



**Australian Government**

# 2015 INTERGENERATIONAL REPORT



**AUSTRALIA IN 2055**

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# TREASURER'S FOREWORD

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I believe that our best years are ahead of us.

To harness the potential of the future we need to prepare and have a plan that aligns with the demographic challenges and opportunities we face. These important issues are clearly identified in the Intergenerational Report.

The Intergenerational Report is the social compact between the generations – children, grandchildren, parents, grandparents and each other.

We are at a critical juncture in our history. To help us make the right choices, the Intergenerational Report sets out what we need to do if we are to maintain and improve our standards of living.

It is fantastic that Australians are living longer and healthier lives but we need to address these demographic changes. If we don't do something, we risk reducing our available workforce, impacting negatively on growth and prosperity, and our income will come under increasing pressure.

To drive higher levels of prosperity through economic growth, we must increase productivity and participation. If we are to achieve these goals we need to encourage those currently not in the workforce, especially older Australians and women, to enter, re-enter and stay in work, where they choose to do so.

With a growing population that will live longer, the Intergenerational Report shows the growth in the costs of many services, especially in health, that will put pressure on the budget and threaten the sustainability of those services. Every day our spending exceeds Government revenue by more than \$100 million. To make up the shortfall we have to borrow that \$100 million per day.

If the status quo had remained, the growing debt burden projected in the Intergenerational Report would have been a major drag on our prosperity and a threat to services that our community expects – that is not the social compact we want. In response the Government has set out a credible trajectory to once again live within our means, and much progress has been made.

Our economic plan, aligned with the Intergenerational Report, will allow us to focus on the key drivers of economic growth – participation and productivity.

In responding to the Intergenerational Report, the Government will continue to promote growth, jobs and opportunity so that we can relieve the burden on Australians and unlock the immense potential of our future.

**J. B. Hockey**



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# THE INTERGENERATIONAL REPORT

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Every five years, the Australian Government produces an Intergenerational Report that assesses the long-term sustainability of current Government policies and how changes to Australia's population size and age profile may impact on economic growth, workforce and public finances over the next 40 years.

The Government is required to produce an Intergenerational Report at least every five years. The first three Intergenerational Reports were produced in 2002, 2007 and 2010.

The Intergenerational Report contains analysis of the key drivers of economic growth – population, participation and productivity – and examines what projected changes in these areas mean for our standard of living and public policy settings.

It is a projection into the future, giving us an estimate of the challenges we face as a nation and where opportunities could come from.

The Intergenerational Report is the social compact between the generations – with our children, grandchildren, parents, grandparents and each other.

# BUILDING A STRONGER AUSTRALIA

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Over the past 40 years, Australia has enjoyed strong economic performance, underpinned by a growing population and a series of major economic reforms.

This economic success has greatly enhanced our quality of life.

**Average incomes have doubled in real terms since 1975, and this increased wealth has been shared broadly across the community.**

But the Intergenerational Report makes it clear that continuing our economic growth and prosperity cannot be taken for granted.

We face a number of challenges and opportunities.

The Intergenerational Report outlines projections of the three long-run drivers of economic growth in Australia – population, labour force participation and productivity.

Understanding how these drivers of economic growth are likely to change over the next 40 years will inform the action governments must take to build jobs, growth and opportunity.

It also illustrates the need to make spending sustainable and to live within our means.

**Together, we must respond to the challenges and opportunities the Intergenerational Report presents to ensure Australians continue to enjoy improvements in their quality of life and enable governments to continue to deliver the services our population needs.**

# POPULATION AND DEMOGRAPHIC CHANGES

Australia's population will grow and change over the next 40 years. Understanding our population structure is critical to understanding what policy settings will be required.

**Australians will live longer and continue to have one of the longest life expectancies in the world.**

Currently, Australia ranks equal first along with Iceland in terms of male life expectancy. Australian women have the fifth longest life expectancy after Japan, Spain, France and Italy.

