

Locking in or Losing

The Business Council of Australia (BCA) represents the Chief Executives of 100 of Australia's leading companies. The BCA's objective is to develop and advocate, on behalf of its Members, public policy proposals and reforms that position Australia as a strong and vibrant economy and society. As part of this objective, the BCA believes the benefits and drivers of strong economic growth must be clearly, frequently and publicly articulated. Without a widespread understanding of the benefits and drivers of strong economic growth, it is difficult to build a case for continuing reforms that underpin sustained prosperity. In the 1980s, some governments around the world have presented significant challenges for Australia in dealing with community issues such as poverty and unemployment. For example, the significant fiscal resources produced from strong economic growth have enabled adequate funding for social welfare and health care support programs. The BCA believes the choice between low or sluggish growth, and strong growth, and how it affects the community, is the real issue in the growth debate, particularly as Australia faces many new challenges, such as population ageing and increased international competition. This is particularly the case when Australia is experiencing a prolonged period of growth, and when many in the community are more likely to assume continuing prosperity can be taken for granted. Equally important is an understanding of the different outcomes for Australia arising from a future of low compared to strong growth. Each mean very different things. For example, if Australia had experienced low growth since 1983, living standards would have been significantly lower than the average 3.6 per cent a year since 1983, living standards would have been significantly lower, and employment prospects would have been significantly lower.

Prosperity:

AUSTRALIA'S CHOICE



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Executive Summary

Economic reform is acknowledged to have played a significant role in Australia's current prosperity. Yet, the direct impact of this reform on the living standards and prosperity of ordinary Australians is not well understood. The Business Council of Australia believes that quantifying the reform 'dividend' for people is important to justify the case for further reform, particularly at a time when imbalances and barriers emerging within the Australian economy highlight that the continued strong growth in the long term cannot be guaranteed.

To this end, the BCA commissioned leading economic modellers and forecasters Access Economics to quantify the impact of the last 20 years of reform on the livelihoods and wealth of ordinary Australians. The BCA also asked Access Economics to quantify the impact on individual Australians of further reform over the next 20 years in order to demonstrate there are significant consequences both for the economy and the prosperity of average Australians of pursuing a low or strong growth future. Access was also asked to identify and quantify the sorts of reform required to underpin strong growth over the long-term.

In summary, the analysis found that:

- The average Australian is better off in terms of real wealth by more than **\$83,000** (in today's dollars) as a direct result of the economic reforms of the last 20 years.
 - If the economy continued to grow by 4 per cent per annum over the next 20 years – an outcome only possible through ongoing economic reform – the average Australian would be a further **\$74,000** better off (in today's dollars).
 - The gap between a low growth (**2.4 per cent growth a year**) and a strong growth (**4 per cent a year**) future can be achieved by building on existing reforms, rather than radical policy solutions, in areas such as increasing productivity, workforce participation, better infrastructure planning, increased investment in education and training, and higher immigration.
 - Without the reforms undertaken since 1983, unemployment in Australia would have been **8.1 per cent** in 2003-04 compared to the rate of **5.8 per cent**. This equates to 315,000 more people in jobs. Unemployment has of course fallen even further over the past year.
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- Productivity improvements alone – the direct result of workplace relations and other economic reforms – have meant every Australian is **at least \$3,000 better off a year**.
 - Continuing reform leading to strong growth over the next 20 years would result in Australia's economy being nearly **40 per cent bigger** by 2025 than would be the case without reform.
 - As a result, Australia could become the **3rd most prosperous country in the developed world** in terms of GDP per capita by 2025. Without reform, we could drop to 18th – the position Australia occupied in 1983 when concerted economic reform started.
 - With the high growth scenario **Commonwealth revenues would increase by nearly 9 per cent** of GDP by 2025 compared to the low growth scenario. This increased tax revenue could be returned to taxpayers by reducing average personal tax rates by 30 per cent, or could be used to fund much of the Commonwealth's projected spending on health and education in 2024-25.
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Introduction

The Business Council of Australia (BCA) represents the Chief Executives of 100 of Australia's leading companies. The BCA's objective is to develop and advocate, on behalf of its Members, public policy proposals and reforms that position Australia as a strong and vibrant economy and society.

As part of this objective, the BCA believes the benefits and drivers of strong economic growth must be clearly, frequently and publicly articulated. Without a widespread understanding of the benefits and drivers of strong economic growth, it is difficult to build a case for continuing reforms that underpin sustained prosperity.

This is particularly the case when Australia is experiencing a prolonged period of growth, and when many in the community are more likely to assume continuing prosperity can be taken for granted.

Equally important is an understanding of the different outcomes for Australia arising from a future of low compared to strong growth.

Each mean very different outcomes for Australia. For example, if Australia's economy had grown at less than the average 3.6 per cent a year since 1983, living standards and levels of prosperity of many ordinary Australians would have been markedly different. Employment prospects would have been significantly less, as would per capita wealth, as this report demonstrates.

Low or no growth outcomes over the period would also have presented significant challenges for Australia in dealing with community issues such as poverty and the environment. For example, the significant fiscal resources produced from strong economic growth have enabled adequate funding of social services and welfare/support payments.¹

The BCA believes the choice between low or sluggish growth, and strong growth, and how it affects the community, is the real issue in the growth debate, particularly as Australia faces many new challenges, such as population ageing and increased international competition.

To highlight the choices Australia faces and their real impacts on not just the economy but ordinary Australians, the BCA commissioned Access Economics to prepare two analyses:

- The first examines the reform-driven benefits of growth over the past 20 years both for the economy and for average Australians; and
- The second examines the challenges and choices that Australia will confront over the next 20 years if we choose to adopt either a low or strong growth path. In particular, it looks at how these two paths will result in very different levels of prosperity and living standards and examines the types of reforms needed to ensure Australia avoids a low-growth future.

The Access Economics reports *The Reform Dividend: 1983-2004* and *The Speed Limit: 2005-2025*, form the basis of this analysis. Both reports are appended to this paper.

¹ Recent research by Ann Harding of the University of Canberra shows that Australia's tax transfer system is strongly redistributive towards lower income Australians. See Ann Harding, Rachel Lloyd and Neil Warren (2004) *The Distribution of Taxes and Government Benefits in Australia*, paper presented to the Conference on the Distributional Effects of Government Spending and Taxation, the Levy Economics Institute, 12 October 2004.

2. Going Backwards: 1950 - 1983

To demonstrate the implications of choices we face today, it is worth looking at Australia's recent economic history. The recession of the early 1980s, associated with a weak world economy, drought and unrealistic expectations regarding a national mining boom that never quite eventuated, bottomed in 1983. At the time, Australia's unemployment rates were at their highest since the Great Depression and our economic performance relative to OECD peers had plummeted (see Figure 1). Australia's productivity performance was languishing, interest rates and inflation were high and the Federal Budget was deeply in deficit. All this had significant impacts on ordinary Australians whose relative living standards and opportunities had been on the decline for some time.

