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Making the Intergenerational Report More Relevant and Useful

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Key points

- The 2021 Intergenerational Report (IGR) is a significant improvement on the previous (2015) report.
- Nonetheless, it has many shortcomings: it is not as independent or authoritative as it might have been; its focus is largely limited to the Commonwealth government, as was the case with previous reports; it fails to highlight many of the issues the public needs to address, given its 40-year projections apply only to existing policies; its focus on fiscal pressures omits serious discussion of the structural deficit it identifies and any consideration of revenue issues; and its sensitivity analysis is limited.
- Future IGRs could take one of two approaches:
  - focusing primarily on fiscal sustainability; or
  - broadening the concept of 'sustainability' by drawing on 'wellbeing' frameworks.

- Major improvements could be made even within a narrow fiscal sustainability perspective: greater objectivity; reference to the whole Australian public sector; highlighting of issues beyond the budgetary bottom line; and inclusion of more sensitivity analyses and scenario assessments, including for the revenue side of the ledger.
- The second approach could build on these enhancements by drawing on international work on 'wellbeing' and facilitating the identification of broader policy issues the nation needs to address in the longer term. This approach would require considerable investment including rebuilding Australian Bureau of Statistics' (ABS) capability in wellbeing measurement.

Introduction

The *Charter of Budget Honesty Act 1998* (Cth) requires the publication of an intergenerational report (IGR) at five-year intervals, assessing the 'long-term sustainability of current government policies over the 40 years following the release of the report, including by taking account of the financial implications of demographic change' (Commonwealth of Australia 1998:section 21). The Act was the product of wider public governance, economic and financial management reforms across many countries (including Australia and New Zealand) in the course of the 1980s and 1990s.

Australian IGRs have been published in 2002, 2007, 2010, 2015 and 2021. This book reviews the most recent (2021) IGR, both in an international context and relative to the four Australian IGRs that have preceded this most recent set of projections and analyses.

This opening chapter provides a brief overview of developments and changes to IGRs since 2002 before presenting a summary assessment of the findings in the body of the book about the 2021 IGR. It then identifies and weighs up options for the scope of future IGRs so that they could be more relevant and useful in drawing public attention to the significant social, economic and environmental issues facing the nation in the longer term.

Subsequent chapters explore different facets of Australia's future sustainability in greater depth and collectively point to ways that future IGRs might better contribute to the identification of the key long-term fiscal and other policy challenges facing the nation and to promote more evidence-based deliberation of those issues.

- Chapter 2 (Mike Woods) describes the international and national origins of Australia's long-term fiscal projections and discusses some of the limitations of the processes used to date.
- Chapter 3 (Steven Hamilton) reviews the economic and budgetary analysis in the 2021 IGR.
- Chapter 4 (Peter McDonald) examines the demographic assumptions and projections behind all five IGRs.
- Chapter 5 (Andrew Podger, Robert Breunig and John Piggott) reviews how the 2021 IGR covers retirement incomes.
- Chapter 6 (Peter Whiteford) examines the assumptions behind the projections of social security expenditures.
- Chapter 7 (Rachel Ong ViforJ) analyses long-term trends in housing, a subject not explored in the 2021 IGR.
- Chapter 8 (John McCallum, Lindy Orthia and Diane Hosking) examines long-term social developments including those referred to in the IGR and those omitted.
- Chapter 9 (Diane Gibson, John Goss and Jane Hall) reviews projections of health and aged-care expenditures.
- Chapter 10 (David Pearce) examines the way that the IGR considers climate change.

The final chapter (by Richard Holden, the national president of the Academy of the Social Sciences in Australia) summarises the academy's recommendations to the government about the role and processes for future IGRs, and as such sets a longer-term agenda for these reports. In the short term, the academy also hopes that a number of these recommendations can be taken up in the IGR the current (Albanese) government has announced it intends to issue later in 2023.

Developments and changes to IGRs since 2002

The annex to this chapter summarises how the five IGRs published to date have developed and changed over time. The key developments and changes are set out below.

First, in terms of authorship and independence, the first four IGRs were authored by Treasury but circulated by the treasurer, initially in parliament. However, there does seem to have been increasing political influence over these first four reports. The 2010 IGR was the first to contain a foreword by the treasurer. It also introduced a broader focus by including a new chapter dealing with wellbeing and considered the environment and climate change risks in some detail in another chapter. The 2015 IGR removed these chapters and based its analysis of economic and fiscal sustainability mainly on the then government's proposed policy (while also still describing the projected fiscal outcome for legislated policy and existing policy). The 2021 IGR was the first to be authored by the treasurer, although it was based on existing policy and, unlike the 2015 report, did not make projections based on the government's proposed policy.