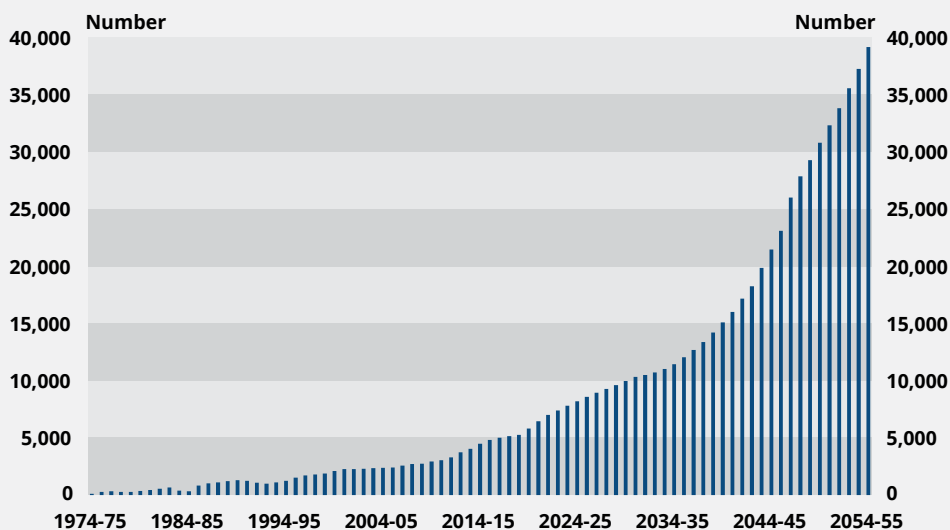
Male life expectancy is projected to increase from 91.5 years today to 95.1 years in 2055, and female life expectancy is projected to increase from 93.6 years to 96.6 in 2055.

The number of Australians aged 65 and over is projected to more than double by 2055 compared with today.

In 2055, there are projected to be around 40,000 people aged 100 and over, well over three hundred times the 122 Australian centenarians in 1975.

These changes will require adjustments to our policy settings and the measures put forward by successive governments to meet community demands and expectations.

## NUMBER OF PEOPLE AGED 100+



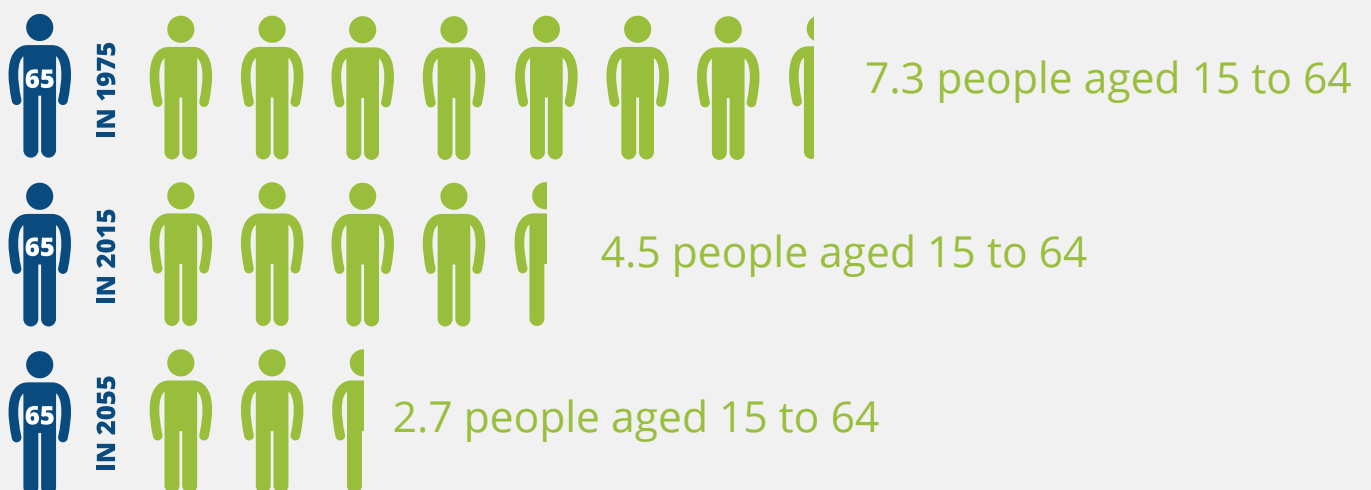
The number of people aged between 15 and 64 for every person aged 65 and over has fallen from 7.3 people in 1975 to an estimated 4.5 people today. By 2055, this is projected to nearly halve again to 2.7 people.

This change in our demographic structure will have important implications for the tax base and the ability of future governments to deliver services at the standards expected by the community.

The Intergenerational Report projects the average annual rate of growth in the population to be 1.3 per cent over the next 40 years, slightly slower than the annual average population growth rate of 1.4 per cent over the past 40 years.

This rate of growth would see Australia's population projected to be 39.7 million in 2055.

## THE NUMBER OF PEOPLE (AGED 15 TO 64) PER PERSON AGED 65+ IS DECREASING



# PARTICIPATION

Australia's future growth and prosperity relies on having a sufficient workforce to fill the jobs of tomorrow.

