What is an intergenerational report?

An intergenerational report assesses the long term sustainability of Commonwealth finances. It examines the impact of current policies and trends, including population ageing and slower population growth, on the Commonwealth's budget 40 years from now.

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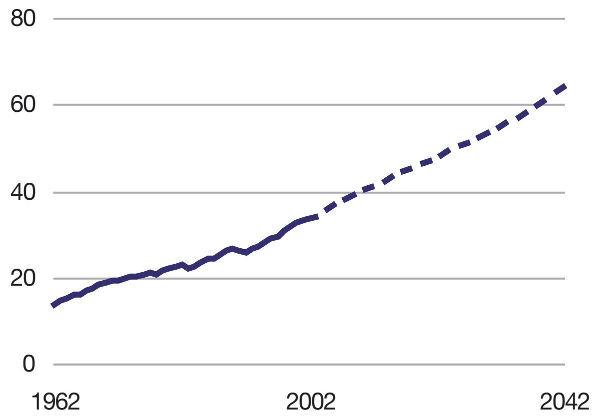
To maintain a strong, fair and resilient Australia we need to plan for the future now

Living standards of next generations will depend on decisions made now

(real GDP per person $’000)



Planning for the challenges of an ageing population

Australia, like most industrialised countries, is experiencing an ageing of its population. This is already beginning to place some pressure on government spending. However, much larger pressures are expected to emerge when the ‘baby-boomer’ generation starts reaching old age in the middle of the next decade.

By careful planning now, we will be better prepared to meet the future challenges of an ageing population.

Australians already enjoy the prosperity and well-being that comes from sound management of government finances and sensible economic policies. The Government wants to continue that performance so that future Australians can look forward to:

- a higher standard of living
- opportunities to improve their own circumstances
- sustainable management of natural resources

To achieve this future, Australian governments need to anticipate and meet future challenges to prosperity. Sound decision making will ensure that the Commonwealth budget remains strong, so all Australians, including future generations, can continue to experience growing prosperity.

Right now, and for at least the next decade, the budget position is in good shape. However, current and future generations could face higher taxes if spending is not kept in check

Examining the outlook for future budgets

In 40 years' time, how might the Commonwealth government budget shape up?

Over the next 40 years, if current trends continue, Commonwealth government spending is likely to rise significantly. Assuming that revenue remains around its current share of GDP, rising levels of spending would push the budget into deficit. The gap between spending and revenue could grow to 5 per cent of GDP by 2042, or $87 billion in today's dollars.

Where might government spending grow and why?

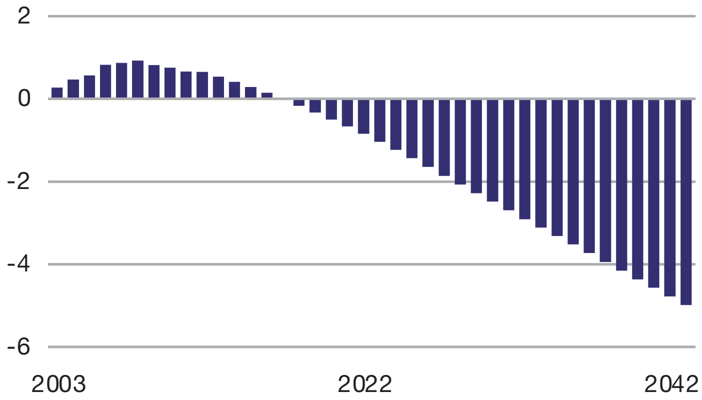
Three key social areas are most likely to have escalating growth. These are health, aged care and age pensions. Health spending will increase because the population is ageing, but more importantly, because people want and expect access to the latest medical advancements.

Uncertainties

We cannot be certain about the future, but it is important to consider what we might have to deal with if current trends and policies continue. This is what the Intergenerational Report does — it is not a fixed forecast, but a picture of what seems likely on current trends.

Widening gap between spending and revenue

(% GDP)



While nothing is certain, some things seem very likely — particularly population ageing and slower population growth. It is sensible to consider now the policies that would better position us to respond to the likely pressures.

Is this projected funding gap important?

