Submission to the Productivity Commission Research Study on the Economic Implications of an Ageing Australia

Social Market Economy Institute of Australia

Economic Implications of an Ageing Australia
Productivity Commission
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Thank you for the opportunity to provide a submission to the Productivity Commission Research Study on the Economic Implications of an Ageing Australia. The Social Market Economy Institute of Australia (SMEIA) is a research institute established to promote the ideals of 'ordoliberal' theory in Australian economic and social policy discussion and debates. The chief proponents of ordoliberal theory and applied policy discussions included German scholars such as Walter Eucken, Franz Bohm, and Wilhelm Ropke. These authors were most prolific during the 1930's and 1940's, during the advent and eventual demise of both the German Weimar Republic and Third Reich, and their writings were influential in the development of post-World War II German economic institutions which emphasised the primacy of free markets and limited government intervention. Other eminent scholars, including Friedrich A von Hayek, had also been associated with the ordoliberal school. In more recent times, economists such as Viktor Vanberg and Manfred Streit have made significant contributions to the ordoliberal literature. Over time, ordoliberal theory has successfully incorporated theoretical perspectives from other streams of economic thought, such as Austrian economics, institutional economics, evolutionary economic thought and constitutional political economy.

Australia is one of many countries experiencing fundamental changes in the structure of its population, particularly with respect to the presence of proportionally fewer children and young people combined with more middle-aged and older people. This phenomenon has been referred to as 'structural ageing', and is influenced by a variety of longer term demographic changes. The purpose of this submission is to examine the underlying trends driving long-term structural ageing outcomes, and to assess the economic and budgetary implications of these trends. The next section will emphasise the combined role of increasing life expectancy, 'baby boomer' generation age progression and declining fertility rates in driving Australia's structural ageing. This will be followed by a discussion of the economic and budgetary implications of structural population ageing. In summary, it is submitted that the long-term approaches to improve labour market participation and productivity are essential to secure Australia's economic prosperity against the background of structural ageing. In addition to this, the submission argues

that a much greater emphasis on market-based competition in 'merit goods' based sectors such as health and education will also aid in the task of boosting productivity growth, enable these sectors to more effectively provide goods and services to changing client groups, while at the same reducing pressure on Australian public finances.

Structural ageing trends at a glance

It has been largely recognised that the structural ageing of the Australian population has been, and will continue to be, influenced by a range of underlying demographic forces. These are discussed as follows.

Life expectancy

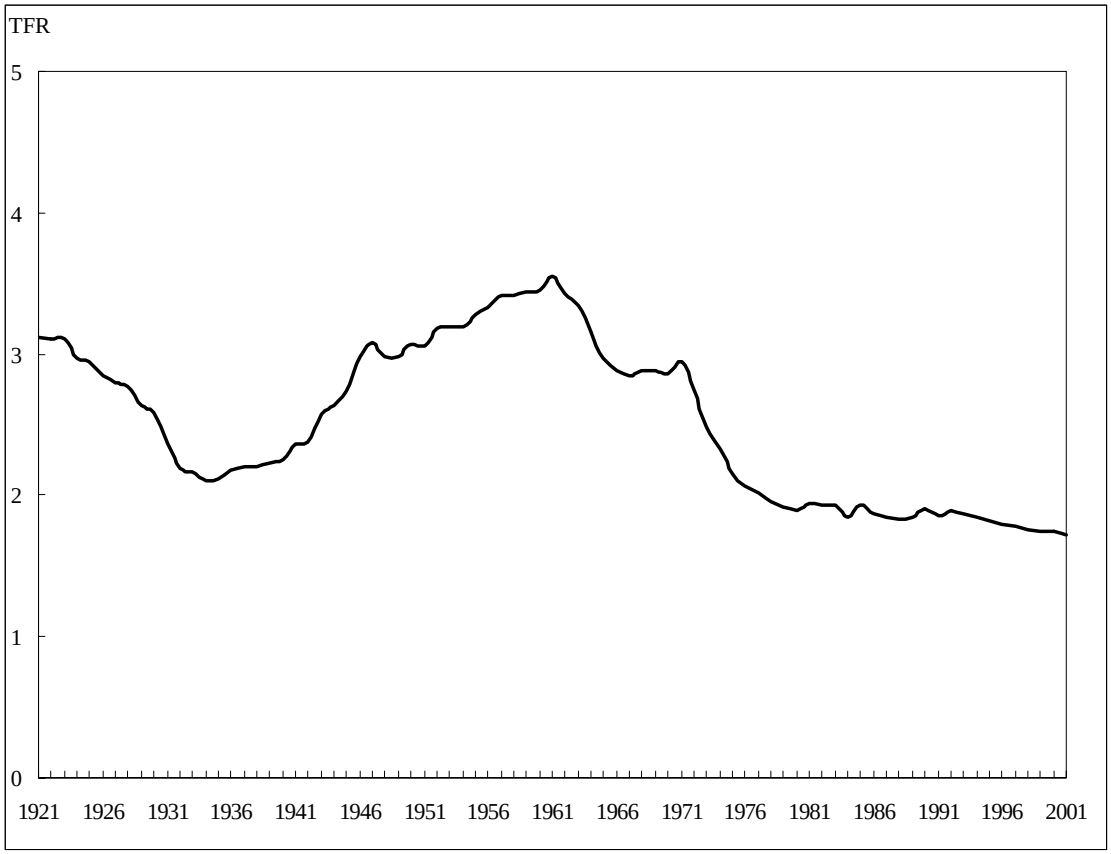
Life expectancy at birth has increased from 66.1 years in 1947 to 76.2 years in 1999 for males, and from 70.6 years to 81.8 years over the same period for females.

The increase in life expectancy in turn has been driven by lower mortality rates experienced at all ages. The crude death rate (ie number of deaths per 1,000 population) has declined from 9.7 in 1947 to 6.8 in 1999, and in particular the infant mortality rate has fallen from 28.5 (per 1,000 live births) to 5.7 over the period. These longevity and mortality trends have been attributed to improvements in living conditions, such as better water supply, sanitation, food quality and health education, advances in medical technology, and improved social conditions.

Fertility

One of the more striking changes in the Australian demographic profile has been the reduction in the total fertility rate (TFR) since the second half of the twentieth century (see Figure 1). Since the post-war 'baby boom' period, which saw the TFR reach a peak of 3.6 in 1961, fertility rates had continued to trend downwards through the 1960's and 1970's. By 1976 the TFR had fallen to below replacement level (ie 2.1 births per woman) for the first time, and this trend continued unabated through the 1980's. Since the 1990's, fertility rates have continued to decline, albeit less dramatically compared to previous decades. Nonetheless, at 1.726 babies per woman, Australia's TFR recorded for 2001 was the lowest on record.

Figure 1: Total fertility rate (TFR), 1921 to 2001



Source: ABS, Australian Historical Population Statistics, ABS Cat. No. 3105.0.65.001.

This decline in Australian fertility levels have been associated with a variety of social and economic developments, including but not limited to:

- Higher levels of educational attainment by women;
- Increasing numbers of women entering the labour market, and removal of barriers to the employment of women;
- Changes in access to birth control methods, including the availability of the oral contraceptive pill in the mid-1960's;
- Rising costs associated with raising children;
- Diminished security and stability of personal relationships, including marriages; and
- Changing attitudes towards family size and structures, including increasing proportions of couples restricting their family size to one or two children, or choosing to remain permanently childless.

These underlying factors have also contributed to the increasing tendency for women to delay the timing of child-bearing activities. This is illustrated in trends in the median age of Australian mothers at first pregnancy (of the current relationship), resulting in a live birth, rising from 24 years in 1975 to 29 years in 2000. In addition to this new, delayed timetable for family formation and childbearing, almost all women, regardless of age, marital status, labour force participation, occupation or education, are having fewer

children. This trend has been popularised as the Australian 'baby strike', and affects overall fertility in two critical ways: first, it 'stretches' out each generation, resulting in fewer children overall (and, hence, smaller family sizes) in a given time period; second, later commencement to birth is associated with lower individual lifetime total fertility. All of these forces act to lower, or at the very least constrain any future increases in fertility rates.

