

PART 1

PASSING ON PROSPERITY

POLICY AGENDA

INTRODUCTION

The Business Council of Australia (BCA) is an association of 100 chief executives representing Australia's leading companies. Collectively, their businesses account for a significant share of Australia's domestic activity and employment and play a strong part in Australia's engagement in global markets.

The BCA was established in 1983 to provide a forum for Australian business leaders to contribute to public policy debates to build a better and more prosperous Australian society. Members of the BCA are committed to achieving the changes required to improve Australia's competitiveness and to establish a strong and growing economy as the basis for a prosperous and fair society that meets the aspirations of the whole Australian community.

The BCA has increasingly used its submissions to the federal budget process to focus on longer-term challenges facing Australia and to outline a comprehensive reform agenda to address these challenges. This reflects the view that annual budget decisions and settings must be anchored in a long-term strategy for growth and must complement and support a broader reform agenda.

Economic growth in Australia has been maintained for longer than many would have predicted. This achievement provides Australia with a unique opportunity to depart from past economic cycles that have seen the nation's fortunes decline because of a failure to manage prosperity effectively.

As such, the BCA considers there is a very real need not only for reforms in the near term to lock in economic prosperity, but to put in place the conditions that allow Australia to pass its current prosperity on to future generations.

For the BCA, 'passing on prosperity' means:

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- + **Consolidating our current economic position through the continued implementation of 'basic' economic reforms in business regulation, infrastructure and tax;**
 - + **Creating the foundations for sustaining economic growth and wealth creation by planning for and investing strategically in long-term growth;**
 - + **Enabling as many Australians as possible – now and in the future – to directly engage in and benefit from economic activity and prosperity through employment and investment; and**
 - + **Providing appropriately for those who cannot.**
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The nation's unprecedented period of growth has contributed to a fundamental change in the attitude of many Australians (see Exhibit 1). The country's economic success in the face of significant challenges¹ has underpinned greater public confidence about Australia's responsibilities and potential. It has resulted in a more aspirational outlook in terms of the challenges and opportunities ahead.

This more confident and aspirational attitude has the potential to lift Australia to a higher trajectory of economic growth, community achievement and prosperity. To do so, however, we must be prepared as a nation to invest in far-ranging policy reforms.

Implicit in this shift in the mindset of Australians is their readiness to embrace a more strategic vision for Australia and accept the need for hard decisions to achieve that goal.

EXHIBIT 1 Change in the mindset

Edited excerpt of an address by BCA President, Michael Chaney, to the National Press Club, 25 October 2006.

I started this address by asserting that a major shift is emerging in the Australian mindset – a shift that potentially positions this country for even greater achievement.

For some time, we've been asking Australians about their opinions, concerns and aspirations for Australia and its place in the world through focus group work across the spectrum of the community. Recently, we've detected attitudes and beliefs that point to a mindset among Australians that is becoming more aspirational, more confident and more capable.

I'm not saying these attributes are predominant in the minds of all Australians at all times. Clearly, our focus group work also highlighted concerns and fears that reflect continuing uncertainties about our world – particularly in an age of resource depletion and global terrorism. And for many disadvantaged Australians, an aspirational view of the world is not a current reality.

But what I am saying is that positive attributes are being expressed by most Australians about Australia with much greater clarity and

more focus than before – and as viewpoints, they should be given greater recognition and encouragement. Let me summarise some of these shifts.

Instead of being focused on basic needs, Australians are increasingly more focused on how they might go about locking in wealth and the prosperity they've worked hard for.

Instead of being risk-averse and inward looking, we are more accepting of risk and more confident we can meet the challenges of competition.

Rather than waiting for others to provide, Australians see themselves shaping their present and future proactively – as one member of the community put it to us in our research, we're now good at 'going out and knocking on the door'.

Instead of seeing ourselves as reliant on traditional manufacturing and resources, we look upon Australia as a sophisticated, modern economy shaped by services and technology.

As I suggested earlier, all these attributes can be best summarised in terms of a transition from 'battlers' to 'aspirants'. But again – this shift is bigger and potentially more profound than what is usually alluded to in political debates.

In the past Australia has been criticised for not managing its prosperity well. Against the current run of strong growth, some have concluded that this criticism is no longer valid.² The BCA considers that, while Australia has become better at managing the good times as well as the bad, there are important exceptions and limits to such a conclusion. It is notable, for example, that:

- + Australia continues to run a significant current account deficit despite the commodities boom.
- + Export performance outside of resources remains poor.
- + Infrastructure bottlenecks are limiting activity.
- + We are failing to manage key resources such as water.
- + Significant pockets of entrenched community disadvantage remain, notwithstanding unprecedented growth.

