Business Council of Australia

SUBMISSION

Submission to the Retirement Income Review Consultation Paper

February 2020

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CONTENTS

KEY POINTS

- The Business Council welcomes the opportunity to provide a submission to the independent Retirement Income Review in response to the consultation paper.
- A comprehensive review of the retirement income system is critical for understanding the outcomes achieved by the current policy settings of the system and to guide future changes.
- The three pillars of the retirement income system – the age pension, superannuation and voluntary savings – have been subject to numerous policy changes over the years without enough consideration to the overall objectives of the system.
- A clear purpose for the retirement income system which has widespread agreement, alongside a set of design principles, is needed and should be used to guide the review. These would provide a measure against which to assess the system and guide coherent policy changes and help to limit ad hoc changes to what is a complex and interrelated system, and improve confidence in it.
- The Business Council proposes that the dual purpose of the retirement income system be to provide for comfortable living standards during retirement, and to reduce reliance on the age pension.
- The Business Council supports the design principles proposed by the consultation paper – adequacy, equity, sustainability and cohesion – and also proposes adding the principle of ‘simplicity’.
- The Business Council strongly supports the government regularly and publicly reporting on whether the retirement income system is achieving its objectives and adhering to the design principles. It should also assess the long-term outlook for the system against the same objectives and principles.
- There are also a number of major, long-term forces shaping our economy that should be considered by the review, the most notable of which is demographic change and falling workforce participation over time.
- The review should help to deliver a system that is less complex and easier to navigate, facilitates comfortable living standards in retirement and alleviates fiscal pressures from an ageing population.

1. PURPOSE OF THE RETIREMENT INCOME SYSTEM

Australia's retirement income system is built on three pillars:

- taxpayer funded **age pension** – which is targeted towards people with low retirement incomes through both income and assets tests
- compulsory **superannuation** – which mandates a proportion of people's wages is set aside for retirement
- voluntary **private savings** – which provides each Australian the flexibility to determine how much they want to save for their retirement in addition to the support provided by the age pension and/or superannuation.

The retirement income system has evolved through a combination of planned reform and an accumulation of ad hoc decisions. This has led to a complex system that does not always operate in a coherent manner.

Australia's retirement income system must have a clear purpose, and it should be well communicated and understood by the public. This can help to limit ad hoc policy changes to the system, while improving confidence in the system and the ability to plan for retirement.

The figures involved in the retirement income system are staggering:

- $2.9 trillion of superannuation assets
- 16 million Australians have at least one superannuation account
- almost $50 billion spent on the age pension each year
- 2.5 million Australians receive a full rate or part rate age pension.

These figures are set to grow as the population ages and the superannuation system matures. Of course, these figures do not even consider other forms of private savings – be they the family home, investment properties, shares or term deposits – which many people will also draw on in retirement.

Australia's $2.9 trillion stock of superannuation assets is 1.5 times the size of our economy and the 4th largest stock of pension assets in the world[1]

People may spend roughly 40 to 50 years saving for retirement during their working lives and may well have over 15 years in retirement.

It is undeniable that the economic and policy landscape will change over such an extended time. It is also reasonable for the public to expect a relative degree of certainty over the

1. APRA, *Quarterly Superannuation Performance Statistics*, September 2019; ABS cat. no. 5206.0; Thinking Ahead Institute, *Global Pension Assets Study 2019*, 2019.

policy arrangements for retirement incomes given these long horizons and the complexity of the issues involved.

Despite this, retirement income policy arrangements have been changed repeatedly, undermining confidence in the system and the ability to plan for retirement. For example, the history of announced changes to superannuation compiled by the Parliamentary Library in 2014 ran to roughly 30 pages.[2] And there have been many changes since then.

This makes a clear, legislated purpose for the retirement income system essential. This new legislation should also include the objectives of each of the three pillars and the design principles which guide how the objectives are best achieved. In addition, a reporting framework should be outlined to regularly evaluate the health of the retirement income system and to assess future changes to the system against the purpose, objectives and principles.

The *Charter of Budget Honesty* which aimed to “improve fiscal policy outcomes” could serve as a model for this new legislation.

Enshrining the objectives of the retirement income system in legislation will provide a guide to policymakers, regulators, business and the community about the system’s fundamental purpose.

By providing a stable framework against which the system can be evaluated, it can highlight decisions which involve trade-offs or where there are flow-through effects from one pillar to another. This will better enable changes to the system to be considered holistically.