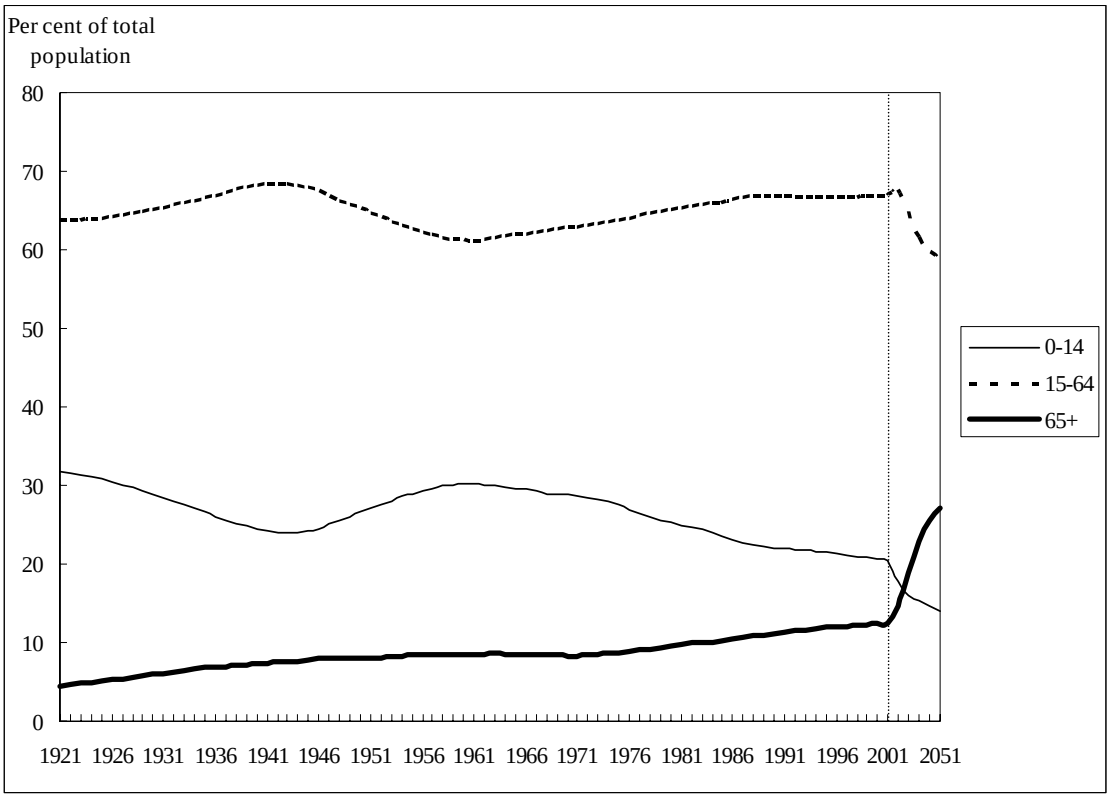
'Baby boomer' age generation progression

In addition to, and consistent with, the trends outlined above, the peak of the large generation of people born between 1946 and 1966 (otherwise known as the 'baby boom' cohort) is expected to be entering into the over-65 year age group between 2011 and 2031.

Structural ageing trends and projections

These three factors broadly combine to contribute to a structurally ageing population, characterised by the relative increase of older people within the total population (see Figure 2).

Figure 2: Proportion of Australian population in various age groups, 1921 to 2051, per cent of total population



Source: ABS, Australian Historical Population Statistics, ABS Cat. No. 3105.0.65.001; ABS, Population Projections Australia 2002-2101, ABS Cat. No. 3222.0 (series B).

As illustrated above, the proportion of the population aged 65 years and over has increased substantially from 4.5 per cent in 1921 to 12.5 per cent in 2001, and is anticipated to further increase to 26.1 per cent by 2051[1]. The proportion of the working age population (ie those aged between 15 and 64 years) has increased from 63.8 per cent in 1921 to 66.9 per cent in 2001, but is projected to fall to 59.6 per cent by 2051. The youth population (ie those aged between zero and 14 years) as a proportion of the total population, has declined in trend terms from 31.7 per cent in 1921 to 20.5 per cent in 2001, and could decline further to 14.4 per cent by 2051.

Towards a 'policy ineffectiveness' proposition in the reversal of structural ageing trends

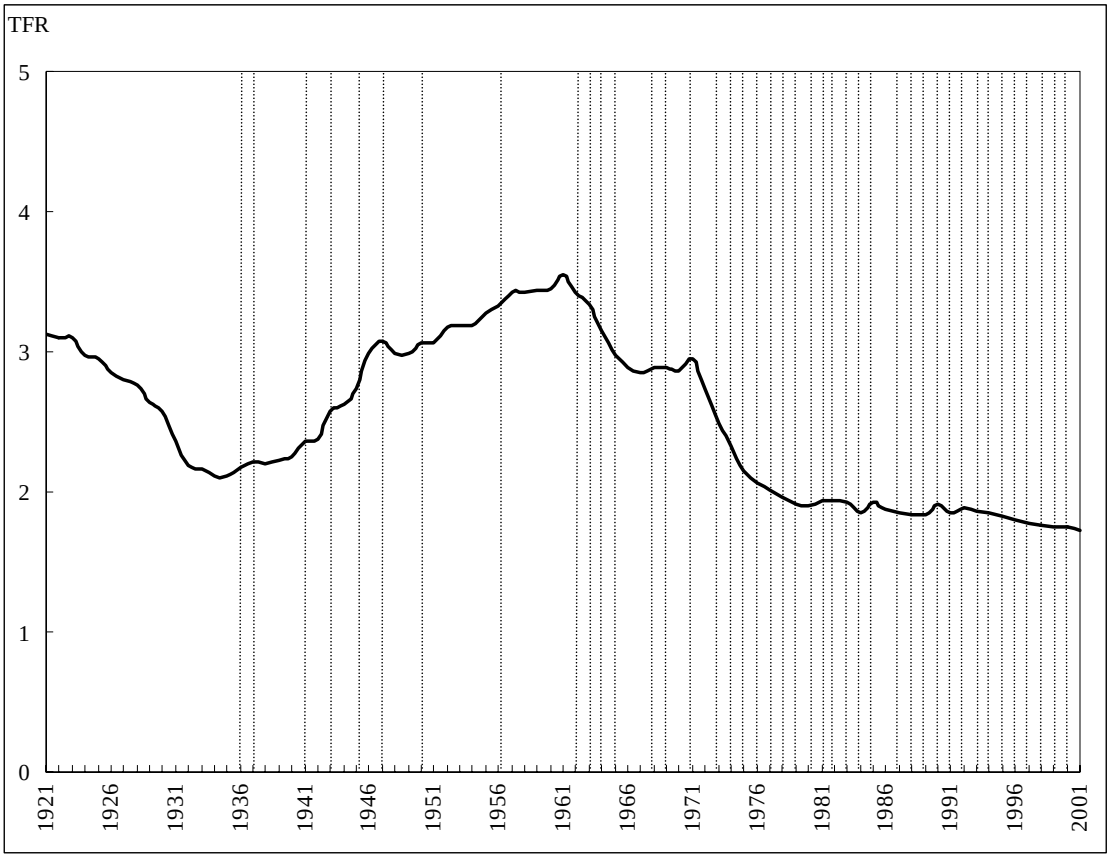
At a general level, any forecast of future Australian population size and structure requires assumptions to be made in relation to future levels of mortality, fertility rates and immigration. However, ABS population projections have shown that variations in these assumptions will not materially alter the prospect of further structural ageing of the population as described above.

In particular, many commentators have taken the view in the past that increasing immigration intakes would serve to redress Australia's impending structural ageing. However, the ABS modelling shows that even if net overseas migration increased to 180,000 persons per annum the proportion of the Australian population aged 65 and over will still increase. The ineffectiveness of a policy of increasing migration to reverse structural ageing is also noted in the Australian Government's *Australia's Demographic Challenges* Taskforce Report, which states that increased migration cannot prevent our population from ageing since migrants will age along with the rest of the population, thus compounding structural ageing over the longer term.

Another popular view relates to the notion that the fertility rate also has the capacity to be improved significantly to effectively redress the projected trend towards further structural ageing within the national demographic profile. ABS modelling also shows that, even if the total fertility rate were to be increased immediately to 2.1 (ie the 'replacement rate'), the proportion of the national population aged 65 and over will still rise over the next few decades. This is supported by Australia's historical experience which reveals that, despite the proliferation of new and increasing family payments (particularly since the 1970's), Australia's total fertility rate has continued to trend downwards (see Figure 3).

[1] In numerical terms, the number of Australians aged 65 years and over is expected to increase from 2.4 million in 2001 to 6.6 million in 2051.

Figure 3: Total fertility rate (TFR) and introduction of new and increased family payments, 1921 to 2001[(a)]



(a) The following family policy initiatives are incorporated:
1936 Minimum Maternity Allowance (MA) payments and income test limit increased – this payment was introduced in 1912.
1937 Rate structure for MA restored to the more generous 1931 levels, and income test limit increased.
1941 Introduction of new Commonwealth Child Endowment (CE) for second and subsequent children under 16 years.
1943 Income test for MA abolished, and payment rates increased; introduction of Child's Allowance (CA) for children under 16 years of age.
1945 Additional Benefit for Children (AB) introduced for first child under 16 years to any person receiving unemployment or sickness benefits.
1947 Prepayment for MA introduced.
1950 CE payable for first child.
1956 Additional Pension for Children (AP) introduced for those children under 16 years. Prepayment rate for MA increased.
1962 Increase in AB rates for second and each additional child.
1963 Mother's Allowance (MoA) for Class A widow pensioners introduced as an extension of CA; eligibility for CA and AP extended to include a child over 16 years until the end of the calendar year in which he/she reached 18 years.
1964 Increase in CE for third and each additional child, and for full-time students between 16 and 20 years; introduction of CE payment for student children.
1965 Guardian's Allowance (GA) introduced; eligibility for CA and AP extended to children of all age pensioners, and full-time students to 21 years of age.
1968 AP extended to first child under reforms to CA and AP; States Grants (Deserted Wives) Act introduced subsidy for States to assist needy mothers without breadwinners not eligible for Commonwealth assistance.
1969 Higher rate of MoA/GA for child under six or with a disability.
1971 AP and AB benefit for first, second and each additional child increased to a uniform rate level.
1973 Supporting Mothers' Benefit (SMB) introduced for unmarried mothers and mothers who are deserted de facto wives, de facto wives of prisoners, and separated wives not eligible for widow's pensions; AP and AB for full-time dependent students payable irrespective of age of student; child age limit of 21 years removed from GA payments; Double Orphan's Pension (DOP) introduced for children under 16 years of age or full-time dependent students under 21 years of age.
1974 MoA and AP extended to Class B Widows with care of a child; women who became sole parents while living overseas, but who had continuously lived in Australia for not less than ten years at some time, eligible for SMB.
1975 DOP extended for those children whose sole surviving parent or adoptive parent had been jailed for a period of ten or more years, or who was a mental hospital patient in need of treatment or care for an indefinite period.

