Deloitte Access Economics

Increasing participation among older workers:

The grey army advances

Report prepared for the Australian Human Rights Commission

Deloitte.

Deloitte Access Economics Pty Ltd
ACN: 149 633 116

Level 1, 9 Sydney Ave
Barton ACT 2600
PO Box 6334
Kingston ACT 2604

Tel: +61 2 6175 2000
Fax: +61 2 6175 2001
www.deloitte.com.au

Susan Ryan

Age Discrimination Commissioner

Australian Human Rights Commission

25 July 2012

Dear Susan,

Economic impact of increased participation among older workers

Our report outlining the potential economic benefits from an increase in workforce participation among older Australians is attached.

I trust that this will assist in raising awareness of the importance of improving attitudes, opportunities and incentives for this group.

Yours sincerely,

Chris Richardson
Director
Deloitte Access Economics Pty Ltd

Contents

Charts

Tables

Executive Summary

Successive editions of Treasury's *Intergenerational Reports* (IGRs) have noted that Australia's intergenerational compact was at risk in coming decades on two fronts:

- **From a quantity challenge**: Australia's ageing population means there will be a big increase in numbers of the aged relative to numbers of workers.
- **From a price challenge**: As the Australian Government heavily subsidises health spending for the aged in particular, the fact that the cost of delivering health care tends to rise over time relative to other costs in the economy means an additional strain.

Those potential problems associated with an ageing population are now well known.

And so too are the potential solutions – Australia needs to see a lift in its productivity growth and its participation rates.

In particular, mature age participation can play a key role in tipping the balance between the number of future retirees and the number of workers available to support them.

The numbers are big:

- An extra 3 percentage points on participation among workers aged 55 and over would result in a $33 billion boost to GDP – or around 1.6% of national income.
- A 5 percentage point lift in participation among this group would see around $48 billion in extra GDP – or 2.4% of national income.

The latter would rank with the gains that Australia has achieved from some of the major economic reforms of times past.

And remember, those gains come on top of an expected $55 billion or 2.7% boost from participation among the over 55s already factored into the latest IGR.

Recent trends in mature age participation

Is that achievable? The good news is that attitudes to older workers have been changing in Australia over time, alongside related changes to the social, cultural and institutional context surrounding those attitudes.

Broadly speaking, the last 30 years have seen two trends in mature age participation:

- A broad increase in participation among Australians in their 50s and 60s, particularly over the past decade.
- A dramatic increase in female participation rates, which have been lifted by both increased mature age participation in the last decade and increased overall participation by younger women over the course of the previous two decades.

Indeed, gains in labour force participation over the last decade have tended to outpace expectations for them – particularly among older Australians.

In other words, rapid changes in the structure of Australia's workforce are no longer simply an expectation, they are increasingly becoming a reality – one that is already reshaping workplaces.

Future movements in mature age participation

But where to next? Future developments in participation among older workers will be particularly important to Australia's overall economic future, as these older age groups will be growing fast at a time when population growth in younger age groups is predicted to slow.

There are a number of reasons to expect continued improvements in mature age participation over time:

- First, some additional flow-through of **higher participation rates among women** can be expected in coming years.
- Second, **increases in the age pension age** are ongoing, with the age for women increasing to 65 before the age for both women and men rises to 67 by mid-2023.
- Third, **traditional attitudes to retirement are increasingly becoming obsolete** as Australians adjust to significant increases in longevity.

With rising life expectancies, and improvements in health care and other technologies, there is every reason to expect that age will be less of a factor in future retirement decisions.

Economic benefits of greater mature age participation

Increasing mature age participation and employment has a range of benefits for the economy, the Government and, of course, for individual Australians with a desire to continue working.

Changes in mature age participation are already predicted to have significant benefits for the Australian economy in coming decades. Deloitte Access Economics sees these expected increases producing a $55 billion or 2.7% increase in national income by 2024-25.

Those gains are impressive. Given the substantial economic benefits expected to emerge from increasing mature age participation, it is useful to consider what might be achieved should further increases be encouraged by greater than expected gains over time.

- If Australia achieves a further 3% increase in mature age participation over and above that currently expected, the national economy would be $33.0 billion, or 1.6%, larger.
- Should mature age workforce participation lift an additional 5%, the national economy would be $47.9 billion, or 2.4%, larger.

The latter would represent a major change in Australia's workforce, with participation among Australian's in their 70s lifting by a half and participation among those aged 50-59 closing in on that of Australians in their 30s and 40s. It is therefore no surprise that the resulting economic benefits would rank with the gains that Australia has achieved from some of the major economic reforms of times past.

Those figures highlight the large and growing benefits of promoting higher mature age participation and employment.

Moreover, by remaining in employment for longer, older Australians can not only increase their current income, but can also save more to support themselves once they do decide to retire. In turn, improving retirement incomes not only raises living standards for future retirees, but can also assist in reducing welfare costs for future governments.

These benefits serve as a timely reminder that effective policies aimed at promoting increased workforce engagement among older Australians are likely to be among the most cost effective tools available to lift national incomes and living standards in coming decades.

Deloitte Access Economics
25 July 2012

1 Background

The Australian Human Rights Commission has asked Deloitte Access Economics to assess the potential economic benefits of increased labour force participation among older Australians.