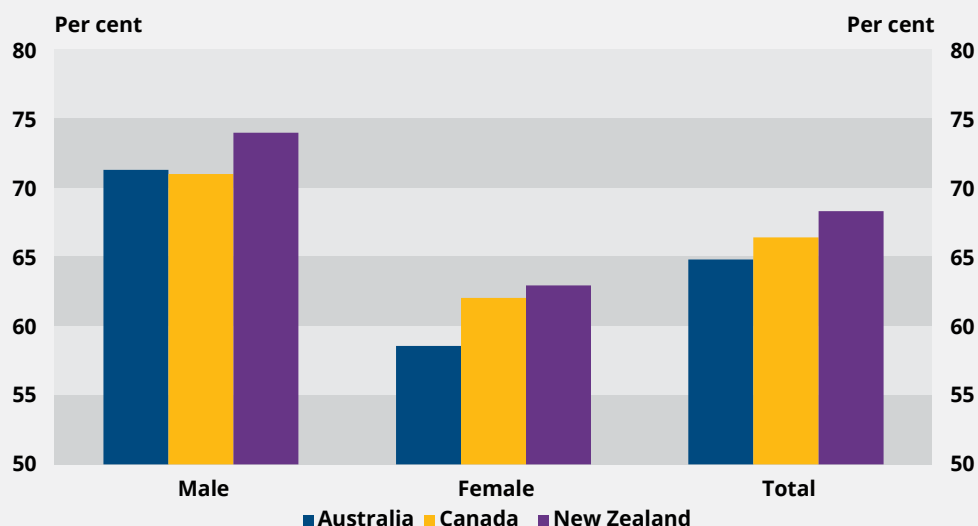
Over the next 40 years, the proportion of the population participating in the labour force is expected to decline as our community ages. By 2054-55, the participation rate for Australians aged over 15 years is projected to fall to 62.4 per cent, compared to 64.6 per cent in 2014-15.

A lower proportion of Australians working will mean lower economic growth over the projection period.

**But there are clear opportunities to increase workforce participation by supporting Australians to get and keep jobs.**

These opportunities include continuing to support increased participation by women and youth, and embracing the potential of older Australians.

## INTERNATIONAL COMPARISON OF PARTICIPATION RATES



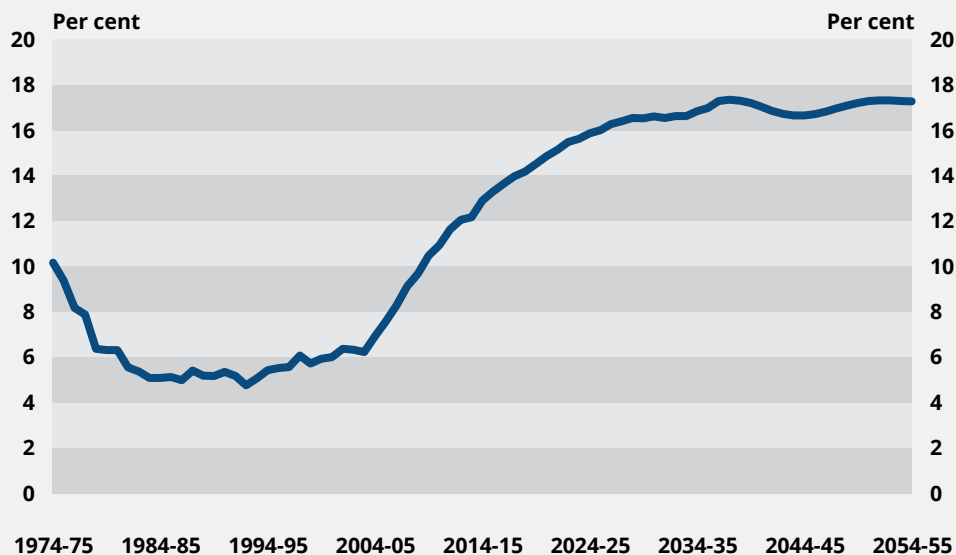
In 1975, only 46 per cent of women aged 15 to 64 worked. Today, 66 per cent of women aged 15 to 64 are employed. By 2054-55, this is projected to increase to 70 per cent.

The Intergenerational Report projects that the proportion of Australians aged over 65 participating in the workforce will increase strongly, from 12.9 per cent in 2014-15 to 17.3 per cent in 2054-55. This provides a significant opportunity to benefit from the wisdom and experience of older Australians, but there is more we can do to embrace this trend.