This crisis point for Australia was the end result of several decades of protectionist policies that sheltered the economy from

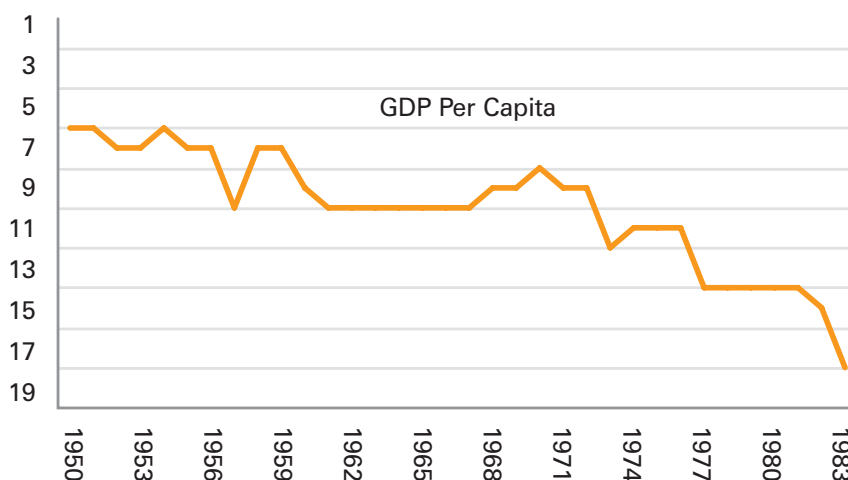
competition. Heavy-handed regulation and centralised intervention in the market, particularly in the areas of industrial relations, generally constrained the economy's capacity to adapt to change.

Rigid economic structures and institutions meant that Australia was unable to make the most of global good times while the impact of global shocks such as sharp increases in global oil prices had disproportionate negative impacts. This longstanding 'closed' policy approach saw the share of exports in economic activity fall below where it was at the start of the 1900s.

With the problems experienced in the 1980s the result of a long period of decline, decision-makers embarked on a major overhaul of the economy to improve its performance, increase its flexibility and bolster its competitive strengths.

FIGURE 1: THE FALL OF AUSTRALIA'S RELATIVE PROSPERITY (1950-1983)

Rank in OECD (of 30)



Source: Groningen Growth and Development Centre and the Conference Board, Total Economy Database, Feb 2005, www.ggdc.net. OECD rank is against all current members (rather than membership at the time).

3. Catching Up: 1983-2004

In the space of a generation, Australia's economy has been transformed. In 1983, Australia was 18th on the OECD league table of relative prosperity. In 2005, Australia now finds itself back in the OECD top 10 in terms of income per head, underpinned by a pattern of strong, consistent growth. Australia's economic output (GDP) more than doubled from 1983 to 2004 – rising by 111 per cent from the September quarter of 1983 to the September quarter of 2004. On a per head basis – a better indication of the rise in individual prosperity and living standards – GDP rose by nearly 62 per cent, while household wealth (expressed as a multiple of GDP) increased from 318 per cent to 615 per cent.

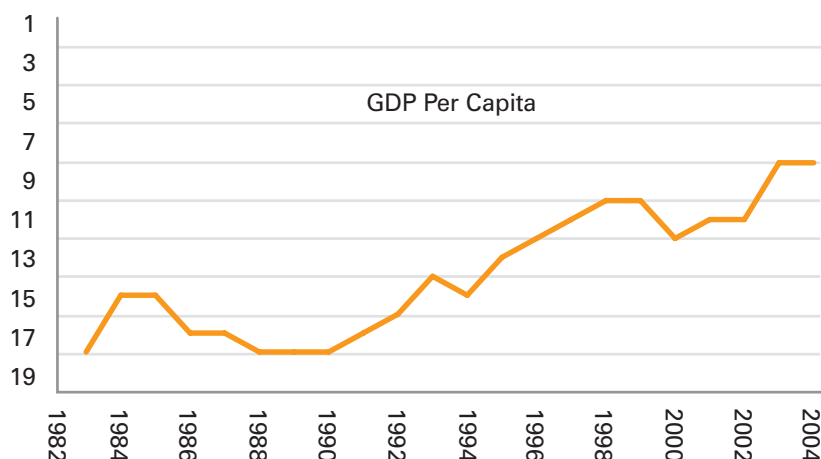
This transformation coincided with a period of concerted microeconomic reform which reshaped most areas of the Australian economy. The economy's competitive environment and Australia's productivity performance improved substantially. The level of productivity in Australia relative to the United States rose from 79 per cent to 84 per cent. The economy also returned to a deeper integration with the global economy as evidenced by a rising share of exports in total output.

Strong growth in turn flowed through to significant job creation. By 2004, unemployment had fallen to the lowest rate since the mid 1970s. In stark contrast with the experiences of the early 1980s, inflation and interest rates remained stable and low. These macro improvements have resulted in material benefits that have flowed throughout Australian society. For example, over the last 20 years, real wages have increased by 25 per cent (up by 20 per cent in the last decade alone). Unemployment has fallen from around 10 per cent to below 5.5 per cent, while youth unemployment improved from nearly 20 per cent to below 15 per cent in just the last decade.

Furthermore, this improved economic performance has benefited people at all ends of the socio-economic spectrum. Recent research has found that income growth over the last decade has been strongest among Australians at the bottom two deciles of income distribution.²

² Ann Harding (2005) *Recent Trends in Income Inequality in Australia*, presentation to the Conference on 'Sustaining Prosperity: New Reform Opportunities for Australia', Melbourne, 31 March 2005.

FIGURE 2: THE RISE OF AUSTRALIA'S RELATIVE PROSPERITY (1983-2004)
Rank in OECD (of 30)



Source: Groningen Growth and Development Centre and the Conference Board, Total Economy Database, Feb 2005, www.ggdc.net. OECD rank is against all current members (rather than membership at the time).

4. Locking in or Losing Prosperity?: 2005 and Beyond

Despite these significant improvements, there are strong indications that Australia's performance has been slipping in terms of its competitiveness and general economic standing.

Two key international reports underline this trend. The annual World Competitiveness Yearbook, released in June by one of the world's leading business schools, Switzerland's IMD (and used by governments around the world to promote their economies as places to invest) showed that despite being the most resilient economy in the world, Australia fell from a ranking of 4th in 2004 to 9th in 2005.

A similar conclusion can be found in the 2004-05 Global Competitiveness Report of the World Economic Forum. In 2004, Australia fell from a ranking of 10th in 2003 to a ranking of 14th in the Growth Competitiveness Index – a measure of macroeconomic competitiveness.