This report examines the potential benefits of increasing participation among older workers in the context of the looming challenges facing Australia's economy and government finances over coming decades.

It examines the economic projections of the Australian Government's 2010 *Intergenerational Report*, and assesses the contribution of expected increases in mature age workforce participation to future growth in the Australian economy.

It also considers alternative assumptions about mature age workforce participation, highlighting the potential economic benefits of encouraging greater engagement with the paid workforce among older Australians.

Deloitte Access Economics' report:

- Outlines the **ageing challenges** facing the Australian economy in coming decades, (see Chapter 2).
- Briefly examines past, emerging and future trends in **workforce participation among older workers** (see Chapter 3).
- The report then discusses **estimates of the benefit to the Australian economy** of increased workforce participation by older workers (see Chapter 4).

2 Australia's ageing challenge

It is now well known that Australia has an ageing population structure. A combination of falling death rates and associated rising life expectancy with the demographic bulge of the baby boomers will lead to a dramatic rise in the number of older Australians in coming decades.

Over the next forty years the number of Australians aged 85 and over will go up by a factor of 5 – some 7 times for men, and 4 times for women (as relative life expectancy for men and women moves into closer alignment).

As successive versions of the Australian Government's *Intergenerational Report* (IGR) have noted, that will have a dramatic impact on both the economy and the Federal Budget:

- Economic growth will slow as a smaller share of the community will be of working age, reducing overall workforce participation.
- Government finances will come under pressure as pension and health care subsidies extended by society to the aged will be more substantial in the future than they are at the moment.

2.1 Economic growth and the 'three Ps'

Economic output – or the size of the national 'pie' – has three basic drivers:

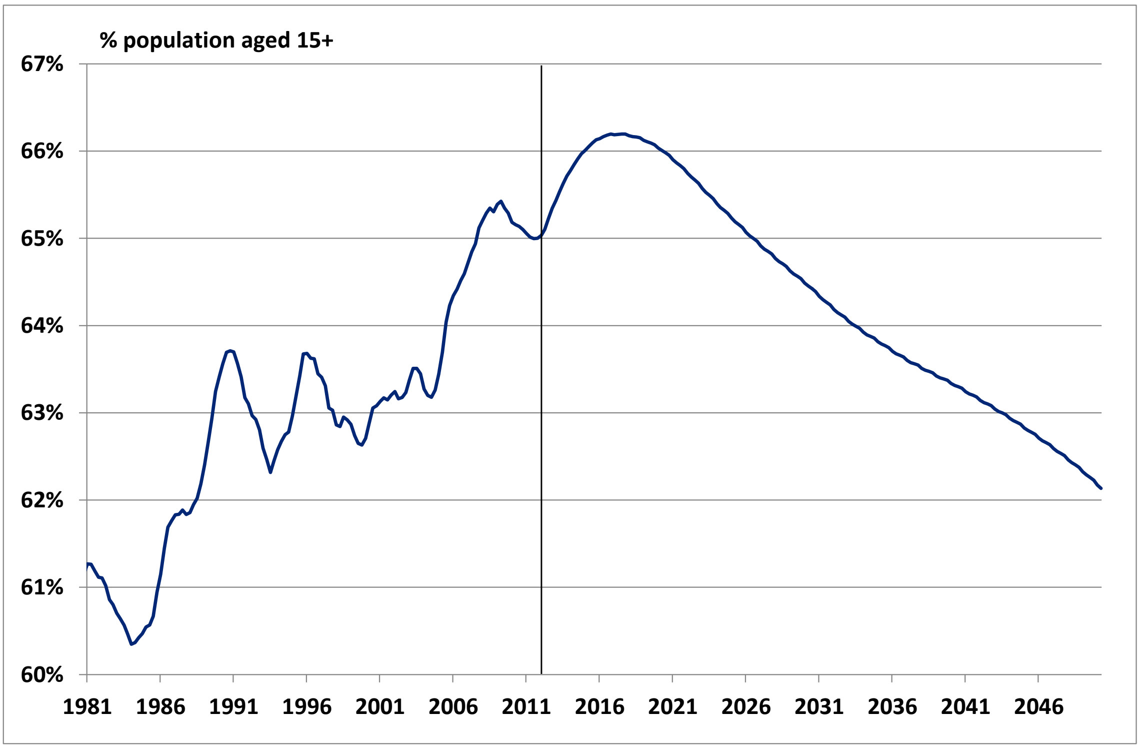
- **Population:** How many people there are in the economy.
- **Participation:** How many of those people choose to work.
- **Productivity:** How much each of those workers can produce.

In one sense, population provides a basic proxy for underlying demand growth in the economy. The supply growth implied by those overall population numbers will depend on how many Australians seek work in coming decades.

Overall participation rates are traditionally defined as the share of those in the working age population (those aged 15 and over) who are in work or looking for it. Projections indicate that increasing rates of retirement among baby boomers will see Australia's participation rates fall over time (see Chart 2.1 below).

To that impact of ageing on likely numbers of workers may be added the effect of the expected slowing in overall population growth, with both factors implying that the first two 'Ps' – population and participation – may wane over coming decades.