Broad political and community support for the legislated objectives is essential to ensure confidence in the retirement income system and long-term policy consistency.

The twin purpose of the retirement income system

The retirement income system should have a dual purpose to:

- provide for comfortable living standards during retirement
- reduce reliance on the age pension.[3]

The objectives of the three pillars of the retirement income system should be consistent with the overriding purpose.

Where necessary, subsidiary objectives such as those proposed for superannuation by the Financial System Inquiry (FSI) should be developed and agreed upon to give more detailed guidance and clarity on how the primary objective can, and should, be translated into detailed policy (see box on p. 9).

There are multiple ways these objectives could be met. The design principles provide additional guidance, on not only what should be achieved, but how it should be achieved.

2. Australian Parliamentary Library, *Major superannuation and retirement income changes in Australia: a chronology*, Research paper series, 2014.
3. While the Business Council supports the purpose and objectives being enshrined in law, the Business Council is not proposing the precise wording for the legislated purpose or objectives.

Figure 1: Framework for the retirement income system

		Purpose of the retirement income system		
		Provide for comfortable living standards during retirement and reduce reliance on the age pension		
		Objective of the age pension	**Objective of superannuation**	**Objective of voluntary private savings**
		Safety net level of income in retirement	*Saving a reasonable minimum share of wages for retirement*	*Additional saving on top of the pension and/or superannuation*
Design principles	*Adequacy* *Equity* *Sustainability* *Cohesion* *Simplicity*	Policy design and implementation		

Principles for designing and assessing the retirement income system

Principles provide a lens through which to design and then assess policy – particularly against its objectives. Policy changes invariably involve a debate on how to best balance these principles and the trade-offs involved. For example, since the Asprey Report in 1975, there has been broad agreement that Australia's tax system should be underpinned by the principles of efficiency, equity and simplicity, but debate is ongoing about how to best achieve these.

Australia's retirement income system, like the tax system, has evolved through a combination of planned reform and an accumulation of ad hoc decisions. The system itself is complex, as are the impact of changes, and careful assessment is required to avoid unintended and possibly perverse economic, fiscal and distributional consequences.

The Business Council supports the design principles proposed by the consultation paper – adequacy, equity, sustainability and cohesion – and proposes adding the principle of 'simplicity' (see below).

There are many dimensions to consider when assessing the retirement income system against these principles, such as:

- how they vary by the circumstances and preferences of individuals
- the interactions between the three pillars, and other policy areas more broadly
- the benefits of policies relative to their costs, including budget impacts and incentives to work and save
- the sensitivity of analysis to different assumptions when making projections about likely long-term outcomes
- whether there are intergenerational questions to consider
- the impact from the forces and trends shaping our economy (discussed further below)

- the impact of uncertainty and constant changes on the effectiveness of the system.

Simplicity

The consultation paper's principle of cohesion considers several factors, including simplicity. However, the Business Council believes there is merit in identifying simplicity as a standalone principle.

Planning for retirement involves complex decisions that spans several decades and includes choices such as when to retire, how much to save and how to best save. The efficacy of those decisions is generally not known until decades later in retirement. These decisions must be made in the context of the retirement income system, the individual elements of which are complex – and only get more complex as their interactions are considered. Compounding these challenges are the numerous policy changes which have been made to the retirement income system to date, and the likely further changes to come.

Simplicity is therefore a principle of paramount importance for both assessing the retirement income system today, and for guiding future policy changes. Simplicity may not be a goal in and of itself but complexity can reduce economic wellbeing by increasing costs to both savers and administrators, reducing transparency, distorting decision making and the allocation of resources, and reducing confidence in the retirement income system. Complexity can have a greater impact on people who have fewer resources to navigate it, and can make it more difficult for policymakers to assess the costs and benefits of different elements within the system.

Complexity can also emerge through numerous (and ad hoc) changes to law, poorly drafted law or evolving regulator interpretations. Where these have been identified through this review process, they should be acknowledged, and where possible, addressed.

Regular reporting against the purpose, objectives and principles

Once a clear purpose for the retirement income system and objectives for its three pillars are established and have widespread agreement, these should be used to guide policy changes alongside the design principles. Reforms of the system should focus on improving the capacity of the system to deliver its objectives in a sustainable way, not simply achieve savings for government.

This review, and any regular reporting that follows, should look at this basic question as a starting point: are the current settings in the retirement income system the most efficient way to achieve comfortable living standards during retirement and reduce reliance on the age pension?

