Submission to the Productivity Commission

Economic Implications of an Ageing Australia

– a Business Perspective

CPA Australia

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Executive Summary

1. CPA Australia welcomes the opportunity to contribute to the Productivity Commission (PC) commissioned research study, *Economic Implications of an Ageing Australia*.

2. As Australia's pre-eminent professional association, representing the diverse interests of more than 105,000 finance, accounting and business advisors, we are committed to working with governments and agencies to ensure current and future economic and social policies foster an environment that maximises economic efficiency and makes Australia a better place to live, work, save and invest.

3. The pressures that an ageing population will place on Australia are shared by many other countries worldwide as birth rates decline and people live longer and retire earlier. It is encouraging to see the federal government and others addressing fundamental issues such as labour supply, productivity and retirement, and the associated fiscal impacts at this point in time.

4. The comments and recommendations made in this submission are focussed at providing the right business environment to enhance prosperity, while at the same time meeting the fiscal challenges of the ageing population.

5. The PC Draft Research Report (Draft Report) provides a very valuable insight into many of the challenges we must confront in the future. However there are a number of issues that we submit require further work. In this regard we make the following comments on the Draft Report as well as some recommendations:

The PC Draft Report – general comments

- There is an inherent lack of information on future labour market behaviour of today's younger cohorts. There is a need for further work to be undertaken perhaps using the Life-Cycle Model (LCM) of consumer behaviour which is the standard model used for studying saving and consumption behaviour

- the PC Draft Report discusses consumption patterns in the context of considering future GST revenues. It is not clear to us, however, that the conclusion reached on this matter (regarding a likely increase in consumption) is justified by the analysis and evidence contained in the PC Draft Report; and

- even if participation and general productivity improvements are not the 'silver bullet' to the problems associated with the ageing population, clearly such changes are highly desirable in underwriting future increases in living standards and for this reason alone should be pursued.

Taxation

6. In respect of taxation and the ageing population, CPA Australia recommends:

- the government undertake further modelling work to consider the implications of retaining the existing personal income tax system over the projection period to 2044-45 given the adverse effects of the current system on the ability of individuals to work, save and invest; and

- as part of the policy changes necessary to encourage greater worker participation and productivity, that the government pursue the reduction of personal tax rates and/or increases in thresholds as a matter of both national interest and national necessity so as to maintain a tax system that will meet the demands and challenges which an ageing population will place on the economy.

Not-for-profit sector

7. In respect of the not-for-profit sector and the ageing population, CPA Australia recommends:

- building on the recent government review of pricing in the aged care sector, further data on the sector and its management is needed to develop appropriate government policies to support the sector in the future

- the government undertake a comprehensive review of the regulatory environment for the not-for-profit sector to improve financial reporting, governance and sustainability

- as part of funding arrangements, governments should consider providing incentives to organisations to improve management and attract more professional staff

- there be increased focus by government agencies that provide grants to the sector to understanding and accessing the governance of recipient organisations

- government consider provision of incentives to ensure more targeted training is available for NFP managers in health and aged care; and

- government gains a better understanding of the role of boards in the sector and provision of support services to boards.

Small business

8. In respect of small business and the ageing population, CPA Australia recommends:

- higher levels of 'firm churning' – the continual entrance and exit of firms in the economy – can be linked to economic growth and inefficient businesses either close or are taken over by more efficient businesses. New firm entry can be linked to job creation, innovation productivity growth and economic renewal.[1] There needs to be a constant supply of new entrepreneurs to ensure continued growth. This is event more critical, if more firms are exiting the market through retirement of the owners. Entrepreneurial activity can be encouraged through policy intervention in schools, reducing barriers to exit and entry, developing an entrepreneurial culture and supporting start-ups. Establishment of a cross portfolio entrepreneurship policy will assist in productivity gains

- the government should consider developing a model that could be used by regional organisations and industry bodies to analyse the potential impact of the increasing closure of small businesses where owners retire and are unable to transfer ownership of the business in particular geographical locations or industries. Organisations would then be able to understand potential impacts where the loss of viable firms may reduce available employment or availability of services

- policy options should be considered to strengthen Australia's enterprise culture, to encourage more people, including school leavers, to aspire to running a business as a viable alternative to seeking paid employment. Development of an enterprise culture requires commitment of both government and the business community to develop and resource appropriate strategies, and

- government should undertake an awareness program to assist those approaching retirement age to assess the saleability of their business and to develop strategies to maximise any return on their business and to ensure they are able to fund their retirement. More programs for this demographic should be developed and delivered by both government and the business sector.

Capital markets, and property

9. In respect of capital markets and property and the ageing population, CPA Australia recommends:

[1] Stevenson L, Lundström *An Entreneurship Policy for the Future: Best Practice Components.*

- the Productivity Commission develop an understanding of the likely impact on the capital markets of the potential change in investor habits and the consequent impact on other macroeconomic variables.

Superannuation

10. In respect of the PC's Draft Report:

    - the Productivity Commission develop an understanding of the likely impact of individuals having inadequate retirement savings on overall consumption patterns and the further impact on the adequacy of retirement savings if individuals need to become more self-sufficient in funding their own health and aged care costs

11. In respect of superannuation and the ageing population, CPA Australia recommends:

    - the government comprehensively reviews the Australian retirement system to ensure it is simple, sufficient and sustainable with individuals being encouraged to save and having adequate retirement savings to maintain a reasonable standard of living in retirement
    - A review should cover areas such as superannuation taxation, preservation and age pension ages, the level of mandatory contributions, contribution and benefit limits, and the nexus between lump sum retirement benefits and retirement income streams
    - The first priority should be a review of superannuation taxation to ensure it is equitable and efficient while providing the necessary incentives to encourage self-provision in retirement. The removal of 'front-end' taxes - the contributions tax and superannuation surcharge - would provide greater incentives for voluntary savings to be made.

Financial planning

12. In respect of financial planning and the ageing population, CPA Australia recommends:

    - The government make a greater investment in the area of financial literacy for consumers to create a positive message around saving and investment and ensure consumers are well aware of the danger of debt – particularly debt for the acquisition of consumer items
    - The government must do more to promote the message that reliance on superannuation guarantee (SG) contributions alone will not achieve a

comfortable self-funded retirement for people. Achieving higher retirement assets can be achieved through a combination of consumer education and the lowering of up-front government taxes such as contributions tax and surcharge to encourage higher contribution levels

- The government needs to support and develop the financial planning industry to ensure there are sufficient professional advisers to support the growing number of retirees. The long term objective of the government must be to transfer the provision of retirement income from the public purse (i.e. aged pension) to self funding. A key element to achieve this will be to ensure there is a strong and professional financial planning industry to ensure people achieve sufficient retirement capital and then invest it appropriately. This can be achieved by the government working closely with professional bodies such as CPA Australia to identify initiatives that can build consumer confidence in financial planning, and

- In supporting the financial planning industry, the government should also promote the provision of financial planning services on a fee-for service basis rather than the commission basis used widely in the industry. The acceptance of commissions can be seen to create unacceptable conflicts of interest and will slow the acceptance by consumers of financial planning as a profession equal to others such as accounting or law.