Chart 2.1: Total labour force participation rates[1]



Source: ABS Labour Force Survey, Deloitte Access Economics

2.2 The Australian Government's Intergenerational Report

Life cycles can be usefully divided into three: childhood, working age and retirement. These three ages of life are important because, as a society, we treat them differently.

In essence every society makes an intergenerational compact with itself. It subsidises investment in children by subsidising the education costs of children, and also their health costs. Society also subsidises retirement, by paying pensions to the less well-off and by subsidising the healthcare costs of the ill and aged. Society pays for these subsidies to the young and the old by taxing the incomes of workers. There is therefore a budget balance over the life cycle, as workers subsidise the young and the old.

However, as the Australian Government's IGRs have effectively noted, key quantity and price effects will change the nature of Australia's current intergenerational compact with itself.

Successive editions of the IGR have noted our intergenerational compact was at risk in coming decades:

- **First from a quantity challenge**: Australia's ageing population means there will be a big increase in numbers of the aged relative to numbers of workers.

[1] Participation projections based on a transition of age-specific participation rates from the most recent values to long run values included in the 2010 IGR.

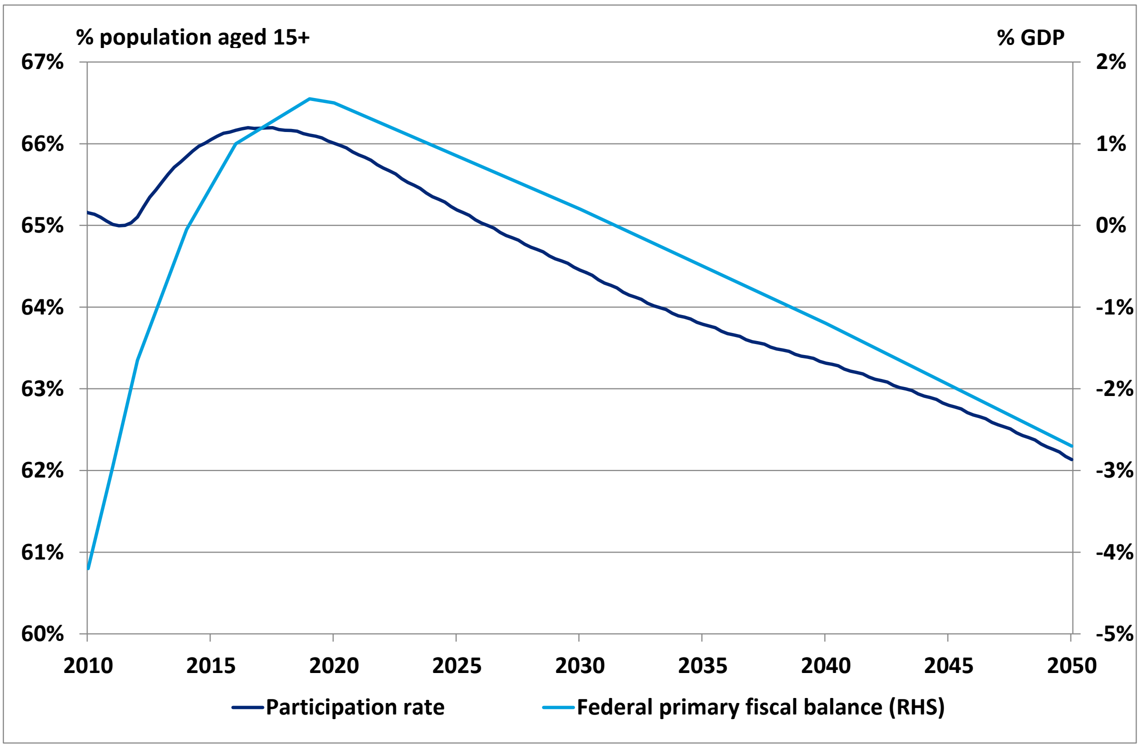
- **And second from a price challenge**: As the Australian Government heavily subsidises health spending for the aged in particular, the fact that the cost of delivering health care tends to rise over time relative to other costs in the economy means an additional strain.

Those twin challenges are projected to result in considerable pressure on government finances in the longer term. With greater quantities demanded of various goods and services implied by an ageing population structure in Australia, there are also relative price effects at work.

Health care costs, which make up a large proportion of Australian Government subsidies to the aged (and other age groups), have tended to grow at a faster rate than economy-wide prices in times past.

Or, in other words, both quantity and price effects are set to operate to raise the cost of society's subsidies to the aged, leading to large, rising and ultimately unsustainable Australian Government deficits.

Chart 2.2: Projected Federal deficits and labour force participation



Source: 2010 Intergeneration Report, Federal Treasury

By pointing out the looming fiscal challenges, the IGRs have told Australians that, for this nation's intergenerational compact with itself to be sustained, either tax rates on workers will have to rise, or subsidy rates and/or the level of services to the young and the old will have to fall – or some mix of those two.

Adding to the problem faced by policymakers, the coming fiscal problems will mirror a wider slowdown in the Australian economy.

The bottom line is simple: **Government spending will be rising at a time when the relative size of the workforce is shrinking.**

3 How has the IGR picture changed over the past decade?

Since the first IGR was released in 2002, some factors have improved the basic figuring on longer term fiscal finances, while others have worsened the outlook.