Second, in terms of assumptions and sensitivity analysis, a range of assumptions are identified and well documented in each report. Sensitivity analysis of the key assumptions is also included in each report. The number of variables used in the first four reports was quite large, while the 2021 IGR took a different approach focusing on what were deemed the most important variables for sensitivity analysis, namely labour productivity, migration and bond yields.

The assumed labour productivity has been based each time on the average over the previous 30 years, resulting in successive estimates of 1.75 per cent, 1.75 per cent, 1.6 per cent, 1.5 per cent and 1.5 per cent. The problem is if there is a downward trend in productivity, as there has been over the last two decades, this methodology presents a lagged measure with an upward bias for estimating current and projected productivity. For this reason, the 1.5 per cent labour productivity assumption in the 2021 IGR may be optimistic. The 2021 IGR noted that several countries had recently reduced their labour productivity rate to 1.2 per cent, and presented an alternative scenario based on this assumption as part of its sensitivity analysis.

Until the 2021 IGR, population growth rates increased over successive IGRs. This is largely due to net migration being larger than anticipated and projected levels consequently being increased. Although the 2021 IGR assumes that migration will eventually return to previous levels, the close to zero migration seen during the COVID-19 pandemic years will have a long-term impact on population, so projected population growth is somewhat lower than for the 2015 IGR.

Third, there have been changes in the highlighted areas of expenditure growth and other factors and outcomes. Expenditure growth in health and aged care is highlighted in all the reports. The age pension was also highlighted in 2007 but removed in 2021. The National Disability Insurance Scheme (NDIS) has been highlighted since 2015.

Climate change was identified as a risk to economic and fiscal sustainability in 2007 and considered in some detail in both 2010 and 2021 (in the context of quite different prevailing policies in each case), but was omitted in 2015. As mentioned, wellbeing was also addressed in 2010 but not in subsequent IGRs.

Finally, the findings in terms of the 40-year deficit projections have changed. Ignoring the 2015 IGR, which was based on projected fiscal policy, the 40-year deficits have gradually declined over time from 5.0 per cent of GDP in the 2002 IGR to 2.3 per cent in the 2021 IGR. However, the 2021 IGR's projected 40-year net debt of 34 per cent of GDP is the highest. While there have been some differences in the demographic and non-demographic assumptions between the IGRs, the predominant reason for the high projected net debt in the 2021 IGR is the debt already accumulated through fiscal stimulus policies to address both the global financial crisis and the COVID-19 pandemic.

A summary assessment of the 2021 IGR

The 2021 IGR is a significant improvement on the previous (2015) report. First, it omits the blatantly partisan use of the IGR process that occurred in 2015 to support the government's then policy proposals that had not been agreed by the parliament. The 2021 analysis is also enhanced by its recognition of a wider range of factors that may impact fiscal sustainability, including climate change and measures to address that change, and including additional sensitivity analysis of the assumptions behind the projections.

But the academy fellows and other researchers contributing to this volume still find the 2021 report has many shortcomings. It was published as the treasurer's report, although under the legislation it could have been authored by the Treasury (as occurred previously). It is therefore not as independent or authoritative as it might have been. Its focus only on the Commonwealth also limits its usefulness, particularly as many key areas of expenditure and expenditure growth (and policy more broadly) are shared between the Commonwealth and the states and territories (see Chapter 2).

Rather than highlighting the issues the public needs to address in considering a 40-year projection of existing policies, the most recent report presents no clear agenda of policy issues that will impact on national wellbeing other than to address continuing fiscal pressures. Even its identification of that issue omits serious discussion of the structural deficit its analysis reveals (and arguably understates) and how that deficit might be addressed (see Chapter 3). It also ignores the impact of the then government's revenue cap on the fiscal balance, implicitly leaving the task of future fiscal repair to containing expenditures and/or improving economic growth. Moreover, the impact of the cap on the future mix of revenues, evident in the projections in the report based on existing tax policies, is not mentioned nor the economic implications of such a change in the tax mix. The report also overstates the impact of demographic developments on expenditure growth (though less so than previous IGRs—see Chapter 4) and does not explore other drivers or any policy options to contain expenditures and repair the fiscal balance (for example, in health and aged care—see Chapter 9).

