**ECONOMIC IMPLICATIONS OF AN AGEING AUSTRALIA**

**SOUTH AUSTRALIAN GOVERNMENT SUBMISSION IN RESPONSE TO PRODUCTIVITY COMMISSION DRAFT RESEARCH REPORT**

## Introduction

The South Australian Government believes that the Productivity Commission's Draft Research Report represents a positive contribution to the debate surrounding the economic and fiscal impacts of population ageing, and extends the quantitative analysis of the likely impacts in a manner which represents an improvement on previous studies in this area.

This submission from the South Australian Government contains responses to some of the issues and analysis contained in the Draft Research Report, and makes some suggestions, both technical and presentational, for the Commission to consider in preparing its Final Report.

## Economic Impacts of Population Ageing

The Commission's analysis of the economic impacts of population ageing provides a rigorous assessment of the likely impacts on the broad drivers of GDP growth. In particular, the cohort projections of labour force participation represent a valuable contribution to understanding likely labour market developments.

One issue which warrants further attention is the implications of an ageing population on growth in incomes as distinct from production which occurs in Australia (GDP). Economists tend to often use per capita GDP growth as a measure of growth in material living standards or even incomes. While Australian GDP growth will have a direct corollary with that component of resident incomes which is derived from labour supply, the returns to capital associated with production in Australia will partly accrue to overseas residents. Similarly Australian residents will earn income from overseas investments. Gross National Income (GNI) is a much better measure of material living standards than GDP.

In the context of an ageing population this distinction could arguably be of some importance. As the size of the working age population shrinks relative to the size of the retirement age population there will be relatively less households trying to generate income from the supply of labour and relatively more households relying on capital income. Slower economic growth in Australia will reduce investment capital demands domestically, but this does not necessarily translate into reduced capital income growth opportunities for Australian resident households and the result may be an increasing reliance on income generated from overseas investments. Under this scenario, growth in incomes and material living standards may not slow as much as is indicated by the projections of per capita GDP growth set out in the Draft Research Report.

## Commonwealth-State Financial Relations

*Specific Purpose Payments*

The South Australian Government's major concern with the Draft Report is the presentation of the relative fiscal impacts of ageing as between the Commonwealth and State and Territory Governments.

The Commission's projections of fiscal impacts suggests that the Federal Budget will experience very large, and relatively immediate, expenditure pressures as a result of population ageing whereas the impact on State and Territory Governments will be relatively smaller and more delayed.

The Commission's estimates of the magnitude of the relative fiscal impacts as between the Commonwealth and State and Territory Governments are, however, highly dependant on the assumptions employed regarding Commonwealth funding to the States for specific purposes such as health (Specific Purpose Payments). The central assumption employed by the Commission (that SPPs grow in line with service demands) is the best possible world for the States. If SPPs were instead to grow in real per capita terms only, there would be a shift in fiscal burden from the Commonwealth to the States equivalent to around 1.7% of GDP by 2044-45.

The fiscal projections in the Draft Research Report implicitly adopt the view that Specific Purpose Payments (SPPs) are hypothecated payments from the Commonwealth to the States to achieve certain objectives, and that as a result SPPs will be driven by service needs. In many cases, programs funded through SPPs meet service delivery objectives which are shared by the Commonwealth and the States. The importance attached to these objectives may vary between the Commonwealth and the States at any given point in time, may change over time, may vary as between the various SPP funded programs and have varying degrees of priority attached to them compared with the respective own purpose outlay funded programs of each level of Government. In a number of instances such funding arrangements reflect a recognition that a range of public and community services are more efficiently delivered at a State or local level but that the Federal Government has the more efficient revenue raising mechanisms at its disposal to assist in financing the delivery of these services.

The potential for population ageing to pose significant burdens on public finances over coming decades highlights the potential for rising opportunity costs of program funding choices. Absent increased taxes, it is conceivable that Commonwealth priorities could be realigned through resource allocation decisions which involve a reduced relative commitment to programs which are currently jointly resourced by the Commonwealth and the States. There are "political economy" forces at work in intergovernmental financial relations as well as "real" economy forces, particularly at times of fiscal stringency[1]. In many significant areas the States would not be able to simultaneously reduce their program effort – conversely any risk of reducing

[1] The Productivity Commission's Draft Research Report "Economic Implications of an Ageing Australia" notes that current grants to the States fell steadily from 1983-84 to 1997-98 reflecting "severe pressures on the Australian Government's budget and the capacity to reduce payments while States could successfully increase their own-source revenue" ppJ.7-J.8

Commonwealth commitment would exacerbate demands on State Budgets. The funding of public hospitals through the Australian Health Care Agreement is a prime example.