On the plus side:

- A combination of government policies and market developments have seen a notable **slowdown in spending growth under the Pharmaceuticals Benefits Scheme** (PBS) – which was a key culprit in the expected blowout in Government costs over coming decades.
- **Retirement ages have lifted** – after being relatively steady for some time, participation rates among older Australians are rising at a faster rate than expected in the IGR.
- Official **migration targets have been rising over time** (the decrease in migration targets following the global financial crisis (GFC) have been partly reversed, with the latest Federal budget lifting the skilled migration target by 5,000).
- And, finally, **birth rates look like stabilising at a higher rate** than envisaged back in 2002.

But not all the news is good. Against that:

- **Productivity growth has faltered** in recent years – and has failed to meet the benchmark assumed in the IGR over much of the past decade. There is a risk that 'reform fatigue' could keep productivity growth, on average, below that benchmark for some time.
- **Life expectancy continues to rise** at a faster rate than the IGR expected (that is, people may be working longer, but they are living longer too).
- **Spending and tax cuts announced since the 2002 IGR have come at considerable cost to the Federal Budget**. Even before the introduction of fiscal stimulus at the height of the GFC, net new policy announcements were running at very high levels. Much of that spending has relied on strong economic conditions (and, in particular, high global commodity prices), but the latter may yet prove to be rather shorter-lived than the demographic challenges Australia faces.

Luckily, we have a good handle on coming costs, because the Commonwealth Government has been informing us about these challenges. And although the challenge in Australia is smaller than that faced by the likes of Japan or Italy or Germany, it's still huge.

The latest Commonwealth Government Intergenerational Report (IGR), released in 2010, contained a lot of good news. Australia in the future will have a rather bigger economy than when Treasury last did these projections back in 2007. Indeed, forty years from now, the economy is projected to be a full 18% larger than Treasury was estimating in 2007.

The revision is mostly thanks to the assumption that migration will average 180,000 a year versus Treasury's earlier estimate of 140,000. Birth rates are also expected to be a little higher, albeit still below replacement rates.

Mind you, bigger isn't necessarily better on the population front. It never has been, and it never will be. However, where increased migrant numbers can generate a genuine gain for Australia is through the impact they can have on Australia's economy due to higher productivity and participation. Our migrants are mostly highly skilled and relatively young – a combination which offers gains in both productivity (thanks to their skills) and participation (thanks to their age and to their skills). Other things equal, that means skilled migrants more than pay their way, contributing notably to tax collections while drawing on public spending by rather less than the average

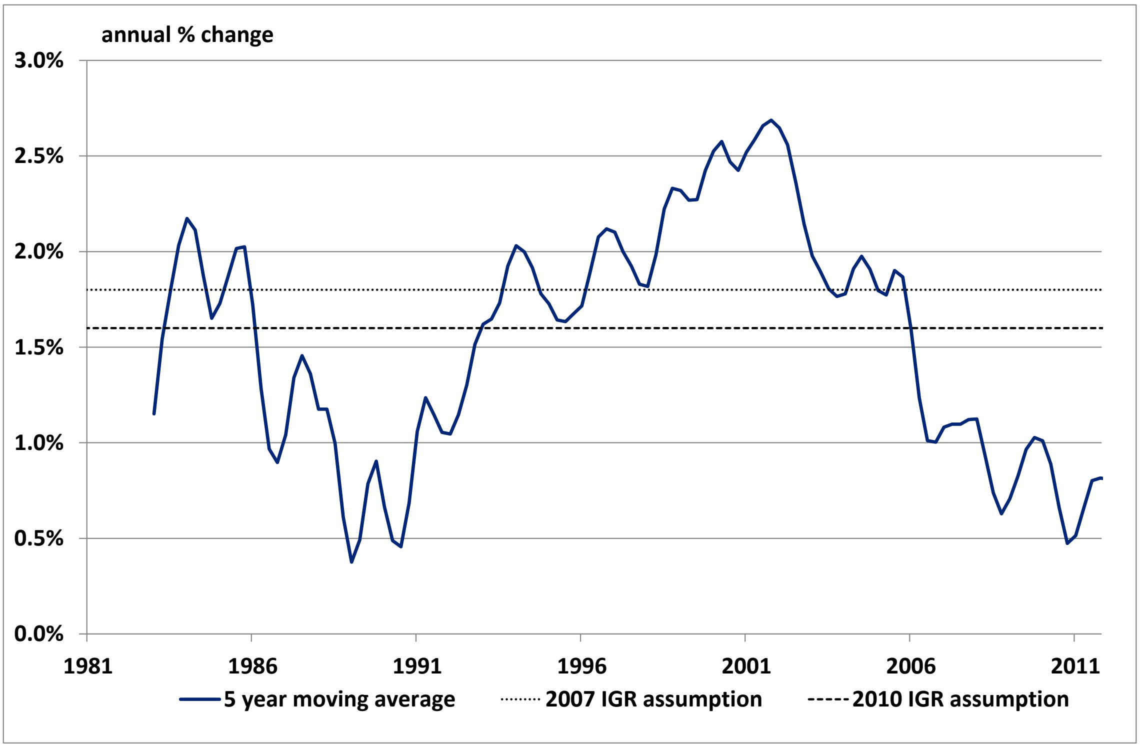
Helped by more migrants, workforce participation has risen in recent years and is now projected to be 60.6% by 2050, more than 3 percentage points higher than the 2007 IGR.

