Much thicker but no wiser

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To stop politicising the Intergenerational Report, hand it to an independent body

HERE'S a projection for you. If the Intergenerational Report's page count keeps increasing at the present rate, the 2050 IGR will be 13,000 pages long. Of course, the country's half a million centenarians will not be able to lift it but, luckily, the Na tional Broadband Network will deliver it to their homes, at last finding a productive use.

But enough of rosy optimism. The IGR is hardly intended to inspire levity. Rather, its findings, as presented by the Prime Minister and the Treasurer, should leave us with a leaden premonition of impending doom.

What ought we to make of these projections of "apocalypse soon"? It is no criticism of the IGR to say its results are highly sensitive to the assumptions made. What matters is whether they are reasonable. Unfortunately, closer examination raises many questions in this regard, and suggests this year's IGR is the most politicised ever.

Start with the assumptions. Few are more important than the fertility rate (the number of births per woman). Fertility rates, however, are notoriously difficult to forecast. Successive IGRs have significantly underestimated fertility, missing the increase that Australia experienced in recent years.

So great is the underestimation that the actual fertility rate in each IGR lies outside the range used for sensitivity testing in its predecessor. But the IGR makes no attempt to explain the discrepancy or to justify the fertility rate used in the analysis.

Given that, the IGR should be read as assessing what the world would look like were its demographic assumptions valid. Naturally, attention has focused on forecast health and aged care expenditure.

Here the projections are stark, with commonwealth spending on health rising from 4 per cent of gross domestic product in 2009-10 to 7.1 per cent in 2049-50. This may be reasonable, but the impact of population ageing on healthcare costs is complex and controversial.

In widely cited articles, health economist Peter Zweifel has described the claim that population ageing raises health costs as a red herring. True, health outlays rise steeply with age, but that is largely due to mortality (a high share of health costs being incurred in the final months of life) rather than morbidity. As we all die once, population ageing does not increase mortality, so the question is whether it increases morbidity.

On Zweifel's estimates it does, but by much less than the health outlays-age curve would suggest.

Cogent arguments can be put against Zweifel's position. But he is right to emphasise the need to distinguish morbidity from mortality. Failing to do so would both overstate health costs and lead to double counting (as health costs would be counted as if the elderly were dying, while aged care costs were counted as if they were not).

It is simply not possible to tell from the information in the IGR whether it adequately makes this distinction. However, it is difficult to see how the method it uses for the period post-2020, when virtually all the spending increase occurs, could do so.

But assume that health and aged care costs did rise as projected in the IGR. Is that a problem?

We don't worry about rising consumer spending on frozen pizza, foolish though it may seem, as those making the decision are voting with their own dollars. For health and aged care, in contrast, we each vote to spend other people's dollars. There are compelling reasons for this, but pressures for efficiency are inevitably blunted, and losses incurred as the taxes needed to finance inefficient spending distort economic behaviour.

This is not a problem to which there are simple answers. But greater reliance on market mechanisms is clearly part of the solution.

The government's National Health and Hospitals Reform Commission has stressed this, suggesting that Medicare be converted into a competitive social insurance system, as found in The Netherlands, Switzerland and Israel. The commission also stressed the need to dismantle the Gosplan-like central planning that distorts our aged-care system.

It is disappointing that the IGR, though waxing lyrical about market mechanisms as the solution to global warming, does not say a single word about these proposed market-oriented reforms.

But this is far from being the report's only, or most significant, sin of omission.

The IGR's overall message, which I accept, is that population ageing makes it imperative that we increase productivity. However, reading the report, one would never realise that this is not merely a question of raising output per unit of labour input but also of making good use of savings and of the capital stock.

One reason we are much richer than previous generations is that we have far more capital to rely on. In 1960, the net capital stock per Australian was $43,000 at today's prices. In 2009, it was $176,000, a more than four-fold increase. But Australia has long had a problem with poor capital productivity.

In 1960 each unit of the capital stock produced, on average, 50c of output. By 1990 that had dropped to only 33c.

Capital productivity experienced an increase in the mid -1990s, as microeconomic reform stripped out inefficiencies, but thanks also to poorly targeted public investment, it is now fast reverting to the historic low it reached during the recession we had to have.

Which brings us back to white elephants, such as the NBN. These are the most certain way yet found of reducing capital productivity. But how often does the IGR, in five pages

vaunting public investment in infrastructure, use the term "cost benefit analysis"? Not once. Clearly, suggesting that public investment only be undertaken when the benefits exceed the costs is no longer politically correct.

The IGR has an important role to play. But each IGR has been more politicised than its predecessor, which must threaten the quality of the product.

The time has come to give the job to an independent body.