The projected worsening fiscal balance is presented as an intergenerational equity issue, but the report fails to explore whether within-generation inequity is likely to worsen under existing policies. Several chapters in this volume (particularly Chapters 5, 6, 7 and 8) demonstrate how existing policies are likely to increase inequality substantially. This is arguably even more concerning than any emerging inequity between generations.

While recognising the likely impact of climate change (and of policies to mitigate and adapt to that change), the report does not attempt to include this in its modelling of the fiscal balance (see Chapter 10). Readers are left with little appreciation of the scale of this impact, nor (most importantly) of the trade-offs involved between costs of action taken in the shorter term and the benefits of such action in the longer term (economic, social and environmental).

The report's sensitivity analyses remain limited notwithstanding the role that assumptions such as on productivity and migration play in the projections. The report fails to consider or use scenario assessments either, to gauge the impact of possible future 'shocks' despite the recent evidence (e.g. the COVID-19 pandemic) of the importance of these (see Chapter 3). There is also no discussion of the policies required to support greater resilience against future shocks, including the case for earlier budget repair.

Addressing the scope of future IGRs: Issues of sustainability and wellbeing

The *Charter of Budget Honesty Act* leaves open how widely the reports are able to define the scope of 'long-term sustainability', and how far beyond 'taking account of the financial implications of demographic change' the IGRs might go. Broadly, future IGRs could take one of two approaches:

- Focus primarily on fiscal sustainability, as has been the case not only for the 2021 report but also the first two reports in 2002 and 2007 and IGR 2015, while significantly improving the value of the report for policy dialogue.
- Broaden the concept of 'sustainability' as was attempted in the 2010 IGR, drawing on 'wellbeing' frameworks developed by the Organisation for Economic Cooperation and Development (OECD) and a number of member countries, notably New Zealand, (including the work undertaken by the Australian Treasury and the Australian Bureau of Statistics more than a decade ago).

Retaining a focus on fiscal sustainability

Major improvements could be made to future IGRs while still pursuing a narrow fiscal sustainability perspective. In particular, the objectivity of the reports could be enhanced by making them the responsibility of an independent authority rather than the treasurer, and 'fiscal sustainability' could refer to the whole Australian public sector including state, territory and local governments.

There are several options open for pursuing these improvements. In New Zealand (a unitary government, of course), the Statements on the Long-term Fiscal Position are prepared and published by the Treasury and the legislation requires the Treasury secretary to sign a statement of responsibility certifying that Treasury has used its best professional judgements about the risks and the outlook. The NZ public service has long had firmer protection from political pressures than the Australian public service (for example, departmental secretaries are employed by the public service commissioner and not appointed by the prime minister). The NZ Treasury's Statements are also complemented by long-term insights briefings that line departments are required to develop independently after public consultations and then publish. The statements are also prepared after public consultations.

A similar approach could be adopted in Australia, though government departments in Australia have not in recent years had the same degree of independence as those in NZ. Other options include the Parliamentary Budget Office (PBO) and the Productivity Commission (PC); alternatively, the Treasury might author the report while drawing on work commissioned from the PC. The PC is well placed to explore state, territory and local government revenues and expenditures given its experience with working across jurisdictions. It might also be better placed than the Treasury to publicly canvass some of the policy issues arising from the fiscal projections, taking advantage of its considerable experience in public consultations.

IGRs that are focused on fiscal sustainability could also highlight issues beyond the budgetary bottom line that the projections raise. Recent NZ statements not only explore the long-term fiscal pressures and the need for prudent management, but also illustrate options for how spending or revenue might be adjusted to move the nation's finances to a more sustainable footing. Increasingly, they have encompassed associated factors such as whether reducing or removing barriers to social and economic participation might offer fiscal benefits as well as improved social outcomes. The most recent NZ report (The Treasury 2022a) incorporates NZ Treasury's own Long-term Insights Briefing into the Statement on the Long-term Fiscal Position and canvasses a range of the policy choices facing future governments on the level of debt, speed of adjustment and associated policy options (including to manage growth in expenditure over time, to improve the quality of public spending and to increase revenues). While the report does utilise a framework for wellbeing analysis of the policy options examined, there is a separate report on wellbeing (see below).