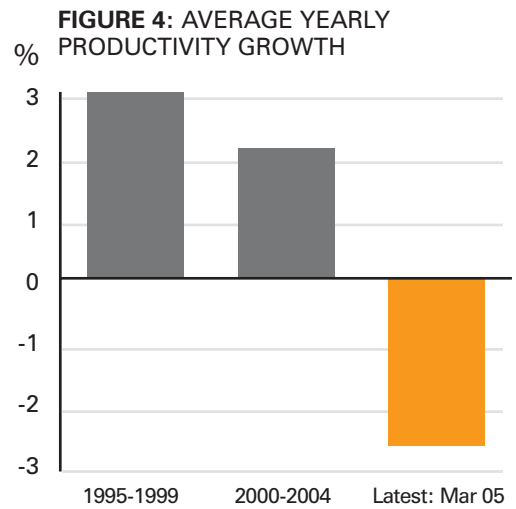
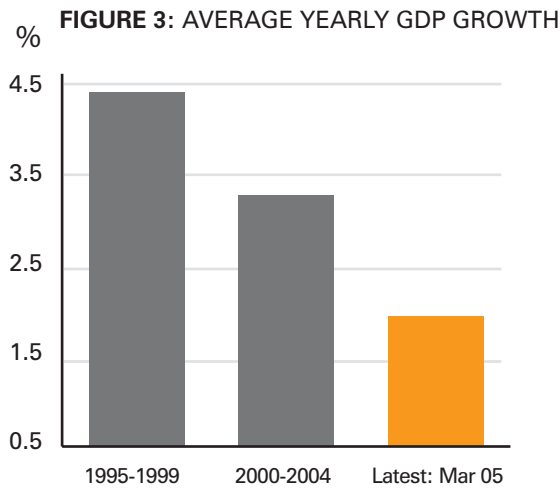
Other factors also point to Australia facing a number of growth impediments, which if left unaddressed could result in our performance going backwards, and as a result, eroding the gains made over the last 20 years.

The BCA argued in its Budget Submission to Federal Treasury in February 2005 that 'the recent composition of economic growth is based on drivers that are not sustainable in the long term'. In particular, the rising level of household debt, capacity constraints particularly in the areas of skills shortages and infrastructure shortfalls, as well as a large current account deficit, represent a series of imbalances which have increased the economy's susceptibility to downturn.

Economic growth has slowed in recent years. Figure 3 shows that average yearly GDP growth slowed to 3.2 per cent over the five years from 2000-04 compared with 4.3 per cent in the previous five year period. The most recent data shows growth has slowed to less than 2 per cent. In fact, in only three of the last 21 quarters, has economic growth in Australia

exceeded the *average* achieved from 1995-99 – and then only just.

Underlying weaker economic growth has been a sharp deterioration in Australia's productivity performance. Average productivity growth has slowed (see Figure 4) and in fact the latest data shows that productivity is going backwards.



These are early warning signs that matter because they have implications for other vulnerabilities that have emerged in the economy.

High levels of household debt and debt servicing are manageable if income and jobs growth remain strong. Will that be the case in a low economic growth future? Similarly, record current account deficits are less of a concern if exports can rebound on the back of strong global growth and sustained competitiveness. But can the latter be achieved on the back of declining productivity?

These findings highlight that we cannot take even our current strong economic position, let alone the future, for granted. Minimising these imbalances to put growth on a sustainable footing requires a new round of macro and micro-economic

reform. The BCA has proposed an integrated agenda of policy recommendations to achieve this objective, focused on four key areas of the economy – taxation, workplace relations, infrastructure and reforming business regulation.

These findings and recommendations concur with recent assessments by reputable organisations, including the Reserve Bank of Australia and the Productivity Commission, that Australia's economy faces a number of vulnerabilities.

The common theme in each of these assessments, like that of the BCA, is that Australia is reaching the limits of its productive capacity and further reform is required for the economy to grow at rates similar to that of the last decade.

The analysis by Access Economics demonstrates the contribution that policy reform has played in transforming the economy over the two decades to 2004. While these reforms have been instrumental in improving growth and prosperity, if we choose to rest on our laurels now, growth will inevitably slow.

The alternative is to recognise that acting now will allow us to lock in past prosperity – not lose it – and to build another cycle of strong performance on that foundation. The Access Economics analysis demonstrates that a series of further reforms building on those already implemented will enable Australia to make the transition from a future characterised by a return to low growth to one of strong growth, and sustained prosperity.

5. The Reform Dividend: 1983-2004

Calculating the Payout

Understanding the extent of the dividend from previous reforms provides an important context to highlight the need for, and benefits of further reform.

While the extent to which Australia's economy has grown and living standards increased over the past 20 years is well known, how our improved prosperity can be directly attributed to past reforms and policy actions is not as well understood.

As Access Economics notes, the question: 'Was Australia merely a lucky country, or were we a smart one?' has not been thoroughly considered. This is because past estimates of the benefits of reform are few and far between, and tend to be partial estimates of single reform packages rather than the total reform agenda. The purpose of the Access Economics report, *The Reform Dividend: 1983-2004*, which forms the first part of this paper's analysis is to undertake a comprehensive quantitative assessment to better understand the reform dividend accrued by Australia over time as a result of policy decisions taken over the 1980s and 1990s.

The BCA commissioned Access Economics to model the impacts of reform on the variables of the prosperity equation which directly influence the living standards and opportunities of Australians:

- Unemployment
- Workforce participation
- Productivity (and therefore real wages)

Access Economics also estimated the overall impact of reforms on economic growth (GDP) and real wealth. Access Economics modelled the impact of reforms by comparing a 'no reform' base case (i.e. had the structure of the economy remained as close as possible to what existed in 1983) to the actual results of the economy that has been transformed by reforms over the past 20 years.

It is important to note that the estimates outlined below are conservative, as many economic impacts of reform have not been incorporated (such as the indirect effects of reform on factors such as technology take-up, and the employment effects of non-labour market reforms). More importantly, the analysis assumes that the economic conditions and indicators that existed in 1983 were maintained right through to 2004. Yet, the likelihood is that without reform, Australia's economic performance could well have deteriorated (for example, productivity growth was already trending downwards). As a result, the reality of a non-reform scenario could have been a far starker outcome than suggested by the Access Economics results.

KEY CONCLUSIONS FROM THE REFORM DIVIDEND: 1983-2004 REPORT

The key conclusions from the Access Economics analysis are as follows:

5.1 Unemployment: more Australians in jobs

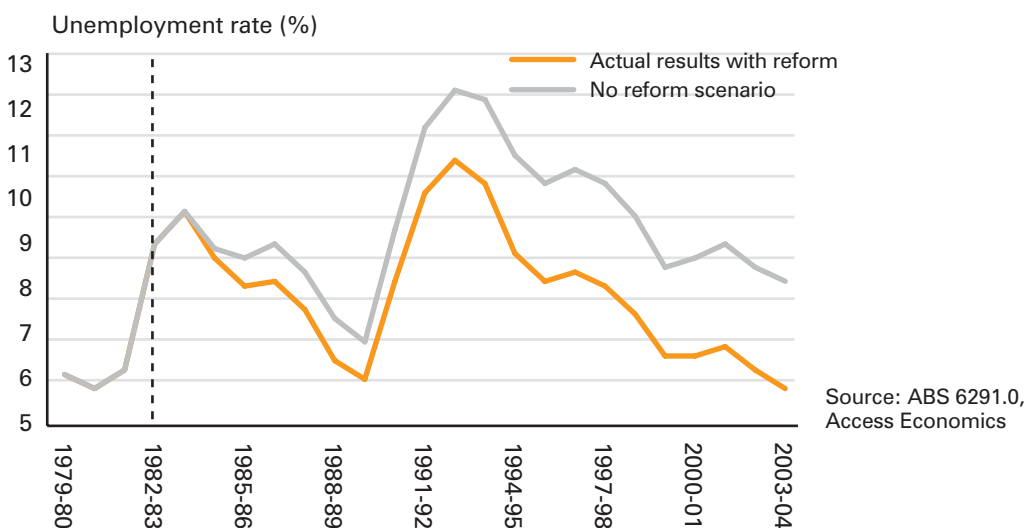
The Access Economics analysis estimates there were **315,000 more Australians in jobs** in 2003-04 as a direct result of past labour market reforms. In other words, the reform dividend resulted in Australia's unemployment rate averaging **5.8 per cent** in 2003-04 (and falling), compared with **8.1 per cent** had reform not been undertaken.

