will be fully optimal if they are developed in isolation from our near neighbours or indeed the rest of the world. For example, shortages of labour in one economy may be balanced by shortages of capital in another.

#### **4.15 General Comment**

We reiterate that, while we recommend addressing the listed issues, the suggestions made under each topic are illustrations only, and are designed to highlight some possible issues or directions for the future work of the Committee. The IAAust would welcome ongoing discussions on any of these matters with the Committee.

A balanced set of policies and strategies must deal with all of these areas to some degree. However the first five - Superannuation, Health Care, Long Term Care, Aged Care, and Immigration - should be given more attention than the others because they have the potential to create the most significant impact.



## 5. Short Term Issues

While we have suggested consistently that this is a long term issue requiring long term solutions, nevertheless those solutions will contain both short- and medium- term elements. A specific question is "Which matters can most usefully be progressed before the next election?". In our view these include:

- generating **informed** non-party-political debate on the issues raised by the ageing population (including commissioning and publishing financial and demographic modelling of the issues)
- identifying broad, high level potential frameworks and establishing principles for dealing with these issues
- as a specific and important part of the framework, searching for the key measures and indices which can be used to test all policy proposals against the end objective of managing the impacts of demographic change
- continually identifying anomalous areas where current practice runs counter to the principles established by the Committee for addressing the issues arising from the Ageing of the population.

## 6. Recommendations

We have suggested in this response a variety of issues, approaches, and options for the consideration of the Committee. Against this background we make four specific recommendations:

- The Committee establish and publish early in its task an interim set of Ageing Population Principles which will underlie its recommendations on strategies.
- These Principles be established on a bi-partisan basis, to avoid significant policy changes circumventing the long term actions required
- The Committee commission financial and other modelling work to investigate alternative strategies and issues. This work should be made public in order to foster an informed debate. Specifically, we recommend that a second Intergenerational Report be commissioned for publication no later than the first year of the next Parliament and that future reports be produced every three years rather than every five years.
- Based on the bipartisan principles adopted, the Committee identify separately those long term directions that are confirmed, and the topics which remain subject to further public policy debate

During the course of the House of Representatives Standing Committee's Inquiry into Ageing, the IAAust would be pleased to make further submissions and to undertake specific research work. As outlined above, our recommendation would be for the Inquiry to focus its initial activities on these four main areas.

For further information regarding this submission please contact Catherine Beall, Chief Executive on tel: 02- 9239 6106 and email: [catherine.beall@actuaries.asn.au](mailto:catherine.beall@actuaries.asn.au).

## **Appendix 1 – Previous IAAust Submissions and Papers**

In addition to regular professional papers written by our members, the Institute has prepared numerous presentations and submissions on issues relevant to the ageing population.

A list of documents follows along with abstracts for some of the more relevant submissions.

**2002:**

### **Comments On The Intergenerational Report 2002-03 (2002-03 Budget Paper No. 5)**

The paper comments on the Intergenerational Report which was issued for the first time with the 2002-03 Federal Budget. The paper reviews some key assumptions used for preparing the long-term projection results quoted in the Intergenerational Report and suggests how further modelling work around these would broaden the range of policy options available to Governments.

### **Submission to the Senate Select Committee on Superannuation & Financial Services - Superannuation and Standards of Living in Retirement**

The submission proposes a number of short and long term objectives suitable for incorporation into a national strategy for retirement incomes. Such objectives include independence and self-sufficiency on retirement, a restriction on superannuation taxes to a percentage of GDP and streamlined integration of superannuation and social security.

### **Submission to Treasury Superannuation Working Group re Options for Improving the Safety of Superannuation**

The submission notes that the current Australian prudential regime for superannuation is reasonably robust, as demonstrated by the relatively small number of superannuation fund failures in the history of the industry. However comments are provided on aspects of the prudential regulation of superannuation that could be improved.

**2001:**

### **Submission to Productivity Commission in Response to Draft Report on Superannuation**

The Role of Actuaries in Superannuation - IAAust submission to the Review of Certain Superannuation Legislation Productivity Commission's Inquiry into the Review of Superannuation Industry (Supervision) Act 1993 and Certain Other Superannuation Legislation

**2000:**

**Framework Principles for the Australian Retirement Incomes System**

The document proposed a set of principles to apply for the provision of retirement incomes for Australians.