Issues raised in the analysis of Australia's 2021 IGR in subsequent chapters of this book suggest future IGRs that remain focused on fiscal sustainability would be more useful if they canvassed broad policy options to raise revenues and to contain expenditures, as well as related policies concerning inequality, productivity, migration and labour.

The IGRs would also be improved if they presented more detailed sensitivity analysis around key assumptions including migration levels, productivity and workforce participation, and if they included some explorations of scenarios of possible future shocks including natural disasters. The latter is a more recent innovation in the NZ statements and allows explanation of the role of prudent fiscal policy in building resilience.

Broadening the concept of ‘sustainability’

Most contributors to this volume see considerable advantage in pursuing this second approach, drawing on the international work on ‘wellbeing’ undertaken since the 2010 IGR (and the academy’s 2014 study, *Measuring and Promoting Wellbeing* [Podger and Trewin 2014]).

The OECD’s work in this area began around 2002 (for example, OECD 2002) and was subsequently influenced by the Stiglitz, Sen and Fitoussi report (2009) commissioned by the then French president Nicholas Sarkozy, who was concerned that existing measures of national progress (in particular GDP) were insufficient. The framework developed by the OECD identified a range of measures of human wellbeing, including measures of both quality of life and material living conditions, and also referred to ‘sustainability of wellbeing’, which requires preserving different types of capital: economic, human, social and natural (OECD 2011).

The ABS has long been a leader in the field of social indicators, and around the turn of the century contributed to the OECD work on wellbeing measures. The ABS pioneered the development of broader measures through its Measures of Australia’s Progress (MAPs) project, which issued its first publication in 2002 (ABS 2002). The Australian Treasury also developed a wellbeing framework for its work in advising ministers, drawing heavily on Amartya Sen’s focus on people’s ‘opportunities’ and making use of the ABS MAPs data. This early work contributed to the attempt in the 2010 IGR to assess wellbeing and the sustainability of wellbeing in its projections of existing policies. That approach was abandoned for the 2015 IGR and Treasury also dropped its wellbeing framework; budget limits also led to the ABS ceasing its MAPs publications from 2015.

New Zealand, under both conservative and progressive governments, has subsequently taken over Australia’s leadership mantle in building and drawing upon wellbeing frameworks. NZ Treasury’s work is supported by Stats NZ, which regularly publishes measures of NZ’s current and future wellbeing, and NZ’s impact internationally, along with contextual data (Stats NZ 2022). Future wellbeing measures use the OECD’s four types of capital mentioned above. The 2021 Statement on the Long-term Fiscal Position is complemented by a new Wellbeing Report, which uses a version of the OECD’s framework (The Treasury 2022b). The report is intended to inform Treasury’s policy and investment advice to governments over time, and future iterations will build on the foundation of this new report.

If future Australian IGRs are to make use of a wellbeing approach, almost certainly considerable investment will be needed to reinstate the ABS capacity so it can produce the supporting data along the lines of its former MAPs. Careful consideration will also need to be given to the selection of domains and measures to ensure that IGRs do highlight the most important longer-term issues for fiscal and broader sustainability that need government and public attention.

In summary, this second approach, if adopted, should build upon the enhancements suggested under the first approach but not attempt to cover every public policy issue that might affect wellbeing now or in the future.

Which is the preferred approach?

Each approach has its advantages and its limitations. The first approach has the advantages of a firm focus and requires fewer assumptions and technical hurdles than the second. The second approach has the advantage of being holistic, recognising that no single dimension of sustainability (even fiscal sustainability) can be properly explored without appreciation of the other dimensions.

While the second approach would require considerable investment, there remains relevant expertise in the ABS and Treasury and that capability could be enhanced in those two institutions and in a third body such as either the PBO or the PC, should they be tasked with producing or contributing to the future IGRs. A first step on the path of enhancement could be through renewed interaction with NZ and others who have developed the wellbeing approach further over the last decade.

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Annex: Developments and changes to IGRs since 2002

IGR	Important aspects of style and methodology, and key findings
2002	Authored by Treasury but circulated by the treasurer (Peter Costello). Introduces the importance of population, participation and productivity as key concepts in future economic growth and projecting expenditure and revenue outcomes. Analyses the impact on main areas of expenditure and revenue. Identifies health and aged care as the main areas of expenditure growth. Assumes a population of 25.3 m in 40 years (2041–42) and annual labour productivity growth of 1.75 per cent, the 30-year average. Discusses budget risks of the environment including climate change. Assumes no changes to existing policy settings. Detailed sensitivity analysis of assumptions on migration, fertility, life expectancy, labour force participation of older males, productivity, unemployment rate and health spending. Projects a deficit in 40 years (2041–42) of 5.0 per cent of GDP from a current surplus of 0.2 per cent using baseline assumptions. The current net debt to GDP ratio was 4.6 per cent. No projection was made of the debt in 40 years' time. Rather, it was stated that there was no target but net debt should be maintained at prudent levels.