The Commission itself notes that SPPs (in total) have "exhibited a slow decline as a share of GDP since the early 1980's"[2]. Since the beginning of the 1990's health SPPs have been relatively stable as a proportion of GDP (from 1990-91 to 2003-04 they have grown at an annual average rate of 5.7%, identical to the growth rate of nominal GDP). Even though ageing pressures over this period have been modest (relative to future projections), there has been little evidence (at least over this period) of health SPPs keeping pace with the non-demographic health demands which the Commission has itself identified (ie the historical growth in public health expenditures over and above general inflation, population growth and per capita income growth).

In the context of historical trends in SPP funding, and projected growing pressures on Federal finances, a case could be made that the SPP projection assumption should be to anchor growth rates to nominal GDP (ie the Commissions' Case B in Appendix J). As a projection methodology this could also be argued to mesh with the Commission's assumption of a constant Federal Government revenue to GDP ratio, on the basis that own source revenue trends could conceivably be an important factor influencing SPP funding decisions by the Commonwealth.

Alternatively, the presentation of the fiscal projections needs to highlight more prominently the potential for fiscal pressures to be transmitted from the Commonwealth to the States and Territories. While the Commission's Draft Report acknowledges the uncertainty attaching to its assumptions regarding Specific Purpose Payments, and the potential risks to State and Territory Budgets, such caveats will often be lost or conveniently ignored by users of the Research findings who focus solely on the central results. It is suggested, therefore, that the uncertainties flowing from the "political economy" nature of SPP funding decisions should be recognised more explicitly in estimated fiscal impacts summary tables with SPPs treated as a "shared" responsibility rather than allocated to the Federal Government. More generally, the Commission's emphasis on the overall fiscal burden facing all levels of Government is supported given the shared nature of many program funding responsibilities.

*Horizontal Fiscal Equalisation*

The South Australian Government welcomes the Productivity Commission's recognition of the importance of horizontal fiscal equalisation in limiting the differential fiscal risks between individual States and Territories resulting from relative divergences in projected demographic trends. This was a prominent theme in our first submission, based on modelling results which incorporated a fiscal equalisation mechanism within the Access Economics intergenerational model - viz:

> "*Without Horizontal Fiscal Equalisation (ie if the GST pool were distributed on an equal per capita basis) States like South Australia and Tasmania which*

[2] Productivity Commission Draft Research Report "Economic Implications of an Ageing Australia", page J.8

*are projected to age more rapidly would experience considerably more fiscal pressure than the average State…Because of HFE, however, South Australia's primary balances per capita would be nearly identical to those of the average State even though its demographic make-up is relatively less budget-friendly.*

*Since HFE equalises the capacity of State Governments to deal with differing demographic-budget trends there is little value in the Commission exploring the fiscal impacts of population ageing between individual State Governments."*[3]

HFE will mean that the fiscal impacts of population ageing will be very similar for individual State and Territory Governments. While the Commission has recognised this important point, the Draft Research Report still presents some (albeit limited and qualified) fiscal impact analysis by individual State and Territory (eg the bottom panel of Table 13.1). It is suggested that these estimates are, in the context of HFE, largely meaningless and should be discarded in preparing the Final Report.

## Expenditure

*Health*

The Draft Research Report provides a comprehensive overview of the common arguments regarding the impact of ageing on health service demands. A key unknown in terms of the demographic drivers is the extent to which the age profile of health costs may change over time. Clearly there is much uncertainty surrounding theories such as compression of morbidity and the extent to which rising life expectancies may defer some of the projected increase in health costs which are concentrated in the final years of life. Such factors may reduce, but probably not eliminate, the projected increase in health costs associated with population ageing. The Access Economics intergenerational model, for example, suggests that incorporating an "age from death" assumption, linked to projected increases in life expectancy, into the age profile of health costs could reduce the projected increase in health costs across all Government funded health programs by around one-fifth in 40 years time.