And although Treasurer Wayne Swan, in releasing the 2010 IGR, noted that there will be only 2.7 Australian workers for every person aged over 65 by 2050, that is actually an improvement on the 2.4 estimated by Treasury back in 2007.

So the demographic news is good. But, on some fronts, the economy in 2050 pictured in the latest IGR will actually look worse rather than better.

Productivity growth is now assumed to be lower than the matching 2007 IGR projections (see Chart 3.1 below) meaning that, in four decades, future incomes are now expected to be 3% less than they were projected to be in the 2007 IGR.

Chart 3.1: Labour force productivity growth



Source: ABS National Accounts (Cat No. 5206.0), Deloitte Access Economics

3.2 Participation among older workers

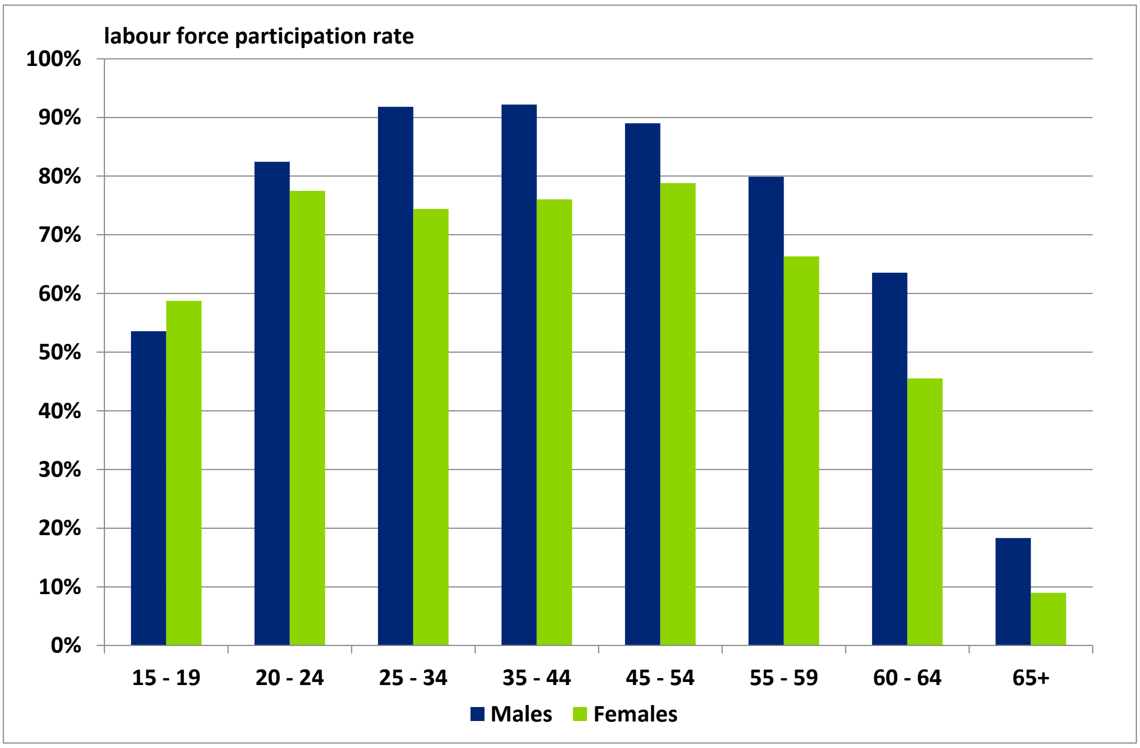
As the discussion in Chapter 2 shows, the potential problems associated with an ageing population are now well known.

And so too are the potential solutions – Australia needs to see a lift in its productivity growth and its participation rates.

In particular, mature age participation can play a key role in tipping the balance between the number of future retirees and the number of workers available to support them.

Labour force participation rates peak for males aged 35-44 before falling as people reach their late 50s and early 60s, as Chart 3.2 shows. Participation rates for females are steadier than those for males between the ages of 20-54, and again fall thereafter.

Chart 3.2: Age specific participation rates by gender, May 2012



That is, not only are relatively few Australian workers remaining in the workforce after the age of 65, but many are leaving the workforce before they reach that age.

As the 2010 IGR noted:

> *Despite recent increases, Australia's mature age participation rate is below that of comparable countries — including the United States, United Kingdom, Canada and New Zealand.*

