

# **Pursuing Opportunity & Prosperity: The Stocktake**

**13 November 2003**

**Chris Richardson  
ACCESS ECONOMICS**



# The IGR & the 3 Ages of Mankind

**3 Ages of Man:** Investment, Production, Retirement.

**Society's intergenerational compact** is that it:

- (1) subsidises investment in children, & it
- (2) subsidises health care costs in retirement, & it
- (3) pays by taxing the production phase in-between.

**IGR said implicit deal under threat:** Ageing means **quantity** of those in 3<sup>rd</sup> age rising, while health care costs mean relative **price** of the 3<sup>rd</sup> age also rising.

Implies new deal: **either tax rises or services cut.**

# The Critics

**Critics said:** Relative price effect uncertain, income effect ignored (so higher taxes no problem) – means IGR not a scary story, but a storm in a tea cup.

**My criticism** is the IGR just wasn't scary enough ...

**Quantity effects now 24% larger**, interest costs ignored, revenue loss ignored (petrol), & non-ageing challenges costly (Defence, education, native title, environment) – so **may not be a 12 year safety margin before Federal Budget problems bite**, and eventual problems worse.

And **State finances** also affected (larger share of health), while **private finances** run risk that returns of the 80s and 90s were above-normal.

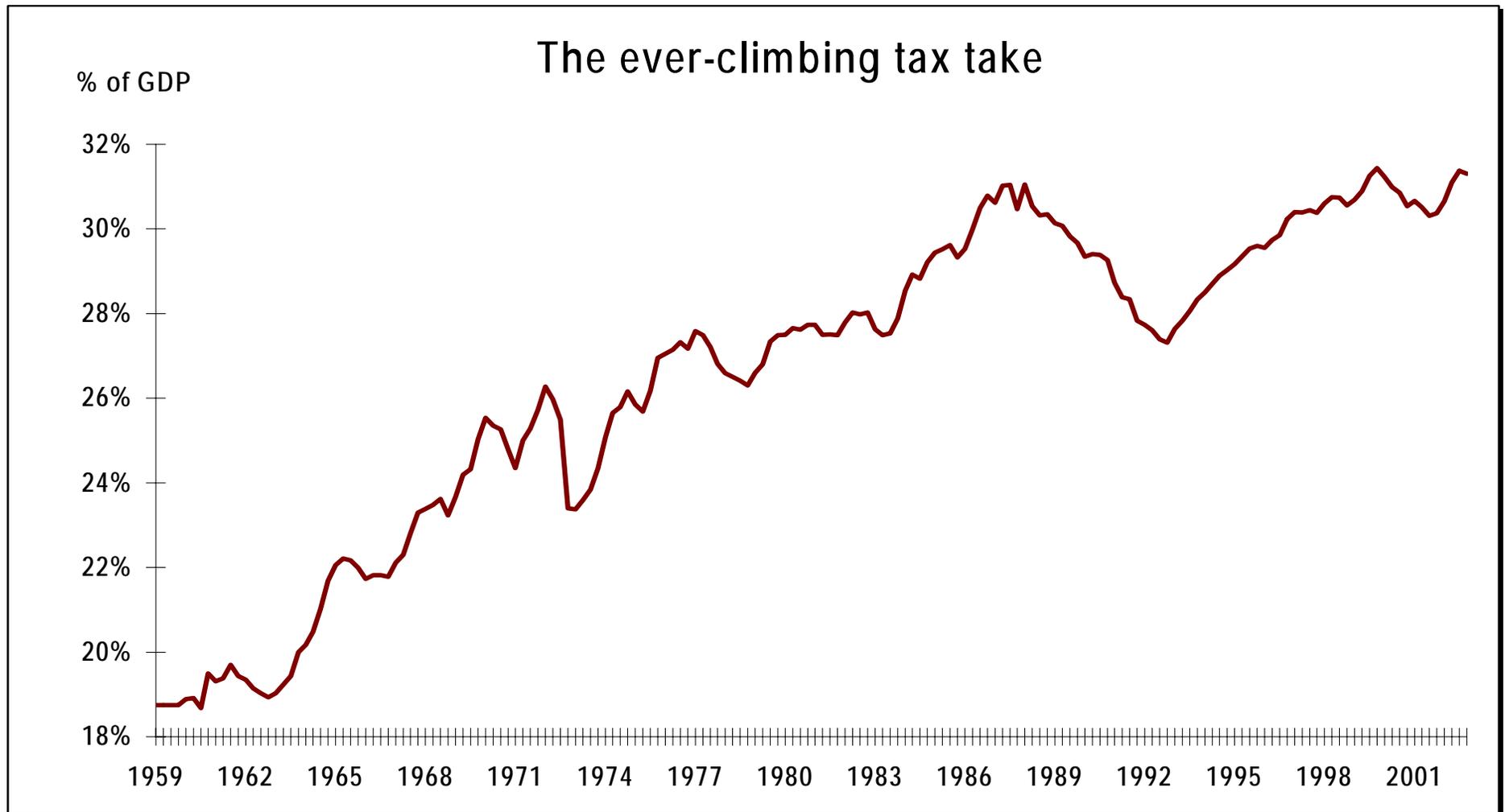
# Bigger the critics: Productivity gains don't come without pain