The Commission's projections of health expenditures incorporate a "non-demographic" growth rate of 0.5% per annum above GDP per capita for all health programs apart from the Pharmaceutical Benefits Scheme. This is based on historical growth in Government health outlays from 1984-85 to 2001-02, and represents the excess growth in such expenditures over this period over and above that which can be explained by inflation, population growth, age composition factors and per capita growth in GDP. Box D.1 in Appendix D sets out the calculation methodology. It is noted that the health premium which is calculated through this methodology may possibly be understated by around 0.3 percentage points per annum. It is understood that the inflation adjustment of 3.7% in the second row is intended to be a general economy-wide inflation factor as measured by the GDP deflator. While it is agreed that this is conceptually the preferred approach, over the period in question the growth

[3] Implications of the Future Ageing of Australia's Population, Submission by the South Australian Government to Productivity Commission Research Study, page 19.

rate in this measure of inflation (using annual average indices) appears to have been 3.4% per annum rather than 3.7%.

The extent to which these historical non-demographic trends will be a guide to the future is clearly speculative. While demonstrated statistically, the exact causes of past “excess expenditure” growth are not known. A variety of factors could have contributed to these historical trends – including rising unit costs of health services delivery relative to other goods and services, new technologies which have increased the quantity and quality of health services provided, community demands for increased availability and accessibility of health services (ie the notion of health as a superior good which causes demand to rise faster than income in a relatively wealthy society), or even inefficiencies in the structure of health service delivery in Australia arising from the overlapping responsibilities of Commonwealth and State and Territory Governments. The extent to which such factors will continue, abate or accelerate in the future and the degree to which each of these factors is controllable or a matter of community choice remains highly uncertain.

One potential future source of pressure on health systems are workforce remuneration levels. Rising demand for health professionals and aged care workers will affect the health and aged care system’s ability to provide the greatly increased demand for services which the Commission’s Draft Research Report predicts. The possible effects of this could include significant changes in work roles (eg nurses vis a vis nursing aides etc) or increased remuneration levels vis-à-vis other occupations in order to attract people into the relevant professions.

*Law and Order*

The Draft Research Report concludes that an ageing population is unlikely to have a significant impact on Government expenditures on law and order. While offenders and victims of crime tend to be over-represented in younger age cohorts (a factor which will tend to alleviate pressure on law and order services in an ageing population), the Commission concludes that general community expectations about safety will generally rise with income and as such will offset any potential fiscal benefit from reduced crime rates.

The Access Economics intergenerational model contains demographic drivers of law and order expenses which derive from current age profiles of victims of crime, defendants and imprisonment. However the overall impact on State Government law and order expenditures is relatively minor – a reduction in outlays of less than 0.1% of GDP over 40 years at the Combined States level. While this tends to confirm the Commission’s conclusion that population ageing in itself will not have significant implications for law and order expenses, community expectations of safety may in fact contribute to pressure for significant increases in Government expenditure in this area.

According to ABS GFS data, law and order expenditures have been one of the fastest growing components of State Government outlays in recent years. At a combined State and Territory level expenditures on public order and safety have grown at an annual rate which has averaged 1.8% per annum higher than nominal GDP growth over the past decade[4].

The belief that community expectations in relation to law, order and safety are rising is reflected in current South Australian Government policy and resourcing decisions. As part of the 2003-04 Mid Year Budget Review the South Australian Government announced its intention to recruit and train an additional 200 police officers over and above normal recruitment strategies designed to replace officers leaving the force. In 2001 police numbers totalled just over 3,600, and when the current recruitment drive is completed in mid 2006 this number is estimated to rise to 3,970. Additional police numbers are directed at a range of objectives including:

- Additional patrols in each local service area of metropolitan Adelaide.
- More police for relief in regional stations
- More staff to backfill secondees in police prosecutions
- Increased staff to investigate organised crime including bikie gangs
- Increased staff to investigate serious sexual offences including past offences
- Investigate e-crime and pursue criminal asset compensation

As part of its law and order priorities the Government has also announced plans to build two new police stations in metropolitan Adelaide, increased resources for police security around critical infrastructure, upgrades in national and State counter-terrorism, emergency management planning and protective security measures, additional resources for both coronial activity and the legal services provided by the Crown Solicitor's Office and Office of the Director of Public Prosecution.