**Submission to the Minister for Aged Care re National Strategy for an Ageing Australia**

The submission argues for a long term superannuation and health funding strategy to provide certainty to Australians and encourage participation. A number of recommendations are made in this submission which deal with superannuation and health care issues.

**1999:**

**IAAust Discussion Paper: Age Discrimination and Superannuation Funds**

**"Financing the Ageing" - Now is the time to act (A Position Paper)**

The future cost strains of the ageing population on Government budgets is estimated and shown as a percentage of GPD. A set of test criteria is determined for assessing current and proposed policy options. Various funding proposals for retirement incomes, health care and aged care are considered and tested against the criteria.

**"Financing the Ageing" - Now is the time to act (A Discussion Paper)**

The preliminary discussion paper used to generate debate within the IAAust prior to preparing the above Position paper.

## Appendix 2 – Example Strategies – IAAust Assessment Criteria

The following tables give an assessment of example strategies and current arrangements, in the three key areas of retirement incomes, health care and aged care, against the nominated assessment criteria.

### Retirement Incomes

Assessment criteria	Current arrangements	Replace means test with tax surcharge	Single point means test, with right of review
Financial sustainability	Some growth in means tested age pension expenditure over time; poor integration	Higher age pension expenditure offset by higher taxation; no integration needed	Age pension expenditure is unlikely to change significantly; direct integration
Efficient use of resources	Significantly effected by high effective marginal tax rates	Improved	Improved
Economic growth	Current policies have a negative impact on investment and labor market decisions	Some improvement although tax surcharge has some similar effects	Greater improvement
Impact on capital markets	No change	Some improvements	Some positive effects
Encouragement of active ageing	Limited	Some improvements	Greater improvement
Independence	Poor	Improved	Improved
Incentives for personal behaviour	No change	Improved	Improved
Efficient use of human capital	Poor	Improved	Improved
Provision of family support	OK	No change	No change
Confidence	Poor	Uncertain	Improved
Transparency	Very poor	Good	Improved
Fairness	Acceptable	Acceptable	Acceptable
Political acceptability	Not applicable	Needs careful presentation	Possible

## Health Care

<b>Assessment criteria</b>	<b>Current arrangements</b>	<b>Medical savings account, with catastrophe insurance</b>	<b>Funded lifetime community rated health insurance, with Medicare</b>
Financial sustainability	Unsustainable in current form	Sustainable depending on the level of support and preservation	Sustainable depending on the level of support given
Efficient use of resources	Inefficient	Improved	Improved
Economic growth	Likely to reduce growth due to declining savings	Improved	Improved
Impact on capital markets	Requires greater level of debt insurance by Government	Improved	Improved
Encouragement of active ageing	Good support	Good support	Good support
Independence	Lack of disclosure	No change?	No change?
Incentives for personal behaviour	Negative	Positive	Positive
Efficient use of human capital	Good support	Good support	Good support
Provision of family support	Neutral	Neutral	Neutral
Confidence	Strong	No change	No change
Transparency	Opaque	Improved	Improved
Fairness	Reasonable	Improved	Improved
Political acceptability	Supported	Possible	Possible

## Aged Care

<b>Assessment criteria</b>	<b>Current arrangements</b>	<b>Government run and pre-funded</b>	<b>Private pre-funding (Opt-out option)</b>
Financial sustainability	Open to doubt	Improved	Improved
Efficient use of resources	N/a	Increased by use of real rates of return	Improved
Economic growth	N/a	Some improvements	Some improvements
Impact on capital markets	No change	Improved	Improved
Encouragement of active ageing	N/a	N/a	Some positive effects
Independence	N/a	N/a	Improved
Incentives for personal behaviour	No change	No change	Improved
Efficient use of human capital	N/a	N/a	N/a
Provision of family support	Improvements possible	Improvements possible	Possible
Confidence	Limited	Enhanced	Enhanced, but only for those able to pay
Transparency	All systems are capable of being made transparent		
Fairness	Poor	Improved	Uncertain
Political acceptability	N/a	Possible	Acceptable

## **Appendix 3 – Framework for Australian Retirement Incomes**

### **Framework Principles for the Australian Retirement Incomes System**

It is recognised that providing financial security for older Australians encompasses a range of important issues including housing, health, retirement incomes and aged care.