1976 CE renamed Family Allowance (FA), and rates increased to include 'cashed' out tax rebates for children and made payable to students under 25 years of age; upper age limit for dependent students receiving DOP increased; SMB subject to automatic six-monthly increases in line with movements in the CPI.
1977 SMB replaced by Supporting Parent's Benefit (SPB), with eligibility extended to male sole parents.
1978 Upper age limit of 25 years introduced for dependent full-time students to be regarded as qualifying children for SPB payments.
1979 FA was made payable on a monthly basis, with effective increases in rates payable; twice-yearly indexation of rate of benefit reinstated (after being replaced by an annual indexation arrangement in 1978); DOP paid on monthly rather than weekly basis, with effective adjusted rate increased.
1980 Six month qualifying period for SPB removed.
1981 Rates of FA for second and subsequent children increased; DOP extended to refugee children.
1982 Rates of FA first and second children increased; FA payment extended to children leaving school and seeking employment; AP and AB paid for child who was leaving school and seeking employment; DOP continued to be paid where students had left school and were seeking employment.
1983 Family Income Supplement (FIS) introduced for low income families not in receipt of pensions or benefit and with dependent children under 16 years of age (full-time students under 25 years); payment of Mother's/Guardian's Allowance (MGA) extended to a married pensioner who was left with the care of children where the spouse was admitted to a hospital or nursing home on a basis likely to be permanent; eligibility for SPB extended to unmarried people who had obtained legal custody of a qualifying child, and for married people with a qualifying child where a spouse was living apart due to illness or infirmity.
1984 MGA increased for all recipients, and single unemployment and sickness beneficiaries with children became eligible for MGA; AB was no longer taxable.
1985 Multiple birth payment for FA recipients introduced.
1987 FA payable for children who were overseas only if the child was an Australian resident, or had been an Australian resident and was living overseas with the person entitled to receive the FA payment; FA income tests on payments for 16 and 17 year olds replaced by a tapered income test applying to all FA payments, which increased income test limits; FIS replaced by Family Allowance Supplement (FAS), with higher rates, including for teenage children, and a more generous income test; Rent Assistance made available to those receiving FAS; Family payment benchmarks announced.
1988 FAS and FA made payable on a fortnightly basis, with effective increases in payment rates; Child Support Scheme introduced.
1989 FAS rates restructured and increased, with one rate for first three children and higher rate for fourth and subsequent children; FA rates increased, and income test limits became subject to annual indexation on the basis of CPI movements in the previous year; Sole Parent Pension (SPP) replaced class A widow's pension and SPB, with eligibility extended to people with substantial control and care of a qualifying child where this existed for at least 12 months before grant of pension.
1990 FA multiple birth payments, MGA, DOP, and FAS subject to yearly indexation in line with movements in CPI for the preceding financial year; annual indexation for FA, with the first rise related to CPI movements for December 1998 to June 1989. AP and AB rates indexed in January of each year; lump-sum bereavement payable on the death of a child eligible for AP/AB assistance and FAS; FAS recipients automatically eligible for Health Care Cards; easing of FAS income test; SPP recipients who ceased to receive payment due to employment were given a Health Care card for six months.
1991 FA fully indexed in line with movements in 1989-90 CPI movements; DOP recipients eligible for continued payments for four weeks upon death of child; employment entry payment introduced for SPP recipients.
1992 Payment of a family allowance bonus under FA in April; FA, FAS and DOP back-paid to date of child's birth if claim was lodged within 13 weeks of the date of birth; education entry payment for SPP recipients introduced.
1993 FA replaced by Basic Family Payment (BFP), with lump sum provisions available for first child; FAS renamed Additional Family Payment (AFP), with AP and AB, rent assistance and MGA integrated into the AFP; Family Income Supplement (FIS) introduced to assist low income families with children who were not in receipt of a social security pension or similar assistance; sole parents receiving Additional Family Payment (AFP), but not the Sole Parent Pension (SPP), entitled to MGA.
1994 Home Child Care Allowance (HCCA) paid to members of couples with children who were primarily engaged in child care, and was introduced as an optional alternative to Dependent Spouse Rebate for those with children.
1995 Parenting Allowance (PgA) introduced, with HCCA absorbed into PgA; refugees receiving SPP were not required to live in Australia for a set period to qualify.
1996 BFP and AFP subsumed into a single payment (Family Payment – FP) with rate structures based on age of child, and Large Family Supplement under FP for fourth and subsequent children; MA reintroduced for children born after February 1996 (it was abolished in 1978); introduction of Family Tax Initiative, with assistance either in cash or tax reductions, and assistance per child with higher rate for families with at least one child under five; MGA increased above normal indexation rise.
1997 Rate of all single pensions maintained at 25 per cent of MTAWE.
1998 FP renamed Family Allowance (FA); Parenting Payment (PP) introduced to replace SPP and PgA; residence requirements for sole parents to receive PP were reduced; a portion of MA was renamed Maternity Immunisation Allowance (MIA), with benefits available for those receiving age-appropriate immunisation.
1999 Eligibility for FA extended to jobseekers aged between 18 and 21 years and full-time students aged 18 to 24, where they qualified for little or no Youth Allowance; 12 month waiting period for single foster parents receiving PP removed.
2000 Family assistance reforms as part of A New Tax System (ANTS), with significant increases in rates across various payments to compensate for the effects of the GST; FA, Family Tax Assistance Part A and Family Tax Payment Part A replaced by new Family Tax Benefit Part A (FTB Part A) – the FTBA was not subject to an assets test, with income tests eased; a new Family Tax Benefit Part B (FTB Part B) was introduced, incorporating MGA, BPP, Family Tax Payment Part B, Family Tax Assistance Part B, Sole Parent Rebate and Dependent Spouse Rebate (with Children). MGA absorbed into new Family Tax Benefit Part B (FTBB); Child Care Benefit (CCB) replaced Child Care Assistance and Child Care Cash Rebate.
Source: Whiteford, Stanton and Gray, 2001; Daniels, 2004.

Notwithstanding that family policies are specifically earmarked towards assisting families with the costs of raising young children[2], and strengthening family resilience by tailoring payments to account for the different circumstances of families and women[3], a number of commentators continue to argue that governments can and should increase fertility rates by increasing spending on 'pro-natalist' programs. However, consistent with the evidence highlighted in Figure 3 pointing to the apparent 'ineffectiveness' of family payments to increase the birth rate to date in the Australian case, many studies show little association between the level of spending on families and fertility rates in developed countries (eg Gauthier and Hatzius, 1997; Castles, 2002; FaCS, 2002)[4]. Even if fertility trends were amenable to changes in government incentives, it may not be desirable to do so in the current context, given the effect that these may have particularly in reducing labour market participation for women as well as magnifying the budgetary burden associated with supporting a larger than expected cohort of children[5].

In summary, while any forecast in relation to future population size and structure requires assumptions to be made about future levels of mortality, fertility and immigration, it nevertheless appears that Australia's population outlook over the next few decades is likely to be dominated by structural ageing.

Economic implications of structural ageing

Most economists agree that an economy's capacity to produce goods and services depends on the quantities of available inputs, such as capital and labour, and the productivity of those inputs. More specifically, for the economy to grow (ie the quantity of outputs to increase), either the quantity of inputs must grow or productivity must improve, or both. The conventional discussion of the likely economic impacts of

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[2] Daniels (2004) shows that the number of family payment beneficiaries have increased significantly over time. In 1942, 487,674 families (with 909,847 children) received the Child Endowment payment. In 2001, 3,484,314 families and individuals (with at least 5,564,568 children) received family assistance, sole parent payments and partnered parent payments. According to the Australian Department of Family and Community Services (FaCS) Portfolio Budget Statements, the Australian Government in 2000-01 provided approximately $10.3 billion in family assistance, including around $10.25 billion for the Double Orphan Pension, Family Allowance, Family Tax Benefit, Family Tax Payment and Maternity Allowances, and an additional $1.2 billion investment towards child care support – this excludes payments and services to individuals, such as AUSTUDY and Youth Allowance, as well as child support initiatives through the Child Support Agency.

[3] According to the Prime Minister, the Hon John Howard, in drawing upon the work of UK sociologist Dr Catherine Hakim, women tend to coalesce into three different groups: home-centred women (who prefer to be at home full-time looking after children); work-centred women (whose priority is career-oriented); and adaptive women (whose hopes and aspirations are in the areas of both work and family). It follows from this that no one family policy will fit all families, and so a range of policies and payment structures are required to provide choice and effectively meet the needs of different families (Howard, 2003).

[4] As illustrated in the discussions above with respect to the determinants of the decline in Australia's fertility rates over the long term, it is reasonable to contend that the apparent 'ineffectiveness' of family payment policy to dramatically increase fertility rates can be attributable to a wide range of factors outside the scope of public policy, such as increasing economic openness and a more dynamic and liberal-oriented society which enjoy greater freedom of choice.

[5] The significant economic transitory costs associated with raising fertility from current levels has been noted by the American economist David Weil (1999), and in the Australian context by Henry (2002) as well as in a number of papers by Ross Guest and Ian McDonald.