Information management and technology

13. In respect of Information management and technologyand the ageing population, CPA Australia recommends:

    - the Productivity Commission develop an understanding of the impact of improved technology on extended work force participation and productivity, through access to both improved education and training to older workers; and

    - the Productivity Commission develop an understanding of the demand for and the resulting impact of, improved access to technology, in light of continuing demand for flexibility and ongoing business, family and community involvement.

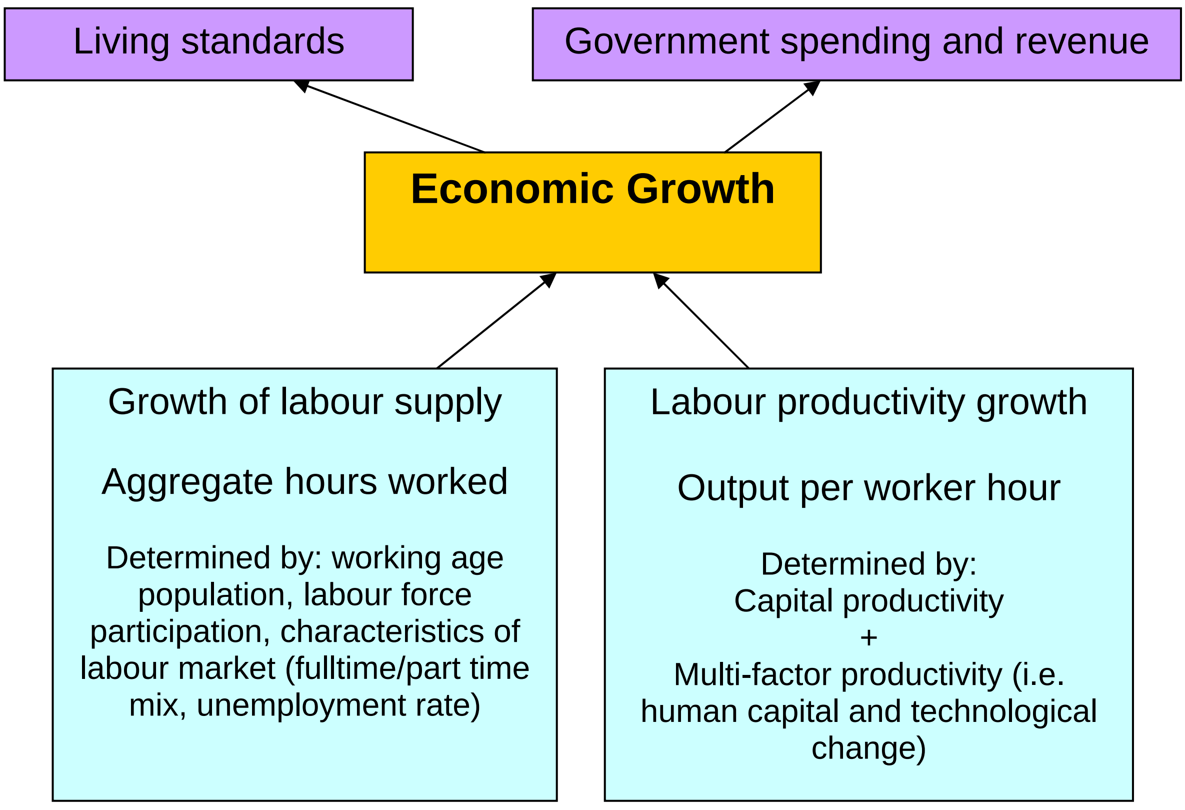
14. In the interests of the members of CPA Australia and the community generally, this submission will be made available to members and other interested parties via our website at www.cpaaustralia.com.au.

1. THE PC DRAFT RESEARCH REPORT

Economic Framework for Considering an Ageing Australia

15. The economic challenges facing an ageing population essentially relate to future GDP growth, improvements in living standards and fiscal sustainability. The broad economic framework for considering these implications of an ageing population can be summarised by Figure 1.1 below (which is a simplified version of Figure 3.1 in the PC Draft Report).

Figure 1.1: Broad Economic Framework



16. A fundamental concern for a society is to sustain improvements in the living standards (intepreted broadly, and including the consumption of goods and services, health status and functionings, and community well-being) of its citizens. At the same time, a primary concern for policymakers is to achieve a sustainable fiscal balance between government expenditure and revenue programs. As highlighted in Figure 1.1, underpinning both of

these objectives is economic growth. The ability to achieve continuing increases in GDP is key to realising the objectives of improved living standards while sustaining fiscal balance.

17. In turn, key drivers of economic growth for an ageing population are increases in total labour supply (that is, aggregate hours worked across the population) and gains in labour productivity (or output per hour worked).[2] Considering each in turn, the future growth in aggregate labour supply is a function of the size of the working age population, the labour force participation rate, and the the hours worked per worker (this is well set out in Chapter 3 of the PC Draft Report). Labour productivity is a function of capital productivity (as the capital stock deepens, this augments labour productivity, other things equal) and multi-factor productivity (which is improved through the accumulation of human capital and technological change). In aggregate, income not used to consume goods and services will provide a pool of savings to facilitate improvement in both capital productivity (capital deepening) and multi-factor productivity. While an ageing population will act to change consumption patterns, it is the aggregate impact on consumption that matters. The impact of an ageing population on aggregate consumption is less clear. This will be determined by future consumption patterns by cohort – which has not been addressed by the IGR nor the PC Draft Report.

18. A useful framework for considering individual and family decision-making in relation to human capital investment, participation, labour supply and retirement behaviour is the Life-Cycle Model (LCM) of consumer behaviour. The LCM is also the standard model used for studying saving and consumption behaviour. The LCM is in essence a framework for examining inter-temporal decision making based on the idea that individuals (and families) make labour supply, consumption and saving decisions to maximise their expected well-being given their limited resources (as represented by their budget or wealth and time constraints). It is a very rich model which highlights the key factors influencing micro-level decisions. As a consequence, the LCM also reveals the pivotal variables through which policy may influence individual behaviour (and at the same time providing a guide to the direction, and possibly the order of magnitude, of the policy impact on family well-being).