A widening gap between spending and revenue could jeopardise Australia's future economic prospects. If the gap was not closed, government debt would increase. High government debt adversely affects Australians through higher interest rates, lower business confidence and lower investment. This would lead to lower economic growth and reduced prosperity for Australia. Eventually, higher government debt has to be repaid and this would impose higher taxes on the next generation.

Higher taxes would mean smaller pay packets and less disposable income for ordinary Australians. With the workforce becoming a shrinking proportion of the population as the population ages, the tax burden becomes heavier for working-age people.

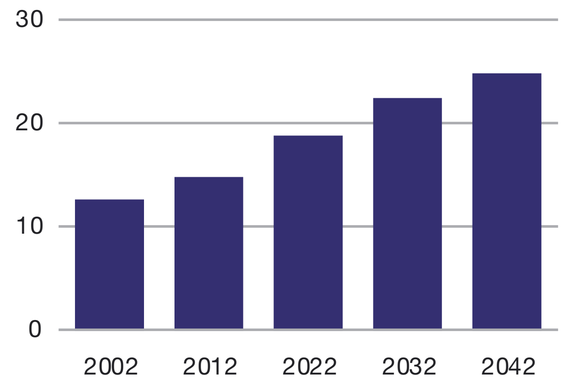
What can be done now to avoid this burden on future generations?

Governments cannot wait 40 years to address this projected funding gap. Acting now to relieve spending pressures avoids more drastic action later when the problems have escalated.

Australia's population will have a smaller proportion of young people and a larger proportion of old people

Around twice the proportion of people 65 and older by 2042

(% population)



More older people, fewer younger people

In 40 years' time, the number of people aged over 65 years will have more than doubled and the number of people over 85 years will have more than quadrupled. In contrast, the number of people under 18 will have fallen slightly.

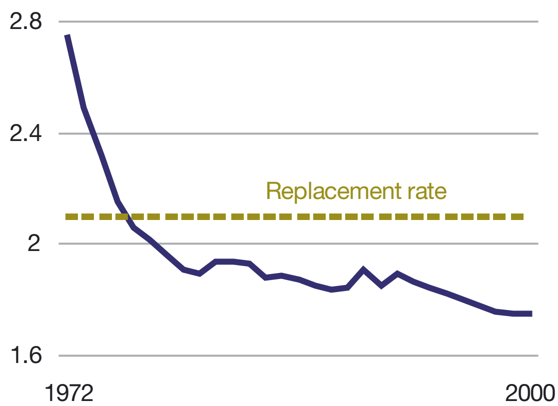
Lower fertility and death rates will drive this substantial ageing of the population.

Continuing current trends, women will have fewer children and people will live longer.

Since the mid-1970s, the number of births per Australian woman has been well below the rate of 2.1 needed for a steady population. This rate may continue to fall from the current 1.75 births per woman to 1.6 births per woman by 2042.

Australians are expected to live longer, due to high living and health standards. By 2042, it is expected that men will live 5.3 years longer than today and women 4.9 years longer than today.

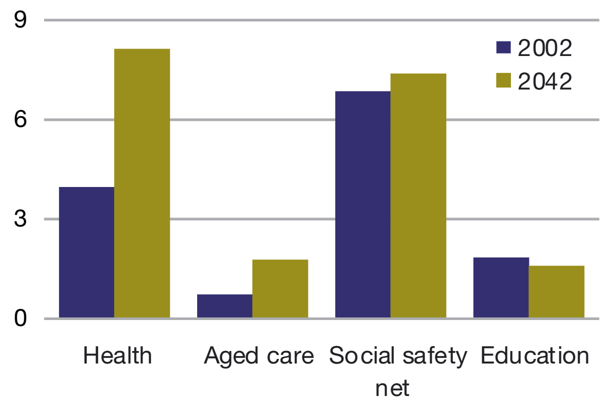
Fertility rates



Government spending is projected to rise

Main spending pressures in 2042

(% GDP)



Spending on health, aged care and age pensions to rise

Already the Commonwealth Government spends over 10 per cent of GDP on health, aged care and the social safety net. In 40 years' time, spending on these areas could rise by half again, costing around an additional $90 billion per year in today's dollars. Health spending will grow mainly because the community expects to be able to use new and better tests and treatments and, to a lesser extent, because of population ageing. Aged care and age pension payments will grow because the population is ageing.