Other commentators (eg Maley, 2002; Blackford, 2003) raise the point that it may be ethically and morally questionable for governments to attempt to 'bribe' or 'coerce' couples to have children. According to Maley, 'Deliberate policies designed to bribe or coerce couples to have more children would be repugnant. Like the Chinese one-child policy, it would treat men and women as no more than instruments in a controlled breeding exercise intended to achieve a certain level of population. It would be implemented in the absence of any certainty of achieving its ends; or whether, if achieved, such a population level would then serve the immediate or long-term interests of the nation. Nothing so smacks of social engineering of the most intimate of human affairs and the commodification of children; it is also more likely to lead to ever more makeshift fiddling with fertility incentives or disincentives, once the mandate to do so is allowed'.

structural population ageing utilise traditional neoclassical growth accounting methods, with the relationship between the rate of output growth and the rates of input/productivity growth expressed as:

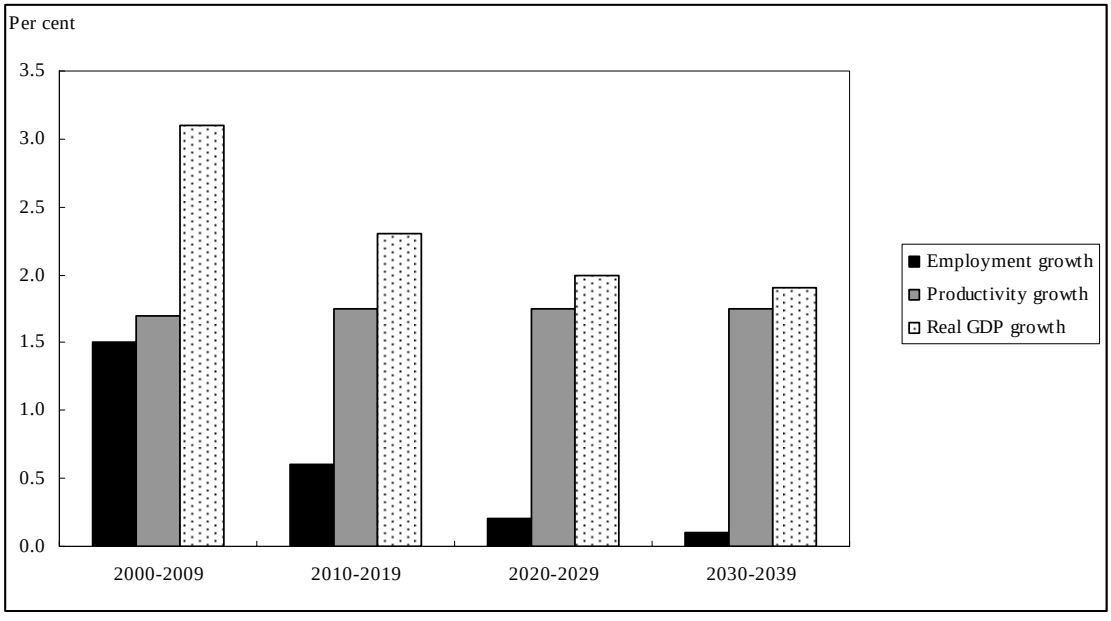
$$\Delta Y/Y = \Delta A/a + \alpha\Delta K/K + (1 - \alpha)\Delta N/N$$

where $\Delta Y/Y$ = rate of output (ie economic) growth;
$\Delta A/a$ = rate of productivity growth;
$\Delta K/K$ = rate of capital growth;
$\Delta N/N$ = rate of labour growth;
α = elasticity of output with respect to capital.
$(1 - \alpha)$ = elasticity of output with respect to labour.

This identity equation is essentially a stylised economy's aggregate production function written in growth rate form. Assuming that the capital accumulation rate is relatively constant over time, economic growth is attributable to productivity and employment growth (which in turn is dependent on an amalgam of factors such as population growth, labour force participation rate, growth rate of employment, and average hours worked).

Most economic modellers have used various derivations of this identity to empirically measure the relative importance of these sources of economic growth. For instance, the 2002 Australian Government Intergenerational Report (IGR) estimated that, on the basis of current policy settings, the rate of economic growth would be expected to slow as a consequence of structural ageing (see Figure 4).

Figure 4: Growth in real GDP, average annual growth rates, per cent, 2000 to 2039

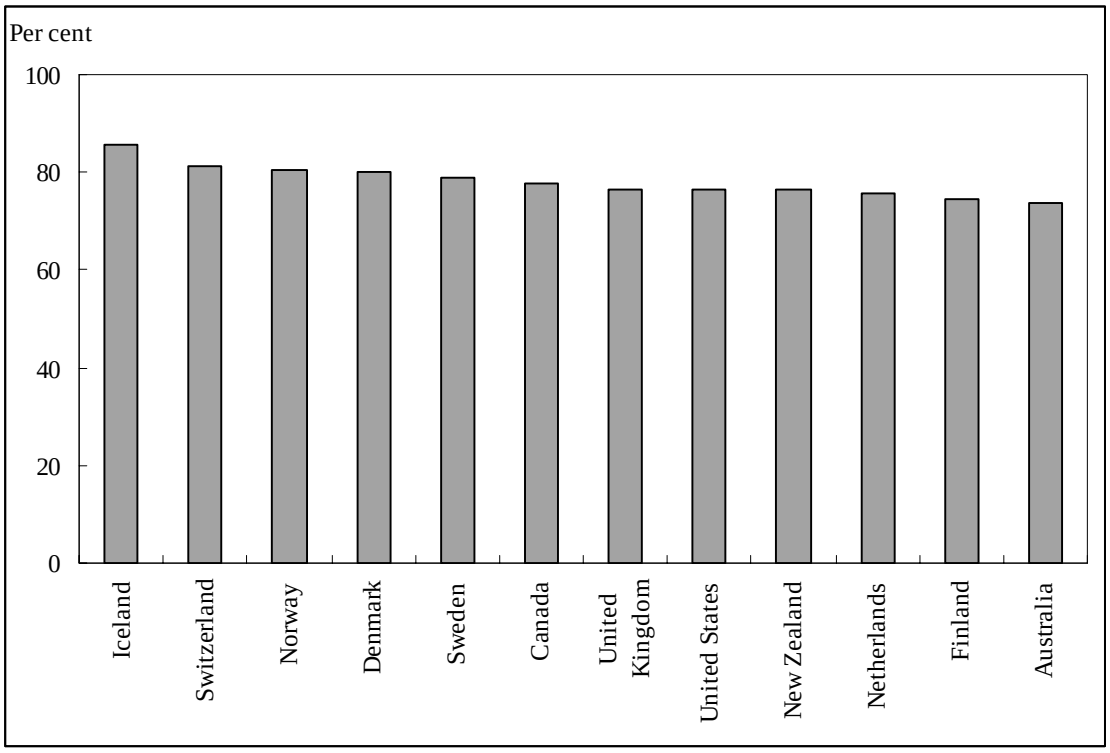


Source: Australian Government, 2002.

As is clearly shown above, the slower projected growth in the labour force is anticipated to contribute to the slowdown of overall economic growth[6]. This is due to the dual effects of the 'baby boom' generation reaching retirement age, and the long-term impact of declining fertility as reflected in a future lower working age population. Other commentators have made similar predictions, with Access Economics suggesting that the rate of growth of the working age population will decline from 170,000 per annum today to only 125,000 for the whole of the decade of the 2020's if left unchecked, and BIS Shrapnel assessing that the growth in the working age population will slow to zero in the late 2020's[7].

In terms of labour market participation, the overall participation rate has been rising over time with increasing female participation partially offset by falling male participation (particularly for those over 55 years of age). However, among the OECD economies, Australia's total participation rate ranks 12th (see Figure 5), with Australia also having a lower participation rate for men aged 25-64, and women aged 55 to 64, compared to the OECD average. Furthermore, in 2002 the labour market participation rate for Australians aged 55 to 64 years was 50.1 per cent compared to 51.9 per cent for the OECD average.

Figure 5: Labour force participation ratios, selected OECD economies, per cent, 2002



[6] Figure 4 also illustrates that productivity growth is expected to be the main contributor to future economic growth. For further information on the role of productivity in driving future economic future, see the following discussion.

[7] More specifically, the growth of the workforce will slow to 140,000 over the next decade, to 60,000 over the following five years, and to zero in the late 2020's (quoted in COTA, 2002). While it is apparent that different models of labour force growth has yielded varying results, these may be influenced by assumptions made in relation to labour force participation rates and other variables affecting the labour market – the potential role of increasing economic participation by those of working age as well as older Australians will be discussed further below.

Source: OECD, 2003.

