The role of a higher age pension in stimulating the economy

Research Paper No. 56

October 2008

Richard Denniss and Josh Fear

1. Introduction

The current slowing in the world economy has raised a number of important issues about the way that the Australian government, and governments in all developed countries, try to manage the macroeconomy. In particular, recent events in the world financial markets have made monetary policy (that is, changes in interest rates) a less effective mechanism for stimulating the economy, because banks are refusing to pass on reduced interest rates to their customers, while other lenders are having difficulty raising funds in an uncertain environment.

Besides monetary policy, the other main mechanism for government's trying to stimulate a slowing economy is fiscal policy (that is, changes to tax rates and the level of expenditure). When the economy is slowing governments can stimulate economic activity by spending more money, thereby increasing the level of demand for goods and services. Fiscal policy is sometimes criticised for taking too long to flow through to the wider economy, yet the Rudd Government recently announced that it wants to bring forward the implementation of major infrastructure projects so that, by the end of the year, the expenditure on selected projects can help stimulate employment and economic activity.

If targeted in the right way, however, fiscal policy need not be slow. While it takes months to develop and select major infrastructure projects, and sometimes years before the first sod of earth is moved, the Commonwealth Government could start injecting tens of millions of dollar into the economy each week by simply increasing the size of a payment such as the age pension. While this paper focuses on the economic benefits of an increase in the age pension, the arguments advanced below apply equally to an increase in any government payment for example support for the unemployed, those with disabilities or carers.

2. Benefits of using the pension to stimulate the economy

As well as stimulating the economy more effectively than a reduction in interest rates and more quickly than expenditure on infrastructure projects, there are a number of strong economic and equity arguments for an increase in the age pension.

1) Age pensioners have a low ‘propensity to import’. That is, when the government injects money into the economy some of that money ‘leaks’ overseas in the form of expenditure on imports and overseas travel. Because, for example, pensioners are significantly less likely to buy imported cars or go on overseas holidays than the community at large, the macroeconomic benefits of injecting money into the economy through age pensioners is superior to the benefits of other forms of expenditure.

2) Age pensioners are geographically distributed across the country. Unlike large infrastructure projects, which have the greatest direct impact in the areas where they are being constructed, an increase in the age pension will deliver a significant increase in expenditure to even the smallest communities. Unlike tax cuts, an increase in the age pension is likely to be disproportionately beneficial for lower-income areas.

3) Age pensioners have a low ‘propensity to save’. Compared to the average Australian, pensioners are more likely to spend any increase in the pension in the short term rather than save it in the bank or pay down their mortgage. Again, this helps to ensure that the benefits of increased government expenditure flow rapidly into the economy.

4) It is equitable. Leaders from across the political spectrum agree that they could not live on the current age pension which, for a single age pensioner is only $281 per week. Recent tax cuts have delivered benefits to most Australians, but age pensioners are yet to enjoy the benefits of 16 years of economic growth.

Overall, the spending and living patterns of age pensioners combine to create a strong economic case for an increase in the age pension. The equity benefits of doing so make the case even more compelling.

3. Financial Impact

The financial impact, and in turn the extent of the economic stimulus, of an increase in the age pension is dependent purely on the size of any increase in the pension, since the number of eligible pensioners is fixed in the short term.

The Commonwealth Treasury has costed the provision of an increase in the single age pension of $30 per week at $1.5 billion per annum while other estimates are as high as $3.5 billion when couples are included.

4. Public Support

In order to inform its submissions to the Commonwealth Government's current reviews into taxation and the age pension, The Australia Institute commissioned an online survey of 1000 respondents to gauge community attitudes. The survey was conducted between 2 October and 8 October 2008. The sample was representative of the adult Australian population by age, gender and state/territory, and respondents were sourced from a reputable independent online panel.

The survey asked two questions about the age pension:

> Q1. 'In your opinion, should the age pension be increased, remain the same, or be lowered?'
>
> Q2. 'Would you be willing to pay more tax so that the age pension can be increased?'

As shown in Table 1 the overwhelming majority of respondents (82 per cent) indicated that the age pension should be increased. Twelve per cent said the pension should remain the same, while only three per cent said it should be lowered.

Table 1: Attitudes to an increase in the age pension by gender

	Male	Female	All
Pension should be increased	78.5%	84.9%	81.8%
Pension should remain the same	13.9%	9.2%	11.5%
Pension should be lowered	3.3%	2.0%	2.6%
Not sure	4.3%	3.9%	4.1%
Total	**100%**	**100%**	**100%**

*Base=1,000

Women were more likely than men to believe that the age pension should be increased – 85 per cent compared with 79 per cent. Interestingly, as shown in Table 2, men were more willing to pay more tax to increase the pension: 54 per cent of men said they would pay more tax, as against 48 per cent of women. Overall, a majority of Australians (51 per cent) are willing to pay additional tax to fund an increase in the age pension, with only 32 per cent unwilling. Significantly, respondents who said the age pension should be increased were much more willing to pay more tax than those who said it should not be increased – 58 per cent compared to 22 per cent. However, if one of the objectives of increasing the pension is to stimulate the economy, then there is no need to increase taxes to fund such an increase. Furthermore, with a large budget surplus the government has the capacity to fund an increase in the pension without raising additional revenue through taxation.