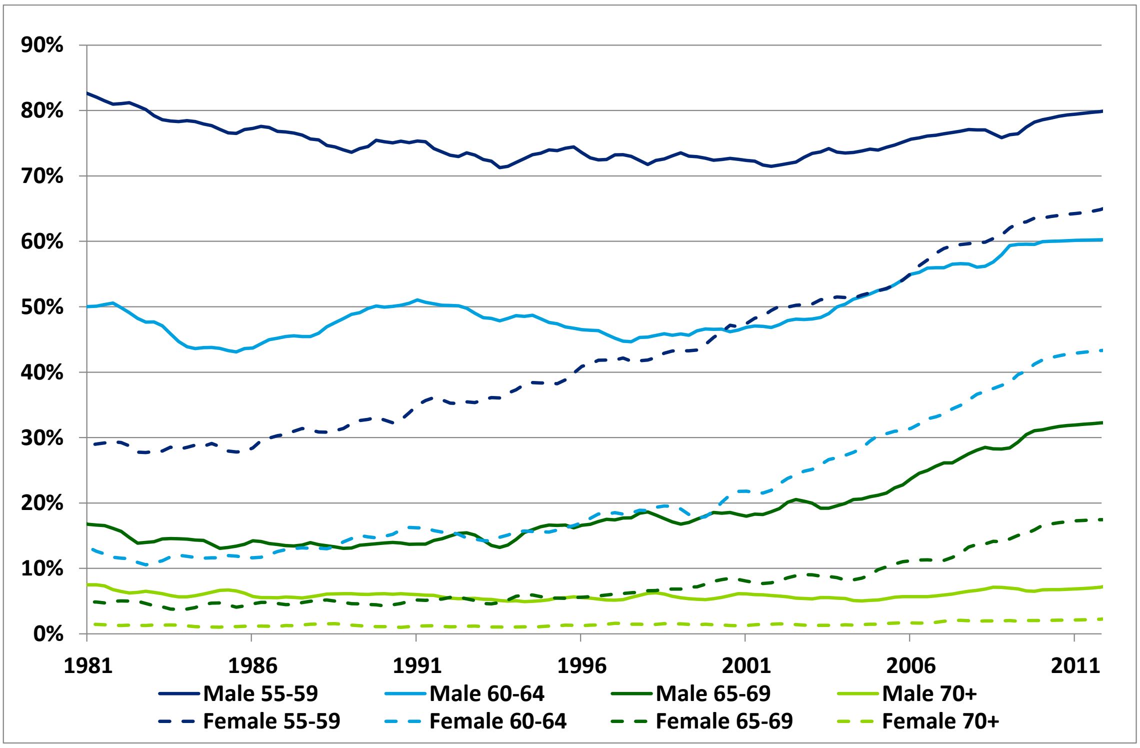
3.3 Past trends

Attitudes to older workers have been changing in Australia over time, along with related changes to the social, cultural and institutional context in which those attitudes have been formed.

For example, the abolition of 'compulsory retirement' is a relatively recent development in Australia, while even today the age of eligibility for the age pension is lower for women than for men – reflecting past attitudes to the role of women in the workforce more generally.

Chart 3.3 shows labour force participation rates over three decades.

Chart 3.3: Labour force participation rates by age and gender



Source: ABS Labour Force Survey

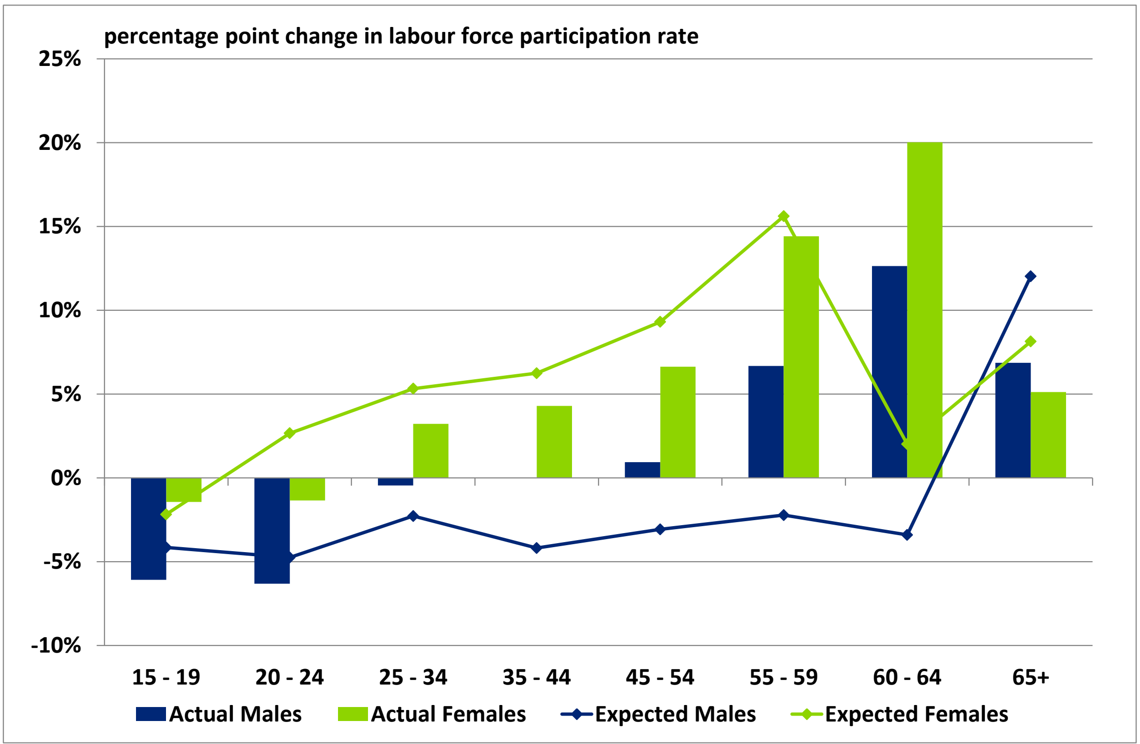
Broadly speaking, the last 30 years have seen two trends:

- A broad increase in participation among Australians in their 50s and 60s, particularly over the past 10 years.
- A dramatic increase in female participation rates, which have been lifted by both increased mature age participation in the last 10 years and increased overall participation by younger women over the course of the previous two decades.