The Business Council strongly supports the government regularly and publicly reporting on whether the retirement income system is achieving its objectives and adhering to the design principles. The long-term outlook for the system should be assessed against the same objectives and principles. Public reporting could occur regularly within the established process for the Intergenerational Report and when there are major new policy proposals.

This review is the first step for setting down a baseline of evidence on the functioning of the system against the objectives and principles. The challenge for the review panel will be to make this assessment while widespread support for the objective and principles is still being established. However, this should not deter the panel from making this initial assessment.

2. THE THREE PILLARS

Roles and objectives of the three pillars

The age pension, superannuation and voluntary private savings all play a role in providing Australians with retirement incomes. Each pillar should adhere to the purpose and principles for the whole system, while fulfilling their particular objective in the overall system.

Within each pillar there are clear roles and responsibilities for government, individuals and the private sector.

The Business Council agrees with the report on strategic issues in the retirement income system which was done as part of the Henry tax review, that providing retirement incomes is the shared responsibility of government and individuals. And that:

- “Governments should provide for minimum and essential needs and facilitate self-provision.”
- “Individuals should save or insure during their working lives to provide resources in their retirement.”[4]

Both government and the private sector have responsibility for ‘service delivery’ in this area through the welfare system and by providing people with opportunities to store and grow their private savings.

The pillars need to operate in a coherent manner

It is particularly important that this review and any future policy changes do not simply consider each pillar in isolation. The interaction between the three pillars and how policy changes in one pillar flow through to the other two (and other policy areas including the tax system, aged care, welfare system, health system, workplace relations and fiscal policy) has been overlooked too often.

It is the role of government to ensure that the age pension, superannuation and voluntary private savings systems are a cohesive retirement income system that meets its overarching objectives and principles. It should also ensure there is coherence with other areas of policy.

It is imperative that this review assesses the extent to which all incentives and concessional arrangements are aligned across the three pillars and with the broader tax and welfare systems.

A failure to understand and account for these interrelationships and impacts on lifetime savings decisions, particularly as demographic and social change occurs, could lead to inequities, add further complexity to an already complex system and generate unintended adverse consequences.

For example, changing preferences are shifting how people engage in the labour market during their transition to retirement. In the late 1970s under 20 per cent of people over 55 worked part-time, today that proportion is closer to 40 per cent and more people over 65 are participating in the labour market than ever before. The retirement income system should not

4. Australia’s future tax system, *The retirement income system: Report on strategic issues*, 2009.

disincentivise people making a more gradual transition to retirement, including through part-time work.

Decisions around the appropriate balance between the three pillars should adopt an evidence-based approach, while also striving for coherence and simplicity.

Good communication and adequate notice of changes is essential

The government should provide clear communication on the policy settings for each pillar of the retirement income system and adequately explain any changes to the public.

Given accumulating superannuation is compulsory for most employees and the long time horizons over which people make decisions about their retirement, it is desirable to maintain a high degree of policy stability, while acknowledging that policy changes will be necessary from time to time.

The retirement income system is highly complex and policy settings, particularly for superannuation, have been changed repeatedly, undermining confidence in the system.

In some instances, it may be appropriate to phase in policy changes to the retirement income system over time or delay their introduction to give those affected adequate time to adjust. Phasing or grandfathering can moderate the need for direct compensation while still protecting beneficiaries of the current system from significant income shocks.

Objective of the age pension

The Henry tax review provides a good starting point for determining the objective of the age pension:

> *"Its purpose is to ensure that all Australians have access to a safety net level of income throughout their retirement that is adequate to provide a reasonable minimum standard of living."*[5]

The age pension provides a safety net for a number of situations that retirees may face including:

- nil or low savings at retirement due to low incomes, intermittent work and/or being outside the compulsory superannuation system
- longevity risk – one of the hardest assessments people face when planning for retirement is estimating their own life expectancy
- financial risk – unexpected major economic downturns can suddenly leave people less prepared for retirement than they expected to be.

The age pension must also be fiscally sustainable and each generation should be able to expect a similar safety net in retirement.

5. Australia's future tax system, *The retirement income system: Report on strategic issues*, 2009.

Objective of superannuation

The Henry tax review also sets out a reasonable objective for the superannuation system:

> *"Compulsory superannuation should ensure that a reasonable minimum share of employee income is saved to contribute additional resources to retirement."*[6]

For some this will mean they will not need the age pension in retirement. For people on lower incomes, it may mean slightly higher incomes (through a combination of private savings and a part pension) in retirement than if they relied entirely on the age pension.