Efforts to crack down on crime along with the implications of global security threats, community expectations in relation to protection from sexual offences and prosecution of offenders, and the influence of technological developments on the nature of criminal activity have all contributed to recent strong demands being placed on Government law and order programs. While demographic forces may not impact significantly in this area, arguably non-demographic cost pressures in law and order should be considered a significant potential factor influencing projected fiscal trends.

*Concessions*

State and Territory Governments provide a range of concessions to households on low and/or fixed incomes to offset the impact of a range of taxes and charges on the cost of living for such households. While not large relative to other programs funded by State Governments (such as health), concessions are clearly exposed to population ageing.

The Commission's Draft Research Report does not consider the impact of population ageing on State Government concessions in a comprehensive manner. There is some

[4] These estimates are based on the 2-digit General Purpose Classification (GPC) data from the ABS Government Finance Statistics. Unfortunately, the introduction of accrual accounting has caused a break in the series in 1998-99 so the analysis was broken into two periods. Public order and safety expenditures grew at an annual average rate which exceeded nominal GDP growth by 1.8% in both the period 1992-93 to 1997-98 (cash based) and the period 1998-99 to 2002-03 (accrual). The ABS have advised that that they are not satisfied with the quality of GPC data prior to 1992-93.

discussion of public transport concessions in Chapter 10, but these subsidies form only part of overall State Government concessions expenditure commitments. Council rate concessions are discussed in the context of the fiscal impacts of ageing on local government but, as the Commission acknowledges, pressures on local government in this area are likely to be ameliorated by the presence of State funded schemes.

The South Australian Government provides a range of concessions. The major concessions provided are:

- Council rates – 60% up to a maximum of $190 per annum for the principal place of residence ($100 per annum for State Seniors Card holders);
- Water - $95 per annum
- Sewerage - $95 per annum
- Energy - $120 per annum, administered through electricity accounts
- Emergency Services Levy - $40 per annum
- River Murray Levy – total exemption (currently $30.60 per annum)
- Public Transport – 50% fare concession
- Motor vehicle registration – 50% concession, 66.6% for incapacitated ex-service persons.

It is estimated that in 2004-05 the total expenditure/revenue foregone by the South Australian Government in relation to the above concession items was over $120 million, or approximately 0.23% of South Australian Gross State Product (GSP). Council rate concessions form the largest single component of this expenditure (around 25% of the total), followed by water and sewerage and energy concessions. Public transport concessions account for around 15% of the total.

Eligibility varies between concessions, but Commonwealth pensioners holding a Pension Concession Card or a DVA Gold Card are entitled to all of the above concessions. Eligibility extends to both full and part rate pensioners. Furthermore in recent years eligibility for some concessions has been extended to self funded retirees[5]. Other Commonwealth allowees are also entitled to concessions (based on entitlement to a Health Care Card), along with some low income earners and holders of a State Concession Card, although eligibility varies as between concessions. There is a Commonwealth SPP which partly offsets the costs of State Government concessions. The SPP agreement has been in place since 1993 and entitles the State to compensation from the Commonwealth in return for it providing certain core State concessions, including motor vehicle registration concessions, to Pensioner Concession Card (PCC) holders irrespective of whether they receive a full or part-rate pension. In South Australia's case the value of this SPP reduces the net cost of the concessions listed above to around 0.19% of GSP in 2004-05.

[5] In South Australia, holders of a State Seniors Card (available to permanent residents aged 60 and over who work less than 20 hours per week in paid employment) are eligible for council rate concessions (although at a lower rate than pensioners), as well as Emergency Services Levy and public transport concessions. Holders of a Commonwealth Seniors Health Card (available to those of pension age who do not receive income support payments, subject to an income test) are entitled to electricity concessions)

The concession recipient profile varies for each concession depending on eligibility rules, but for most concessions the profile is heavily weighted towards older age groups[6]. For council rates and the Emergency Services Levy, around 85% of concession recipients are pensioners and a further 10% are self funded retirees. For water and sewerage concessions around 95% of recipients are pensioners (self funded retirees are not eligible for this concession). Accordingly this program is heavily exposed to population ageing.