Table 2: Willingness to pay additional tax to fund an increase in the age pension by gender

	Male	Female	All
Willing to pay more tax	54.4%	48.1%	51.2%
Not willing to pay more tax	30.5%	32.5%	31.5%
Not sure	15.1%	19.4%	17.3%
Total	**100%**	**100%**	**100%**

*Base=1,000

Table 3 illustrates differences in attitudes towards the age pension across age groups. While a majority of all age groups support an increase in the age pension, support also rises with age: 65 per cent of 18-24 year olds supported an increased compared to 89 per cent of those over 55. Younger respondents were also less willing to pay more tax to increase the pension, with 33 per cent of 18-24 year olds reporting that they were willing to pay more tax compared to 72 per cent of 55-64 year olds.

Table 3: Attitudes to increasing the pension and lifting taxes by age

	18-24	25-34	35-44	45-54	55-64	65+	All
Pension should be increased	64.5%	74.7%	82.6%	87.4%	89.0%	88.6%	81.8%
Pension should remain the same	21.0%	13.5%	11.3%	6.6%	9.0%	10.3%	11.5%
Pension should be lowered	4.8%	3.9%	2.1%	3.3%	2.1%	0.0%	2.6%
Not sure	9.7%	7.9%	4.1%	2.7%	0.0%	1.1%	4.1%
Willing to pay more tax	33.1%	38.2%	48.7%	54.1%	71.7%	60.0%	51.2%
Not willing to pay more tax	48.4%	47.8%	33.8%	27.3%	15.2%	18.3%	31.5%
Not sure	18.5%	14.0%	17.4%	18.6%	13.1%	21.7%	17.3%
Total	100%	100%	100%	100%	100%	100%	100%

*Base=1,000

Table 4 provides data on the degree of support for an increase in the age pension, and the willingness to pay additional taxes to fund such an increase, by household income. The most striking finding is the relative lack of support for an increase in the age pension, or tax increases to fund an increase, in high income households.

Despite earning more than 10 times the value of the age pension each year, respondents in households earning over $150,000 per annum were the least likely to agree that the approximately $14,500 per year age pension should be increased and were far less willing to reduce their own incomes, through increased taxes, to support those less fortunate than themselves.

The survey results show that 81 per cent of households earning less than $40,000 per year, and 85 per cent of those households earning between $40,000 and $80,000, support an increase in the age pension, while only 73 per cent of those earning over $150,000 felt similarly.

This pattern is even starker in relation to the willingness of respondents to support an increase in tax to fund a rise in the age pension. While 56 per cent of those earning less than $40,000 were willing to pay more tax, only 34 per cent of respondents from households earning over $150,000 were willing to do so. Further, respondents from households with incomes over $150,000 per year were the most likely to believe that the age pension should actually be reduced, and were more certain in their views about whether they were willing to pay extra tax.

Table 4: Attitudes to increasing the pension and lifting taxes by gross household income

	Less than $40,000	$40,000-$80,000	$80,000-$150,000	More than $150,000	All
Pension should be increased	80.9%	84.7%	79.6%	72.6%	81.3%
Pension should remain the same	12.4%	11.3%	12.9%	14.5%	12.3%
Pension should be lowered	2.7%	2.3%	2.2%	3.2%	2.5%
Not sure	4.0%	1.7%	5.3%	9.7%	4.0%
Willing to pay more tax	56.4%	51.8%	50.2%	33.9%	51.7%
Not willing to pay more tax	21.5%	32.9%	35.1%	58.1%	31.4%
Not sure	22.1%	15.3%	14.7%	8.1%	16.9%
Total	100%	100%	100%	100%	100%

*Base=886. Excludes respondents who did not nominate their household income.

5. Conclusions

While the equity case for increasing the pension is widely accepted by all political leaders and the vast majority of the Australian public, the Rudd Government has argued that it is important to first conduct an extensive review. However, the current economic situation is an additional reason to increase the pension immediately, providing a simple and effective mechanism to stimulate the Australian economy.

The government is constrained in its use of more conventional fiscal policy measures, such as infrastructure spending and tax cuts, by the time lags involved and the significant tax cuts already budgeted or planned. Given that the pension will need to be lifted eventually, it makes good macroeconomic sense to lift it now. In addition to the equity arguments for doing so, there are three strong macroeconomic reasons for using an increase in the age pension to stimulate the economy:

1) pensioners spend less than average on imports, meaning less of the stimulus will 'leak' overseas.

2) Pensioners save less than average, ensuring that the stimulatory effect will occur quickly

3) Pensioners are geographically well distributed, and disproportionately located in low income communities. This ensures that, unlike expenditure on infrastructure or tax cuts, the benefits of an increase in the age pension will flow directly to communities that need assistance most.

In addition to these macroeconomic arguments, the vast majority of the Australian public (82 per cent) believe that the pension should be increased. While a majority of the public also express a willingness to pay more tax, such tax rises are not necessary if the objective is to stimulate the economy.