The change is due to the fact that no reform would have meant a continuing misalignment between wages and productivity. This inhibits job creation and raises unemployment.

This estimate of the employment effects of labour market reforms over the last 20 years is likely to be conservative as it does not consider how broader economic reforms (both labour market and non-labour market) have increased the productive capacity of the economy and thus allowed higher employment at constant relative wage levels.

(See *The Reform Dividend: 1983-2004*, page 33)

FIGURE 5: REFORM LOWERS UNEMPLOYMENT

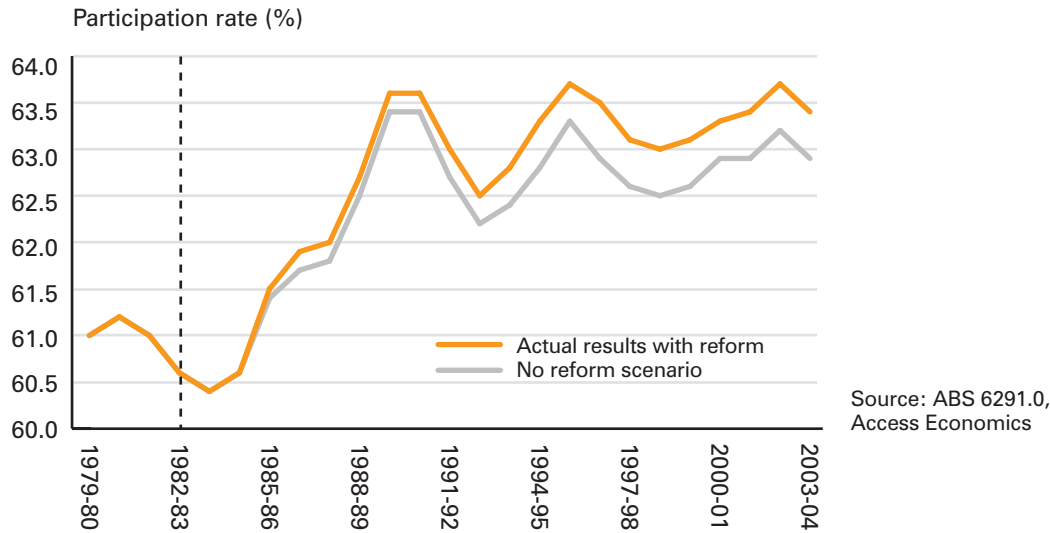


5.2 Workforce participation: more Australians in the workforce

Without reform, Australia’s overall participation rate would have been **63.0 per cent** rather than **63.4 per cent**. While this seems a minor change it would have effectively cut the supply of available labour by **87,400 people** in 2003-2004. This in turn would have compounded Australia’s current skills shortage problem. According to the Access Economics analysis, this increase in participation rates would not have occurred without deregulation of the labour market, which has contributed to reducing barriers to job creation and job flexibility.

(See *The Reform Dividend: 1983-2004*, p. 32)

FIGURE 6: REFORM CONTRIBUTES TO HIGHER RATES OF PARTICIPATION



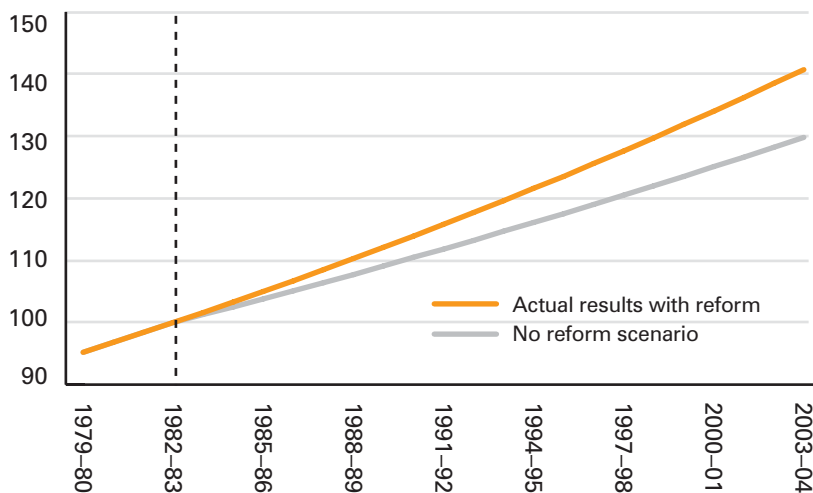
5.3 Productivity: a more productive labour force

Australia's improved productivity performance resulting directly from the reform agenda, including labour market and tariff reform, national competition policy and financial deregulation, accounts for around **\$3,000 per person per year of the improved GDP per head** than would have been the case without economic reform. Again, this is likely to be an understatement as the analysis considers the increase in productivity growth due to reforms in Australia relative to the gains in the rest of the OECD. To the extent that other OECD nations have been reforming their own economies, this yardstick is a deliberately tough one.

(See *The Reform Dividend: 1983-2004*, p. 34)

FIGURE 7: REFORM LIFTS PRODUCTIVITY

Productivity (Index: 1982-83=100)

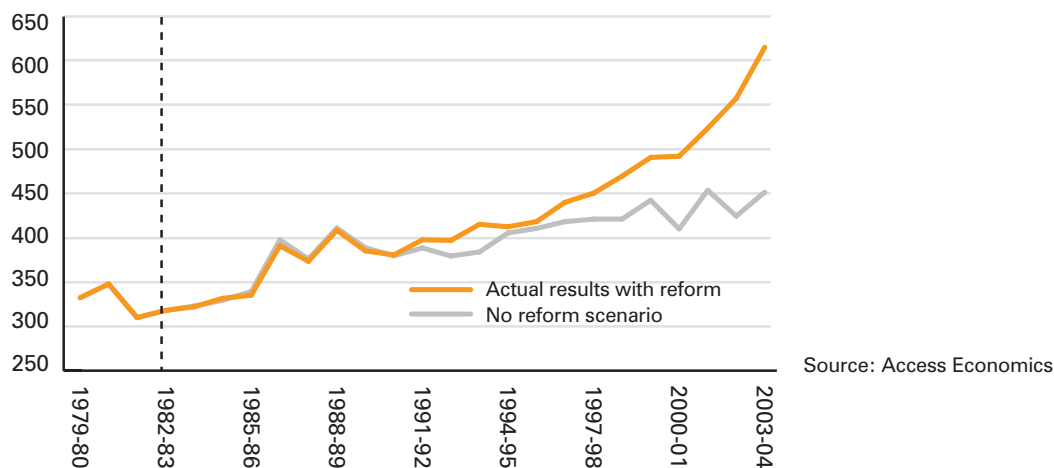


5.4 Economic growth (GDP) and real wealth

Overall the Access Economics analysis estimates economic reforms since 1983 have resulted in **GDP per head being 10.8 per cent higher than it would otherwise have been.** This increased income has led to higher levels of personal wealth. In 1983, Australians had household private net wealth of 3.18 times national output (GDP). By 2003, this had increased to 6.15 times. **Without reform, Access Economics estimates that household net wealth would have been only 4.51 times GDP.**