Estimating the impact of population ageing on concessions expenditure requires assumptions to be made about the average value of concessions. While eligibility is primarily determined as a result of Commonwealth decisions regarding access to relevant concession cards and pensions/allowances, the value of concessions is determined by the State Government. Some concessions are structured such that the value of the concession will rise in line with the value of the underyling tax or charge (ie motor vehicle registrations, public transport, River Murray Levy). Others are fixed dollar values which are not automatically indexed but are instead subject to periodic adjustment. During the past five years the aggregate concession value in South Australia for council rates, water and sewerage and energy has risen by around 23.5% in nominal terms. This equates to a real increase of 0.75% per annum above the Adelaide CPI over the same period.

As a rough guide to the impact of ageing on concessions expenditure, a simple projection methodology has been applied which projects increases in current recipient numbers by the projected growth in South Australia's population by relevant cohorts[7]. From a current level equivalent to 0.19% of GSP (net of SPPs), concessions expenditures are projected to increase to 0.28% of GSP in 40 years time under an assumption of 0.75% per annum real growth in the average values, or to 0.37% of GSP if it were assumed that average concession values rose in line with nominal GSP growth[8]. Thus population ageing has the potential to increase State Government concessions expenditure by 0.1 to 0.2 per cent of GSP over the next 40 years.

## Revenue

*Payroll tax*

The Commission's projection methodology for payroll tax revenues is supported. The results suggest that payroll tax revenues are likely to remain constant as a share of GDP, which is consistent with the results obtained from the Access Economics intergenerational model.

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[6] The profile of recipients of public transport concessions may differ from other concessions, but is not known.

[7] Pensioner and self funded retiree recipient numbers are inflated in line with projected growth in South Australia's population aged 65 and over. Other recipients, which are only a small proportion, have been projected based on growth in the working age population. Population projections are based on ABS Series 11 – see page 16 of previous SA Government submission.

[8] These estimates follow the Commission's approach of assuming that Commonwealth SPPs track the rising service demands under each scenario. However, while the current indexation arrangements for this SPP include a volume component based on the number of PCC holders, the price indexation factor is based on a wage cost index factor which in the last couple of years has only been around 2% pa.

On page 11.6 of the Draft Research Report, the opening paragraph describes payroll tax as a complex tax with a progressive rate structure. Such a description may have been appropriate to describe historical payroll tax arrangements but is not appropriate to current policy settings. With the possible exception of Queensland, current payroll tax structures are quite straightforward with a single tax rate applying to payrolls in excess of a nominated threshold level. All taxpaying firms obtain the benefit of the full threshold. As a result, average tax rates increase with payroll size; this differs from a progressive rate structure where marginal rates increase with payroll size.

Historically, payroll tax structures were more complex and varied more across jurisdictions. Previously, a number of jurisdictions applied a tapered threshold deduction which reduced with payroll size; some jurisdictions also applied multiple marginal rates (ie, progressive rate structures). Queensland is the only State or Territory that still has a tapered threshold that reduces as payroll size increases. However, it is not levied in an overly complex manner, with one marginal rate of tax and a deduction threshold reducing as payrolls increase.

*Conveyancing revenue*

The South Australian Government's main concern with the Commission's projections of revenues is the assumed increase in real house prices which underpins the projections of State and Territory Government conveyancing duty revenue.

Based on long term trends in real detached house prices in Australia, the Commission has based its conveyance duty projections on real dwelling price growth of 2.3% per annum in most States (a lower growth rate of 1.2% per annum has been used for Tasmania and South Australia). This factor, when combined with projections of household formation and transaction numbers, results in an increase in conveyance duty revenue for all States of just under 0.4 percentage points of GDP over the next 40 years.

The historical growth in real house prices of 2.3% per annum has occurred, however, in an environment when economic growth in Australia has been higher than is likely to be the case over the next 40 years. Real GDP per capita has grown by 1.9% per annum over the past 32 years, whereas the Commission's own projections indicate that this will slow to as low as 1.25% per annum by the mid 2020's[9]. On average over the next 40 years the Commission's projections indicate real GDP per capita growth of around 1½% per annum. Arguably slower income growth resulting from an ageing population is likely to lead to slower growth in real house prices than has been apparent over the past three decades. Furthermore, it is debatable whether very long run divergences between real house price growth and per capita income growth will be sustained. While this has been the case to a moderate extent since 1970 in Australia, this may be a statistical artefact reflecting the choice of time periods, and indeed the most recent periods arguably include a degree of overshooting. Alternatively it may reflect the impact of structural changes in the taxation treatment of housing and/or the transition to a low inflation environment which, on a no policy change basis, would be an inappropriate basis for future projections. While potential land supply constraints will impact on house price growth, over the long term income constraints will arguably

[9] Assuming productivity growth of 1.75% per annum.

eventually lead to population movement away from centres with rising real costs of housing.

