RE: IMPLICATIONS OF THE FUTURE AGEING OF AUSTRALIA'S POPULATION

The Securities Institute of Australia (the Institute) welcomes the opportunity to provide comments to the Productivity Commission on the economic implications of an ageing population.

It is crucial that there is the provision of a financially secure retirement for older Australians and that Governments adopt integrated long-term approaches to retirement incomes.

The Institute is the professional body that represents the securities and financial services industry. It was established in 1966 and has more than 11,500 members and 25,000 students in 59 countries and through our Retirement Incomes Subcommittee can provide comment on retirement incomes issues such as the implications of an ageing Australia.

The main policy areas that the Institute's submission will address include:

1). The impact of an ageing Australia, particularly on retirement incomes;
2). Options for funding retirement (for example superannuation, market linked income streams, MLIS, and pensions);
3). Role of financial literacy and consumer education.

1. Impact of an ageing Australia

Overview of the current situation

Current projections reveal that by 2025 there will be less Australians in the under 20 age bracket than there are Australians aged between 60 and 80 years. To put this problem another way, in 2025 it is estimated that there will be about 3.5 workers to every person aged over 65 (at present there is about 5.3 workers). This represents a 34% decline in the working population relative to those aged over 65. By 2050 there is expected to only be 2.1 workers for every person aged over 65 – this is a 60% decline on today's circumstances.

There are many reasons for the decline in the expected number of workers. Declining fertility and longevity appear to be the biggest contributors to this phenomenon. The Business Council of Australia states, "our population ageing has been a slower process than in Europe and Japan".[1]

The OECD has also identified the challenges of population changes, particularly as the 'baby boomer' generation enters pre-retirement and retirement. The OECD expects that population ageing could lead to a slowdown in labour force growth, labour shortages and slower economic growth.[2]

Our view is that Governments at the State and Commonwealth levels must plan and implement pre-emptive policies to address the implications of an ageing Australia as we perceive that it does have macroeconomic implications with its affect on retirement savings, superannuation and pension reforms.

A range of policy measures will be required to assist in solving the problems that an ageing of the population presents. To date the following have been advanced:

1. Encouraging women to enter into and remain in the workforce;
2. Encouraging workers to delay or postpone retirement;

[1] BCA, 'Australia's Population Future', pp 25, 2004.
[2] Social Policy Division OECD, Peter Whiteford. 'Anticipating Population Ageing – Challenges and Responses', 2004.

3. Putting in place measures to ensure that productivity continues to increase on a year by year basis for the next 20 years;
4. Reducing retirees dependency on the Government's Aged Pension by ensuring retirees have sufficient savings to generate their own retirement income needs;
5. Reducing Government expenditure by tightening up eligibility for the Disability Support Pension and reducing the government assistance in the Pharmaceutical Benefits Scheme;
6. Putting in place measures to increase the fertility rate or to encourage higher levels of immigration.

Policy responses that the Institute supports include for example: encouraging more women into the workforce and the promotion of older workers in the labour market.

In fact, in 2003 at an address to the Committee for Economic Development of Australia, Prime Minister John Howard stated, "there is an overwhelming national interest case, as well as an overwhelming business case, and an overwhelming personal satisfaction case, to embrace the notion of an ageless workforce". [3]

Governments must implement strategies now and plan for the retirement of such generations and particularly the 'baby boomer' generation of Australia. Declining fertility rates have also been well documented and the Institute supports the view that it is a social trend that shows no sign of changing. However the Institute notes a Business Council of Australia report released earlier this year that as the population increases then GDP increases exponentially. The report states "over the past 40 years, half of Australia's GDP growth has been directly attributable to population growth". [4]

The Institute does believe that the private provision of retirement savings throughout a worker's life is an important piece of a complex puzzle that will ultimately assist in solving the challenges the aging of the population represents.

Most countries are predicting a shortfall in superannuation savings and the vitality of economies will also no doubt affect the flow of wealth to retirement incomes with developed countries, such as Australia, projected to have longer life expectancies moving forward.

Longevity Risk

Australians must plan for the great unknown, particularly given the current life expectancy tables and the fact that outliving your money is a major risk for nearly all retirees who are in good health. This submission will also highlight the longevity risks for Australians based on the results of the government's *Intergenerational Report* and some findings in the latest Life Tables released by the Australian Government Actuary.

The Institute also supports the Business Council of Australia's proposal on 27 April 2004 for a National Population Council to be established. The BCA states it would bring together "governments, business, academics, unions and community groups – to improve coordination, focus and 'buy-in' on population policy". [5] This would contribute to a longer term strategy aimed at ensuring population growth contributes to Australia's economy.