Looking back, **changes in labour force participation over the last decade have tended to outpace expectations – particularly among older workers.**

Chart 3.4 compares the (then) expected gains in labour force participation by age and gender over the 40 years to 2041-42 with actual outcomes over the last decade.

Chart 3.4: Expected and actual changes in labour force participation by age and gender



Source: ABS Labour Force Survey, *Intergenerational Report* 2002-03, Deloitte Access Economics

It shows the notable surge in labour force participation among both men and women aged 55 to 64 was largely unexpected. Indeed, official projections had expected a slight fall in participation among males in this group.

At the same time, much of the gain in participation among those aged 65 and over predicted over the next 40 years has already occurred in just 10 years.

In other words, rapid changes in the structure of Australia's workforce are no longer simply an expectation, they are an increasingly reality that is already reshaping Australian workplaces.

3.4 The potential for future gains

Future developments in participation among older workers will be particularly important to Australia's overall economic future, as these older age groups will be growing fast at a time when population growth in younger age groups is predicted to slow.

While much has changed in the last decade, labour force participation among older Australians still has the potential to lift further in coming years. As the 2010 IGR notes:

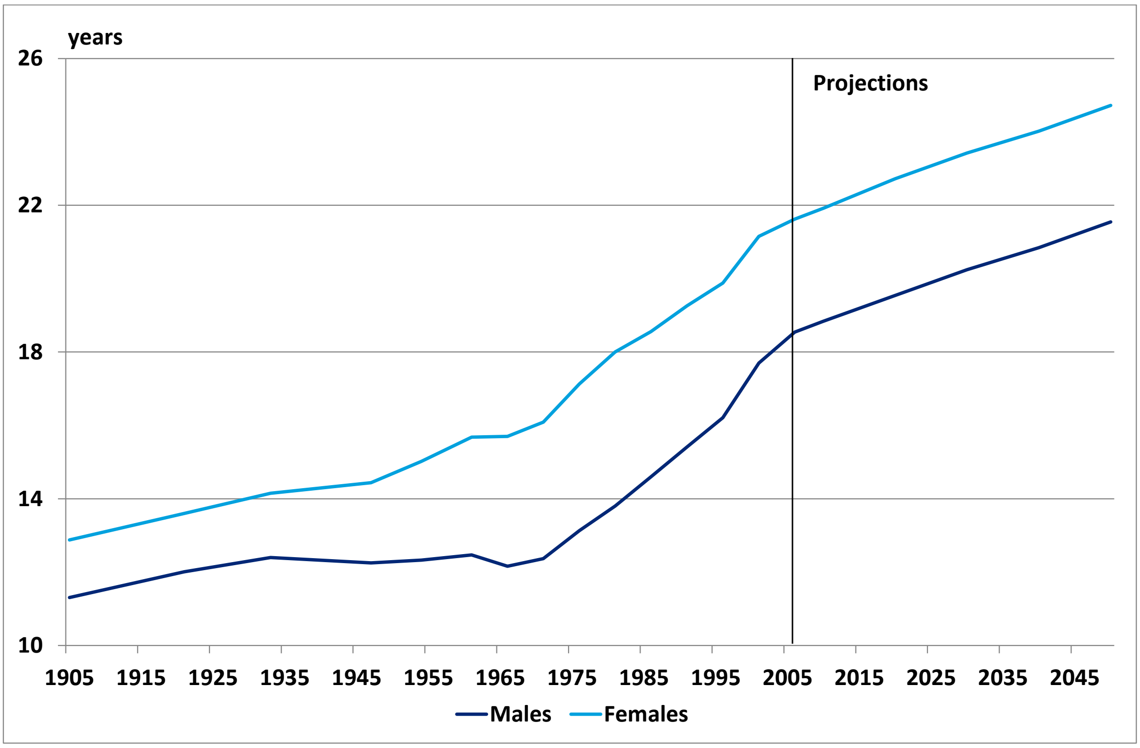
> *Australia's mature age participation rate of 58.9 per cent in 2008 is the thirteenth highest in the OECD. This is higher than the OECD average (56.3 per cent), but lower than the United States, the United Kingdom, New Zealand and Canada. International comparisons show there is scope for Australia to increase participation rates for the mature age group.*

There are a number of reasons to expect continued improvements in mature age participation over time.

- First, some additional flow-through of **higher participation rates among women** can be expected in coming years.
- Second, **increases in the age pension age** are ongoing, with the age for women increasing to 65 before the age for both women and men rises to 67 by mid-2023.
- Third, **traditional attitudes to retirement are increasingly becoming obsolete** as Australians adjust to significant increases in longevity.

With life expectancies continuing to rise, and improvements in health care and other technologies, there is every reason to expect that age will be less of a factor in future retirement decisions.

Chart 3.5: Australian life expectancy at age 65[2]



Source: Australian Government Actuary, Deloitte Access Economics

These processes are likely to continue for some time, in part because past developments in mature age participation have failed to keep pace with other demographic and social developments over a number of years.