It is also the case that the Commission's assumption of increasing real house price growth is not related to ageing per se. While it is acknowledged that some non-demographic factors, such as those relating to health demand and technology, need to be considered in the long run fiscal projections, this is the only example of such a factor being inserted into the Commission's revenue projections. Indeed at the Commonwealth level the Commission adopts a very simplified assumption that revenues will grow in line with GDP. If there is a view that asset prices have a long run trajectory which exceeds income growth, then it could be argued that the full consequences of this should be explored (including in respect of capital gains tax) for the sake of consistency, along with the full range of other conceivable non-demographic drivers of tax bases.

However there would seem little value in such a detailed analysis. The South Australian Government believes that the assumed growth in real house prices is sufficiently speculative and conceptually debateable that it should be removed from the Commission's methodology for projecting conveyance duty revenues. Instead, it is submitted that real house price growth should be assumed to track growth in real GDP per capita.

A couple of technical points in relation to the conveyancing duty projections are also raised for clarification.

On page 11.18 of the Draft Research Report it is stated that the most important underlying reason for projected conveyancing duty revenues rising as a share of GDP over the next 4 decades is the assumption that house prices will continue, on average, to rise at rates higher than real per capita GDP. It also states that if house prices were to rise by around 1.75% per annum, then conveyancing duty would remain roughly fixed as a share of GSP for most jurisdictions, and if house prices rose by less than 1.75%, conveyancing revenue as a share of GSP would contract.

Due to historically below average real house price growth in South Australia and Tasmania, a growth rate of 1.2% per annum was used in projections of real house price growth for those States. This assumption represents a lower rate of growth in real house prices than projected per capita GSP growth in these two States for most of the coming 40 years. Notwithstanding the use of a growth rate below 1.75% for South Australia and Tasmania, and below the rate of per capita GSP growth in these States, the results show that the ratio of conveyance duty to GSP is projected to <u>increase</u> over the next 4 decades even in these two States. The results for South Australia and Tasmania appear to require further explanation.

On page G.1 of Appendix G, in reference to conveyancing duty rates, the second paragraph states:

> *"The top marginal rates of duty vary between the jurisdictions, as does the transfer value at which it applies<u>. The Northern Territory applies its top marginal rate to the entire transfer</u>. All other jurisdictions apply the top marginal rate to the value in excess of*

*the top tier, together with a fixed fee reflecting the cumulative effects of the previous tiers. "*

The Northern Territory does apply its top marginal rate to the entire transfer, but only if the value of the transfer is above the top threshold level (currently $500,000).

The underlined sentence could possibly read: "For property transfers in excess of the top tier, the Northern Territory applies its top marginal rate to the entire transfer" or "The Northern Territory applies a proportional rate for property transfers in excess of $500,000". Either of these statements more accurately reflects the current structure of conveyancing duty in the Northern Territory.

## Sensitivity Analysis

In addition to the presentational aspects of SPPs discussed above, it is suggested that the fiscal impact projections should highlight the uncertainties more clearly in the form of sensitivity analysis around a range of assumptions.

The Commission has constructed two alternative demographic scenarios, P1 and P2, which highlight the impact of varying the fertility, mortality and migration assumptions which underpin the base case population projections. The projected aged dependency ratio by 2050-51 under these alternative projections could be as low as 37% or as high as 61%. The range of fiscal impacts associated with these sensitivity bands should be explored at least in terms of the presentation of the aggregate projections of fiscal impacts.

Given the even more speculative nature of non-demographic factors (particularly those such as the 0.5% per annum health loading which represent projected growth rates over and above the influence of income growth), it would be useful if the Commission separately identified in the projections of fiscal impacts the "pure" ageing effects to highlight the additional contribution from the non-demographic assumptions.