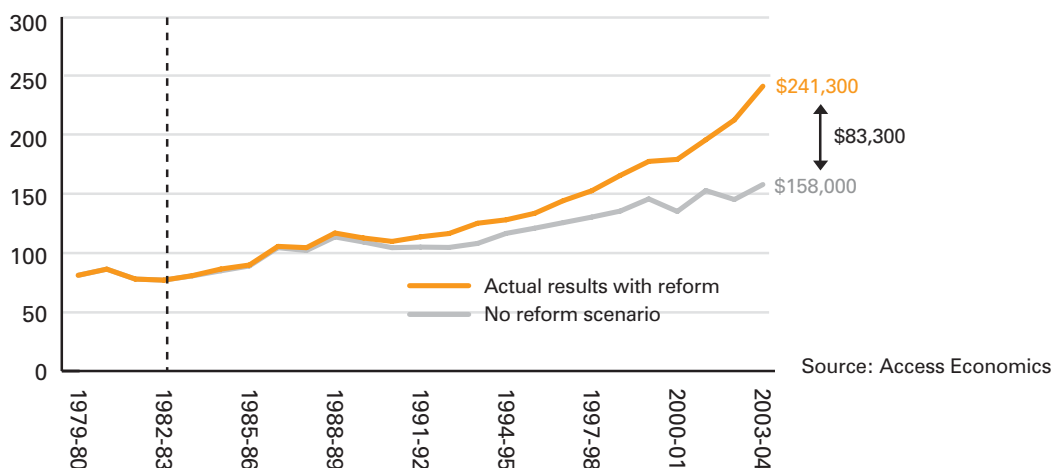
(See *The Reform Dividend: 1983-2004*, p. 35-36)

FIGURE 8: ESTIMATED DIFFERENCE IN WEALTH TO GDP RATIO
Wealth to GDP ratio (%)



The Access Economics analysis shows this differential – the gap between the reform and no-reform scenarios – translates to each Australian being an average of \$83,300 better off – an equivalent to one-third of total current real wealth per head.

FIGURE 9: ESTIMATED DIFFERENCE IN REAL WEALTH PER HEAD
Real wealth per head (\$000–2002-03)



6. Research Summary

The research provides a demonstration of the tangible benefits of reform and strong growth to the Australian community. However, Australia started from a relatively low base, having surrendered advantages in living standards, competitiveness and wealth generation in the decades prior to embarking on reform. Australia had a lot to do simply to 'catch up' on the economic expansion and growth in living standards which the nation had forgone.

Australia now finds itself in a situation where demand has largely caught up with the supply potential of the economy. Unemployment is at its lowest rate since the mid-1970s, and capacity utilisation is, on some measures, close to its highest level ever.

When an economy is at or near full capacity, future growth is determined not by demand, but by the supply potential of the economy. This point emphasises the vital importance of further economic reform to unlock productive

capacity. Furthermore, the imperative for reform is upon us. With interest rates, unemployment and inflation largely under control, Australia now has a unique opportunity to lock in this prosperity for the long term, and in doing so, avoid the downturns that have plagued Australia and other so-called 'miracle' economies in the past.

The political and policy imperative for Australia should be focused on the choice between low versus strong growth – not the traditional paradigm of 'boom or bust' (positive or negative growth). The second Access Economics report, *The Speed Limit: 2005-2025*, summarised in the next section, shows there are real material costs if Australia opts for the comparatively easy choice of nil or minimal reform from here on in. This would be compared to a more proactive reform agenda, similar to that of the last 20 years, that puts Australia on the path of sustained strong growth and improved standards of living.

Australia now finds itself in a situation where demand has largely caught up with the supply potential of the economy.

7. The Speed Limit: 2005-2025

Breaking the Barriers

Australia can stand still and let decline set in, as it had done up until 1983, or we can lock in the prosperity and economic wellbeing to which we have become accustomed. While the economy enjoys a springboard to locking in prosperity with low inflation and unemployment, there are a number of long-term challenges facing the Australian economy that highlight the importance of acting now to ensure strong growth into the future.

Economic headwinds will be generated by the mass retirement of baby-boomers. This demographic, which has for some time boosted the share of the working age population and workforce participation rates, is now entering retirement and leaving work. For example, Australia's working age population usually grows by an average of around 166,000 people every year. But trends already in place will see the working age population grow by just 190,000 for the entire decade of the 2020s – a tenth of the current pace.

Furthermore, without the implementation of a new economic reform agenda, productivity growth is likely to slow. Indeed the recent productivity slowdown has been particularly dramatic and suggests that the productivity gains from past reforms are already starting to wane.

These less positive trends are confirmed in official projections for the Australian economy. Federal Treasury's Intergenerational Report of 2002 projected average annual GDP growth over the coming two decades of 2.7 per cent. This represents a full percentage point below that which we have experienced over the last two decades. Similar projections have been made by the Productivity Commission.³

These projections are far from worst-case scenarios. As the Access Economics analysis shows, the Intergenerational Report assumes that workforce participation rises among the mature-aged over time as retirement is delayed by many baby-boomers. With its 'business as usual' scenario Access Economics assumes that participation rates for differing age cohorts remain constant. **On this basis it concludes that Australia's economic growth may average just 2.4 per cent per annum over the next two decades, and as such, is used as the basis for the low-growth scenario for 2005-2025.**

The recent productivity slowdown has been particularly dramatic and suggests that the productivity gains from past reforms are already starting to wane.

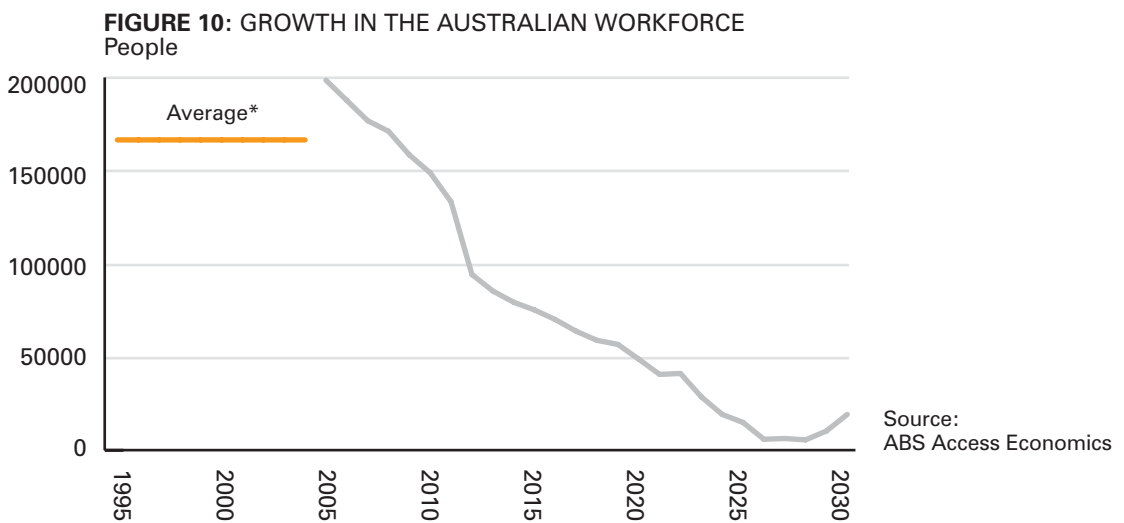
³ Productivity Commission (2005) *The Economic Implications of an Ageing Australia*, Productivity Commission Research Report.