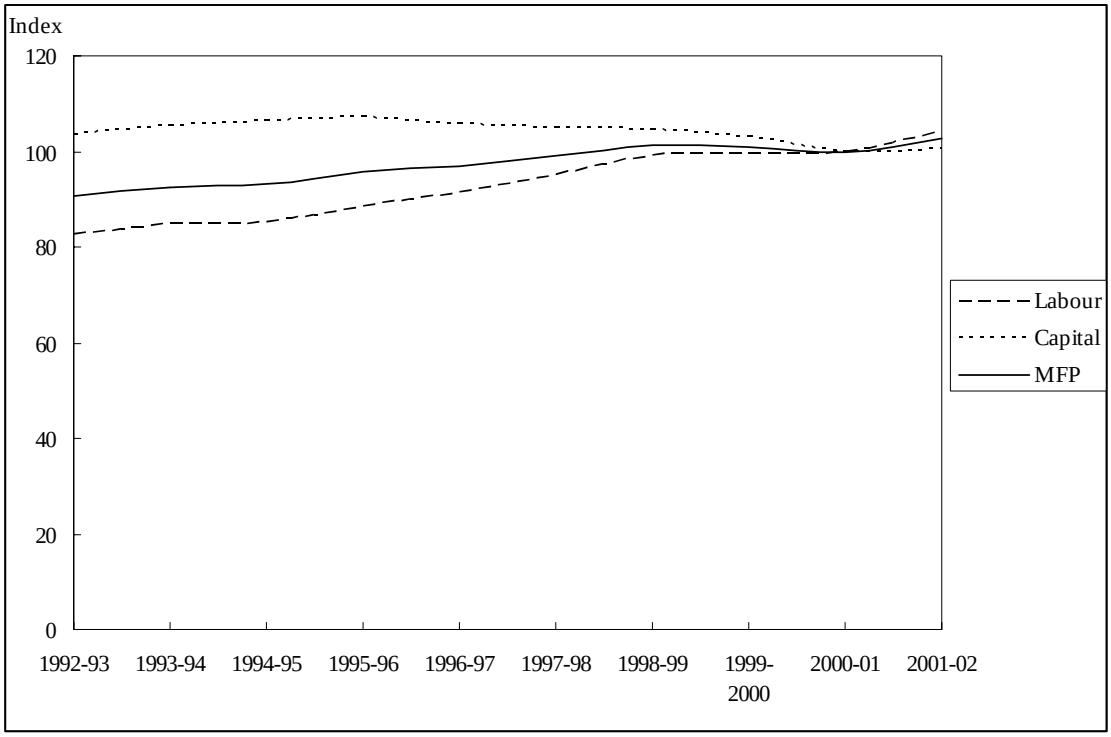
According to the IGR, it is projected that, in the absence of policy change, the overall labour participation rate will decline from around 64 per cent at present to just over 55 per cent by 2041-42 as a result of the Australian population moving into older age cohort brackets – compounding the projected effect borne by a falling proportion of people of working age into the future.

Apart from the impact of changing labour force dynamics, Australian economic growth in the decades ahead will also be influenced by trends in productivity growth. Productivity growth, defined as the extent of growth between economic output and the inputs, such as labour and capital, which have been utilised to produce that output, is typically described in terms of three broad measures:

- Capital productivity is measured as the amount produced per unit of capital services utilised.
- Labour productivity is measured as the amount produced per hour worked.
- Multi-factor productivity (MFP) is a measure of the efficiency of the production process that takes account of more than one input.

Over the past three decades, productivity growth has averaged around 1.7 per cent per annum. However, during the 1990's productivity growth averaged 2.2 per cent per annum, which is both high by historical and international standards. According to the ABS, the average annual productivity growth rate between the latest 'growth cycle' peaks in 1993-94 and 1998-99 was 1.8 per cent for MFP and 3.2 per cent for labour productivity (see Figure 6). In particular, the growth rate for MFP over the latest cycle is higher than for any preceding cycle since this measure was introduced in 1964-65. This robust productivity performance has continued into this decade, and has underpinned Australia's strong economic performance over the last ten years.

Figure 6: Productivity growth, market indexes, 1992-93 to 2001-02



Source: ABS, 'Measuring Australia's Economy: Productivity', in 'Australia Now', ABS Cat. No. 1360.0.

According to a wide number of experts, Australia's impressive productivity growth performance in recent years can be attributed to two main factors:

- The implementation of comprehensive structural reforms, including trade liberalisation, financial market deregulation, labour market reform, taxation reform, reforms to improve commercial incentives for government business enterprises, welfare reform, corporate law reform, and reforms to key goods and services markets including transportation (including the waterfront), electricity, gas and water, telecommunications, and higher education. These reforms have acted to sharpen incentives for economic agents to become more productive, and by allowing businesses greater flexibility to adjust to the demands of greater competition.
- The increasing adoption of information and communication technologies (ICTs) by the business sector. ICTs effectively represent enabling technologies that provide a platform for other productivity-enhancing innovations, such as improvements in new products and production processes, by Australian companies.

It is clear that the growth rate of productivity represents a key driver of GDP growth over the long term. This has been reinforced by a number of economic commentators, who have illustrated the compounding effects of small variations in productivity growth rates on overall economic growth and living standards. The American economists Alan Blinder and William Baumol state that 'small differences in rates of productivity growth compound, like interest in a bank account, … can make an enormous difference to a society's prosperity' (Blinder and Baumol, quoted by Productivity Commission). Banks

(2004) illustrated that, if the rate of productivity growth increased to 2.05 per cent per annum over the next few decades, then GDP would increase cumulatively by over $5.6 trillion by 2050-51 relative to GDP attained by a productivity growth rate of 1.75 per cent (see Table 1). In other words, a sustained 0.3 per cent increase in productivity is projected to lead to an increase in real GDP per capita in 2050-51 by 15 per cent.

Table 1: GDP implications of different productivity growth scenarios

	2.05 per cent per annum after 2002-03	1.75 per cent per annum after 2002-03
Average growth in GDP per capita (per cent)		
2000's	2.06	1.85
2010's	1.79	1.49
2020's	1.57	1.27
2030's	1.73	1.43
2040's	1.87	1.57
Real GDP per capita in 2050-51 ($)	88,073	76,467
Additional real GDP 2003-04 to 2050-51 ($ billion)	5,651	-

Source: Banks, 2004.

This has been supported by a series of influential papers on the economics of ageing as produced by the Australian economists Ross Guest and Ian McDonald, who have shown that any negative impact of structural ageing on future living standards, defined as consumption per person, is likely to be small over the next few decades, and that these impacts will be more than offset by growth in labour productivity alone. On the assumption that labour productivity will average 1.5 per cent per annum, and that current rates of fertility and immigration continue, then living standards will be around 80 per cent higher in fifty years time compared to today even in the face of a structurally ageing population, with even greater increases in productivity improving the outlook for living standards[8].

Notwithstanding the key messages outlined above with respect to the centrality of productivity in Australia's recent economic growth story, it is notoriously difficult to make predictions about the future growth path of productivity. However, many economists tend to agree that the prospects for continuing strong productivity growth in the Australian economy remain reasonably favourable into the foreseeable future. This is partly due to the sense that the productivity gains from recent microeconomic reforms, such as labour market and taxation reform, are still working their way through the economy, and, as will be discussed below, there remains considerable scope to engage in further microeconomic reforms to unleash the productive potential of a dynamic market economy. The modelling presented in the IGR is predicated on the basis that labour productivity growth will average 1.75 per cent per annum over the next few decades, while the Guest and McDonald papers employ their assumptions on future productivity

[8] The relatively negligible impact of structural ageing on long-term living standards is due to the effect of reduced capital requirements of a proportionally smaller workforce (eg as reflected in a smaller share of the national output devoted to investment in plant and equipment such as personal computers and work desks) as well as reduced consumption demands from a smaller number of children in the population. In general, these effects imply that more of the (growing) national output is available for consumption, rather than investment, which in turn translates to higher long-run living standards.

growth on the reasonable grounds that the 1.4-1.5 per cent per annum labour productivity benchmark used in their projections are based on the Australian productivity growth average from the past eighty years.

In summary, on the basis of current policy settings and demographic parameters, the predominating view of the impact of long-term structural ageing of the population on the Australian economy is that, in the absence of consistently robust growth in productivity factors over time, then the reduction of the growth of the working age population (ie the future labour supply) may dampen growth in future economic activity.

Budgetary implications of structural ageing

The prospective structural ageing of Australia's population over the next few decades has also raised concerns about the future implications for the level of governmental outlays, and taxation revenues required to finance these expenditures. A number of authors have made projections, on a 'no policy change' basis, of the impact of structural ageing on the Australian Government's budgetary position (see Table 2). These studies point to a generalised deterioration of the budget balance, with other factors held constant, by between 1.8 per cent of GDP to eight per cent of GDP over the coming decades.

Table 2: Impact of structural ageing on Australian Government fiscal balances, per cent of GDP[a], [b]

Projection	Base year	2001	2011	2021	2031	2041	2051
Kelley (1988)	20.0	18.4	19.5		21.8		
	(1985)	(2000)	(2015)		(2030)		
EPAC (1994)	21.3	19.9	20.6	22.3	24.5	25.1	25.2
	(1990)						
Alvaro and Creedy (1996)	18.1	18.5	19.3	21.4	24.0	25.6	26.1
	(1988)						
Creedy (1999)	18.3			21.7			26.3
	(2001)						
Guest and McDonald (2000)	20.7	20.6	21.2	23.4	25.9	27.3	28.0
	(1997)						
Dang, Antolin and Oxley (OECD) (2001)	16.7						22.3
	(2000)						(2050)
Australian Government (2002)	13.9		13.6	15.1	17.1	19.2	
	(2001-02)		(2011-12)	(2021-22)	(2031-32)	(2041-42)	