If Australia's participation rates could be increased to those achieved in other countries, the size of the economy would increase. For example, Canada's female participation rate is around 4 percentage points higher than in Australia. If Australia's female participation rate could reach Canada's level, it is estimated that our GDP would be a permanent \$25 billion higher<sup>1</sup>.

Similarly, higher GDP could be achieved if Australian participation rates of people aged 65 and over could match those of New Zealand.

## PARTICIPATION RATES OF PEOPLE AGED 65+



<sup>1</sup> Grattan Institute, *Game Changers: Economic Reform Priorities for Australia*, 2012.

# PRODUCTIVITY

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The world is a competitive place.

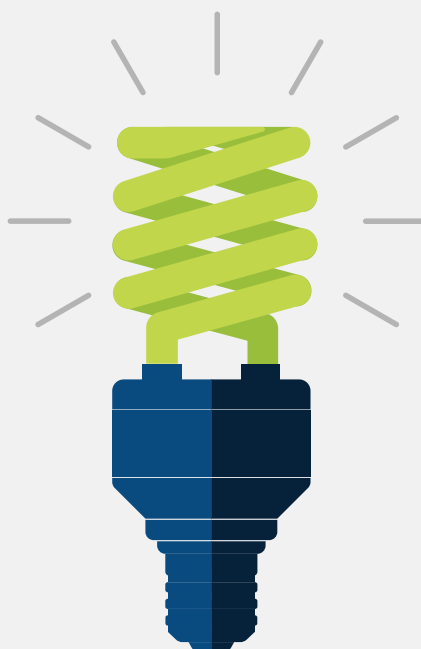
In the years ahead, improving Australia's economic performance and living standards depends on us working smarter and more efficiently.

It is not about working longer and harder. It is about producing more with the same effort.

We have to be more productive to ensure we do not fall behind, to create new opportunities for jobs and to drive our incomes higher.

During the 1990s, Australia's productivity growth was especially high, with an estimated average of 2.2 per cent growth per year. This has been widely attributed to the significant economic reforms during the 1980s and 1990s.

These reforms created more competitive and flexible markets in which businesses became more efficient and innovative and new and improved technologies were adopted.

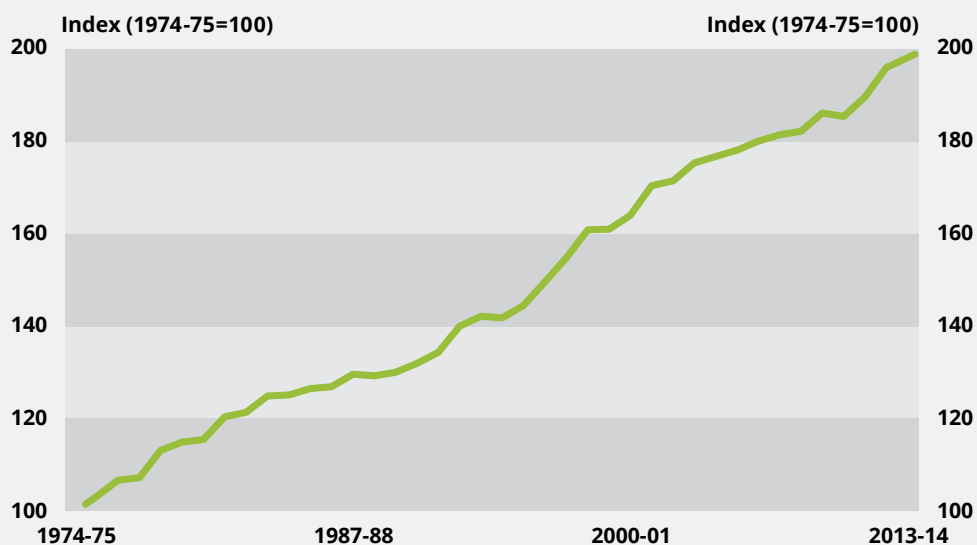


Today, Australians produce twice as much in goods and services for each hour worked as they did in the early 1970s.

More recently however, our productivity growth has slowed, with an average of 1.5 per cent growth per year observed through the 2000s. This is the rate of productivity growth the Intergenerational Report assumes over the next 40 years.

Achieving this rate of productivity growth will require continued reform to ensure individuals, businesses and government can harness opportunities from technological developments and the changing nature of our economy.

## REAL GDP PER HOUR WORKED



# ECONOMIC PROJECTIONS

The Intergenerational Report shows that Australians can have a positive and prosperous future.