It follows that superannuation policies, including tax policy, should be cost effective and facilitate accumulation of superannuation balances large enough to provide for comfortable living standards during retirement, but not large-scale wealth accumulation.

Consistent with the overarching objective of the retirement income system, superannuation settings should be calibrated to reduce reliance on the age pension over time.

The Business Council supports the principles in the subsidiary objectives outlined by the FSI.

Objectives for superannuation proposed by the Financial System Inquiry

Primary objective

To provide income in retirement to substitute or supplement the age pension.

Subsidiary objectives

- facilitate consumption smoothing over the course of an individual's life
- help people manage financial risks in retirement
- be fully funded from savings
- be invested in the best interests of superannuation fund members
- alleviate fiscal pressures on government from the retirement income system
- be simple, efficient and provide safeguards

Source: The Australian Government the Treasury, *Financial System Inquiry Final Report*, 2014.

Objective of voluntary private savings

> *The objective of voluntary private savings is to allow for people to save for retirement in addition to the pension and/or compulsory superannuation contributions. Government should not put in place disincentives to save.*

Savings are vital for domestic wealth creation, providing funds for investment and smoothing lifetime consumption choices.

Voluntary private savings provide each Australian the flexibility to determine how much they want to save for their retirement in addition to the support provided by the age pension and/or superannuation. This decision will reflect their personal circumstances and

6. Australia's future tax system, *The retirement income system: Report on strategic issues*, 2009.

preferences. For people on low incomes, putting money aside for retirement may be difficult given current demands on their income.

As much as possible, the tax settings for various forms of savings should not distort the choice between consuming today and saving (and then consuming tomorrow).

The objective of voluntary private savings within the retirement income system is less clear cut than the other two pillars. Some private savings beyond compulsory superannuation contributions are clearly intended as retirement income (the clearest example being voluntary contributions to superannuation).

However, in addition to being used for retirement income, most voluntary private savings are also used for other purposes. For example, while the family home often becomes an important part of retirement incomes, this is almost never its primary purpose. People save for a variety of reasons including to make large purchases (for example, homes, cars and holidays) as well as to smooth their consumption over time.

Policy settings need to acknowledge these differences compared with the other two pillars whose sole purpose is to facilitate retirement incomes.

The differences between compulsory superannuation contributions, voluntary superannuation contributions and other private savings should also be acknowledged. In each one, a person has varying degrees of control around the decision to invest and how the assets can be used once an investment has been made. Policy settings should take into account the degree of constraint or flexibility people have when using each type of saving vehicle.

Roles within the three pillars

Roles within the age pension system

Government

Australia has long accepted that it is the role of government to ward against poverty in old age. What this has meant in practical terms has differed considerably across the decades.

The role of government is to determine who receives the age pension and how much they receive. The government should make these decisions in the context of:

- meeting community expectations of adequacy while ensuring the pension is fiscally sustainable
  - the adequacy of the pension should be considered from time-to-time to ensure it aligns with community standards
- long-term trends which will increase or ease pressure on the age pension
- not creating barriers to work during transition to retirement (in particular through interactions with the tax system).

Individuals

The role of individuals is to fund the age pension (alongside other taxpayers). This means the age pension for each generation will be (predominately) funded by younger generations.

People accessing the age pension have a responsibility to provide accurate information on their circumstances so that people in similar situations are treated similarly.

Roles within the superannuation system

Government

The primary role of government is to set the rules of the system for both individuals and superannuation funds. This includes:

- tax settings for contributions, returns and withdrawals and thereby how much taxpayer assistance is given to this form of saving
  - There is a strong case for relatively favourable treatment of superannuation because savings are compulsory for employees and locked in for very long periods, and cascading tax effects could have punitive impacts. Noting that the tax system should facilitate superannuation balances large enough to provide for comfortable living standards during retirement, not large-scale wealth accumulation.
- given the tax assistance available, setting appropriate caps on concessional contributions, how much can be contributed (including setting the superannuation guarantee) and the preservation age
  - noting that changes to the superannuation guarantee involve a trade-off between income today and income tomorrow
- regulatory settings governing the behaviour of superannuation funds and ensuring a competitive market to contain costs and provide choice. Key regulatory settings include:
  - sound prudential regulation
  - transparency and accountability with respect to fees.