19. A fundamental implication of the LCM is that families will allocate their expenditures over time to maintain a stable stream of consumption in the face of changing family income. Expected life-time well-being is maximised by smoothing consumption over time through saving and borrowing activities. Although family income may fluctuate (for example, due to changes in wages, hours of work, or even with retirement), if families have access to

[2] The PC Draft Report also discussed the importance of population size (as the third of the critical 'three P's of population, participation and productivity'). However, projections regarding participation and productivity are more controversial aspects of the model exercises, and these varirables are also more amenable to policy action.

(formal or informal) saving and borrowing mechanisms, they will maintain a smooth consumption through time[3].

20. To consider the aggregation implications of individual decision making and an ageing population, it is useful to think of the population at any point in time as consisting of a series of 'birth cohorts' - each with its own historical experiences and at a different stage in the life-cycle. The mix of birth cohorts evolves over time, as younger birth-cohorts are relatively smaller (representing a smaller share of the total population) during the process of population ageing. It is important to recognise that there may be substantial differences between birth-cohorts in terms of their socio-demographic characteristics (human capital, health capital, family formation), life-time experiences (histories of unemployment, real interest rates, wage paths, demographic events) which can have very persistent effects, and even preferences (attitudes toward risk, patience and saving objectives, willingness to forgo of leisure-time / non-market time for wages). One very important difference across birth cohorts in Australia is the substantial increase in the average level of educational attainment over the 20th century– which in turn is linked to higher levels of labour market participation, labour earnings and productivity. Similarly, there have been fundamental changes in the demographic structure of families, social attitudes concerning the role of women and the labour market opportunities available to women. Consequently, the experiences of older cohorts may provide a poor guide to the future outcomes for today's younger cohorts. For instance, the labour market participation rates of men and women witnessed today may not be an accurate guide to the labour market attachment of younger generations. There remains a significant degree of uncertainty about the likely participation rates of the younger cohorts as they age and approach the retirement window.

21. Cohort differences are discussed in the PC Draft Report (2004: Chapter 3, page 12) and the projections throughout Chapter 3 attempt to recognise important differences across cohorts and take account of the changing composition of the population as cohorts age. However, there is an inherent lack of information on future labour market behaviour of today's younger cohorts. The salience of the cohort differences should not be underestimated and it is important to acknowledge the fundamental uncertainty concerning the projections of future behaviour of younger cohorts.

Review

22. As discussed in outlining the economic framework, the key variables in assessing the impact of an ageing population are:

[3] See Bateman, H., G. Kingston and J. Piggott (2001), *Forced Saving: Mandating Private Retirement Incomes* Cambridge; New York; and Melbourne: Cambridge University Press, pp27-50), and Browning, M. and T.F. Crossley (2001), 'The Life-Cycle Model of Consumption and Saving' *Journal of Economic Perspectives*, vol. 15 (3), pp.3-22 for an insightful survey of recent research which draws out the broader implications of this framework.

- Working age population: demographic projections - fertility, mortality, immigration

- Labour supply: assumptions about future labour market behaviour (to estimate participation rates and average hours worked)

- Labour productivity: assumptions about future capital deepening and multifactor productivity (to estimate future labour productivity growth)

- Fiscal gap: assumptions about future tax revenue and future costs of government programs (to estimate future budget balances)

23. Overall we consider that the projections and assumptions used in both the Integenerational Report (IGR) and the PC Draft Report are reasonable.

24. For projections of economic growth and GDP per capita the crucial assumptions relate to demographic trends, the labour market and labour productivity. Here the demographic assumptions are least uncertain as they are based on long run trends using ABS data. The greatest uncertainty relates to the projections for labour productivity growth and labour force participation. For labour productivity growth both the IGR and the PC Draft Report use the long term average of 1.75% pa. This is not an unreasonable assumption as one can only guess the future path and impact of technological change. Similarly uncertain is the future labour force participation of today's young cohorts. As we have noted earlier, the current labour market behaviour of older workers may not be a good guide to the labour market behaviour of older workers in the future.

25. For projections of the fiscal gap in the middle of the 21st century additional projections for total government revenue and expenditure are required. On the expenditure side the greatest uncertainty relates to future health costs particularly arising from non demographic factors. The problems associated with projecting future health costs are well documented in the PC Draft Report. However, we would query whether both the IGR and the PC Draft Report gives adequate consideration to the impact of an ageing population on Commonwealth tax revenue. Relevant here is the observation that, under current policy, retirement income is concessionally taxed as compared to labour income. Perhaps the assumption of no change in tax revenue as a percent of GDP over the next fifty years needs to be qualified and possibly modified.

26. Regarding productivity growth v/s labour supply increases, the PC Draft report notes that productivity gains are clearly worth achieving in their own right but questions their contribution to closing the fiscal gap unless the tax share of GDP is allowed to rise which could bring its own adverse effects working in the opposite direction. In any event, as noted above, we support the government's commitment to maintain the tax/GDP ratio over the projection period and that it be made more explicit in future.

27. On the other hand, unlike the PC draft report, we are more optimistic that measures to increase the labour supply, such as through encouraging/facilitating higher participation rates among older Australians, offers a more promising way to address ageing issues, including the fiscal gap problem. We note from its latest Survey of the Australian Economy, that the OECD shares this view. In particular, the OECD recognises the following benefits from such an approach:

- increased tax revenues without creating higher government expenditures
- fewer people drawing on age and disability support pensions, and
- the potential to eliminate that portion of the fiscal gap relating to demographic change (even though a large part of the gap arising from growth in health spending not related to ageing would still remain).

28. CPA Australia has also identified the following issues that we believe should be more adequately addressed as part of this review.

Tighter control on government spending

29. One way of managing the potential fiscal gap downwards going forward is via tighter control and scrutiny of existing and future government outlays, including the financing of any additional ageing related expenditures from savings that might be made in existing government programs. This could be over and above those savings arising from the reductions that are expected to occur as a result of the projected slower growth in the numbers of younger people due to past fertility declines.

30. Measures to shift the cost of some government services (albeit without restricting access by lower income earners) from the public sector to the beneficiaries of such services may also warrant further consideration. The type of measure adopted would, no doubt, vary depending on the type of service being provided. But it could include some appropriate combination of user charges, income contingent loans and private insurance. Improvements in financial management processes and general government accounting should also be a component of this approach. For example, greater transparency and uniformity in reporting on the net budgetary position (surplus/ deficit) of the Commonwealth and the various States/Territories is one area for possible improvement.

31. Notwithstanding the above, we welcome the government's adoption of a ceiling on its overall tax revenues and debt levels (and, by implication, budget outlays as well) but, as noted below, its current commitment to a specific tax/GDP ratio needs to be clarified and formalised in future budget documents. Appropriate links between these fiscal ceilings and the present Charter of Budget Honesty is also desirable.