Economic growth is projected to be 2.8 per cent per annum on average over the next 40 years with annual growth per person of 1.5 per cent. This would see the annual income of the average Australian rise from \$66,400 today to \$117,300 by 2055.

This growth rate is expected to be slightly slower than the 3.1 per cent per annum, or 1.7 per cent per person, achieved over the past 40 years due to an ageing population and gradual decline in the participation rate.

To achieve this level of growth going forward, we must take steps to build jobs and opportunity. We also need to make choices today to prepare for the future.

## COMPONENTS OF REAL GDP GROWTH PER PERSON



# LIVING WITHIN OUR MEANS

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The Intergenerational Report shows how our population will change over time and the need to build jobs, growth and opportunity to improve our living standards in the future.

We also need to ensure we can pay for our future.

We have a responsibility to plan and budget not only for today, but for tomorrow.

But we are currently living beyond our means. The Australian Government is spending over \$100 million per day more than it collects and is borrowing to meet the shortfall.



# THE BUDGET POSITION

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The Government has a responsibility to balance budgets and spend taxpayers' money carefully.

The Government provided a plan that, if fully implemented, will get the Budget back on track to a sustainable surplus. These measures would make a significant contribution to reducing fiscal pressures over the longer term by addressing unsustainable rates of growth in expenditure and government debt.

This Intergenerational Report has set out three policy scenarios and projected their impacts on the Budget, net debt and spending growth.

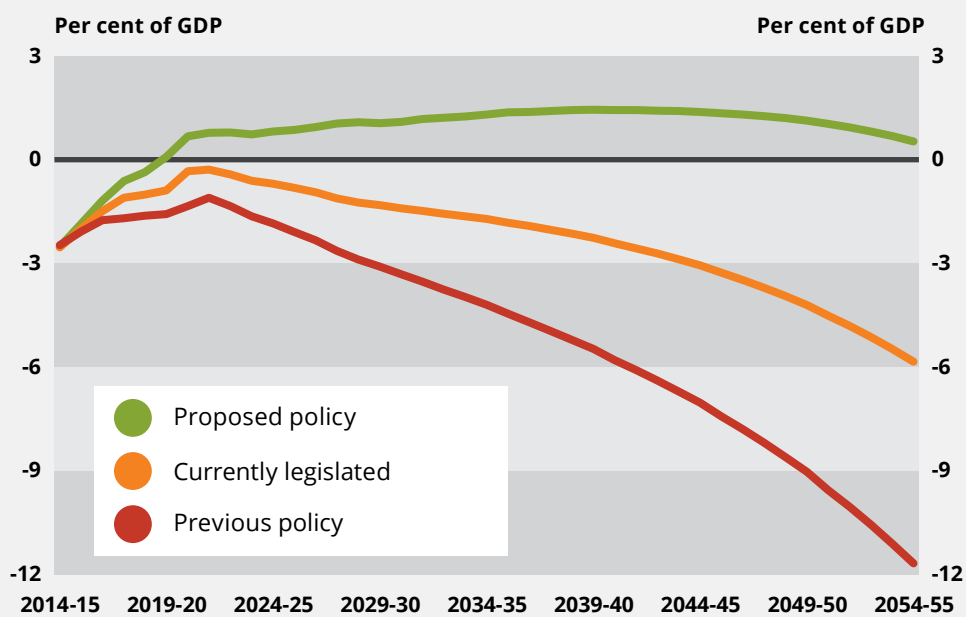
- The scenario 'previous policy' shows projections based on the policy settings in place prior to the 2014-15 Budget. Under this scenario, the underlying cash deficit would reach 11.7 per cent of GDP in 2054-55, and net debt would reach almost 122 per cent of GDP (\$5,559 billion in today's dollars).
- The scenario 'currently legislated' shows a set of projections on the basis of laws currently passed by Parliament. Under this scenario, the underlying cash balance is projected to remain in deficit, deteriorating to almost 6 per cent of GDP by 2054-55. Net debt is projected to reach almost 60 per cent of GDP (\$2,609 billion in today's dollars) by the end of the projection period.
- Finally, the scenario 'proposed policy' shows projections based on the full implementation of the policies of the government of the day. This scenario projects the underlying cash balance to improve to a surplus of 1.4 per cent of GDP in 2039-40, and then moderate to a surplus of around 0.5 per cent of GDP in 2054-55. Net debt is projected to be fully paid off by around 2031-32.

The first two scenarios show a very significant deterioration in the Budget. The third scenario shows that the Government's current set of policies would bring the Budget back to a sustainable path over the medium to long term.