Individuals

It is incumbent upon individuals to actively plan for retirement throughout their working life to enable consumption smoothing over their lifetime. This includes taking an active role in managing their superannuation.

Every person is the best judge of what they consider to be an adequate or comfortable standard of living in retirement. Although it should be acknowledged that this is a complex task given the number of variables involved and the difficulty in making reasonable assumptions over very long time frames.

Private sector

The private sector is best placed to provide a diverse array of investment options for superannuation assets, reflecting demand for different types of investment and risk profiles. These products should be clearly explained, so that consumers are well equipped to make the best decision for their circumstances.

Given the substantial and growing pool of superannuation, it is essential that best-practice governance arrangements are in place and the sector is efficient and well managed.

The Business Council supports the principles in the subsidiary objectives outlined by the FSI – in particular, the objective that superannuation should be invested in the best interests of fund members.

Trustees should always act in accordance with the legal principles governing the use of members' funds. This includes, but is not limited to:

- acting honestly
- exercising care, skill and diligence as a trustee
- performing duties and exercising powers in the best interests of the beneficiaries
- operating the fund in a manner that is consistent with the 'sole purpose' test.

Roles within voluntary private savings

Government

There are a variety of ways individuals save and invest. Given this, it is important that, as much as possible, the government applies consistent design principles across different forms of savings as well as aligning with the objectives of the retirement income system.

It is government's role to provide appropriate regulation of the financial sector. Regulation needs to be regularly reviewed and, where necessary, amended to ensure it is fit for purpose. As with any policy area, the benefits of regulation should clearly outweigh the costs.

The taxation of income from savings should be efficient, equitable and simple. As an overriding objective, the choice between consuming today and saving (and then consuming tomorrow) should not be skewed by the tax system.

Nor should tax policy distort investment decisions. More neutral treatment of savings income would promote more efficient savings and investment allocation across different asset classes as well as reduce compliance costs and inefficient tax planning. It is worth noting that the considerable social benefits of owner-occupied housing also support continued special treatment of the family home.

Individuals

Voluntary private savings provide people with the most flexibility to manage their current and future consumption.

Each person is best placed to decide the rate of saving and investment vehicle(s) that are most suitable to their needs which will likely include planning for retirement, saving for large purchases and consumption smoothing.

It is the responsibility of each person to keep appropriately informed about their investment choices and balance the returns and risks according to their own preferences and goals.

Role of the private sector

The role of the private sector is to provide a diverse array of investment options for consumers, reflecting demand for different types of investment and risk profiles. These products (including the risks and potential returns) should be clearly explained to potential investors.

In offering investment products, the private sector should use best practice corporate governance and broad normative behaviours to ensure investments are well managed, including:

- abiding by legislation
- being accountable and having clear delegation of authority and accountability
- transparency and an openness to disclosure, which supports understanding and trust
- good stewardship
- operating ethically.

3. FORCES SHAPING OUR ECONOMY

Our economy is shaped and framed by major forces, many of which are beyond our control. They include:

- the ongoing economic shift towards Asia
- the impact of demographic change and falling long-run workforce participation
- the increasing emergence of disruptive and innovative technology.

These forces mean that ongoing strong economic growth and prosperity cannot be taken for granted. Understanding these forces and their effects must therefore guide policymaking over coming years.

Asia was the world's fastest growing major region in 2019, accounting for more than two-thirds of global growth.[7] In the context of the retirement income system, capital is more likely to flow to faster growing countries – all other things being equal. The region also has a high savings rate, which drives down global interest rates. At the same time, the pace and scale of innovation and disruption has implications for future growth, the competitiveness of our businesses and the way we work.

The largest impact on the retirement income system and the way it achieves its objectives will arguably come from demographic change and falling long-run workforce participation.

Demographic change

Australians are living longer, healthier lives than ever before. A girl born in Australia in 2019 is likely to live until she is almost 85 years old, 20 years longer than a girl born 100 years ago.[8] She will be in full health for almost 90 per cent of her life.[9]

These changes, driven by major advances in medical science and technology, together with the large 'baby boomer' generation beginning to retire, are reshaping our society and our workplaces. Already around 470 people turn 75 in Australia every day.[10] People will be spending more years in the workforce, working in more diverse ways and older Australians are also increasingly living more active lives.

The 2015 Intergenerational Report (IGR) outlines the scale of demographic change likely to occur in Australia. It estimates the number of people aged 65 and older will more than double over the next 40 years.[11] This will shift the structure of Australia's population.