Sustaining growth as the economy operates at close to full capacity means that the issues the Australian economy now faces are different in nature to past challenges. The focus now must be on raising the longer-term capacity for growth, in other words on enhancing the supply side of our economy. This presents new challenges for governments, which tend to favour demand-side management. Even in regard to issues such as water, governments seem to find it far easier to seek to constrain demand rather than invest in new supply, despite the complete inadequacy of the former in terms of better managing water over the long term.

Better managing and addressing supply-side issues requires governments to invest for future growth through:

- + The establishment and maintenance of a policy environment that supports and enables productivity, competitiveness and high levels of business investment; and
- + Greater effectiveness and efficiency in government activities, especially infrastructure planning and coordination.

These challenges are long-term, or intergenerational, in nature and require governments and policymakers to depart from the paradigm of short-term approaches and 'just-in-time' fixes and adopt a mindset that involves more strategic decision making.

To its credit, the federal government initiated just such an approach with its Intergenerational Report. That report addressed the long-term fiscal implications of an ageing population. It identified and quantified a clear fiscal 'gap', which in turn focused debate on the different ways in which Australia could respond.

The Intergenerational Report created an important policy discipline. This year, the government will update the report. This update will provide valuable information to inform policy development and help stimulate and broaden public debate on the key priorities for Australia's future.

To harness the potential created by Australia's new mindset, the BCA is calling on all governments to use the Intergenerational Report as a template to set out strategic frameworks for the effective management of key contributors to long-term growth and prosperity.

This submission outlines a comprehensive reform agenda for Australia. Effective implementation of such an agenda requires a long-term strategic vision, commitment and framework for reform. While many of the issues identified fall outside of the direct realm of fiscal policy, as noted above, budget decisions and settings must be anchored in a long-term strategy for growth and must complement and support this broader reform agenda. In an election year the temptation might be to pay less attention to this long-term discipline. But if growth and prosperity are to be sustained, strategic policy making needs to be a permanent endeavour and not sidelined or abandoned during election years.

Within the broader reform agenda outlined below, the BCA sees two key priorities for 2007:

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- + **A commitment to business tax reform consistent with ongoing business competitiveness and intergenerational fiscal requirements; and**
 - + **A demonstrated improvement in federal–state relations and the establishment of new policy infrastructure that provides the capacity for governments to anticipate and respond to current and future challenges in a cooperative, efficient and effective way.**
 - **Timely implementation of the Council of Australian Governments (COAG) commitments in respect of regulation, infrastructure and the new National Reform Agenda, and a resolution to the current crisis in water management, are necessary outcomes for 2007 in this context.**
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If growth and prosperity are to be sustained, strategic policy making needs to be a permanent endeavour and not sidelined or abandoned during election years

Recognition of the need for further business tax reform remains the outstanding issue in terms of the fundamental business reforms outlined by the BCA in its Locking in Prosperity reform agenda. Failure to achieve meaningful reform in this area will undermine the benefits of broader reforms and limit Australia's capacity to lay the foundations for passing on prosperity.

Likewise, it has become increasingly clear that a dysfunctional federal system, too often guided by parochial interests and short-term political aims, is undermining the capacity to achieve comprehensive reform and therefore growth and prosperity in Australia.

A commitment to addressing these issues and a clear framework and timeline for doing so should be articulated as part of the 2007–08 Budget.

SETTING THE BAR HIGHER

Some might reflect on Australia's recent economic performance from both a cyclical and structural perspective and conclude that our current performance is 'as good as it gets'.

Cyclically, we have benefited from an exceptionally strong and sustained recovery in global economic activity and high commodity prices. Both are expected to unwind, to some extent at least. The economy has moved relatively smoothly through different phases of activity – transitions that in the past had derailed growth. Nonetheless, a number of imbalances or risks have developed that need to be addressed (these are discussed further in Part 2 of this submission). Experience would suggest that correcting these imbalances will require a slowdown in activity.

On the structural side, the baby-boomers have now reached an age where the impact of their ageing is likely to soon be felt. The government's Intergenerational Report and work by the Productivity Commission have highlighted the likely impact of demographic trends. Dramatically slowing labour supply, an increase in the number of 'dependants' relative to taxpayers, and higher tax burdens are some of the areas of particular concern.