Other areas of government spending that are not directly affected by demographic change, such as defence and the environment, are projected to remain as roughly the same share of GDP. An ageing population means spending on education and on superannuation paid to former government employees is likely to fall as a proportion of GDP.

Government revenue is likely to remain at a constant share of GDP. The main source of Commonwealth revenue will continue to be income taxes.

Commonwealth health spending could double as more people want the latest technology and more older people use more medicines

Demanding high-tech health and better medicines

In 40 years' time, Commonwealth health spending is likely to more than double to 8.1 per cent of GDP. An ageing population contributes to this.

This increase is mainly because people want access to the latest testing technology and medicines. For example, spending on the Pharmaceutical Benefits Scheme (PBS) could rise to more than five times its current level, making it by far the most expensive item on the Commonwealth's health budget, more expensive than spending on hospitals and doctors.

Australia currently has one of the highest life expectancies in the world, partly because Australians enjoy a high level of health care. The Commonwealth provides most of the money for health care. Commonwealth spending on health is around 4 per cent of GDP. The Medicare levy raises only a small proportion of this, around 20 per cent.

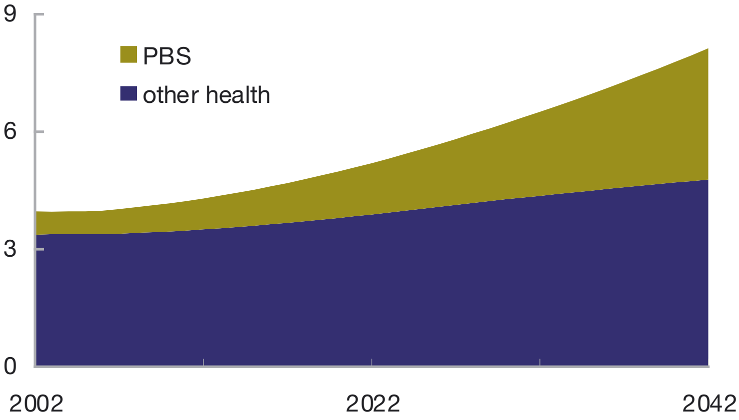
Advancing health technology

Medical technology is helping people to live longer and have a better quality of life. Improved testing methods and treatments (over recent years) include:

- premature babies now have a better chance of survival
- organ transplants are common and artificial organ implants are becoming a reality

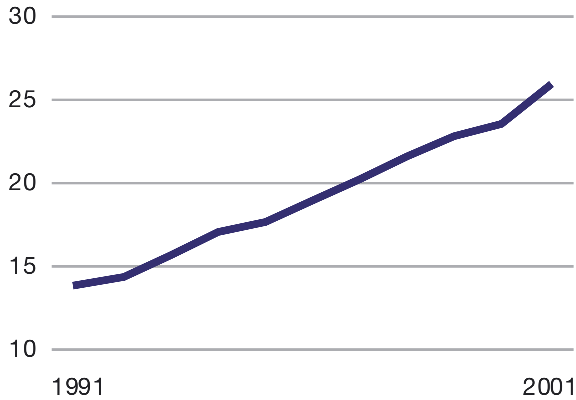
Health costs to rise steeply from 2002 to 2042

(% GDP)



Higher average cost of prescriptions to Government after copayments

(today's dollars)



- people infected with HIV can now expect to live for years, rather than months, due to the rapid introduction of antiretroviral drugs such as Kaletra. Such drugs cost about $10,000 per patient per year but are made affordable through the PBS

But these improvements come at a significant cost and the cost is growing rapidly each year. All areas of health spending (hospital, doctors and medicines) are growing, but the fastest growth is in the PBS.

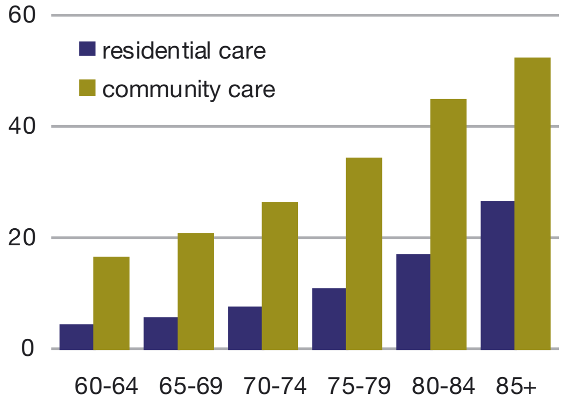
For over 50 years, the Commonwealth has subsidised pharmaceutical products through the PBS. Generally, people do not pay the full costs of their medicines. People who have a health concession card pay no more than $4.60 for a prescription — others pay no more than $28.60. This means that as new, more costly drugs are introduced, the subsidy that the government pays keeps rising. So in 40 years' time, spending on the PBS could be more than five times its current level.