This document concentrates on the principles that apply to the provision of retirement incomes for Australians.

It is agreed that the following principles can be used to benchmark any policies or initiatives.

#### **That the overall framework:**

Adopts an integrated long-term approach to ensuring adequate and sustainable retirement income for all Australians

Encourages an overall increase in national savings to enable sustainable economic growth and an internationally competitive economy

Encourages a savings culture within the community through education and relevant fiscal and legal structures

Provides an environment where those who are able, are encouraged to be self-reliant

Recognises that considerable changes are occurring in labour markets, family structures and personal desires and so establishes a framework to maximise coverage, participation and saving for retirement on an equitable basis

Is simple to understand

Has an efficient and effective regulatory structure

Has the confidence of the Australian community and support from all major political parties

#### **That the overall framework for the provision of retirement income:**

Maintains the diversified sources of funding for retirement as reflected in the three pillar structure for retirement incomes of a means tested age pension, compulsory superannuation (the SGC) and voluntary superannuation/savings

Encourages coherent integration between these three pillars

Encourages the provision of retirement benefits, primarily in the form of income streams

Is equitable between individuals, across lifetimes and between generations

Recognises the importance of disclosure for consumers and a robust consumer protection regime, together with consumer education



## **That in respect of each pillar**

### **Age Pension:**

Is maintained as a safety net for all Australians at no less than its current level in real terms

Continues to be funded from general taxation

And associated means tests, provide appropriate incentives for retirees to invest their financial resources and participate in the labour force

### **Compulsory superannuation system:**

Has as its objective the provision of retirement incomes

Enables a level of compulsory contributions that both supplements the age pension and reduces the long term costs to Government of retirement income provision

Has the broadest possible coverage and participation

Is sufficiently flexible to accommodate, after preservation age, both the payment of contributions and the receipt of benefits, as appropriate

### **Voluntary saving through superannuation and other vehicles:**

Should be encouraged as part of the savings culture, with particular preferences given for medium and long term savings

Is flexible, recognising a range of individual life-cycle positions

### **That the taxation of superannuation:**

Ensures that superannuation is taxed in a manner that maintains community support and confidence and recognises the costs to individuals of its long term perspective and high level of preservation

Should be designed to provide a clear incentive to save, preferably at the point of contribution, and have a focus on taxes on benefit payments, as this provides the simplest method of achieving equity, provides increasing revenue in future years and is consistent with international practice

Is simple to understand

Can be operated transparently and efficiently

30 October 2000

## Appendix 4 - The Institute of Actuaries of Australia

The Institute of Actuaries of Australia (IAAust) represents over 1,250 Fellows and 1,400 other members. The profession specialises in applying mathematical, statistical, economic and financial analysis, to longer-term financial contracts, in a wide range of practical business situations particularly those involving risk assessment.

The actuarial profession has a capacity, an obligation and an interest in contributing to public policy across a range of practice and areas of expertise. Many actuaries work in superannuation and retirement incomes, health, financial planning and related financial services fields. Members of the IAAust are therefore well placed to make a valuable contribution to developing appropriate long-term policies that address the financing of adequate retirement incomes, health care, aged care and related issues associated with the ageing of Australia's population.

In any review of retirement, health and aged care funding, our members can add value in the public interest by:

- analysing the financial long-term impact of structural change;
- assisting in the development and implementation of programmes mitigating long-term financial risks;
- providing informed commentary and expert analysis on matters within the profession's broad areas of expertise, particularly the financial services industry and the health and social security systems;
- evaluating the impact of demographic changes (including the ageing of the population); and
- assisting with the complex transitional problems associated with any structural changes.

Any major reform will lead to behavioural changes and some outcomes might be unclear. Given the training and experience of our members, they are in a unique position to advise on the effect of reforms in the fields in which we specialise.

The IAAust looks forward to continuing its active contribution to the development of fair and sustainable financial systems for Australia.