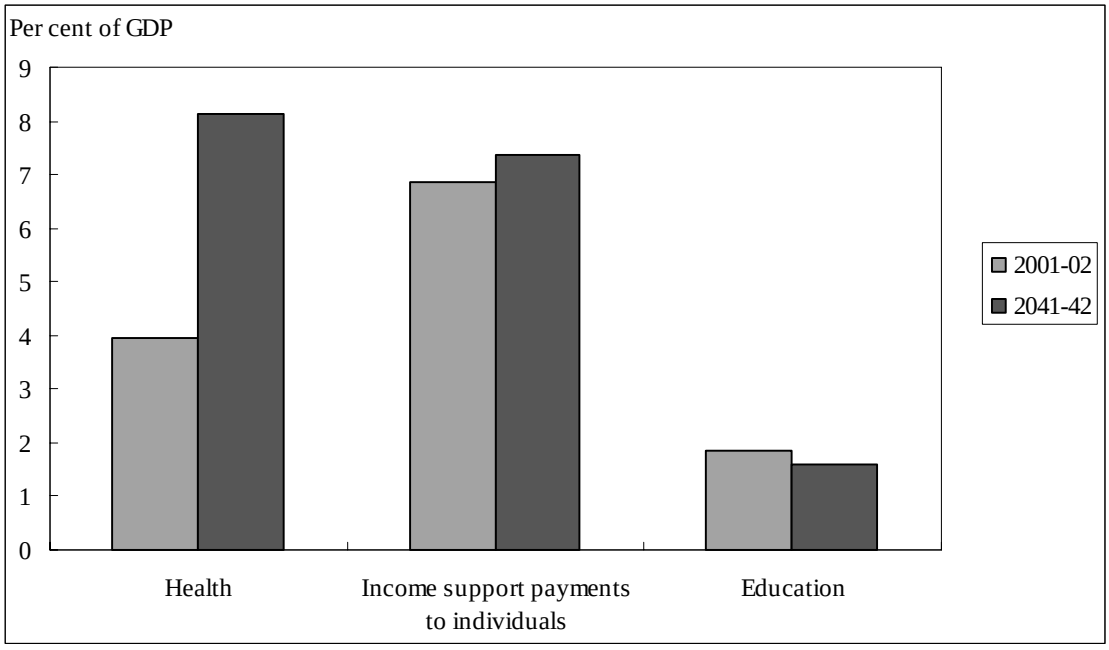
(a) The annual net migration and fertility assumptions adopted by the studies were (respectively) as follows: Kelley (100,000; 1.93); EPAC (0.54 per cent; 1.87); Alvaro and Creedy (80,000; 1.87); Creedy (80,000; 1.9); Guest and McDonald (0.54 per cent; 1.796 to 1.75); Dang, Antolin and Oxley (0.9 per cent to 0.41 per cent; 1.72 to 1.56); Australian Government (90,000; 1.75 to 1.6).
(b) Projections may include other expenditure functions, such as health and aged care, and education, which may be affected by demographic changes.
Source: Various.

While these studies embody different model specifications and assumptions regarding the scope of future demographic change, these and other studies have consistently illustrated that a higher proportion of older Australians within the total population may lead to considerable upward pressure on the Australian Government's budgetary burden, as a

proportion of GDP. Similar outlooks have been expressed in relation to the broad fiscal impact of demographic changes at both a State and local government level[9].

It is generally understood that the clearest channel through which demographic changes, such as structural ageing, affect future public finances is through age-related expenditures, particularly health, education and income support payments. Figure 7 illustrates the projected changes in various Australian Government expenditures (on a 'no policy change' basis) as a result of structural ageing over the next forty years.

Figure 7: Impact of structural ageing on selected Australian Government expenditure functions, per cent of GDP



Source: Australian Government, 2002.

The IGR suggested that, if current policies are not adjusted, the required adjustment in taxes and spending to support an ageing population would be in the order of five per cent of GDP by 2041-42 (or $87 billion in today's dollars). As illustrated above, much of the increase in government expenditure over this period reflects projected increases in demands by an ageing population for health care services[10]. On the other hand, the IGR

[9] For example, the Victorian Government (2003) has estimated that, on the basis of unchanged policies, Victoria's 'fiscal gap' (ie budget deficit before net interest costs) is projected to equal approximately four per cent of Gross State Product (GSP) by 2041-42 (or $15 billion in today's dollars). In its submission to the Australian Government Taskforce on Australia's Demographic Challenges, the Queensland Government (2004) drew on the collaborative research work of States and Territories to state that the 'fiscal pressure' facing the State/Territory Governments is projected to increase by 3.2 per cent of national GDP by 2041-42, again in the absence of corrective policy measures undertaken by the States.

[10] State Government projections with respect to the budgetary impacts of structural ageing provide broadly similar results. Expenditure on health, on the basis of current policy settings, is projected to increase over the next few decades. For example, the NSW Government quotes preliminary Productivity Commission estimates that State and Territory funded health expenses will rise from 1.9 per cent of GDP in 2001-02 to 3.3 per cent of GDP by 2050-51.

predicts that expenditure on education, as a proportion of GDP, will decline in response to slower growth in the number of students on the back of declining fertility[11].

The level of public expenditure devoted to welfare payments (such as unemployment benefits, payments to the disabled and sole parents, and age and service pensions) have been the subject of intense discussion over the past few years. Associated with this are long-term trends which highlight that the number of working age people receiving welfare payments continues to increase, even in spite of robust economic growth. Around one in six working age adults receive more of their income from welfare payments[12], with one in eight receiving more than 90 per cent of their income from welfare. Approximately one-third of lone parents and nearly half of single 55-64 year olds rely on welfare for more than 90 per cent of their income. More disturbingly, as at June 2002 there were 446,800 Australian families with children under 25 in which no parent had a paid job (with two-thirds of these families being lone parent family types). Of particular concern are the number of children within these jobless families (852,400 children), and the attendant risk of intergenerational welfare dependency. The IGR illustrates that, with no policy change in the future, welfare payments to individuals is projected to increase from 6.85 per cent of GDP in 2001-02 to 7.38 per cent of GDP[13].

In summary, if current public expenditure and other policy parameters remain unchanged, and that the projected demographic changes posed by structural ageing holds, then it is likely that Australia will face increasing public spending and/or tax pressures into the future[14].

By government or by market?: On the potential policy responses to structural ageing

It is clear that Australia will continue to experience structural ageing over the coming decades, and that this demographic trend *per se* is not amenable to public sector manipulation. However, the discussion above implies that it is essential not to discount the future economic and budgetary implications arising from an ageing population. Even bearing this in mind, SMEIA contends that it is essential to fundamentally question which

[11] However, there remains debate at the State level as to whether governmental education expenditure will increase – the Victorian Government concurs with the Australian Government's assessment that education expenses may fall slightly due to the declining proportion of school-age children. However, other States have referred to the possibility that public sector expenditure on education will increase as a result of the need to enhance human capital investment through 'lifelong learning' and other education and training investments. NSW has also referred to the inflationary nature of per student unit educational costs, including the costs of providing ICTs in schools.

[12] According to analysis presented by Peter Saunders of the Centre for Independent Studies, in 1965 only three per cent of working-age adults depended on welfare payments as their main or sole source of income; that figure is now around 16 per cent. Within this, the number of people receiving two of the main working age income support payments – the Disability Support Pension (DSP) and Parenting Payment Single (PSS) – has been increasing. With one in nine people aged 54 to 64 years receiving the DSP, it has effectively become a 'displaced unemployment' benefit – in other words, unemployment for mature aged people has been redefined as a 'disability'. In relation to the PSS, half of the recipients are reliant on their payment for the majority of their income, and that recipients are spending an average of 12 years within the welfare system.

[13] According to Tesfaghiorghis (2002), with current policy variables remaining constant, the number of working age welfare recipients is projected to grow from 2.9 million in 2001 to around 3.6 million in 2051 (an increase of 21.3 per cent), The number of DSP recipients is projected to grow from 639,400 in 2001 to 870,200 in 2051, sole parent payment beneficiaries increasing from 392,200 in 2001 to 405,200 in 2051, and the number of persons receiving unemployment benefits growing from 906,300 in 2001 to 1,087,300 in 2051.

[14] Notwithstanding the findings made by Guest and McDonald on the future implications of demographic change for economic living standards, as presented above.

broad change-agent is best equipped to enable Australia to adjust effectively to long-term structural population ageing. In particular, it appears that the prevailing conventional view remains that addressing the economic and budgetary implications of structural ageing should be left to governments (and thereby general taxpayers) to resolve – that is, it is somehow appropriate for current policy settings and the structure of public services to remain unchanged, and that taxpayers in the future should be left to shoulder the burden of increasing health care and other public expenditure demands by our ageing population.

On the other hand, the possibility that private markets ought to play a greater role in enabling the Australian economy to adjust to demographic change, and to play a greater service delivery role, has not been sufficiently recognised in the current debate in relation to the appropriate responses to address long-term structural population ageing. This is somewhat surprising, given that the projected increases in taxation revenue required to pay for current age-sensitive public services could make matters worse by reducing our economic potential, including negatively impacting on the incentives for individuals and families to work and save.

The discussion of the properties and features of competitive market systems has represented a venerable tradition in the economics literature, including in the writings of ordoliberal theorists. In broad terms, the market mechanism is a dynamic set of arrangements, involving buyers and sellers engaging in voluntary exchange, through which the resources of an economy are utilised so as to produce the goods and services that satisfy the wants and needs of members of the community. The terms of the voluntary exchange in free markets are defined by prices, which transmit coded information not only in relation to the underlying costs of producing goods and services but also consumer willingness to pay for products.