Technology is likely to continue to advance — bringing substantial health benefits. But with more older people in the community — who use the most medicines — the costs will escalate. In 40 years' time, the PBS could account for 3.4 per cent of GDP, making it the largest part of the Commonwealth's spending on health.

Spending on aged care may more than double, with the number of people aged over 85 quadrupling

Nursing home use increases with age

(% of age group)



Many more people needing aged care

The majority of older Australians live healthy, independent lives. For those that need assistance, the Commonwealth Government provides funding for care for the aged so they can continue to live in the community or move to residential care. Community care helps people live independently in their homes for as long as possible. The Government also supports carers in their caring role.

If it becomes necessary, people can be cared for in nursing homes. These provide accommodation, meals and access to medical services. Residential care is more costly than community care.

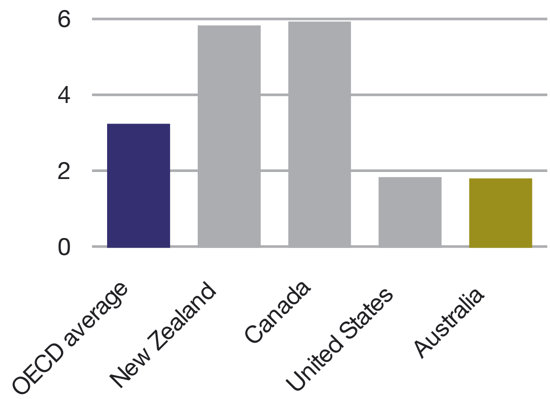
Of people aged over 85, over 25 per cent are cared for in residential care and over 50 per cent receive help to live in their own homes.

As the number of older people increases over the next 40 years, more people will require both community care and the more costly residential aged care. By 2042, spending on aged care is likely to more than double as the number of people aged over 85, who are more likely to require residential care, quadruples.

Private superannuation savings means less pressure on government age pension spending

Australia's age pension spending to grow relatively slowly in next 40 years

(% GDP increase by 2050)



Super savings keep age pension spending down

One of the Government's higher priorities is to provide for people who have contributed to society throughout their life. Age pension payments are the largest part of Australia's social safety net.

Already 2.7 million Australians are old enough to receive the age pension. In 40 years' time, 6.3 million Australians are likely to be of age pension age.

But increasingly, Australians have been preparing for their retirement by contributing to superannuation schemes. By taking responsibility for their own retirement income, retirees rely less on government payments and can enjoy higher standards of living. It also reduces the burden on future taxpayers to fund age pensions for retired people.

Australia is well placed to take care of its retirees in the future because of its age pension and maturing superannuation systems. Spending on age pension payments in Australia is likely to grow more slowly than spending in most other industrialised nations.

If substantially more people are in the workforce then economic growth will be stronger and the funding of government services will be spread more evenly across the population

Encouraging more people to join the workforce

In the future, Australia will have more older people and fewer children. This means the working-age population and the number of workers will be low compared with the total population.

With lower growth in employment, economic growth is slower. Government revenue increases with growth in the economy, so slower growth in employment would result in slower revenue growth.

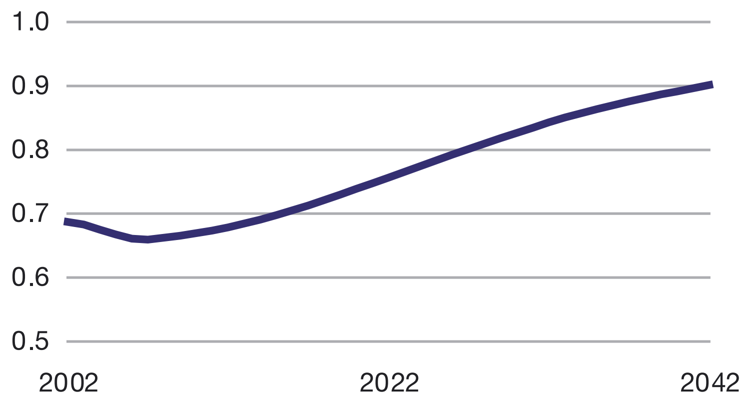
Conversely, stronger growth in employment would increase economic growth and increase government revenue used for funding government services.