What are the implications of demographic change?

The ageing of Australia's population carries with it many implications and challenges which, while not insurmountable, underscore the need to plan and have an innovative and productive economy that creates wealth to enable us to meet those challenges. It also

7. IMF, *Regional Economic Outlook: Asia and Pacific*, October 2019.
8. ABS cat. no. 3302.0.55.001 and 3105.0.65.001.
9. Australian Institute of Health and Welfare, *Health-adjusted life expectancy in Australia: expected years lived in full health 2011,* Australian Burden of Disease Study series no.16. BOD 17, 2017.
10. ABS cat. no. 3101.0.
11. Australian Government, *2015 Intergenerational Report*, 2015.

means continuing to develop a retirement income system that is best placed to meet these challenges.

On economic growth

The 2015 IGR projects that economic growth will slow over the next 40 years, driven by slowing population growth and a falling participation rate due to the ageing of the population. It noted the economy grew an average 3.1 per cent a year over the past 40 years, but projected growth to slow to 2.8 per cent a year the next 40 years.

An economy with an ageing population may also be a less dynamic economy. Younger people are more likely to take on risk, particularly as they are less likely to have dependents or high levels of debt. This may also make them more likely to pursue new ideas, develop new products or start new businesses.

An ageing population could see less risk taking and innovation, leading to lower productivity growth and economic growth. An analysis of population ageing across US states over the period 1980 to 2010 found a 10 per cent increase in the share of population aged over 60 reduced the growth rate of GDP per capita by 5.5 per cent. Two-thirds of this reduction was due to slower growth in labour productivity, and a third was driven by slower growth in the labour force.[12]

An ageing population could also lead to lower levels of investment (and hence lower productivity growth) relative to the investment needs of a faster growing population.

On the budget

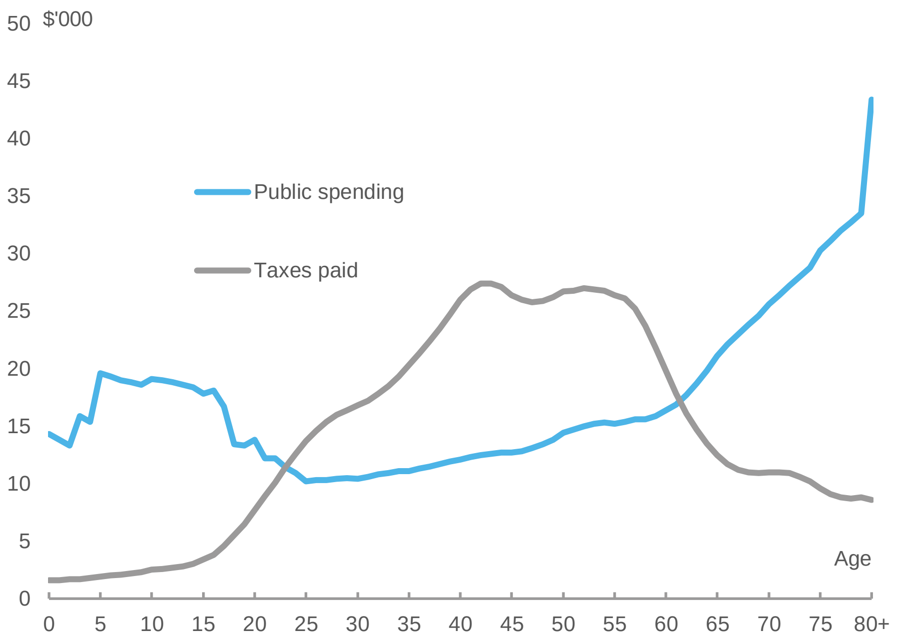
An ageing population will, all other things being equal, result in increased spending on government pensions, aged care services and health care (Figure 2). At the same time, there will be a relative reduction in tax collections given relatively fewer working age taxpayers. For example, the 2015 IGR estimates there will only be 2.7 people aged 15 to 64 years for each person over 65 in 2055, down from 4.5 people in 2015 and 7.3 people in 1975.

The profile of government spending and taxes by age is not fixed. It can change over time as conventions and norms change across society, or due to policy changes. Examples include:

- the increase to the age pension age to 67 years on 1 July 2023
- the decline in full rate age pension recipients over the past 20 years observed in the consultation paper
- as more workers retire who have experienced at least a 9 per cent superannuation guarantee rate for most of their working lives.