Fiscal Gap

32. The PC Draft Report sees three areas that may need to be addressed to bridge the projected 7% gap:

- population
- economic growth (via labour supply and productivity)
- cost-effectiveness of government services, particularly health/aged care.

33. The report's main conclusions in this regard are:

- other than increasing the skilled component of migration, population is not seen as the answer to the ageing problem
- labour force participation rates among older Australians are relatively low by OECD standards and action should be taken to address this - however, productivity benefits from improvements in this area are unlikely to be significant
- productivity gains are worth achieving but, assuming no consequent increase in the tax share of GDP, their impact on the fiscal gap is likely to be muted (main impact would be in respect to government services, particularly if productivity gains exceeded those in the general economy)
- action to improve the efficiency/effectiveness of health care services (eg. changes proposed in the Productivity Commission's October 2004 draft report on National Competition Policy reforms) could significantly reduce the fiscal gap (and also improve patient outcomes).

34. The draft report's conclusions in this regard as to the significance (or lack thereof) of productivity and labour supply factors in bridging the potential fiscal gap arising from population ageing seems at odds with its earlier views on this point as summarised in paragraph 5 above. It also appears to run counter to the general view that faster growth and employment represent the easiest ways to meet the cost of increased government outlays in future years, which is a view that has been supported by Treasury. Given the importance of this issue it would seem that it needs to be further examined.

Education/ skills development

35. Ongoing education and training (particularly of older people) is an important factor in maintaining and lifting participation rates and improving the productivity of the workforce. A question arises, however, of the extent to which such training should be the responsibility of government and/or the private sector and who should bear the cost. It would appear preferable for the private sector to be responsible for much of this ongoing training to ensure that it is closely related to the needs of particular employers. To the extent that workers wish to obtain broader skills, the cost may be either borne by employers (if they so choose) or by workers themselves subject to some public assistance via use of the self-education provisions in the income tax law.

36. More direct public assistance may be required, of course, in the case of some people outside the workforce on working age benefits (e.g. unemployment assistance) as is currently the case but this should not give rise to any significant additional spending by governments in the future given other changes in respect to welfare reform as mentioned below.

Retirement savings

37. The report has little to say on superannuation or retirement savings except to note that past government action in this area has meant that Australia does not have the sustainability problems here as do other OECD countries (including particularly the US). See our comments under *a. Retirement savings* later in this submission.

Consumption Patterns

38. The report discusses this issue in the context of considering future GST revenues:

- much of the wealth of older Australians is in owner-occupied housing and superannuation assets
- to the extent that a proportion of this wealth is liquidated (and presumably superannuation assets will be run down) then the ratio of total private consumption to GDP should rise (other things being equal)
- however, future consumption ratios are unlikely to be higher than at present given that the current ratio is historically high
- dissaving by the old is generally less than expected due to bequests. uncertainty re length of life and illiquidity of some assets
- on balance, the aggregate consumption ratio could be expected to rise.

39. It is not clear to us, however, that the conclusion reached on this matter (regarding a likely increase in consumption) is justified by the analysis and evidence contained in the PC Draft Report.

Magnitude of Ageing Problem

40. The report states that population ageing is *not* a crisis but still raises major policy challenges because the projected fiscal gap must be financed and/or managed down in some way. As noted above, the view is put that the solution does not lie in population or general productivity changes/improvements (although the latter are critical to future living standards generally), but rather in improvements in the productivity of Australia's health system.

Link with Intergenerational Report (IGR)

41. While the report places less emphasis on participation and general productivity improvements as a solution to the ageing problem, it notes that such changes are clearly highly desirable in underwriting future increases in living standards. These changes would also provide the wherewithal to deal with the ageing problem as a last resort (ie. to the extent that the tax/GDP ratio was allowed to rise to deal with the situation).

Comments/ recommendations

- There is an inherent lack of information on future labour market behaviour of today's younger cohorts. There is a need for further work to be undertaken perhaps using the Life-Cycle Model (LCM) of consumer behaviour which is the standard model used for studying saving and consumption behaviour
- the PC Draft Report discusses consumption patterns in the context of considering future GST revenues. It is not clear to us, however, that the conclusion reached on this matter (regarding a likely increase in consumption) is justified by the analysis and evidence contained in the PC Draft Report, and
- even if participation and general productivity improvements are not the 'silver bullet' to the problems associated with the ageing population, clearly such changes are highly desirable in underwriting future increases in living standards and for this reason alone should be pursued.

2. TAX AND THE AGEING POPULATION

Personal tax and welfare reform

42. The PC argument on tax is basically as follows:

- tax (particularly income tax) revenue will rise in line with GDP on the basis of 1.75% pa GDP growth over the next 40 years. resulting in GDP per capita rising by around 90% (almost doubling over the period) - the slight fall in revenue of 0.2% is attributable to an expected decline in GST revenues due to increased consumption of GST-free items such as health services offset partly by increased conveyancing revenues;

- it assumes the tax/GDP ratio will remain unchanged over the period. This simply reflects the federal government's commitment on this point although, in view of its importance, this issue clearly needs to be clarified in the ageing population context. We understand that the figure for 2003/04 was 23.1% which was slightly lower than the 23.3% for the previous year, and expected to decline to 22.6% in 2005/06 but this may need to be adjusted now to take account of the government's pre-election spending commitments. The above commitment relates only to Federal taxes and thus does not cover State taxes (including GST) which are around 8% of GDP - however, growth in State taxes may be constrained by the difficulties in increasing the GST as well as the impact of proposed Inter-Governmental Agreement (IGA) changes on other State taxes;

- even with full indexation of the personal tax thresholds, a significant share of the projected fiscal gap would be covered as productivity growth pushed up workers' real earnings (eg. more than half of the projected 7% fiscal gap in 2044-45 on the basis of 1.75% annual productivity growth or 4.5% of the gap with 2.05% per annum growth);

- nevertheless, this outcome would involve an (effective) average increase in individual income tax rates by about 8% because a greater proportion of people's real incomes would be taxed at higher rates (some potential disincentive effects from such an outcome are noted and also that it would be inconsistent with the federal government's commitments on taxation levels);

43. Although not made explicit in the draft report, this would clearly appear to strengthen the argument for personal tax reform to ensure that appropriate tax/GDP ratios are maintained.

44. CPA Australia has long argued for a personal tax and welfare system that better encourages people to work, save and invest. The IGR, and to a lesser extent the PC Draft Report on the *Economic Implications of an Ageing Australia* both conclude that

much of the future ongoing success of the Australian economy lies in increased productivity, which in turn is influenced by the level of worker participation. A restructured tax and welfare regime is essential to provide the right incentives for people to participate and be productive in the workforce.