The implications of these trends and longer-term projections are clear. Without concerted efforts to improve labour supply and productivity in the future, the Australian economy will be limited by supply constraints to low levels of growth. Efforts to stimulate growth by raising demand (for example through lower interest rates) will be temporary as these benefits will ultimately dissipate through higher inflation and interest rates.

Therefore the choice is either that Australians will need to become accustomed to lower rates of economic

and income growth, or Australia will need to embark on a new wave of reforms aimed at further re-energising Australia’s growth capacity over the next 20 years.

Political and policy debate appears now to be framed by a perspective that following an unprecedented period of sustained strong growth, low growth is somehow inevitable and acceptable. Yet we should not lose sight of the fact that there are real choices and impacts arising for Australians if policy-makers set the country on a course of strong growth, or by default, low growth.



* This is the average annual increase in the workforce recorded for 1995-2005.

Political and policy debate appears now to be framed by a perspective that following an unprecedented period of sustained strong growth, low growth is somehow inevitable.

'I think we will have to get used to seeing GDP growth rates starting with the numbers two or three, rather than three or four.'

Reserve Bank of Australia, Governor Ian Macfarlane – testimony to Parliamentary Committee, 18 February 2005

The BCA believes the preferred course of action should be to implement reforms aimed at enhancing Australia's supply potential and locking in the prosperity we have enjoyed as a nation over the last 20 years. This is because, as the last 10 years have demonstrated, growing the overall economic pie is the best means of achieving widespread prosperity and increasing standards of living.

Why four per cent is better than two per cent – implications of a strong or low growth future

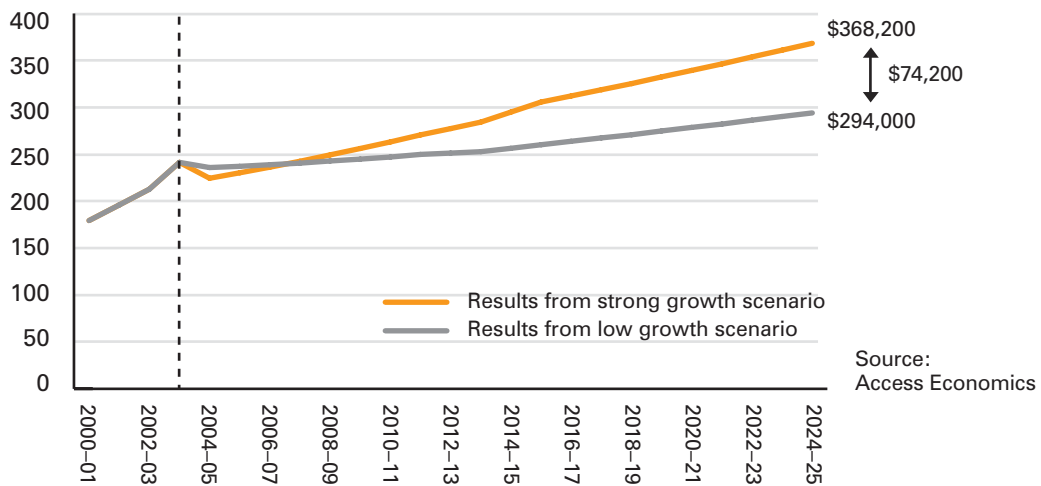
The policy goal for Australia should be to continue to sustain growth close to or at 4 per cent. This is the growth rate sustained for most of the last decade, and on which current living standards have been underpinned.

Economic modelling by Access Economics found that if Australia can sustain growth close to or at 4 per cent per year as opposed to a 'business as usual' rate of 2.4 per cent, by 2025:

- Australia's economy would be **39 per cent bigger**.
- GDP per person would be **31 per cent higher**.
- The wealth of the average Australian would be **25 per cent or one-quarter higher**.

(See *The Speed Limit: 2005-2025*, p. iv)

FIGURE 11: ESTIMATED DIFFERENCE IN REAL WEALTH PER HEAD
Real wealth per head (\$000 – 2002-03)



To put these projections in context, the BCA commissioned Access Economics to model some key household statistics, based on the difference between average 4 per cent and 2.4 per cent per annum economic growth over the next 20 years.

The results show that following a strong growth future rather than a low growth path will have significant implications for people's incomes. By 2024-25, income per capita would be \$16,500 a year higher (in today's dollars) under a scenario of 4 per cent average growth rather than 2.4 per cent average growth.

Furthermore, the average real wealth of individuals would also be significantly higher under the strong growth scenario. As Figure 11 shows, **real wealth per capita in 2024-25 would be \$368,200 (in today's dollars) – some \$74,200 higher than real wealth per capita under the scenario of 2.4 per cent average GDP growth.**

Increased economic growth in the future will not only improve the personal financial circumstances of Australians. It will also provide the necessary resources to ensure that Australia is better placed to satisfy community needs.

For example, analysis from Access Economics shows that, assuming a constant Commonwealth tax to GDP ratio in the future, the high growth scenario is likely to **increase Commonwealth taxation receipts by 9 per cent of GDP by 2025**, compared to the low growth scenario. This is **equivalent to almost \$80 billion in additional revenues** in today's dollars.

Thus increased revenue growth could be used to fund significant tax cuts or could be reinvested in more services and/or infrastructure.

Access Economics estimates that the increased tax revenue under the 4 per cent growth scenario could be given back to tax payers by **reducing average personal tax rates by 30 per cent** from where they would otherwise be (the equivalent of 5.5 cents in the dollar on the average rate of personal tax).

Alternatively, Access Economics also estimates that the 9 per cent of GDP increase in tax receipts under the high growth scenario (relative to GDP in the low growth scenario) could **effectively fund much of the Commonwealth Government's projected spending on health and education in 2024-25.**

Increased economic growth in the future will not only improve the personal financial circumstances of Australians. It will also provide the necessary resources to ensure that Australia is better placed to satisfy community needs.

8. Reform Possibilities

There are many reform possibilities Australia can pursue to maintain growth at current levels – in other words to close the gap between the current projections of 2.4 per cent and the 4 per cent growth required to sustain prosperity.