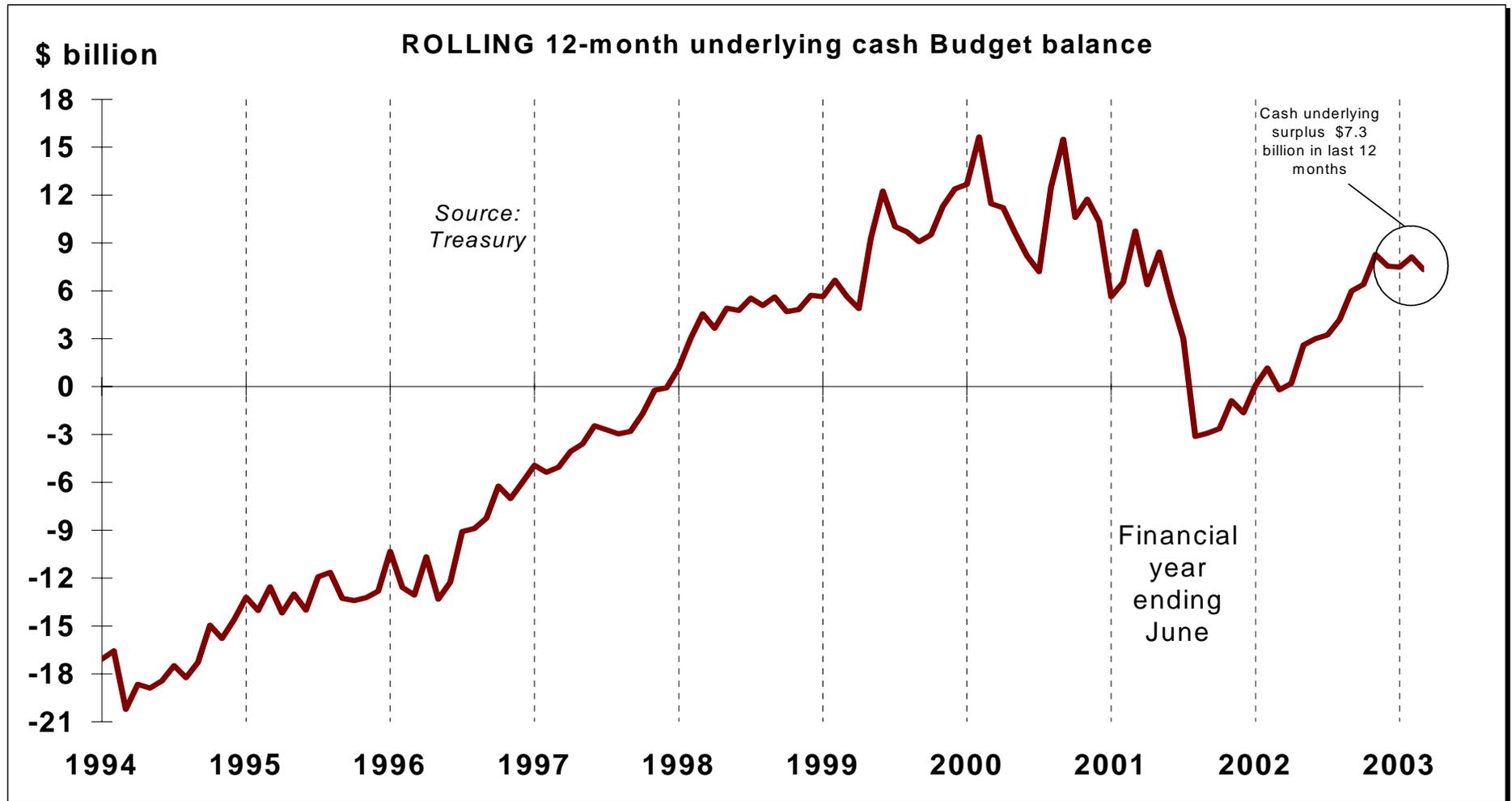
# Don't soothe the policymakers: challenge them instead

Most concentration has been on the 'painless' economic solutions - participation, productivity. But neither is that painless. Hard to affect the many micro decisions behind participation, and hard to get better productivity without turning around the reform fatigue seen in recent years. So if we tell policymakers the problem is 12 years away & it may painlessly 'solve itself' anyway, we run the risk of the usual default.

# Default solution: beer, cigs up – and deadweight losses up too



# Yet the debate is over the pre-election tax cut ...



# Spending \$5-6 billion - should we??

**Where should any tax cut focus?** 2 major efficiency disincentives built into the personal tax rate scale:

(1) 'Poverty traps' mean those seeking work (or seeking more work) often lose much of their wages to lost benefits and higher taxes.

(2) The top 2 marginal rates are well above the company tax rate, implying all sorts of unfortunate incentives.

# Tax is the default end to this story

IGR best seen as a hurry up call. Australia needs debate what spending needs to be cut and/or what taxes need to go up.

If we fail to exercise the public - if this debate on policies for our future stays off the front pages - then our taxes will rise (not fall) over time, and so will deadweight losses ...