45. In March 2004, CPA Australia released the discussion paper *Reforming Australia's personal tax system: a model for the future* that considered 18 different tax scale models. This report represents some initial modelling work undertaken by our organisation in an effort to find a way forward on reducing personal tax rates and also addressing the tax/ welfare EMTR type issues. Building on this initial work in 2005 -2006 CPA Australia, in conjunction with the University of New South Wales will undertake further modelling work aimed at creating a better personal tax and welfare system for the 21st century. We will be discussing our findings with the government and Treasury, and in due course the results of this research will be made public.

46. It is generally now well accepted that the current tax-welfare system has two major defects that need to be addressed if Australia is to have a more effective personal tax system. They are the high marginal rates and the thresholds at which they commence; and high effective marginal tax rates (EMTRs) paid by many low and middle income families.

47. It is perhaps less widely understood that personal tax rates are not only an issue for individuals and families. It is also an important issue for business. Most businesses, for example, in Australia are taxed at personal tax rates.

48. It should also be acknowledged that the relationship between tax rates and participation is not simple, that is, there is no identifiable direct relationship between the two. Other factors enter into it such as choice (e.g. choosing more leisure time instead of extra work and income). However the fact remains that high tax rates and EMTRs are disincentives to participation and therefore productivity, although the extent has yet to be quantified

49. We acknowledge the changes the government has implemented to date, including changes to the tax thresholds in the 2004 Federal Budget as well as the further changes to commence from 1 July 2005. But we maintain that more systemic reforms are still required to the personal tax system to address the fundamental problems identified above, These changes would also enhance labour participation and productivity rates and thus ameliorate fiscal pressures from an ageing population. Significantly, the Productivity Commission's recent draft report on National Competition Policy (NCP) reforms also notes that personal tax/welfare reform should be firmly on the agenda, as does the December 2004 OECD Survey of the Australian Economy.

50. The OECD report noted in particular that, while recent increases in the threshold level at which the top marginal tax rate of 48.5% (including Medicare Levy) applies are welcome,

increased benefits would flow from more wide ranging reforms aimed at reducing the top marginal rate. Such reforms may also be necessary to deter professionally qualified young people from going overseas, thereby enhancing the growth potential of the Australian economy.

51. On the EMTR issue, the OECD noted that effective marginal tax rates – arising from tax/social welfare interaction - remain high for many low income earners and need to be addressed. It suggested that efforts towards lowering EMTRs should continue subject to close monitoring of the fiscal costs involved.

Recommendations

52. Regarding tax policy and the ageing population CPA Australia recommends that:

- the government undertake further modelling work to consider the implications of retaining the existing personal income tax system over the projection period to 2044-45 given the adverse effects of the current system on the ability of individuals to work, save and invest; and
- as part of the policy changes necessary to encourage greater worker participation and productivity, that the government pursue the reduction of personal tax rates and/or increases in thresholds as a matter of both national interest and national necessity so as to maintain a tax system that will meet the demands and challenges which an ageing population will place on the economy.

3. PERFORMANCE OF THE NOT-FOR-PROFIT SECTOR

53. The not-for-profit (NFP) sector delivers a large proportion of community, health and aged care services in Australia. Yet, unlike the private sector, NFPs do not receive market feedback on performance through public reporting and share price changes, so often are not operating at optimal efficiency. Many NFP facilities operate on government funding.

54. There are 700,000 NFPs in Australia of which little over half are incorporated. Around 35,000 organisations employ more than 600,000 people (12 per cent of private sector workforce). NFP income was around $33.5 billion, contributed 3.3 per cent to GDP and had an expenditure is similar to that of the NSW and Victorian governments.[4] Thirty per cent of income was from government grants and contracts and 9 per cent from household transfers. In 1997, Australians donated $2.8 billion to non-profit organisations and in 2001 the business sector provided $1.4 billion as gifts and sponsorship.

55. The importance of the sector cannot be denied. The main areas in which NFPs operate include social services (26 per cent), health (15 per cent), education and research (24 per cent) and culture and recreation (21 per cent).

56. Health, aged and community care have been (in the past) predominantly provided by the government and NFP religious groups. In 2002, 63.3 per cent of residential aged care places were provided by religious or charitable organisations, with 27.4 per cent provided by private suppliers and government provided 9.3 per cent. Arguably, these groups have traditionally not been as business minded or innovative as others in identifying ways (other than what they are funded for) to improve their business and service to the service user.

57. Given the importance of the NFP sector in providing health services and aged care, it is a concern that the sector does not operate as efficiently as it could. The sector is highly regulated and controlled by government through the allocation of licences, in order to protect the recipients of care, however little supervision of management or financial performance is undertaken. Many of these organisations initiate projects based primarily on community needs or injustices in the system, not efficiencies or profits.

58. Funding shortages or lack of management capacity restrict the level of wages in the sector making it difficult to attract professional managers to these organisations. Other barriers to attracting qualified professionals include poor environment, lack of equipment, lack of professional development, poor governance and lack of board support or understanding or commercial strategies to improve viability or standards.

[4] About Nonprofits Not for Profit Network, Brisbane www.nfpn.com.au

59. A recent report on governance in aged care based on a survey of aged facilities in South Australia and the Northern Territory, stated 'Effective non-profit governance is more difficult as performance of nonprofits is more complex to define, support and measure; group dynamics are complicated by the voluntary nation of non-profit boards, and the extensive use of volunteers throughout nonprofits, and many non-profit boards have the added task of fundraising. Additionally, some commentators state the non-profit sector often undervalues organisational capacity.[5]

60. The survey found:

- 80 per cent of organisations were incorporated associations, reflecting the domination of religious and charitable organisations;
- only 42 per cent of boards had conducted an evaluation of their performance and self assessment was the most common form of evaluation for those that did;
- under 5 per cent provided any remuneration for board members;
- the most common professions background of board members were small business, government, management, aged care and accounting, while the lest common were member representative, social worker public relations and marketing;
- 31 per cent of directors were retired;
- 23 per cent of board members has served on the board for over 10 years and 10 per cent were in their first year;

61. Other factors which impede the efficiency of the aged care sector include:

- Diversity of providers of aged care (there are 1,593 approved providers operating 2,958 facilities)
- Most organisations are primarily concerned about operational issues as opposed to governance and professional issues. Often operational problems are caused by failure of governance and financial management.
- The sector is characterised by a predominantly unionised workforce

62. There is a lack of relevant information on the sector, which also makes it difficult to assess the skills base of managers and boards.

[5] P Wright *Governance in Aged Care – what's really going on?* 2002

63. Efficiency and performance improvements in the NFP sector and particularly the aged care sector need to be addressed to ensure maximum benefit from government expenditure in this sector.