According to a number of experts in market process theory who understand the underlying precepts of ordoliberal economic theory (eg Vanberg, 1994; Kasper and Streit, 1998), the dynamic properties of free market competition can be more specifically conceived as a evolutionary trial-and-error process, in which rivalrous firms compete against other in introducing new products, marketing techniques, technologies and new inputs, new forms of organization and financial arrangements which enhance their customer market shares relative to other firms. These innovations essentially represent the conjectures of firms and their entrepreneurs about what current preferences are and how they can be best satisfied, and firms will continually strive to provide goods and services at prices acceptable to consumers. In this environment, firms are under ongoing pressure to perform, improve and change – if a firm succeeds in producing goods/services which are acceptable to consumers, then they may be rewarded with profits for their endeavour; on the other hand, firms which produce products which are refuted by consumers may lose market share as consumers shift their demand towards the goods and services offered by other firms. The dynamic process of the market mechanism is reinforced by continuous producer rivalry, where firms earning profits for successful product innovations are at risk of having their profit margins competed away by other innovative entrepreneurs.

As an open-ended discovery procedure, competition within the free market system most effectively perform the fundamental functions of allocating the economy's scarce resources between alternative uses as well as distributing the output of goods and services between consumers. Competition provides the spur to ensure that producers are responsive to the diverse needs of consumers, their production costs are kept to a minimum, their profit margins are not excessive, and that firms are technologically progressive and innovative. Since the market-based approach to economic organisation relies on choice and competition, it represents the economic analogue of the rights of individuals to personal liberty and freedom of action

In summary, the market is an evolving structure, involving voluntary exchange between individuals, which reacts effectively and efficiently to change, including in the nature of long-term demand and supply conditions. It adjusts in a way so as to deliver goods and services which are tailored to the needs of individuals and the community as a whole, including, in this context, a structurally ageing population. It is on these grounds that this submission contends that a comprehensive range of microeconomic reforms, which will work to enhance labour market participation, boost long-term growth rates of productivity, and deregulate key sectors of the economy such as health and education, are critical to ensure that economic prosperity and rising living standards can be guaranteed for the benefit of future Australians, including the projected growing cohort of older Australians.

Labour market participation

SMEIA strongly commends the active role of the Australian Government in reforming the labour market, such as promoting enterprise bargaining and broader measures to promote labour market flexibility, as well as the introduction of a contestable employment services market, as well as the Australians Working Together (AWT) welfare reform package which has emphasised the obligation of welfare beneficiaries to the broader community in terms of more actively seeking meaningful employment opportunities. Nonetheless, in a dynamic, evolving economy, there is further scope for Australia to enhance the extent of labour market participation of various age cohort groups into the future through additional labour market and welfare reforms, which may include the following broad measures:

- Labour market reforms to provide families and older workers with greater choice in relation to working arrangements to facilitate their ongoing connection with the labour market. These include a more flexible award system (including providing businesses with an opportunity to 'opt out' of the award system), a lower minimum wage floor[15] and reform of unfair dismissal legislation, and removing disincentives to work inherent in the tax and superannuation systems. These reforms would ensure that wages and workplace relations are more consistent with the circumstances faced

[15] According to the OECD (quoted in Buckingham, 2004), Australia has the second highest ratio of minimum-to-median wages in the OECD, behind France. An excessively high mandated minimum wage serves to raise the cost of employing less skilled and experienced workers, leading to higher unemployment and lower economic participation among these workers.

by individual firms, encourage employers to expand and employ more workers (including those with lower skills bases), and containing government welfare outlays by enhancing labour market participation, including for more mature aged workers, and hence improving self-provision for retirement through greater private savings.

- Reforms to tackle welfare dependence and reduce the disincentives acting against economic self-reliance that exist in the current welfare system. The economist and welfare reform expert Peter Saunders and other commentators have advocated additional welfare reforms, including the introduction of time limits for unemployment benefits with full-time Work for the Dole after six months, enforcing the expectation that parenting payment claimants should at least return to work once their children went to school, introducing tighter eligibility criteria for Disability Support Pensions, and invoking greater financial penalties for welfare system abusers.
- Disincentives to work can also be reduced by lowering income taxes, thereby raising disposable incomes for individuals and families by rewarding them for undertaking productive and meaningful work opportunities, and enabling families to have a greater capacity to use higher after-tax incomes for future savings.

It is expected that these and other reforms to enhance labour market participation will represent a critical long-term plank to retain and improve the engagement of individuals and their family members in a growing economy, leading to an accumulation of private wealth and savings and reducing long-term pressures on government budgets as the Australian population ages over the coming decades.

Productivity growth

As noted in the discussion above, productivity factors will be vital in increasing future GDP per capita and living standards. However, without further policy reforms, productivity growth may not be able to sustain the recent strong growth rates enjoyed since the 1990's[16]. Notwithstanding that the productivity gains from recent microeconomic reforms, such as taxation reform, labour market reform, welfare reform, reforms to sectors such as telecommunications, stevedoring and higher education, corporate law reform, and improvements to competition standards, are still working their way through the Australian economy, maintaining and improving upon our recent productivity growth performance requires the extension, and in some cases the introduction for the first time, of the microeconomic reform agenda in the following areas:

- labour market deregulation;
- welfare reform;
- further application of National Competition Policy, including the professional services sector;
- removal of industry assistance;
- reforms to services sectors such as education and health;

[16] It is also useful to note that there remains a productivity gap of some 20 per cent between Australia and the United States.

- further reforms in product markets such as energy, infrastructure, water resources, and transport;
- further trade liberalisation, including tariff reductions, and foreign investment liberalisation[17]; and
- reforms to Australia's fiscal federalism arrangements[18].

A stable medium-term macroeconomic framework, characterised by stable and prudent monetary policy and a commitment to fiscal balance, is also necessary to boost productivity, particularly within capital markets. More specifically, this can facilitate the maintenance of an environment conducive to low and stable inflation and low interest rates, thereby encouraging investment, the adoption of new technologies, and the efficient use of capital stocks. These measures will ensure that the Australian economy remains strong into the longer term in the face of structural ageing.

Service delivery deregulation

Health care

Most studies on the budgetary impacts of long-term structural ageing of the Australian population, most notably the IGR, hypothesise that public sector health expenditures will represent a major pressure point on governmental budget constraints. In the absence of policy change, both the Australian and State and Territory Governments are projected to face rising health expenditures as a percentage of economic output. An important factor underlying these increases is expected to be the rapidly growing proportion of older Australians, as the health care requirements of the elderly are, on average, higher than those of the young. Furthermore, many studies indicate that advances in medical technology will present another key driver of increasing public sector health care costs; technological progress in health is tending to create greater pressures on public resources as the range of possible treatments expands, which in turn also appears to be promoting increasing demand for, and use of, health services more broadly as new innovations to treat complex medical conditions become available.

However, it is also clear that the current structure of the Australian health system, which is predominated by government intervention through direct provision of services as well as regulation of private operators, will only serve to contribute to the further escalation of taxpayer burdens directed to health care. In general terms, the 'health insiders' (eg general practitioners, medical specialists, public hospitals, health departments) tend to drive debate on the future health expenditure directions on one hand and, on the other, with consumers and the general community left largely disenfranchised and at the mercy of a cumbersome health system which is unresponsive to customer needs and inefficient

[17] Consistent with this, Wolfgang Kasper recently produced a paper outlining a proposal for a Global Free Trade Alliance (GFTA), which enables signatory economies, potentially including Australia, to grant free access to traders and investors from free market economies.

[18] Including reforms to the ramshackle, socialistic system of horizontal fiscal equalisation (HFE), and reducing vertical fiscal imbalance (VFI) by realigning the taxation system to enable States and Territories direct access to the personal income tax base and abolishing GST revenue grants to the States.

in its operations. According to health and social services expert Vern Hughes, the major characteristics of the health system in its current form include that:

- The system is highly fragmented, with little continuity of care across program, service and practitioner types, with few incentives for the sector to become consumer-oriented.
- There is little or no financial incentive for practitioners and providers to keep people well and out of their surgeries or clinics – most the financial incentives favour repeat business.
- Consumers have little market-based bargaining power in the organisation and pricing of services, with insufficient avenues for consumers to substitute one care regime for a better or more price-effective regime.
- Consumers have little control or access to information systems around which the complexity of the system is structured.

A central key to these problems is that, at present, government simultaneously plays the role of funder, regulator, monitor, purchaser, and owner of assets as well as the major provider of services (Samuel, 2000). This restricts consumer choices and competition within the health system and adds to the overall government budgetary burden of the health system.

The Australian Government has made some crucial steps to promote consumer choice and reduce the longer term budgetary pressures of rising health expenditure as the population ages. In particular, the 30 per cent private health insurance rebate on contributions, introduced on 1 January 1999, has played a major role in containing government expenditure on health, by alleviating budgetary pressure on public hospitals, as well as arresting the long-term decline in private health insurance membership levels. Recent research has shown that, if the private health insurance rebate scheme were abolished, then combined Australian and State/Territory Government health expenditures would escalate from 6.4 per cent of GDP in 2001-02 to 12.7 per cent of GDP by 2041-42 – with the net cost of abolishing the rebate estimated at 0.5 per cent of GDP (Econtech Pty Ltd, 2004). Private health insurance coverage would also decline dramatically, once again placing pressure on the governmental health system into the future. Therefore, the current policy settings of the Australian Government in promoting choice in the health insurance market will greatly assist in reducing the long-term health expenditure burdens associated with structural ageing.

Nonetheless, additional reform measures could be introduced in the Australian health sector, including at the State and Territory level, to promote real and long-lasting market-based competition within the sector and encouraging individuals and families to take greater responsibility for their own health care needs. Some steps in this direction may include:

- Better targeting of Medicare and other public sector health care schemes to those in genuine need, including those on low incomes, the chronically ill and the elderly, and encourage the further development of the private health insurance industry, including

by removal of regulatory roadblocks on the capacity of the sector to provide quality insurance products to consumers.