The Government is open to alternative measures to bring the Budget back to surplus.

The policies proposed by the Government, if fully implemented, will improve Australia's capacity to respond to the challenges and opportunities outlined in the Intergenerational Report.

## PROJECTIONS OF THE UNDERLYING CASH BALANCE



# SPENDING

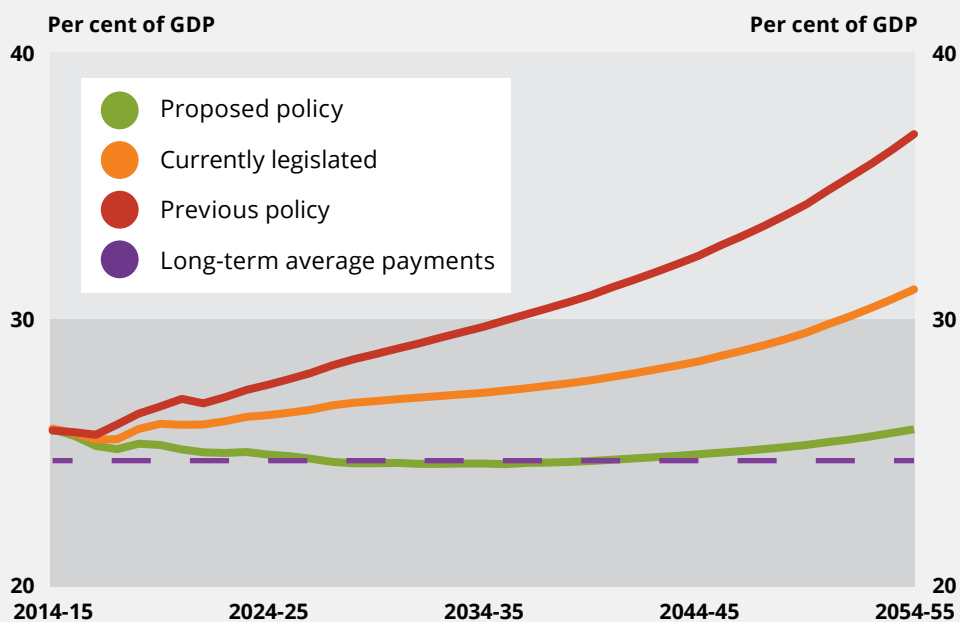
Australia cannot continue to fund ever-increasing budget expenditures.

Under the 'previous policy' scenario, spending as a per cent of GDP was on track to grow to 37 per cent, far greater than the previous high of 28 per cent. If left unchecked, this would mean drastic cuts to payments, higher taxes, or both.

Under the 'currently legislated' scenario, total Commonwealth spending is projected to reach 31.2 per cent of GDP in 2054-55 (\$1,422 billion in today's dollars), with real spending projected to grow at an average rate of 3.1 per cent per annum.

The 'proposed policy' scenario shows that expenditure will remain broadly in line with current levels, with real spending to grow at an average rate of 2.7 per cent per annum, thereby reaching a total of 25.9 per cent of GDP.

## PROJECTIONS OF TOTAL AUSTRALIAN GOVERNMENT SPENDING



# DEBT

Returning the Budget to surplus will reduce further growth in net debt, and then allow the Government to pay off the debt already incurred.

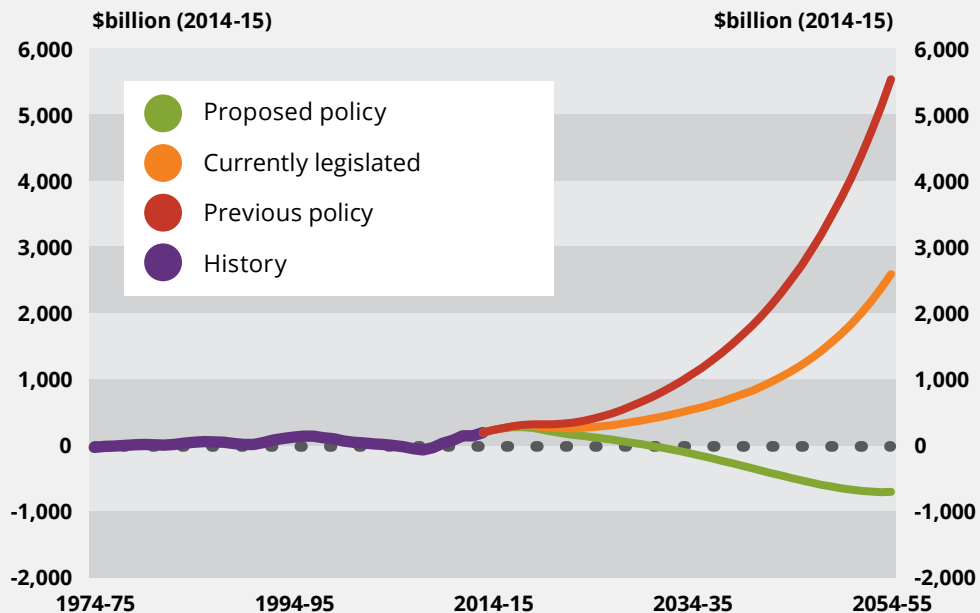
Today, the Commonwealth Government is spending \$40 million a day on the interest payments on its debt.