Add to these trends slower productivity growth as the benefits of past reforms dissipate and it is not surprising that policymakers have begun to condition the public to the idea that the days of four per cent growth are over (Exhibit 2).

EXHIBIT 2 Four per cent growth: a thing of the past?

'I think we will have to get used to seeing GDP growth rates starting with the numbers 2 or 3 rather than 3 or 4 for a time.'

Reserve Bank of Australia Governor Ian Macfarlane, in the opening statement to the House of Representatives Standing Committee on Economics, Finance and Public Administration, Sydney, 18 February 2005.

'It remains the case that our potential growth rate will be lower in the future because of the impact on 'population' and 'participation' of the demographic changes I have spoken about on several other occasions.'

Dr Ken Henry, Secretary to the Treasury, 'The fiscal and economic outlook', address to the Australian Business Economists, Sydney, 16 May 2006.

While the Australian economy has continued to grow, rates of growth have stepped down from those achieved in the 1990s. Over the past two years, average annual GDP growth has slowed to 2.7 per cent. This fact does not appear to have sounded many alarm bells.

A low-growth future is not an inevitability. We should set our sights higher and pursue a more aspirational goal for Australia's economy. We must guard against the complacency that typically accompanies periods of high growth and actively work to manage our economic prosperity so it lasts over the long term.

This requires a different mindset from governments and policymakers. In particular, it requires a strategic and proactive view of how Australia should best utilise its current strengths to pass on prosperity, supported by a clear roadmap for achieving that goal.

A CLEAR GOAL FOR SUCCESS

Over the past 15 years, Australia has climbed the OECD league table in terms of living standards (see Table 1) largely through the flow-on effects of reforms beginning in the 1980s that opened our domestic economy to global competition, and equipped business with the capacity to meet that competition as well as capture new markets overseas.

There is no reason why we should not aim to continue to achieve such success. While there is no shortage of debate on the need for reform, there is far less clarity regarding the outcomes sought. In pursuing a new round of reforms aimed at passing on prosperity, we can and should aim to be in the highest band of OECD countries in terms of living standards by 2012.

Some might argue that such a goal is unachievable. The BCA strongly disagrees. Since 1990, our ranking has climbed from 17th to 7th, underpinned by reforms that have made our economy more competitive globally.

To this end, in 2007 the BCA will map out a clear set of reform standards that must be supported if Australia is to lift its living standards into the top five band of the world's developed economies by 2012.

Ranking among the top five in the OECD in terms of living standards by 2012 is an achievable goal for Australia. Research conducted for the BCA by Access Economics shows that maintaining growth rates at around the rates achieved over the past decade, as opposed to accepting a decline in growth rates, will deliver such an outcome.³

Others might argue that such a goal is overly simplistic. The reality is, however, that sustaining future economic growth will provide additional opportunities and potentially, the means to pass on prosperity to future generations (see Exhibit 3).

EXHIBIT 3 The benefits of sustained strong growth

Continuing reform leading to strong growth over the next 20 years compared with a lower growth outcome (of 2.4 per cent) would, by 2024–25, result in:

- + Real per capita GDP being \$16,500 higher;
- + Real per capita wealth being \$74,000 higher; and
- + Commonwealth revenues being 9 per cent of GDP higher – a result that could be returned to taxpayers by reducing average personal tax rates by 30 per cent, or used to fund much of the Commonwealth's projected spending on health and education in 2024–25.

TABLE 1 GDP per capita – rankings of OECD countries

1980		1990		2005		2012 [^]	
1	Switzerland	1	Luxembourg	1	Luxembourg	1	Luxembourg
2	US	2	Switzerland	2	US	2	US
3	Luxembourg	3	US	3	Norway	3	Norway
4	Norway	4	Norway	4	Ireland	4	Ireland
5	Iceland	5	Iceland	5	Iceland	5	Australia
6	Germany*	6	Japan	6	Switzerland	6	Switzerland
7	Netherlands	7	Netherlands	7	Australia	7	Iceland
8	Canada	8	Denmark	8	Netherlands	8	Denmark
9	Belgium	9	France	9	Denmark	9	Austria
10	France	10	Belgium	10	Austria	10	Finland
11	Denmark	11	Canada	11	Canada	11	Netherlands
12	Sweden	12	Austria	12	Belgium	12	UK
13	Austria	13	Finland	13	UK	13	Japan
14	Australia	14	Sweden	14	Sweden	14	Sweden
15	Italy	15	Italy	15	Finland	15	Canada
16	Finland	16	Germany	16	France	16	Belgium
17	UK	17	Australia	17	Japan	17	France
18	Japan	18	UK	18	Germany	18	Italy
19	NZ	19	NZ	19	Italy	19	Germany
20	Spain	20	Spain	20	Spain	20	Spain
21	Greece	21	Ireland	21	NZ	21	Greece
22	Ireland	22	Czech Republic	22	Greece	22	Portugal
23	Hungary	23	Greece	23	South Korea		
24	Portugal	24	Portugal	24	Czech Republic		
25	Poland	25	Hungary	25	Portugal		
26	Mexico	26	Slovak Republic	26	Hungary		
27	South Korea	27	South Korea	27	Slovak Republic		
28	Turkey	28	Mexico	28	Poland		
n.a.	Slovak Republic	29	Poland	29	Mexico		
n.a.	Czech Republic	30	Turkey	30	Turkey		