We agree with the view of the Chairman of the Productivity Commission, Gary Banks, that "while ageing per se is not a problem, it will have consequences that pose genuine policy changes". [6] Budgetary implications and the impact of pension reforms on the Australian economy are also discussed by Banks and he compares Australia with OECD countries when he states, "in one area, aged pensions, Australia is relatively well placed in comparison to most developed countries". [7]

[3] CEDA address by Prime Minister John Howard, 2003.
[4] Business Council of Australia, 'Australia's Population Future', 2004.
[5] BCA Media Release, 27 April 2004.
[6] 'An Ageing Australia: small beer or big bucks?' pp 4, Gary Banks, Chairman, Productivity Commission.
[7] Pp 16

In 1999 Professor Paul Johnson stated at a Productivity Commission conference, "Australia has managed, either by historical accident or brilliant foresight, to avoid the most pressing public pension finance problems faced by many OECD countries". [8]

As stated above, there are longevity risks associated with the current life expectancy tables in Australia. Indeed, there is the probability that some Australians will outlive the current official data, *2000-02 Australian Life Tables* (released by the Australian Government Actuary in June 2004) and these tables indeed highlight that life expectancies are getting longer at a rapid rate. The 2000-02 ALT's show that newborn males can expect to live to 77.64 years and females to 82.87 years.

A male born during 2000-2002 has a 62% chance of living longer than the expectancy of 77.64 years and a newborn female has a 60% chance of living longer than 82.87 years. A 65 year old male has a 50% chance of living longer than their expected 78 years and a female of the same age has a 53% chance of living longer than 83 years (these statistics were determined for example by the number of males living at 78 years divided by the number of people living at the start of the year).

The problem with the ALT is that it assumes there is no change to the current rate of mortality and that there will be no further improvements in lifestyle and medicine. Mortality (the rate at which community members die) has declined rapidly over the last 120 years for younger ages. For older Australians, mortality has halved over the last 30 years for those aged 65 or older. This is an incredible achievement.

Government reforms

Our ageing population also leads to a pool of fewer paid workers. In February 2004 the Federal Government made some announcements regarding an 'ageless workforce'. While the Institute generally supports the broad policy initiatives, we consider much more can be achieved. The OECD has referred to policy solutions that could improve employment prospects for older persons such as: removing financial disincentives to work, encouraging employers to retain and hire older workers and improving the employability of older workers. [9]

The linkage between superannuation, non-super and Centrelink benefits has been improved over the past decade, however there remain some inconsistencies. Mature Age Allowance and the Partner's Allowance may have been removed for new applicants but it is still possible to receive government assistance and be under the age of 65. Eligibility to Newstart Allowance and Disability Support Pension needs to be reviewed and benefits must be improved for older workers to delay retirement.

The present Pension Bonus Plan is welcome but access needs to be extended and the size of the benefits requires improvement. Current schemes would not encourage Australians to delay retirement. When the Government announced that from July 2005 it would introduce measures to make it possible for retirees to move to retirement over a period of time, there will also be an ability to take part of a superannuation lump sum sometime after age 55 and receive a non-commutable income stream. The Institute welcomes the new benefit structure.

The Institute also supports increasing the minimum age for the age pension for all retirees, for example to age 70 over a 10 year period starting in July 2005 with provision to increase it to age 75 over another 10 year period.

The role of retirees and productivity

Retirees play a vital role and valuable task of providing much needed free labour as volunteers and carers. Although the real economic benefit gained by this free labour is not quantifiable it is assumed to be considerable. If retirement is delayed then there could be the consequence that there will be a smaller pool of volunteers and unpaid workers. What impact

[8] Prof Paul Johnson, 1999: pp 23.
[9] Social Policy Division, OECD, Peter Whiteford, 'Anticipating Population Ageing – Challenges and Responses', 2004.

would this have? Potentially one way to solve this problem may be to put voluntary labour into GDP data so that the withdrawal of older workers from this type of activity can be gauged.

Indeed productivity increases will be fundamental to Australia maintaining economic growth. According to the OECD the challenges of population change have implications for the future labour force and for social programs (this is in light of fertility rates declining and life expectancy increases). [10]

2. Options for funding retirement (for example superannuation and pensions) and whether current superannuation projections are adequate

Allocated Pensions

Anecdotal evidence from financial planners suggests that allocated pension clients often think that their product will last for as long as they require it to last. However, the problem with this assumption is that allocated pensions have little or no ability to address longevity.

Investment experience tells us that the maximum Pension Valuation Factors (PVFs) are designed to ensure the product is a term pension that ceases at the age of 80. Given current life expectancy figures, a retiree living under the illusion that their allocated pension will provide them with a lifelong retirement income probably needs to assess whether the product will sustain them for at least another 5 years longer than they reasonably expect to live, based on the current life tables.

The Australian Financial Review reported on 20 September 2004 that at the Australian Population Association Conference in Canberra it was revealed by representatives from the Department of Family and Community Services that “the cost of paying the age pension will triple in less than 20 years despite rising superannuation savings”. [11] Habtermariam Tesfaghiorghis and William Sermeno revealed that the government must implement policies that increase workforce participation and according to the *AFR* the report predicts that age and service pension payments will rise from 2.9 percent of GDP in 2001-02 to 4.6 percent of GDP in 2041-42.

Market linked income streams (MLIS)

While we acknowledge concerns with market volatility, MLIS are products that potentially take longevity into account. They achieve this by allowing the term of the product to be based on the life expectancy of a person who is five years younger than the pensioner/annuitant (or if a reversionary pensioner/annuitant is nominated then the life expectancy of the reversionary).