In the 'previous policy' scenario, net debt is projected to reach 122 per cent of GDP, or \$5,559 billion in today's dollars. These levels of debt would negatively impact economic growth, waste significant resources on interest payments, and leave Australia exposed in the event of an economic downturn.

Net debt is projected to reach almost 60 per cent of GDP, or \$2,609 billion in today's dollars in the 'currently legislated' scenario.

Under the 'proposed policy' scenario, net debt would be paid off by 2031-32. Reducing the level of debt will allow the Government to provide further tax relief, to direct taxpayers' money to vital government services, and to invest in jobs, growth and opportunities.

## NET DEBT: HISTORICAL, AND SCENARIOS IN REAL DOLLARS



# REVENUE

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The Intergenerational Report projects tax receipts to continue to recover from the Global Financial Crisis until they reach 23.9 per cent of GDP, the average level between 2000-01 and 2007-08. Once taxes reach 23.9 per cent of GDP, currently expected in 2020-21, it is assumed that tax policy will be adjusted to maintain the tax-to-GDP ratio.

This could include the return of bracket creep to taxpayers.

The strong budget position projected under the 'proposed policy' scenario would afford significant scope for future governments to provide further tax relief.

By contrast, if payments were to increase to levels projected under the 'previous policy' scenario, taxes would need to be raised to a sustained level of 28 per cent of GDP to balance the Budget.

This level of taxation would impact on participation incentives for many people and potentially reduce workforce participation and investment, depressing growth.

# HEALTH SPENDING

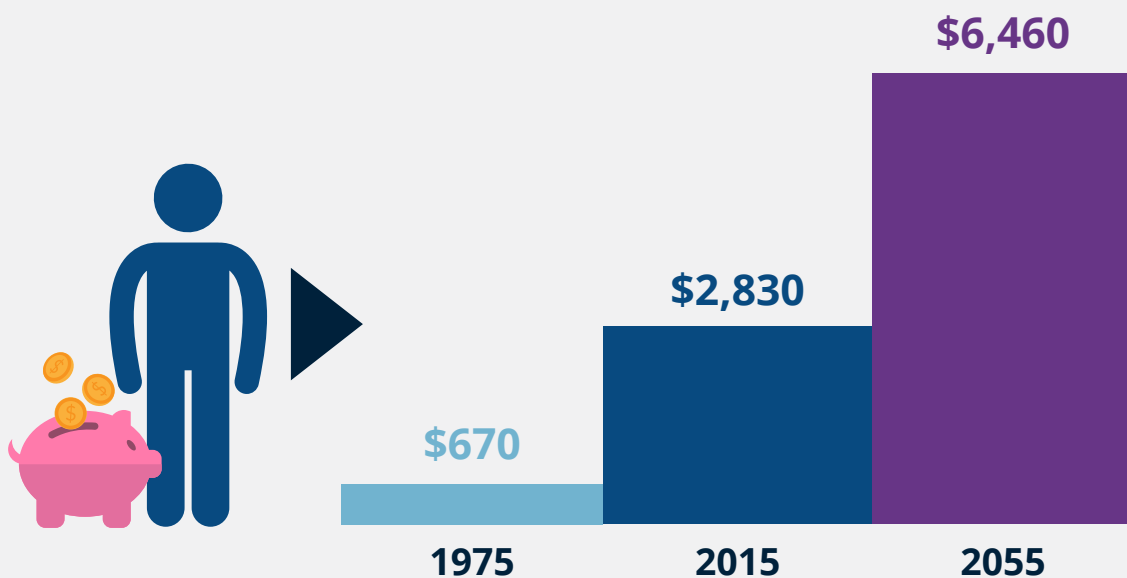
The Intergenerational Report describes the continuing improvements in the health of our community.

It also projects the funding requirements to continue to meet these community standards in the face of rising costs, new technology and treatments, and the needs of an ageing population.