12. Maestas, N, Mullen K & Powell, D, *The Effect of Population Aging on Economic Growth, the Labor Force and Productivity*, NBER Working Paper No. 22452, 2016.

Figure 2: Total government spending and taxes by age (2009-10)



Source: Australian Government, *2015 Intergenerational Report*, 2015.

There are many factors that drive total spending on pensions, such as demographics, payment rates and scope of eligibility. A consistent trend across OECD countries is that public pension outlays tend to be higher for countries with higher dependency ratios (Figure 3). Dependency ratios are projected to increase across all OECD countries which, all other things being equal, would result in increased government spending from an ageing population.

Figure 3: Public spending on pensions versus dependency ratio, by OECD country, 2015

Source: OECD, *Pension spending (indicator)*, doi: 10.1787/a041f4ef-en, accessed on 03 February 2020; OECD, *Pensions at a Glance 2017*, 2017. Note: Dependency ratio defined as the number of individuals aged 65 and over per 100 people of working age defined as those aged between 20 and 64.

An ageing population will also see a tax system that raises relatively less tax revenue. This will be driven by factors such as:

- relatively fewer income taxpayers of working age, who would need to pay more tax for personal income tax to raise the same amount of revenue as today
- more individuals in the retirement phase of superannuation where no tax is paid on earnings in superannuation funds
- increased spending on GST-exempt goods and services.

On capital markets

An ageing population may impact capital markets as labour becomes more scarce relative to capital. All other things being equal, this would see higher real wages and lower returns to capital (and savers). Higher real wages may induce greater workforce participation as returns to labour increase.

Interest rates have been low in recent years as the supply of savings has been higher than the demand for productive investments. The increased supply of savings may be driven by an ageing population combined with an increased life expectancy, as individuals must save more for retirement. It may also be a legacy of the global financial crisis and previously high levels of borrowing.

Weak business investment in Australia has been driven by several factors including the cumulative impact of excessive regulation, a lack of competitiveness, the cost of doing business, and increased uncertainty and risk.

One outcome of lower interest rates has been lower returns for savers, particularly retirees who tend to invest in low risk assets. At the same time, lower interest rates have meant higher asset prices. Recent research points to a long run structural decline in interest rates which, if it persists, will have profound implications for future growth and retirement incomes.[13] The increased supply of savings may eventually stabilise and reverse as more individuals retire and draw down their savings, making capital relatively more scarce.

The long-term fiscal position of federal, state and territory governments may also have implications for capital markets. This is why we need to understand the long-term budget position of the whole nation and to improve the IGR, as recommended in the Business Council's Budget Submission 2020-21.

Budgets that are not in a sustainable long-term fiscal position will need to be progressively restored over time to build resilience and flexibility for dealing with economic shocks and volatility. If this remains unaddressed, it may eventually undermine investor confidence and have consequences which flow through financial markets.

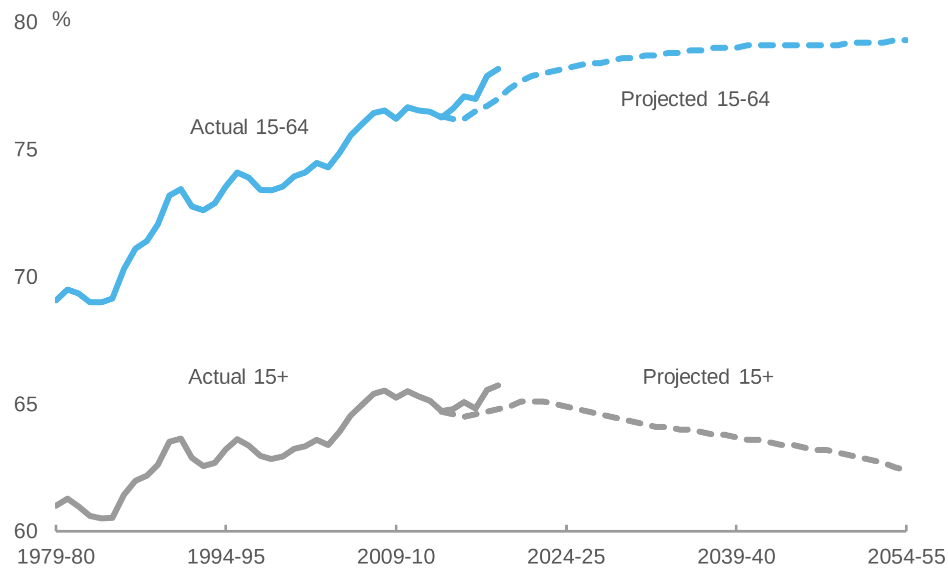
Labour market participation

Over the next 40 years, labour force participation is projected to rise in some age groups, while it will remain steady in others. In particular, the participation rates of women and people