That is, not merely will mature age participation need to adapt to future changes in social and demographic norms, but further gains will be needed to catch up to past changes.

[2] More formally, the measures presented are the complete expectation of life at age 65. The projections shown are based on the continuation of the historical 100 year trend improvement in mortality.

4 Benefits of higher mature age workforce participation

Increasing mature age participation and employment has a range of benefits for the economy, the Government and, of course, for individual Australians with a desire to continue working.

In this chapter, we examine the potential economic payoff resulting from higher mature age participation, first from the perspective of the economy as a whole, and then from the point of view of combatting looming challenges for government finances.

4.1 Benefits to the economy

With greater participation and employment among older Australian will come higher incomes, both for individual workers and across the Australian economy as a whole.

As one of the ‘three Ps’ participation rates have a direct impact on overall national income. Keeping more Australians in work for longer will also lift living standards.

So how much will expected changes in participation rates contribute to future living standards?

Table 4.1 provides estimates of the economic benefits of three possible scenarios for mature age workforce participation:

- The expected increases in participation rates included in the projections underlying the 2010 IGR.
- An additional 3% increase in workforce participation among Australians aged 55 and over, over and above those expected increases.
- An additional 5% increase in workforce participation among Australians aged 55 and over, again, over and above the expected increases.

Increased national income as a result of each of these scenarios is measured relative to unchanged workforce participation among Australians aged 55 and over.

Table 4.1: Economic benefit in 2024-25 of additional mature age participation

	$bn (2009-10)	% GDP
Expected increases	55.0	2.7
Additional 3%	33.0	1.6
Additional 5%	47.9	2.4

Source: Deloitte Access Economics

Changes in mature age participation are already predicted to have significant benefits for the Australian economy in coming decades. Deloitte Access Economics sees these expected increases producing a $55 billion or 2.7% increase in national income by 2024-25.

Those gains are impressive. Given the substantial economic benefits expected to emerge from increasing mature age participation, it is useful to consider what might be achieved should further increases be encouraged by greater than expected gains over time.

- If Australia were to achieve a further 3% increase in mature age participation over and above that currently expected, the national economy would be $33.0 billion, or 1.6%, larger.
- Should the expected improvement in mature age workforce participation be lifted further still to 5%, the national economy would be $47.9 billion, or 2.4%, larger.

The latter would represent a major change in Australia's workforce, with participation among Australian's in their 70s lifting by a half and participation among those aged 50-59 closing in on that of Australians in their 30s and 40s. It is therefore no surprise that the resulting economic benefits would rank with the gains that Australia has achieved from some of the major economic reforms of times past.

Those figures highlight the large and growing benefits of promoting higher mature age participation and employment.

They also serve as a timely reminder that effective policies aimed at promoting increased workforce engagement among older Australians are likely to be among the most cost effective tools available to lift national incomes and living standards in coming decades.

4.2 Other indirect benefits

In addition to direct increases in national income, which flow to workers via higher wages, to businesses via higher profits and to the government via higher tax revenues, there are other benefits to increased mature age participation.

Increasing mature age participation would not only have direct impacts on the national economy, but it would also support a range of other positive outcomes for individuals and the Australian Government.

Australian policymakers have been trying to encourage a lift in retirement ages for some time. That is no surprise: after all, changes in retirement decisions can have a major impact on the adequacy of **retirement savings**, as delayed retirement allows a longer period to accumulate assets, while reducing the length of time those assets will be required to support members in their retirement.

By remaining in employment for longer, older Australians can not only increase their current income, but can also save more to support themselves once they do decide to retire. In turn, improving retirement incomes not only raises living standards for future retirees, but can also assist in reducing welfare costs for future governments.

Further, emerging evidence suggests that greater engagement with the workforce among older Australians can assist to maintaining social inclusion and improving health outcomes over time.

Limitation of our work

General use restriction

This report is prepared solely for the Australian Human Rights Commission. This report is not intended to and should not be used or relied upon by anyone else, or quoted without permission except for the Australian Human Rights Commission, and we accept no duty of care to any other person or entity. The report has been prepared for the purpose of informing public debate. You should not refer to or use our name or the advice for any other purpose.

Contact us

Deloitte Access Economics
ACN: 149 633 116

Level 1
9 Sydney Avenue
Barton ACT 2600
PO Box 6334
Kingston ACT 2604 Australia

Tel: +61 2 6175 2000
Fax: +61 2 6175 2001

Deloitte Access Economics is Australia's pre-eminent economics advisory practice and a member of Deloitte's global economics group. The Directors and staff of Deloitte Access Economics joined Deloitte in early 2011.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/au/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

About Deloitte

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries, Deloitte brings world-class capabilities and deep local expertise to help clients succeed wherever they operate. Deloitte's approximately 170,000 professionals are committed to becoming the standard of excellence.

About Deloitte Australia

In Australia, the member firm is the Australian partnership of Deloitte Touche Tohmatsu. As one of Australia's leading professional services firms. Deloitte Touche Tohmatsu and its affiliates provide audit, tax, consulting, and financial advisory services through approximately 5,700 people across the country. Focused on the creation of value and growth, and known as an employer of choice for innovative human resources programs, we are dedicated to helping our clients and our people excel. For more information, please visit our website at www.deloitte.com.au.