At the moment many people wishing to work find they cannot. For example, they may lack suitable skills or have disabilities. People who wish to work need the support that allows them to work. The Government is acting now to address the welfare and work balance in the Australians Working Together package. But in the future, it will be even more important to help these people to find work.

The ageing of the population is likely to bring new opportunities for employment as older people will have new and different requirements for goods and services.

More adults not working compared with those working

(ratio of adults not in employment to those in employment)



Employment brings many benefits to people, including higher incomes, social networks and a greater capacity to provide for themselves. It also leads to lower government spending on pensions and allowances such as the Disability Support Pension and unemployment allowances.

Spending on the Disability Support Pension has grown significantly. In 1980, 229,000 people received this benefit. Now, 624,000 people receive it. Over one in ten people aged between 50 and 64 years receive it. This growth is projected to continue, although at a slower rate.

Spending on unemployment allowances is closely related to the unemployment rate. With the unemployment rate projected to fall to five per cent, government spending in this area is likely to fall.

More opportunities for people of working age to work would lead to even bigger falls in government spending on pensions and allowances.

Education and training will continue to be critical to producing a better skilled workforce and improving living standards

Fewer young people, lower education spending

By 2042, the number of students is likely to have fallen, so education spending, while growing at a solid rate, is likely to fall relative to GDP.

The proportion of people aged 5 to 24 years will fall as a result of women having fewer children. At the same time, older people are likely to increase their participation in training or further education. Despite this, the number of students is expected to fall.

High living standards in the future depend on workers having better skills. Lifelong learning, education and training will be critical for improving skill levels. The demand for high quality education and training will ensure that spending on education will remain a priority.

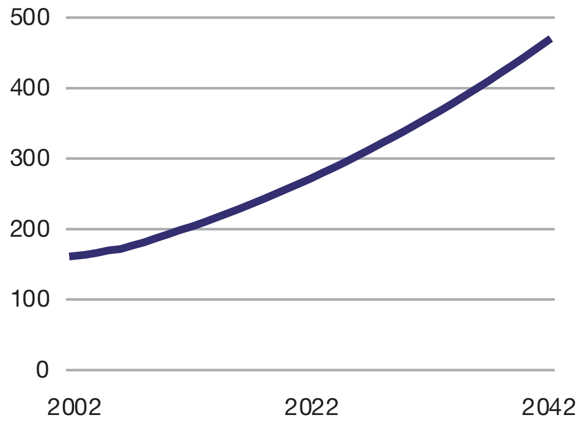
This Government has increased opportunities to participate in education and training. Higher education is more accessible as a result of the additional university places provided in recent years. Further places have been made available through vocational education and training providers, including through the options available under the New Apprenticeship programme.

At the same time, private spending on education has been increasing, largely as a result of the Higher Education Contribution Scheme and the Postgraduate Education Loans Scheme.

Governments must live within their means to ensure stability and continuity in government services

Spending projections (without policy change)

(billions of today's dollars)



Living within our means

Over the next 40 years, Commonwealth governments will face significant challenges. Future spending pressures will need to be managed responsibly so the quality of life of all Australians continues to improve.

In recent years, the Australian economy has been particularly resilient to world events. To retain that resilience, governments must maintain sustainable government finances.

This is why the Government acted, when it was elected in 1996, to restore the budget to surplus. It is why the Government has reformed Australia's tax system, to provide a more secure long-term revenue base. And it is why the Government is acting in this year's Budget to address growth in the Pharmaceutical Benefits Scheme and Disability Support Pension.

Future governments will also need to make the difficult decisions that ensure future generations of Australians continue to enjoy the stable and resilient economy that we have today. Governments also will need to continue to take a long-term view of policies and consider their long-term consequences.

This Government's commitment to sound budget planning will ensure Australia continues to have a prosperous and strongly growing economy well into the future.