* West Germany
[^] Projections were not done for all OECD countries

Note: The calculations were prepared by Access Economics and incorporated in BCA research released in August 2005, *Locking in or Losing Prosperity: Australia's Choice*. The calculations are based on long-term growth and population projections using the Groningen Growth and Development Centre and the Conference Board Total Economy www.ggdc.net and World Bank databases.

Australia's standing in the OECD: scope for improvement

To achieve a ranking within the top five countries in the OECD in terms of living standards by 2012 will require further reforms to respond to challenges that will otherwise weigh on growth and prosperity in the future, and to improve national performance and standing in terms of the underlying drivers of growth (including productivity and labour force participation). The reforms needed to achieve this goal are as important in their own right as the target itself, but are more likely to happen if we have a clearly articulated target to aspire to.

Choosing a target that benchmarks Australia against other successful economies also highlights the areas in which Australia needs to do better to remain competitive and grow strongly. These are discussed in more detail below.

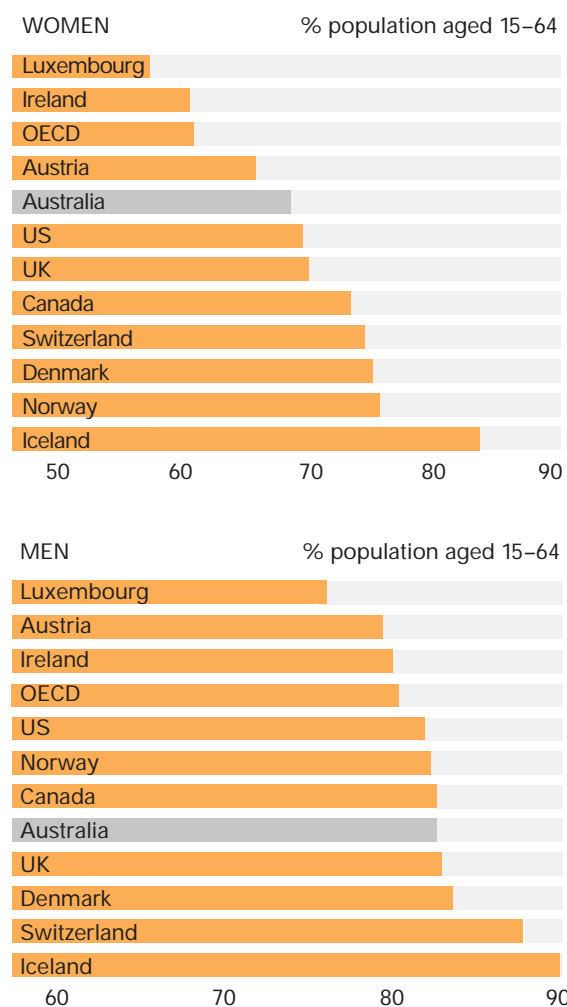
Participation

Australia's performance in terms of labour force participation rates has improved significantly, with participation rates rising steadily for males and females across virtually all age groups.⁴ Nevertheless, there is considerable scope for improvement.

Participation rates for men and women in Australia remain below those achieved in other OECD countries (Figure 1).