Commonwealth health expenditure is projected to increase from 4.2 per cent of GDP in 2014-15 to 5.5 per cent of GDP in 2054-55 under the 'proposed policy' scenario. In today's dollars, health spending per person is projected to more than double from around \$2,800 to around \$6,500.

If no changes to policy had been made, health expenditure was on track to reach 7.1 per cent of GDP in 2054-55 under the 'previous policy' scenario.

## HEALTH CARE SPENDING PER PERSON (IN TODAY'S DOLLARS)



# SOCIAL SERVICES

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In a prosperous, compassionate society like Australia, it is critical that the Government provides a social safety net for those in need. It is equally important this safety net is sustainable to guarantee it will be there for generations to come.

In 2014-15, the Government will spend around \$150 billion on social services and welfare – or around 35 per cent of the Commonwealth Budget. This includes spending on pensions, aged care, payments to families and individuals, and the National Disability Insurance Scheme. The change in our demographic structure will put pressure on spending in many of these areas.

The Government's proposed policies – or other proposals of a similar value – will help put the community's social safety net on a sustainable path.

# EDUCATION

Australia's education system is crucial to improving our productivity and harnessing the opportunities of the future.

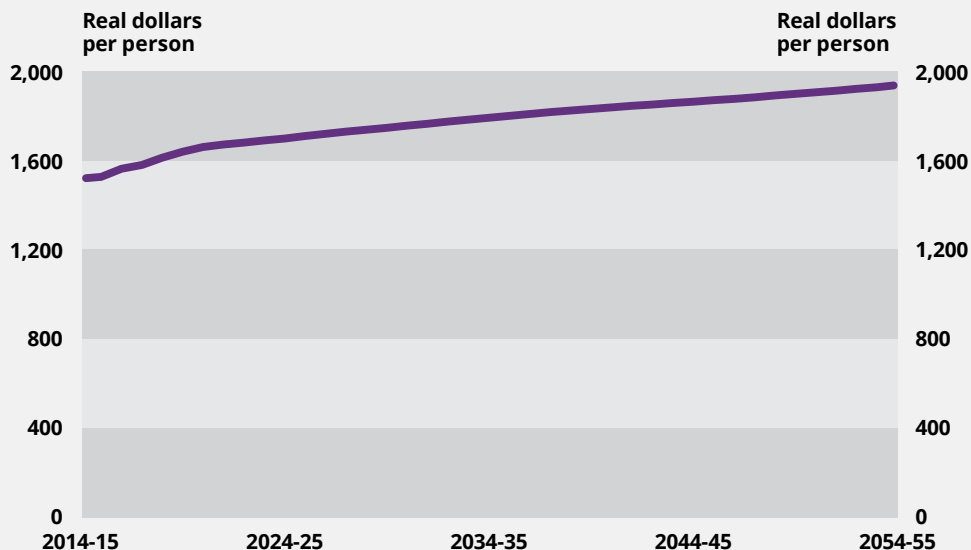
Our people, their aspirations and their capacity to innovate, will drive our prosperity into the future.

Over the coming decades, younger people will make up a smaller proportion of our population as life expectancy increases and the population ages. This means there will be a smaller proportion of the population likely to be engaged directly with education, especially in the primary and secondary sectors.

Nevertheless, Commonwealth Government spending and lending is projected to rise from \$1,500 per person today to \$1,900 in 2054-55.

If we are to improve the standard of education services we receive, we must build a more globally competitive system and spend our dollars in a smarter way.

## EDUCATION SPENDING AND LENDING PER PERSON



# OPPORTUNITIES FOR THE FUTURE

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This Intergenerational Report prompts consideration of the policy settings required to build jobs, growth and opportunity, and ensure that Australians continue to enjoy high and rising living standards over the next 40 years.

Continued steps to boost productivity and encourage higher workforce participation will be critical to driving this economic growth.

Further increasing female participation will be important, including with policies to support parents and prospective parents.

We also need to harness the full potential of all demographic groups, especially older Australians, youth, people with disability and the long-term unemployed.

To enhance productivity, government will need to continue to focus on reforms that can improve the competitiveness of our businesses and markets, and provide an environment that encourages entrepreneurship and innovation.

This will also include taking advantage of opportunities presented by changing technologies and new markets, both at home and abroad.

In addition to these policies, the Budget must be balanced to avoid ever-increasing deficits and spiralling debt.

The 2015 Intergenerational Report shows that we can have a positive and more prosperous future if we plan for tomorrow, today.