## Implications

The fiscal 'gaps' projected by this type of modelling exercise could be addressed through a mix of expenditure restraint, tax increases, higher economic growth and/or government borrowing. In reality, however, it is unlikely that Governments would allow the latter to assume a major role in financing expenditure commitments over the next 40 years by allowing significant and ongoing Budget deficits to occur.

Long term projections of the fiscal impacts of ageing do rely heavily on non-demographic assumptions, in particular those regarding community expectations surrounding the quantity and quality of public services and their relationship to income levels. While there are probably strong grounds to believe that community expectations of health, education and law and order services will rise with incomes, and in a relatively wealthy society may even rise faster than incomes, opportunity costs will also play a significant role in both community expectations and Government decision making.

As a modelling assumption the purported linkage between community expectations of Government service levels and income levels tends to downplay the importance of higher economic growth in dealing with the fiscal challenges of an ageing population. An alternative perspective is that higher economic growth will increase the capacity of Governments to deliver a given level of services for a given level of taxation effort. It seems likely that this type of 'expenditure capacity' approach will, in fact, be how Governments approach ageing related pressures in the future. Rather than population ageing requiring drastic policy action, Governments will need to continue with prudent budget management and make trade-offs between service provision and taxation as they always have. Community expectations regarding the tradeoffs between taxation and services levels will evolve incrementally, and in the context of fiscal challenges posed by population ageing these expectations may evolve in ways which do not necessarily replicate the experience of recent decades. These expectations may also evolve in different ways across the spectrum of services which are currently provided by Governments. Resource allocation as between Government funded programs will arguably assume as much importance as addressing the fiscal "gaps".

More generally, it would be useful if the Final Report explored more fully and specifically the fiscal policy implications of population ageing. In particular the Draft Research Report tends to the view that intergenerational equity concerns lead to the conclusion that current generations should not be burdened with the costs associated with financing rising health and aged care demands over the next 40 years, in large part because productivity growth will deliver higher real incomes to future generations providing them with a relatively greater capacity to meet these costs. However the Commission also notes that:

> "*there are credible risks that the demographic or cost pressures might raise the fiscal stakes of ageing higher than those projected by the Commission. Early action would also help mitigate such risks*[10]" and
>
> "*…uncertainties about the future extent of ageing suggest continued monitoring of population trends and the development of long-term policy approaches that are flexible enough to deal with quite different population ageing outcomes*[11]"

Given the uncertainties associated with the projected fiscal impacts of population ageing, it would be useful for the Commission to set out in more detail what it believes would be an appropriately flexible fiscal policy approach to deal with this uncertainty (with the emphasis on fiscal as distinct from economic policy). Furthermore if there are grounds to believe that the balance of risks is weighted towards greater than projected fiscal gaps are there grounds for a precautionary approach in fiscal policy setting and what may this entail?

The Commission's Draft Research Report briefly highlights the importance of increased efficiency and effectiveness in the delivery of health care services as a policy imperative which assumes even greater importance as the population ages.

[10] Implications of the Future Ageing of Australia's Population, Submission by the South Australian Government to Productivity Commission Research Study, page XLIV.
[11] Ibid, page 2.37

The promotion of primary and preventative health care arguably looms large in consideration of improved health service effectiveness. A paper by McGowan[12], using South Australian data, demonstrates that the acute (hospital) costs associated with cancer and chronic disease are reduced the older the age at death. The author also presents evidence that people from lower socio-economic backgrounds have reduced average life expectancies, and concludes that:

> *"…it is possible to combine Fries' Compression of Morbidity argument with the evidence that age of death is associated with cost and the observation that socioeconomic status is related to age of death, to propose a comprehensive framework for preventative health care service delivery.*
>
> *Health systems aim to optimise the health and well being of the population with the available resources. They have preventative, restorative and maintenance objectives; to prevent ill health, restore the ill to a state of healthiness and to maintain health of the well. Leaving aside the important role of the health system to respond to the ambient level of human frailty with restorative services, the goal of a population health approach should be to defer the onset of disease and disability more quickly than it extends length of life. This seemingly simple and clear objective can serve to focus much of the hitherto uncoordinated health system effort, into a targeted and measurable collective endeavour. Much like the commercial sector is clear about stockholder returns, the health system should be clear about it objective to defer onset of disease and disability more quickly than extend length of life*."

[12] McGowan, C, *Compression of Morbidity – the Australian Experience*