- Measures to promote the competitiveness of public hospitals and other public sector institutions involved in service delivery such as nursing homes, clinics and community health centres, by facilitating the greater involvement of for-profit, non-profit community-based organisations and other consumer intermediaries, such as health cooperatives, friendly societies and mutual associations, in delivering health services.
- Removal of anti-competitive restrictions and regulations, including in the areas of workplace relations reform, the supply of medical practitioners, and other restrictive practices.
- Further extend the application of price signals in the sector which more closely reflect the true costs of various medical interventions, to prevent the unnecessary use of health services, to improve resource utilisation, and to transmit knowledge to providers as to the providers as to the products and services that consumers demand.

These and other market-based reform measures would serve to promote a competitive market order in health, and reassert consumer sovereignty in the marketplace. Providers will be pressured to compete for patients by improving access and the quality of services, introduce innovations that are of value to consumers, and to lower healthcare costs. This would be of particular benefit to the growing cohort of older Australians over the coming decades. Critically, these reforms would also serve to reduce future public sector outlays on the health system nationally.

Education

Notwithstanding the IGR projections that public education expenditure, as a proportion of GDP, will decline over the next few decades, the degree of human capital accumulation, in the form of investment and individual participation in education and training activities, has been increasingly recognised as a means to spur additional productivity gains and economic growth into the future. In the context of Australian school education, one the key social trends influencing the development of young people over the past two decades has been the drift in school enrolments from government to non-government schools, and the associated growth in private investment in schools. According to ABS schools data, non-government school enrolments had increased by around 330,000 students (or 13 per cent) between 1983 and 2003, while government school enrolments had declined by over 26,000 students (or one per cent) over the same period.

There has been much discussion in relation to the underlying factors contributing towards increasing parental private investment in school education, as reflected by the preparedness of parents to increasingly exercise their right of choice to send their children to non-government schools. These factors include:

- Catholic and independent schools, on average, relative to government schools, provide superior academic outcomes for students, as proxied by the proportion of

students entering tertiary education institutions and associated test entry scores (eg Marks, 2004).

- The greater capacity of non-government schools to deliver an environment more conducive to the effective social, cultural and moral development of children. In simple terms, there appears to be a greater congruence between the values, morals and aspirations instilled by the family at home and those taught in non-government schools (eg NSICA, 1998; DEST, 2004).
- In conjunction with these factors expressed above, parents living in households of lower size (with less children) with rising incomes, together with the altruistic motivation to provide the best educational environment for the children, will tend to favour the enrolment of their children in non-government schools and pay the requisite fees to do so[19].

Given the trend towards enrolments in the non-government school sector, and the long-term desirability of this trend from the perspective of providing the best economic and social opportunities for children as well as for fiscal sustainability objectives, SMEIA considers that it is critical that any public funding arrangements for, and regulations that apply to, schools should not act as a disincentive to private contributions and investment in education. Accordingly, we strongly support the role of the current Australian Government in supporting the choice of parents to enable their children to attend high-quality schools of choice, regardless of sector, and also support the principle that all Australian children of school age should receive at least some public funding in support of their education[20].

It is clear that there is an increasingly greater payoff from private investment in school education, and that this should be encouraged. In addition, there is a clear need to initiate further microeconomic reforms in the school education sector, particularly within the government school sector which tends to educate children from low socioeconomic backgrounds as well as rural and remote area students. Reforms which could further promote the extent of market-based competition within and between the school sectors would serve to enhance the quality of educational services, and promote positive spin-off effects for the ongoing development of Australia's future human capital reserves[21]. A range of alternative reform options have been canvassed both in Australia as well as overseas, and may include:

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[19] According to the Australian Parents Council, in their recent submission to the Senate Employment, Workplace Relations and Education References Committee into schools funding: 'Choice in school education can be predicted to grow. Reasons for that growth include higher levels of parental education and the recognition that education is a key to the future employability and resourcefulness of their children. Declining numbers of children in families and the growing capacity of parents to pay will also dictate choice' (Australian Parents Council, 2004). The broad interdependency between low fertility and declining household sizes, associated with long-term structural ageing, rising incomes and progressively increasing private investment in human capital has been recognised previously in the path-breaking analysis of Nobel Prize laureate economist Gary Becker.

[20] Generally speaking, the recurrent schools funding model currently applied by the Australian Government is a student-centred mechanism, and appreciates that young children do not have economic resources of their own accord to fund their own education. Further, it is noted that the current Australian Government schools funding policy is fiscally sustainable – it has been estimated that, if funds to non-government schools were withdrawn forcing children to be conscripted to government schools, then Australian taxpayers would face an additional budgetary burden of some $4 billion per annum.

[21] Indeed, such measures would also be beneficial for those parents, including those on lower incomes, who are currently unable to effectively exercise choice in sending their children to potential school sector alternatives.

- Public reporting of student academic performance at a school level, through the publication of 'league tables' comparing the performance of both government and non-government schools, as well as clearer student report cards provided to parents[22].
- Promoting the autonomy of principals in individual schools (especially within the government sector), such as greater freedoms to administer budgets, develop curriculum, raise incomes and employ teaching staff, which would then provide schools with a greater capacity to tailor educational services to the needs of local student populations.
- Introduction of 'non-systemic' government schools (otherwise known as 'charter schools') that are subjected to lower levels of centralised regulation, including in the areas of curriculum, school hours, disciplinary procedures, and teaching recruitment and retention, and which therefore have a greater capacity to modify services for the benefit of students.
- Introduction of expenditure voucher systems for parents to promote parental choices amongst competing schools and school systems, or tax credits to parents which enable their students to 'opt out' of the government school system when enrolling into non-government schools.

These potential reform options would encourage all schools, and in particular those within the government sector, to become more accountable and responsive to the needs of parents and their student children. In other words, school education delivery will focus less on satisfying supplier interests, particularly teacher labour unions, and more on the consumers – students and their parents. This will in turn improve the quality of educational services, and hence promote the development of human capital to secure Australia's economic future against the background of a structurally ageing population.

Given the long-term increase in the number of students attending tertiary education institutions, it is essential that the higher education sector effectively meets the future skills needs of individuals and, through it, the broader Australian economy. The Australian Government has implemented crucial microeconomic reforms within the higher education system, including enabling universities greater freedoms to set fees and creating additional performance-based incentives for universities to differentiate their missions and course content. Many of these key reforms aim to improve the financial capacity of universities, so that in turn they can more effectively provide world-class education services to students. In the longer term, additional reforms to promote greater price flexibility and admissions deregulation (including the abolition of student quota places), encourage new entrants into the higher education sector, and facilitate competition between universities for students could be introduced to promote human capital development and harness Australia's productivity potential as the structure of our population ages.

Further steps should also be taken to promote market-based competition within the vocational education and training (VET) and training market, including the promotion of

[22] For a defence of the 'league table' system of reporting school performance, see Gannicott (1998).

competitive neutrality between private education and training providers[23] and the publicly funded sector (TAFE institutes and universities), to meet the needs of industries and the Australian economy into the future. This is critical given the role of private training providers in delivering responsive, customised and efficient delivery of post-compulsory education and training, including in higher education, vocational education and training (VET), and specialised courses, and a growing emphasis on 'lifelong learning' as a means of boosting future productivity growth and labour market participation.

Conclusion

Australia has a progressively ageing population structure – from around 13 per cent today, the proportion of the populated aged 65 years and over is projected to increase to 27 per cent by 2051. It appears that this trend will continue to be driven by two main factors – lower fertility rates and higher life expectancy. Since the 1970's the number of births per woman has been below the rate of 2.1 needed for a 'steady' population, and is projected to fall further over time. The life expectancy of Australians is also expected to increase, as a result of continuing reductions in mortality rates. The demographic change towards a structurally ageing population appears inevitable, and cannot be reversed by measures to boost the birth rate or to raise net migration numbers.

The drivers of structural ageing arise from beneficial trends affecting society – longer, healthier lives and higher living standards. Longer lives result in larger numbers of aged people, while higher living standards are associated with falling fertility rates. In this context, structural population ageing is a social, economic and technological achievement. Notwithstanding this, it is essential not to underplay the future economic and budgetary implications arising from an ageing population. The challenge for Australia into the future is to develop policies and measures that will generate sustained strong economic growth, which focuses on labour force participation for individuals and families, stimulating future productivity growth, and promoting market-based service delivery measures in 'merit goods' sectors such as health and education services. SMEIA considers that this greater reliance on the free market order, and the development of strategies to foster microeconomic reform and promote smaller government, would represent the best combination of policy responses over the coming decades to structural population ageing.

In summary, a steadfast commitment to market-based reform will ensure that GDP per person and living standards can keep rising at sustainable rates, that community expectation of ever-rising governmental assistance is appropriately moderated, and that goods and services, as being provided by private sector operators, are more closely tailored to the needs of a changing population. These reform measures will in turn ensure that Australia enjoys an older and more prosperous future combined with greater economic freedoms.

[23] According to the Australian Council for Private Education and Training (ACPET), the number of students trained by private training providers of post-compulsory education and training has risen from 23,000 in 1995 to more than 200,000 in 2004 – an increase of over 700 per cent. The private training sector generates a gross turnover in excess of $1 billion, and employs around 15,000 teaching and administrative staff nationally.

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