Intergenerational Equity

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POLICY DIALOGUE ON INTERGENERATIONAL EQUITY
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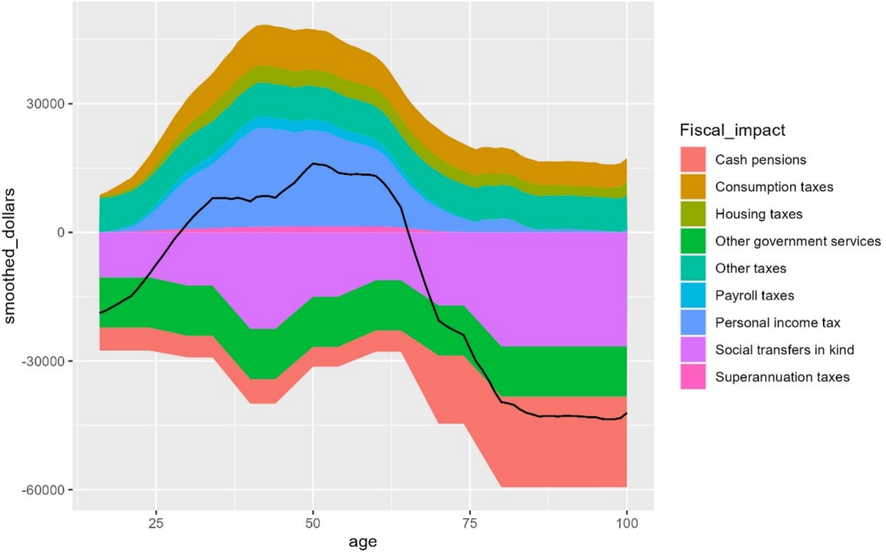
Outline

- The intergenerational contract
- How has it changed over time?
- The components of post-tax final income
- Implications for Australia
- Concluding Remarks

The intergenerational contract

- When people are young, they are net recipients of services and pay relatively little in taxes.
- During working age, people pay more in taxes than they receive in services.
- After retirement, people typically receive more in government benefits and services (such as age pension, aged care and health care) than they pay in taxes.