64. It is also noted that the government recently undertook a comprehensive review of pricing in the aged care sector. Building on this review, further data on the sector and its management is needed to develop appropriate government policies to support the sector in the future.

Recommendations

65. In respect of the not-for-profit sector and the ageing population, CPA Australia recommends:

- building on the recent government review of pricing in the aged care sector, further data on the sector and its management is needed to develop appropriate government policies to support the sector in the future
- the government undertake a comprehensive review of the regulatory environment for the not-for-profit sector to improve financial reporting, governance and sustainability. Consideration should be given differential treatment of NFPs dependant on size, complexity and purpose to avoid creating an unnecessary compliance burden for the smallest organisations
- as part of funding arrangements, governments should consider providing incentives to organisations to improve management and attract more professional staff
- there be increased focus by government agencies that provide grants to the sector to understanding and accessing the governance of recipient organisations
- government consider provision of incentives to ensure more targeted training is available for NFP managers in health and aged care; and
- government gains a better understanding of the role of boards in the sector and provision of support services to boards.

4. SMALL BUSINESS AND THE AGEING POPULATION

66. Australia's ageing population is reflected in ownership of small businesses. In 2001, 30 per cent of small business owners were aged 50 or more and this figure had increased by 10 per cent per annum since 1999. Planning for succession or exit becomes critical for owners over 50. CPA Australia conducted a survey of 600 small business owners' succession and exit plans in April 2004. Some of the key findings included:

67. Seventeen per cent of business owners are planning to leave their business in the next two years and a further 22 per cent are aiming to leave in 5 years. Half (52 per cent) expect to retire when they leave the business, and 14 per cent expect to start another business.

68. The most popular exit strategies are advertising the business without identifying a buyer (26 per cent) and selling or passing the business to family members (25 per cent). Nineteen per cent plan to make a trade sale and 17 per cent expect to liquidate. CPAs agreed with the likely exit strategies.

69. Thirty per cent believe it would be difficult finding a buyer for their business, mainly due to the specialised nature of the business, the expertise needed and the limited market. Accountants are the most common source of assistance for small businesses looking for help.

70. Forty per cent of owners say their business is totally dependent on them and another 44 per cent feel the business is dependent on them to a major extent. Despite this, 71 per cent feel someone else could take over. The main reasons why it would be difficult for someone to take over include the need for special skills and the unique knowledge of the owner.

71. Forty-three per cent of owners have children they believe are capable of taking over the business and half of these believe their children would be willing to take the business over. The majority of business owners with willing and able children were prepared to pass the business on to their children and 57 per cent would be happy to sell the business to their children. Most preferred a strategy that allowed the owner to retain some control and/or income stream from the business.

72. Small business owners are prepared to document processes (60 per cent) and upgrade technology (53 per cent) to improve chances of a sale, but were less inclined to restructure their business (38 per cent), spend three to five years preparing the business for sale (36 per cent) or to employ more staff (26 per cent). Growing, innovative firms were more likely to implement changes to maximise the value of the business sale.

73. Fifty per cent of business owners consider their business as the primary asset to fund their retirement. Eighty-seven per cent anticipate retirement income from another source such as superannuation (62 per cent), the family home (25 per cent) and other assets (52 per cent).

74. Of the owners that are planning to use their business as the primary source of retirement funding, 30 per cent said they expect to have trouble finding a buyer and a further 12 per cent were unsure about the prospects for sale. Forty per cent of the those using their business as the main source of retirement funding were planning to exit in the next 5 years.

75. Currently, 7.5 per cent of small businesses exit each year, but these are more than offset by new entrants. Business exits play an important role in the economy, ensuring that the pool of existing businesses are both productive and efficient. Inefficient and unprofitable businesses are replaced by new businesses bringing new ideas, products, services, technologies and processes that respond to changes in the marketplace.

76. Generally, business exits are positively correlated with business entry, with more businesses entering a market where there is a high proportion of exits. However, a significant increase in the number of exits could have major economic consequences if strategies are not in place to ensure a growing pool of viable, efficient There is a real need to review the economic and employment impact of an increase in exits – regions, industries and sectors need more information about the likely economic impact consequences in order to develop strategies to ensure a viable pool of businesses.

77. Many older business owners will rely on the sale of their business to fund their retirement as they have not invested in superannuation outside the business and the last thing they want to hear after investing years of hard work is that the business is not marketable and they will not be able to recover a fair value for their business assets.

78. It is possible to conclude that as the ‘baby boomers’ look to retire, there will be an increasing number of businesses on the market. With the shift from a manufacturing to a more service oriented economy, many current businesses are mono-generational, that is, they are not necessarily being developed as family dynasties or even to give other immediate family members employment. These types of businesses also add to the ever changing face of business ownership.

79. There are a number of implications for government policy associated with business exits. While most government agencies provide programs to support start-ups and business growth, strategies for later business lifecycle are less common. The changing environment and ageing population will lead to increased numbers of businesses for sale in the future and possibly a decline in the number of business units in some sectors. Exit programs could be included in the armoury of support programs, particularly in regional areas and

areas with low employment where the closure of a business could significantly impact on the local economy.

80. Business succession at the firm or industry level can also be used to encourage innovation, change and productivity improvement in small business as businesses restructure, become more strategic or knowledge based in order to maximise the value of the business. Transition of business ownership can also revitalise established older businesses. New larger businesses are often created from the consolidation of a number of smaller businesses, with possibility of efficiency gains and higher market penetration. Pharmacies are a case in point for this style of government intervention in an industry. These changes can all be used in achieving policy outcomes.

81. Business owners, particularly those closer to retirement, need to be made aware of the importance of preparing their business for succession to ensure they get the best outcome they can. There is also value in ensuring viable businesses, especially those that employ, continue to perform whether as an individual firm or as part of a larger entity.

Recommendations

82. In respect of small business and the ageing population, CPA Australia recommends:

- higher levels of 'firm churning' – the continual entrance and exit of firms in the economy – can be linked to economic growth and inefficient businesses either close or are taken over by more efficient businesses. New firm entry can be linked to job creation, innovation productivity growth and economic renewal.[6] There needs to be a constant supply of new entrepreneurs to ensure continued growth. This is event more critical, if more firms are exiting the market through retirement of the owners. Entrepreneurial activity can be encouraged through policy intervention in schools, reducing barriers to exit and entry, developing an entrepreneurial culture and supporting start-ups. Establishment of a cross portfolio entrepreneurship policy will assist in productivity gains

- the government consider developing a model that could be used by regional organisations and industry bodies to analyse the potential impact of the increasing closure of small businesses where owners retire and are unable to transfer ownership of the business in particular geographical locations or industries. Organisations would then be able to understand potential impacts where the loss of viable firms may reduce available employment or availability of services

- policy options should be considered to strengthen Australia's enterprise culture, to encourage more people, including school leavers, to aspire to

[6] Stevenson L, Lundström *An Entreneurship Policy for the Future: Best Practice Components.*

running a business as a viable alternative to seeking paid employment. Development of an enterprise culture requires commitment of both government and the business community to develop and resource appropriate strategies, and

- government should undertake an awareness program to assist those approaching retirement age to assess the saleability of their business and to develop strategies to maximise any return on their business and to ensure they are able to fund their retirement. More programs for this demographic should be developed and delivered by both government and the business sector.