In the 2000-2002 ALT, for example if we assess a 65 year old male and a 62 year old female, the allowable terms of the product would be between 18 and 22 years (male) and 24 and 29 years (female). It would therefore seem that the allowable terms for the MLIS are sensible, however if government introduced longer terms such as eight years, the result would be that the 65 year old male would have produced a maximum of 25 years as opposed to the 18-22 years described above.

As stated in a review by the Senate’s Standing Committee on Community Affairs, the Securities Institute generally welcomes the Government’s views on market linked income streams.

We have expressed a concern about the term that is allowed for these products. We believe that there is a danger that these products do not sufficiently provide for improvements in life expectancies which have been occurring rapidly over the last 30 years and which are expected to continue to occur at a similar rate.

[10] Social Policy Division, OECD, Peter Whiteford, ’Anticipating Population Ageing – Challenges and Responses’, 2004.
[11] AFR, 20 September 2004. ‘Age pension costs to triple, study warns’, pp 5.

Many investors recognise that longevity is a risk that they need to plan for once they retire. As noted above allocated pension products do not solve longevity risk. Therefore, we believe that the allocated pension products PVFs, which determine the minimum and maximum level of income, should be reviewed because they are based on the 1985-87 Australian life tables. Since that life table was released we have had three new Australian life tables, including the recent 2000-02 table that highlight that Australian life expectancies are increasing rapidly.

Superannuation

The Institute's policy position on superannuation is partly contained in the 'Call for Super Action' document that was released on 28 April 2004. The proposed actions of the Super Coalition were to:

- Acknowledge and accept the Senate Select Committee on Superannuation's finding that the goal for an adequate level of retirement income should be around 65% of pre-retirement income;
- Remove the 15% contribution tax, thereby increasing the level of superannuation benefits for all Australians;
- Extend the co-contribution incentive to those earning up to $60,000, thereby providing clearer incentives to save for the longer term;
- Continue to improve the feasibility of integrating work and retirement during a phased retirement period, by enabling all persons under age 70 to be able to turn the income stream from an allocated pension, on or off, with no work test applying". [12]

This Coalition also agreed that currently Australia's retirement income system is based on three major support structures, namely: the age pension, compulsory superannuation and voluntary superannuation.

As previously mentioned many scholars, including scholars from the OECD highlight that Australia is better placed than most countries, as a result of such a system, however it is clear that current policies will not see most Australians adequately through their retirement. A key to the problem can be as simple as encouraging more Australians to save and also by Governments adopting adequacy goals.

Senate Select Committees for example have found that a retirement income of 45% of a person's pre-retirement income will not adequately see an individual through retirement. As stated by the 'Call for Super Action', "the adoption of an adequacy goal will assist all governments in designing retirement income policies relating to contributions, social security and taxes, as well as assisting individuals in planning for retirement". [13]

One issue that particularly needs attention is the ability of women to build up adequate retirement assets due to their often broken working patterns.

The Institute has previously called for reform to super fund tax as an incentive for all Australians to save, not just targeted at certain Australian workers. It is important for the Government to make available age pension, promote greater superannuation and provide incentives for voluntary savings (through appropriate tax concessions). Also tax concessions should be appropriately product-neutral – to ensure investment choice and to ensure innovation in the market is not unduly hindered.

3. Role of financial literacy and consumer education

The Institute lodged a submission to the Commonwealth's Consumer and Financial Literacy Taskforce ('the Taskforce') on 30 July this year and we will be implementing community education programs to improve financial literacy in crucial areas where there has been recent legislative reforms.

[12] 'Call for Super Action', 28 April 2004.
[13] Call For Super Action, pp 6.

In the Institute's submission we referred to the 21 June 2004 announcement by the Government and the Australian Democrats that they agreed to pass the Superannuation Choice of Fund rules. The then Minister for Revenue and Assistant Treasurer, Senator Helen Coonan, announced that "as part of the Choice of Fund legislation the Government will establish a five person advisory committee to formulate an education campaign for Choice and the Government will commit a further $2 million to a consumer information centre". [14] The Institute supports such initiatives. With the introduction of Super Choice on 1 July 2005 consumers need to be adequately equipped to make the right choices and see them through their retirement.

The Taskforce released its preliminary recommendations on 31 August 2004 to Government and we supported the key recommendation for the establishment of a national financial literacy body with a strategic approach. The Institute recognises that a significant challenge for consumers and information providers is lack of stability regarding the legislative and regulatory framework for financial services, as there is, for example a complex nexus between tax, social security and superannuation policy.

Conclusion

Much work needs to be completed on the implications of Australia's ageing population, particularly on our economy. The Institute supports strong commitments by all levels of government to confront and address this issue with long term and sustainable policies. Ultimately we want a financially secure retirement for all Australians.

The Institute looks forward to receiving the final report and to further consultation with the Productivity Commission on the issue of an ageing Australia and would welcome further involvement in future research and policy projects, as appropriate, on this crucial policy issue.

[14] Media release, Senator Helen Coonan, 21 June 2004