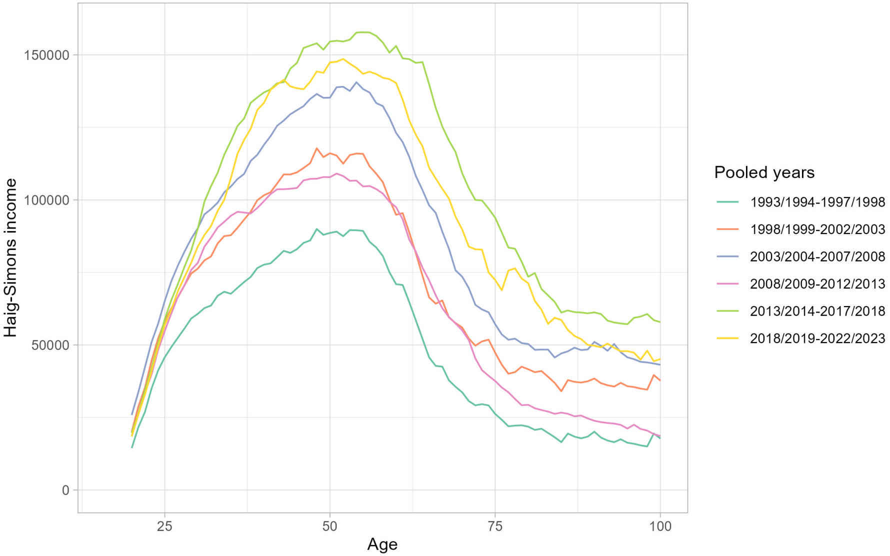
The intergenerational contract



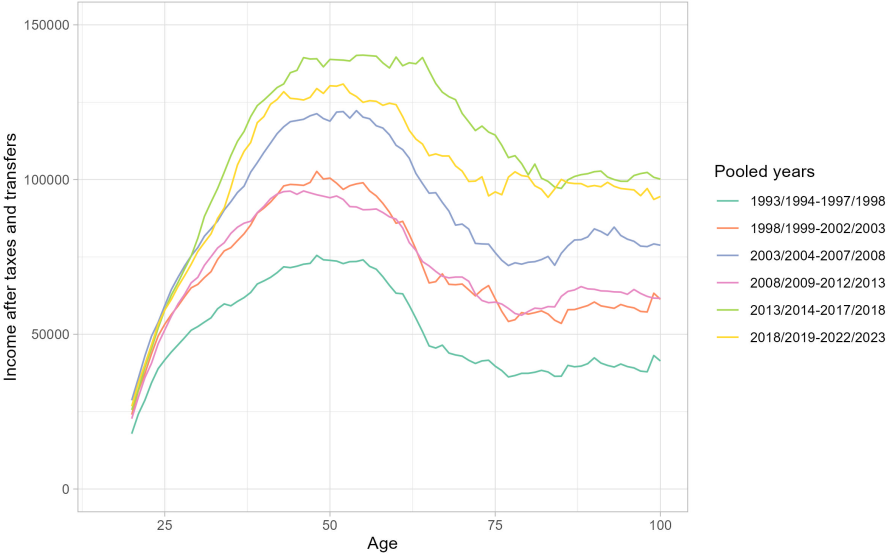
The intergenerational contract

- An intergenerational contract presents no problem:
  - Provided that each working generation supports the old and young to a similar extent.
- Most tax and transfer systems around the world incorporate some kind of intergenerational contract.
- But, the intergenerational contract has become more generous over time:
  - Indexing of pension payments to average earnings rather than inflation
  - Policy decisions to increase pension rates and aged care funding beyond these indexation rates
  - Health costs growing faster than CPI
  - Australians are living longer than previous generations
- This has happened as wealth and income of older Australians is higher than previous generations, undermining the rationale for these payments.

Have things changed over time? Income



Have things changed over time? Final Income



What is happening?

- In the 1990s, the average pre-tax income (including capital income) for Australians above the age of 65 was around \$20,000 per person (in 2023 dollars). By the 2010s, this figure had increased to over \$50,000 per person. Once government payments and services are considered, post-tax income amongst those over the age of 65 is around \$84,000.
- This is significantly higher than the average post-tax income for those aged 18-30 in the same period (\$57,000).
- The key forces that have driven this are:
  - House price inflation
  - Tax treatment of superannuation
  - In-kind services provided to older people

Implications for:

1. Inter-generational equity
2. Broader tax and transfer design
3. Housing policy
4. Budget sustainability
5. Lifetime income smoothing

Inter-generational equity

- If house prices increase in the future the way they have increased in the past, then future generations can expect to see their incomes in retirement continue to grow.
- In this case, there is no inter-generational equity problem *per se*
  - There is a within-generation inequality problem between those whose parents have assets and those who don't
- If returns to asset are more modest, then it is likely that younger generations will never achieve the level of wealth currently possessed by older generations of Australians.

Other considerations

- The distribution within each age group has important implications for policy
- Government impacts private incomes
  Housing policy
  Better housing policy might mitigate the need for other kinds of policy changes given its disproportionate size
  Land tax vs. stamp duty; zoning and regulation; land release
- The role of policy and capital markets in facilitating the realisation of income streams at different points in time.
- Government transfers are only one aspect of inter-generational transfers
  These take place privately as well in a variety of ways (informal care of children; intra vivos gifts; etc.)

Tax and transfer policy design

- Only two-thirds of income is being taxed through the personal income tax system
  This despite our ‘comprehensive’ system
- Efficiency consequences: places a larger burden on the ‘taxable’ parts of income
- Equity: all types of income don’t flow equally to people

Housing policy

- Preferential tax treatment
- Zoning and planning regulations
- Heritage protections
- Means testing
- A lot of incentives not to downsize!
- COVID-19 policies supported asset prices

Budget sustainability

- Dialling up the current system to deal with the structural budget deficit will make all this even worse

Lifetime income smoothing

- Young people are struggling with
  - Mortgages and high housing costs
  - Costs of children including childcare
  - Paying income tax and GST
  - 12% super guarantee
- Old people are dying with unspent superannuation balances

Discussion