5. Capital markets, and property

83. The effect on the capital markets of having a higher proportion of the population as retirees has not been assessed in the PC Draft Report. For the first time, as far as we are aware, a significant proportion of the population will potentially move from taking a wealth creation focus to their investments and move to a wealth realisation focus as assets are used to fund retirement. We have no data on the extent to which self-funded retirees are likely to sell assets (thus potentially depressing demand and asset prices) and the extent to which they will be able to live off the income from investments (thus retaining the investment intact for the next generation).

84. However we can see the potential for major shifts in investment patterns including

- the disposal of assets in order to fund living costs, and
- an increasing demand for income-producing investments rather than capital gains.

85. either of the above scenarios could impact prices in the capital markets, and the taxable income of retirees, but the actual impact is unknown. We consider that the effect of the potential changes in demand patterns across the capital markets needs to be assessed.

Recommendation

86. CPA Australia recommends that the Productivity Commission develop an understanding of the likely impact on the capital markets of the potential change in investor habits and the consequent impact on other macroeconomic variables.

6. FUNDING RETIREMENT AND THE AGEING POPULATION

a. Retirement savings

87. The PC draft report has little to say on superannuation or retirement savings except to note that past government action in this area has meant that Australia does not have the sustainability problems here as do other OECD countries (including particularly the US). The major problem with unfunded pension liabilities is restricted to the public sector (largely the Commonwealth) and is thus less severe than elsewhere.

88. It does not touch on the 'adequacy' issue but notes that the future old will own a much greater share of national wealth than the current old (around 50% of the nation's family wealth is projected to be held by people aged 65 or more by 2031 as compared to only 22% currently) and that some of this accumulated wealth could be used to finance the fiscal gap, perhaps via higher taxes and/or bequests to their children.

89. While the report has focussed on the impact of the ageing population on the economy and government revenue and expenditure, it has not touched on the impact on the individual. It is well accepted, and supported by research, that the current retirement savings system will not provide adequate savings for many individuals to maintain a reasonable standard of living in retirement. We need to understand what impact, if any, this have on consumption patterns, and whether the adequacy of retirement savings will be further eroded if individuals need to become more self-sufficient in funding their own health and aged care costs.

90. Modelling conducted for CPA Australia by the National Centre for Social and Economic Modelling (NATSEM)[7] showed compulsory superannuation guarantee (SG) contributions would, when received over a whole working life, provide a 'modest but adequate' standard of living in retirement. However, for many individuals a modest but adequate standard of living will be substantially lower than what they experienced before retirement. For example, high income families will experience a 61% drop in living standards in retirement, while very high income couples will experience a fall of 69%. Further, not all individuals, especially approaching retirement now or with broken work patterns, will have enjoyed SG contributions over their whole working life. What impact will such a drop in living standards and disposable income have on future consumption patterns?

91. Also, the complexity of, and constant changes to, Australia's retirement savings system creates a level of uncertainty and distrust, discouraging voluntary superannuation savings and further leading to inadequate retirement savings.

[7] NATSEM (2004), *Superannuation – the right balance?, NATSEM, Canberra*

92. When compared internationally, the replacement rate of retirement income for Australians lags behind other countries. For example, the IMF reports that disposable income of United States elderly is 92% of pre-retirement income ,compared to 68% in Australia. Similarly, in the United Kingdom it is 78%, and in Canada 97%.

93. Australia's superannuation system is heavily taxed by international standards, especially in the accumulation phase. Compulsory and voluntary employer contributions are taxed at between 15% and 27.5% ((depending on the contributor's taxable income), fund earnings are taxed at a headline rate of 15%, and lump-sum retirement benefits in excess of $123,808 are taxed at 16.5%.

94. Australia has the only retirement system that is taxed at all three points. By comparison, the United States, United Kingdom and Canada all have systems that exempt contributions and earnings from tax and instead tax end benefits. Not only does this ensure that contributions to retirement savings are maximised and not eroded by taxes, it also ensures there is less impact on a government's overall tax revenue as revenue from 'front-end' taxes and income tax reduces.

95. In December 2002, the Senate Select Committee On Superannuation, in it's report *Superannuation and standards of living in retirement*, recommended contributions tax be gradually removed in the long term and replaced with a new approach to taxing end benefits. Despite the government's response on 11 February 2005, that the contributions tax will not be removed and there is no gain in shifting taxation to the benefits stage, CPA Australia maintains that superannuation taxation is unnecessarily complex and high by international standards and should be reviewed.

Recommendations

96. In respect of the Productivity Commission's Draft Report:

- the Productivity Commission develop an understanding of the likely impact of individuals having inadequate retirement savings on overall consumption patterns and the further impact on the adequacy of retirement savings if individuals need to become more self-sufficient in funding their own health and aged care costs.

97. In respect of superannuation and the ageing population, CPA Australia recommends:

- the government comprehensively reviews the Australian retirement system to ensure it is simple, sufficient and sustainable with individuals being encouraged to save and having adequate retirement savings to maintain a reasonable standard of living in retirement

- A review should cover areas such as superannuation taxation, preservation and age pension ages, the level of mandatory contributions, contribution and benefit limits, and the nexus between lump sum retirement benefits and retirement income streams

- The first priority should be a review of superannuation taxation to ensure it is equitable and efficient while providing the necessary incentives to encourage self-provision in retirement. The removal of ‘front-end’ taxes - the contributions tax and superannuation surcharge - would provide greater incentives for voluntary savings to be made.

b. Financial planning

98. Financial planning will play an increasingly vital role in the provision, and management of, retirement assets for the ageing population.

99. One impediment to this role is that many Australians currently have a culture of spending, not saving. CPA Australia released a research report in May 2004 entitled ‘Debt and the X and Y generation’ which highlighted this culture amongst younger Australians. The research explored the attitudes of, and patterns of, savings/investments and debt amongst 18 to 45 year olds. Whilst the survey showed that the participants held strong concerns about financing their lifestyles, particularly mortgage and interest repayments, debt was considered an acceptable part of meeting their current needs. There was also a demonstrated attitude that those needs should be met ‘now’. Most considered that the best way to achieve their current needs was to take advantage of the various debt options available, including credit cards and store cards. On average, debt levels among the participants (estimated at $118,000 including the house mortgage) exceeded average savings/investments (excluding the house) of $90,500. Interestingly, almost seven in ten believed savings was ‘something they would do in the future’.