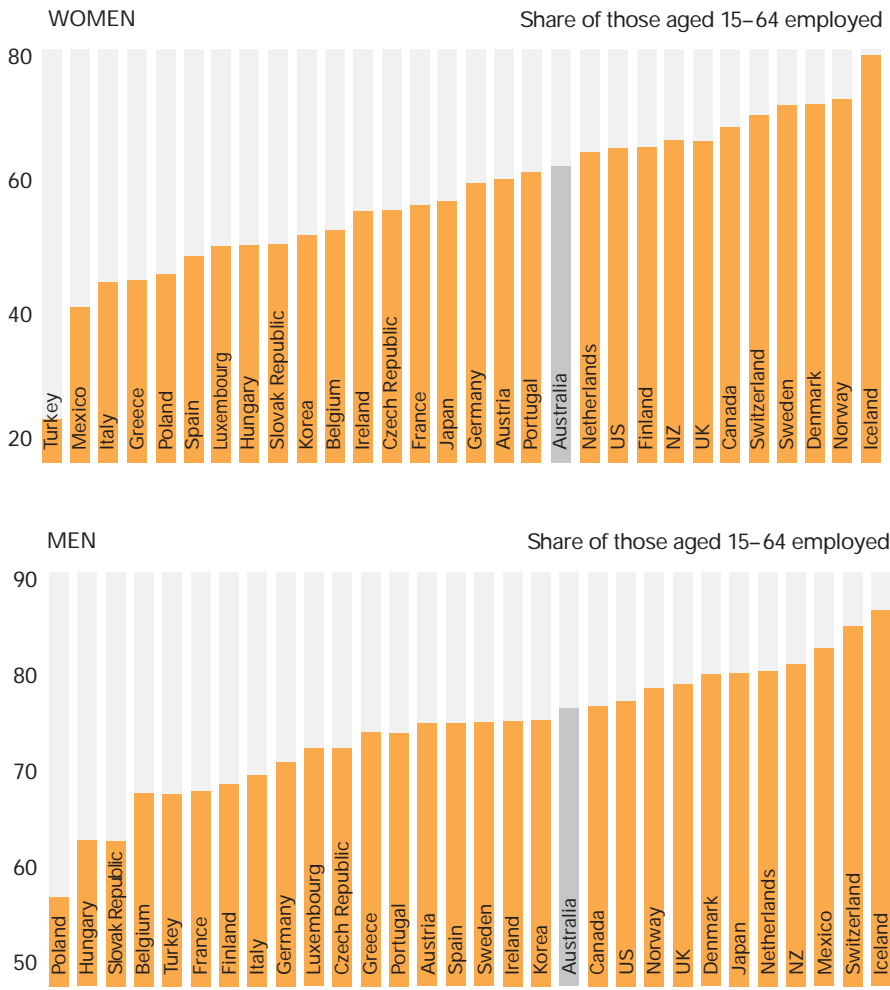
In addition, the share of people of working age in employment remains below many other OECD countries, notwithstanding the steady decline in unemployment in Australia (Figure 2).

FIGURE 1 Labour force participation rates



Source: OECD Factbook 2006.

FIGURE 2 Employment to population rates



Source: OECD Factbook 2006.

Productivity

Despite strong growth over the past decade, the level of labour productivity in Australia remains well below that achieved in other OECD countries, including most of those ranking higher in terms of GDP per capita (Figure 3). This means that workers in Australia are still not able to produce as much per hour worked as those in the United States, Ireland, the Netherlands, Sweden and others.

More worryingly, labour productivity growth has slowed sharply in Australia. This has been underpinned by slower growth in multifactor productivity, which, simply expressed, is how effectively we use and combine capital and labour in production (Figure 4).

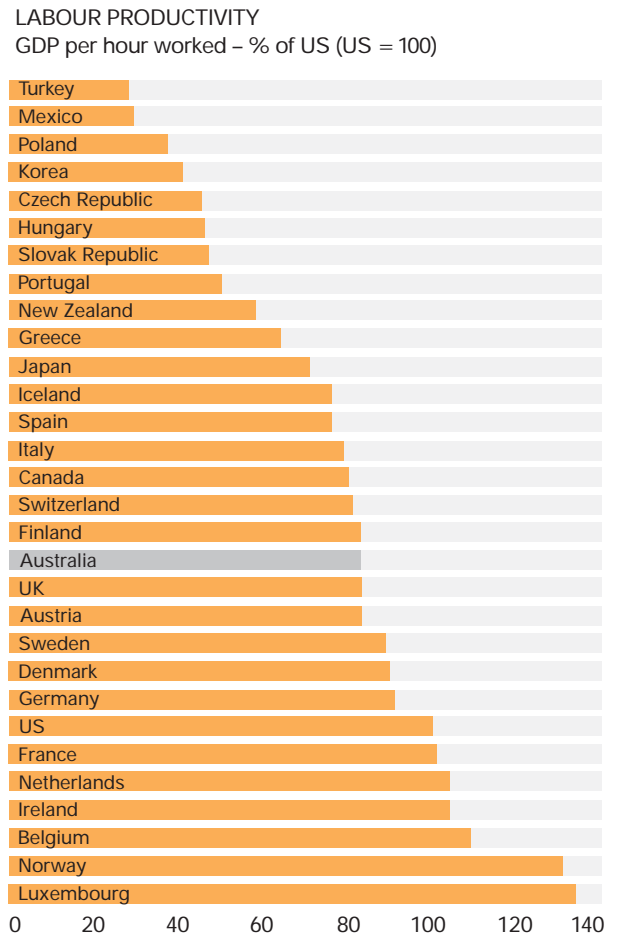
This deterioration in productivity performance is a very real concern. Strong productivity growth has underpinned past economic growth and prosperity and will become an increasingly important determinant of competitiveness, growth and living standards as the population ages and labour supply slows.