There are a number of ways in which this gap can be closed to provide the platform for sustained prosperity. Over the past six months, the BCA has outlined an integrated agenda for future reform focused on tax, workplace relations, business regulation, education and training, and infrastructure provision. As an integrated platform of policy analysis and recommendations, they provide direction to a revitalised reform agenda for Australia and a basis on which the economy can sustain strong growth in the long term. In order to better understand how Australia's economy can be reenergised to achieve 4 per cent growth, the BCA asked Access Economics to model the economic impacts of a range of policy initiatives and outcomes. These include the impact of a number of the policy recommendations outlined by the BCA as part of its reform agenda. In this way, we can better understand and quantify the type and scope of reform to achieve the 1.6 per cent per annum difference in GDP that separates Australians from a low or strong growth future.

8.1 Higher workforce participation

Australia's aggregate workforce participation rate is set to fall as the population ages. This is because older Australians tend to have lower rates of workforce participation compared to younger employees. The impact on participation is compounded compared with other OECD countries because older Australians have typically lower participation rates than their OECD peers. Workforce participation is also affected by disincentives in the tax and welfare systems and due to inflexible work environments.

Improving workforce participation, and therefore labour supply, in the future will require a number of policy responses, such as:

- increasing financial incentives to work by lowering the effective marginal tax rates that impact welfare recipients returning to work;
- further workplace relations reform to support job creation and to enable the adoption of more flexible work practices to support increased workforce participation of women, older Australians, individuals with disabilities etc.;
- strengthening eligibility requirements for benefits, and possibly raising the age of access to superannuation and pension entitlements; and
- education and training policies that support the capacity of individuals to gain and retain employment.

Potential Dividend:

If Australia could manage to achieve a lift in workforce participation rates to the equivalent of the OECD 80th percentile rate in each age cohort, this would imply rising workforce participation rates through to around 2015, compared with the 'base case' which would see aggregate participation rates falling steadily over the next two decades. According to Access Economics, raising workforce participation rates along these lines would **increase the average annual growth rate by 0.6 percentage points over the two decades to 2024-25 and result in a 14 per cent increase in GDP compared to the 'base case' by 2024-25.**

8.2 Investment and capital deepening

Higher levels of labour productivity growth can be achieved by increasing the amount of capital that each worker has to work with: capital deepening. Business, the public sector and households need to be willing to invest more in future growth and spend less on 'today'.

Population ageing could prompt some additional capital deepening as labour

supply constraints push down the relative availability of labour and hence push up the cost of labour relative to capital. However, increased capital deepening is more likely to occur if broader reforms aimed at improving the allocation and use of resources in the economy are implemented – in particular reforms aimed at regulation, pricing, planning and government relations associated with infrastructure.

Potential Dividend:

Access Economics estimates that if capital deepening occurred at a rate slightly faster than that achieved over the past two decades – 1.25 per cent a year compared to 1.15 per cent a year – **economic growth could average 0.1 percentage points above the 'higher participation' scenario over the period to 2024-25.**

8.3 Greater efficiency in the allocation and use of resources

Australia's recent productivity performance has been weak. This may be due to a lack of concerted momentum in microeconomic reform. The OECD has noted that 'the pace of reform (in Australia) recently has not been as strong as it could have been'.⁴

A reinvigorated and broadened microeconomic reform agenda will be of vital importance to multi-factor productivity performance over the next two decades.

Multi-factor productivity can be thought of as improvements in productivity due to:

- implementation of new technologies (better machines);
- improved education, worker skills and work practices (a more efficient workforce); and
- shifts in production towards higher value added goods and services (i.e. a better composition of output).

Microeconomic reforms contribute positively to each of these by deregulating markets thereby allowing resources to flow more freely to those areas where they are most productive and most highly rewarded. Microeconomic reforms also encourage a competitive business environment that focuses on innovation and values worker skills.

Scope for further reform exists⁵ in areas such as:

- further workplace relations reforms to enhance the flexibility of agreement making and reduce impediments to job creation and workforce participation;
- tax reform, where the BCA recently recommended the lowering and compressing of personal income tax rate scales, reducing company tax rates, abolishing inefficient State taxes, and eventually increasing recourse to taxes on consumption rather than income;
- another round of competition policy reforms focusing on greater harmonisation across the Federal-State system (this cuts across regulatory and Federal-State issues discussed below) and increased competition in sectors which continue to enjoy significant protection;
- improved business regulation (including the reduction of duplication across Federal-State, and within State systems);
- improved planning and provision of infrastructure; and
- Federal-State reforms to improve accountability and efficiency in the delivery of goods and services (including notably health and education).

⁴ OECD Economic Survey of Australia, 2005

⁵ The BCA has published detailed action plans for reform of workplace relations, taxation, business regulation and infrastructure. These are available at www.bca.com.au.

Potential Dividend:

The modelling analysis undertaken by Access Economics indicates that a reinvigorated microeconomic reform agenda has the capacity to lift **GDP and GDP per head by 8.9 per cent by 2024-25 or 0.4 percentage points in additional growth per year** on top of the gains that could be achieved by higher participation and capital deepening.

8.4 Increasing education and skill development

People with higher levels of educational attainment and skills have higher participation rates and tend to stay in the workforce for longer.⁶ Raising the average level of educational attainment (and ongoing skill development) can also deliver higher levels of productivity.

Potential policies aimed at ensuring an effective level, and appropriate mix, of skills in the economy include:

- a legislative guarantee giving all young people access and support to complete 12 years of initial education or vocational equivalent;
- greater investment in literacy and numeracy programs in primary and secondary education;
- identification of young people 'at risk' of not completing schooling or training, and the effective provision of alternative pathways to completion;
- increasing competition and flexibility within the vocational training and higher education sectors to ensure the ability of providers to deliver education options appropriate to the skill needs of the economy; and
- consideration of the appropriate private/public funding mix in the education sector.

⁶ Steven Kennedy and David Hedley (2003) *A Note on Educational Attainment and Labour Force Participation in Australia*, Commonwealth Treasury Working Paper 2003-03.

Potential Dividend:

Access Economics analysed the economic impact of raising the retention rates of schools, and increasing the shares of people achieving university degrees and non-university diplomas by 5 percentage points each over the next ten years. The results suggest that policies aimed at achieving **these outcomes are likely to deliver average annual growth rates that are 0.1 percentage points higher than the 'reinvigorated reform' scenario over the next two decades.**

8.5 Higher immigration

The benefits of extra migrants, particularly skilled workers, to economic activity in Australia could be substantial. New migrants benefit growth by making the population, workforce and economy bigger, and potentially better by increasing the average level of education, skill and experience among those in the workforce.

Potential Dividend:

Access Economics estimated that by increasing the extra migrant intake by a little over 60,000 annually – in addition to the current official target of 105,000 a year – **GDP growth would improve by an average 0.3 percentage points a year over and above the ‘investing in education’ scenario over the next two decades.**

This modelling is a conservative estimate because it assumes that the extra migration only increases the Australian population without improving its skill mix or allowing greater economies of scale.