100. We encourage the federal government to consider the development of programs to change this culture of spending and reform the current message that debt is an acceptable part of life. The CPA report found that participants were concerned about preparing for their future and in particular developing a savings plan that will provide for retirement. Most saw this as their own responsibility and did not expect government back up, but saw it as a difficult task. Seeking advice on financial matters was quite widespread and despite the use of informal sources such as family and friends, there was a demonstrated willingness to consider using financial planners, albeit with reservations about cost, quality and accessibility. It is also interesting to note the influence current baby boomers may be having on the savings and spending habits of their children through the provision of informal financial advice.

101. We submit that the current concern about financial matters among younger Australians be used as a catalyst to review the value of existing savings vehicles within the marketplace. Some savings vehicles, like superannuation products, are not regularly used by consumers to save by way of voluntary contributions. Others, like bank deposits, provide no incentive to save. The CPA report found that there were some reservations among participants about the merits of saving due to the perception that they would not be rewarded adequately for doing so.

102. It seems clear that financial planning will become increasing relevant to the achievement of the social wellbeing of Australians and the policy objectives of their governments in relation to the ageing population. The relevance of financial planning will bring with it a

greater focus on how financial advice is delivered and the regulatory and professional regimes that govern it. Access to quality financial advice will be vital for all Australians to ensure a financially sustainable lifestyle and to provide for retirement years. There will be growing recognition of the need for qualified and competent financial planners, who can provide accessible and ethical advice. It is very important therefore that the federal government give due consideration to working with professional associations to ensure the provision of this advice, through qualified advisers who adhere to rigid professional standards. The immediate emphasis should be on the introduction of undergraduate programs for financial planning and continued promotion of financial planning as a progressive, ethical and professional career option.

103. Access to financial advice is only one step, and it will lose its impact if the financial literacy levels of Australians remain at their current low level. The CPA report found that over half the participants did not feel well informed about their financial options and nearly three quarters agreed that young people do not manage their finances well. CPA Australia encourages the further development of financial literacy programs and suggests an immediate focus on Generation X and Y and young women as a separate cohort, given their workforce participation are expected to continue increasing over the coming years.

104. Currently financial planning and financial services advice is focused on wealth creation and meeting the future lifestyle objectives of its subjects. This is likely to change to wealth management and the realisation of assets with the ageing population. CPA Australia calls for more modeling on what is likely to happen when an ageing population starts realising their retirement assets on an international scale and demands for new investments change. It is likely that this will have an impact on economic growth, but it is a complex area with differing views.

105. There is also likely to be changes to the financial planning model itself to suit the new needs of its clients. It is anticipated that there will be a shift away from lifestyle and retirement planning towards the management of realised assets and investment portfolios. When self funded retirees start accessing income streams from super, they will need advice on how to manage their funds whilst realising assets. This will be especially relevant to those with self managed super funds as these retirees will be ill equipped to deal with the compliance and other issues of managing a fund in such circumstances.

Recommendations

106. Regarding financial planning and the ageing population CPA Australia recommends:

- The government make a greater investment in the area of financial literacy for consumers to create a positive message around saving and investment and ensure consumers are well aware of the danger of debt – particularly debt for the acquisition of consumer items

- The government must do more to promote the message that reliance on superannuation guarantee (SG) contributions alone will not achieve a comfortable self-funded retirement for people. Achieving higher retirement assets can be achieved through a combination of consumer education and the lowering of up-front government taxes such as contributions tax and surcharge to encourage higher contribution levels

- The government needs to support and develop the financial planning industry to ensure there are sufficient professional advisers to support the growing number of retirees. The long term objective of the government must be to transfer the provision of retirement income from the public purse (i.e. aged pension) to self funding. A key element to achieve this will be to ensure there is a strong and professional financial planning industry to ensure people achieve sufficient retirement capital and then invest it appropriately. This can be achieved by the government working closely with professional bodies such as CPA Australia to identify initiatives that can build consumer confidence in financial planning, and

- In supporting the financial planning industry, the government should also promote the provision of financial planning services on a fee-for service basis rather than the commission basis used widely in the industry. The acceptance of commissions can be seen to create unacceptable conflicts of interest and will slow the acceptance by consumers of financial planning as a profession equal to others such as accounting or law.

7. INFORMATION MANAGEMENT AND TECHNOLOGY

107. The PC Draft Report makes it clear that information technology will play an important role as the population ages. As we experience the dynamic benefits of improved technology, it is clear that accessible technology has the potential to powerfully extend, expand and enhance user experience and productivity. Addressing the needs of those who are likely to benefit from the use of accessable technology will require collaboration between government, corporates and industry.

108. As the population ages, more workers and computer users will notice changes in their abilities and experience difficulties and impairments. At the same time, older workers may remain in the workforce long past the previously expected retirement ages. Maintaining or even enhancing productivity among these workers, regardless of abilities, difficulties and impairments, will become an increasingly vital economic issue for business as the population continues to age. Add to this, the growing trend of technology for work, information and communication, and it becomes clear that future users will demand and expect greater accessibility to technology and in particular computers, and internet access, regardless of their abilities.

109. In addition, with the ageing population becoming more 'information technology savvy', the increased accessibility of technology can and probably will, enhance the services the older population require. Currently, information technology is used by the potential ageing population in a variety of daily activities, from workplace to online banking and various other services. Hence, they will demand access to information technology services that will improve their overall quality of life. The use of technology for the older generation will greatly assist them in remaining independent, having greater control over their own life in a flexible manner, and maintaining connections to family and community. This will be particularly important as difficulties and impairments increase with age. Indeed, information technology can change the role of carers from one of provider of services to one of partner of the people for whom they care. Access to the internet can empower the older generation to assist in their own care, through the delivery of effective and timely information.

110. It is fair to assume that improved communications and access to information through interactive computers and information technology will be the platform in the years to come. In order to assist our ageing population, future government polices need to provide incentives to ensure that the needs of our ageing population are met, and in fact that our ageing population can continue to contribute to the overall community in a meaningful way.

Recommendations

111. CPA Australia recommends:

- the Productivity Commission develop an understanding of the impact of improved technology on extended work force participation and productivity, through access to both improved education and training to older workers, and

- the Productivity Commission develop an understanding of the demand for and the resulting impact of, improved access to technology, in light of continuing demand for flexibility and ongoing business, family and community involvement.