13. Schmelzing, P, *Eight centuries of global real interest rates, R-G, and the 'suprasecular' decline, 1311-2018*, Bank of England Staff Working Paper No. 845, January 2020.

aged over 65 are projected to rise over time. However, because people aged 65 and over are still likely to have a much lower participation rate than younger people, the proportion of the total population that is participating in the labour market is expected to decline as the population ages.

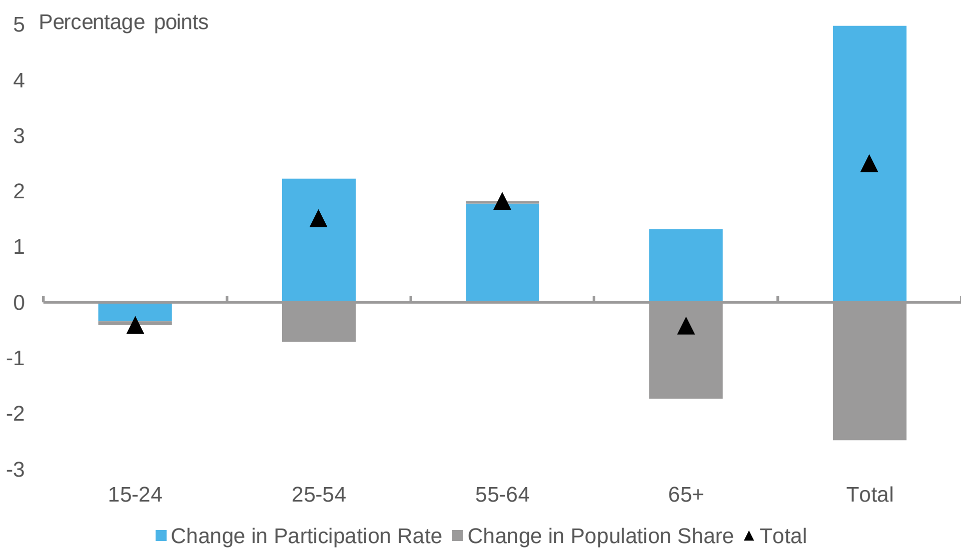
Figure 4: Historical and projected participation rates



Source: Australian Government, *2015 Intergenerational Report*, 2015; ABS cat. no. 6202.0.

To illustrate, the total participation rate has increased around 2.5 percentage points over the past 15 years (Figure 5), driven by a 5.0 percentage point increase in participation rates and offset by a 2.5 percentage point fall mainly due to a larger share of older people in the population. Increasing participation rates for workers aged 55 and over accounted for over half of the total increase in the participation rate. The participation rate for those aged 65 and over increased from around 6.5 per cent 15 years ago, to be around 15 per cent today.

Figure 5: Contribution to the change in total participation rate over the past 15 years



Source: Business Council calculations using ABS cat. no. 6291.0.55.001. Note: data used are 12 month averages.

Almost half of all people who retired within the past 20 years cite access to a retirement pension or superannuation as the main reason for retiring from work.[14] The Parliamentary Budget Office has observed that participation rates begin to fall between the ages of 55 and 60 as individuals begin to qualify for access to their superannuation, followed by a sharp drop in participation at the age pension qualifying age of 65.[15] More broadly, the recent increase in participation rates for older workers has been driven by a number of factors that will continue to play a role into the future. They include:

- better health and technology enabling people to work longer and making some jobs less physically demanding
- labour market flexibility providing more opportunities to work part-time, including as part of a transition to retirement[16]
- the rise in participation for those aged 55 and over has coincided with an increased level of debt for this cohort and changes in retirement intentions, but it is unclear which way the causality runs.[17]

14. ABS cat. no. 6238.0
15. Parliamentary Budget Office, *Australia's ageing population: Understanding the fiscal impacts over the next decade*, 2019.
16. For example, see Clark, R. L. and Ritter, B. M, *How are employers responding to an ageing workforce?*, NBER Working Paper No. 26633, January 2020.
17. Debelle G, *Employment and Wages*, Australian Council of Social Service (ACOSS) National Conference 2019, Canberra – 26 November 2019.

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