9. The Reform Package: Impact on Growth Prospects

Each of the reforms summarised above has the potential to enhance Australia's growth prospects over the next 20 years. Each builds on the one before it to close the gap between a low and strong growth future.

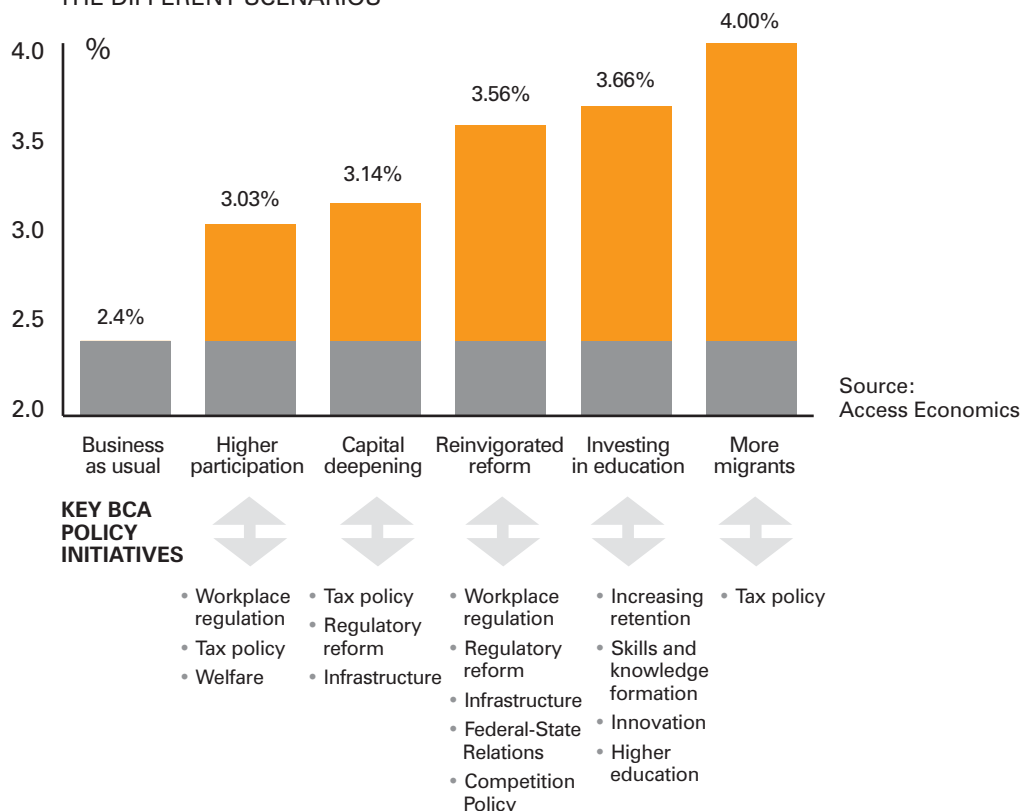
While each individual reform component may appear to deliver relative benefits, a total package of reform has the capacity to lock in and sustain the prosperity we have enjoyed as a nation over the past 20 years. Taking a 'no reform' approach means the outlook is inevitably one of lower growth in output and income.

The analysis undertaken by Access Economics shows that the largest potential gain in average growth would arise from boosting Australian participation rates at given ages up closer to OECD best practice.

The second largest potential gain to average growth rates would come from adopting a reinvigorated reform agenda. A further gain to growth could come from boosting migration. Finally, there would be further gains to GDP growth were business and governments to invest at a slightly faster rate in the economy, and were there greater investment in education.

The BCA has outlined an integrated reform agenda based on changes to our workplace relations, tax, infrastructure and business regulation systems. While not the only policy options available to close the gap, the table below outlines why these policy areas are important vehicles to achieve the changes necessary for a strong growth future.

FIGURE 12: CUMULATIVE ANNUAL OUTPUT GROWTH UNDER THE DIFFERENT SCENARIOS



10. Australia's Choice: Future Perfect or Back to the Future

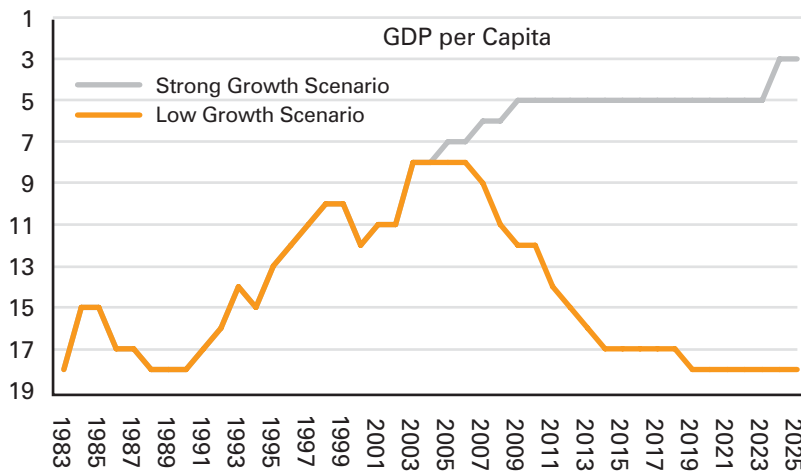
To balance *The Reform Dividend: 1983-2004* research, the BCA also asked Access Economics to project the impact of two decades of both 4 per cent and 2.4 per cent per annum growth on Australia's OECD ranking in relation to relative prosperity.

(See *The Speed Limit: 2005-2025*, page viii).

As Figure 13 shows, under the strong growth scenario, Australia would achieve a remarkable **3rd** position on the table of the globe's most prosperous nations – up from 8th today.

Under the low-growth scenario, Australia would slip back to 18th – the ranking it started from in 1983. In doing so, Australia would have effectively wasted two opportunities. It would lose the opportunity to lock in prosperity and lose the comparative gains achieved by 20 years of reform between 1983 and 2004.

FIGURE 13: THE RISE OR FALL OF AUSTRALIA'S RELATIVE PROSPERITY
Rank in OECD (of 30)



Source:
BCA and Access
Economics

11. Conclusion

The Access Economics reports, *The Reform Dividend: 1983-2004* and *The Speed Limit: 2005-2025*, demonstrate the achievability of Australia maintaining a strong growth path. As the analysis demonstrates, choosing a low-growth versus strong-growth future has real implications not only for the overall economy. The policies outlined above demonstrate the sorts of reform required to make sure Australia is able to lock in prosperity for the long term.

They are not radical policy solutions – rather, they are logical and measured extensions of previous reforms rather than ‘resting on our laurels’. Most of them represent the logical next steps to reform of those important areas of economic activity that have been the subject of review and change for the past 20 years. The difference now is whether Australia has the foresight and willingness to lock in prosperity, or lose it, thereby effectively committing itself and future generations to another prolonged cycle of losing ground.

The Reform Dividend

1983-2004

A STUDY BY ACCESS ECONOMICS PTY LIMITED
FOR THE BUSINESS COUNCIL OF AUSTRALIA

JULY 2005

The Speed Limit

2005-2025

A STUDY BY ACCESS ECONOMICS PTY LIMITED
FOR THE BUSINESS COUNCIL OF AUSTRALIA

MAY 2005

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