IGR	Important aspects of style and methodology, and key findings
2007	Authored by Treasury but circulated by the treasurer (Peter Costello). Minimal changes to the structure of the report. Assumes a population of 28.5 m in 40 years (2046–47), higher than previously, mostly because of increased net migration level assumptions. Assumed annual productivity growth remains at 1.75 per cent. Continues to assume no change to existing policy settings. Identifies the age pension as well as health and aged care as major area of expenditure growth. Specifically addresses climate change as a long-term risk for economic and financial sustainability. Discusses broad policy choices to address fiscal sustainability issues. Sensitivity analysis on same variables as 2002 IGR except health spending. Projects a deficit in 40 years (2046–47) of 3.25 per cent of GDP. Net debt as a percentage of GDP was projected to increase from the current negligible level to 30 per cent in 40 years.
2010	Foreword by the treasurer (Wayne Swan) included, although report still authored by Treasury. The main changes to the structure of the report are the addition of chapters on 'Climate Change and the Environment' and 'Sustainable Society'. The latter chapter includes discussion of the future for different aspects of wellbeing. Assumes a population of 35.9 m in 40 years (2049–50), reflecting assumption of higher levels of migration. Assumed annual productivity growth was reduced to 1.6 per cent, the new 30-year average. Continues to assume no changes to existing policy settings (although it discusses the benefit of changes to the government's fiscal strategy). Sensitivity analysis on the same variables as 2007. Projects a deficit in 40 years (2049–50) of 2.75 per cent of GDP in part due to slower ageing of the population. Net debt as a percentage of GDP was projected to increase from the current 3 per cent to 20 per cent in 40 years.
2015	Foreword by the treasurer (Joe Hockey) included, although still authored by Treasury. The main changes to the structure of the report are the removal of the chapters on 'Climate Change and the Environment' and 'Sustainable Society'. A new chapter on 'Preparing for the Future'. This provides consideration of the policy settings required to build jobs, growth and opportunity, and raise living standards. Assumes a population of 39.7 m in 40 years (2054–55) and a fall in productivity to 1.5 per cent. Adds NDIS as a main area of expenditure growth. Analysis of fiscal sustainability is based on three scenarios: (1) previous policy, (2) legislated policy and (3) the government's proposed policy. Legislated policy is closest to what was used for previous reports. Much of the analysis is based on the government's proposed policy. Sensitivity analysis on the same variables as 2007.

IGR	Important aspects of style and methodology, and key findings
	In 40 years, projects a deficit of (1) 11.7 per cent, (2) 6 per cent or (3) a surplus of 0.5 per cent of GDP depending on the scenario. Based on the government's proposed policy, net debt as a percentage of GDP was projected to reverse from the current 15 per cent (largely due to fiscal stimulation for the global financial crisis) and to become an accumulated net asset of 15 per cent in 40 years. The basis for projections using either previous policy or legislated policy was not clear.
2021	Published by the treasurer (Josh Frydenberg) rather than Treasury. Treasurer's statement had a link to the report. The main change to the structure of the report was the removal of the chapter on 'Preparing for the Future'. The analysis on the environment and climate change was much more extensive than in the previous report. Assumes a population of 38.8 m in 40 years (2060–61), lower than in the previous report because of COVID-19 impacts on migration and a lower (but more realistic) fertility rate but assumes migration gets back to previous levels. Assumed productivity remains at 1.5 per cent but recognises this is significantly higher than the recent productivity cycle and higher than assumed by other like countries. Removes age pension as one of the main areas of expenditure growth. Analysis of fiscal sustainability is based on current policy. Sensitivity analysis is limited to migration and labour productivity, but bond yields are added. Projects a deficit of 2.3 per cent in 40 years (2060–61). Net debt as a percentage of GDP was projected to increase from the current 30 per cent (higher than in 2015 because of the COVID-19 stimulus) to 34 per cent in 40 years.

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