These comparisons serve as vivid reminders of the potential for Australia to do better.

In a competitive global market, how Australia compares with its peers in regard to these fundamental indicators reflects its ability to compete and in turn the ability to meet the expectations and aspirations of all Australians.

These comparisons also serve to remind us that we must continue to take account of how our economic peers and competitors are adapting their policies to sustain growth and competitiveness and the implications for policy settings in Australia.

FIGURE 3 Australian productivity lags

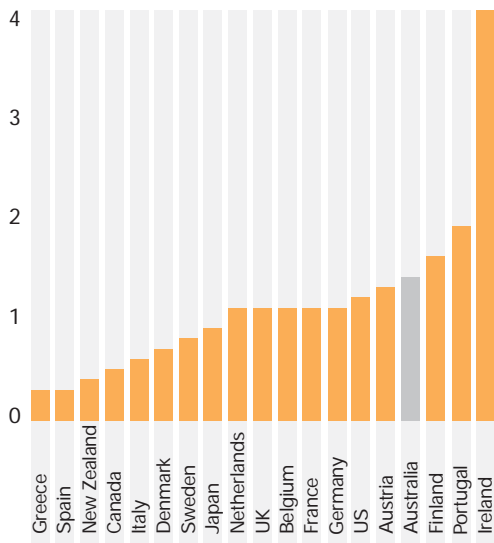


Source: OECD Factbook 2006.

FIGURE 4 Australia's multifactor productivity performance in perspective

1990s: Among the top performers in the OECD

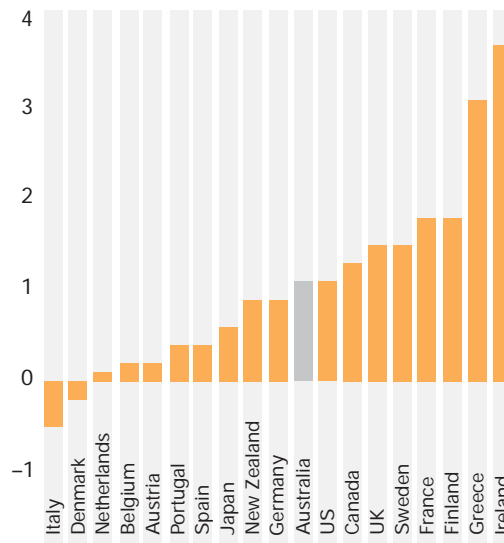
Average annual % change



Source: OECD Factbook 2006.

Early 2000s: Relative performance declines

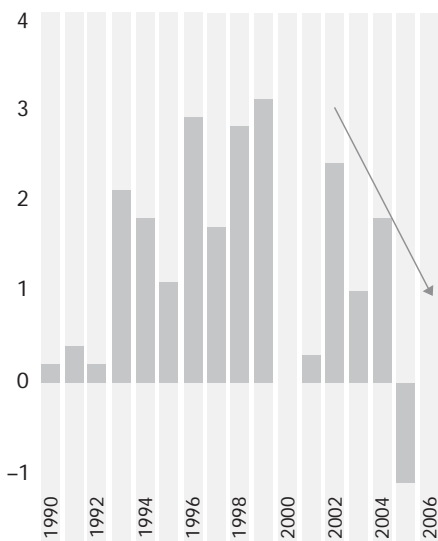
Average annual % change



Source: OECD Factbook 2006.

Most recently: Further deterioration

% change



Source: ABS 5204.0, *System of National Accounts 2005-06*, Table 22, 2006.

A CLEAR ROADMAP FOR PASSING ON PROSPERITY

If Australia is to sustain strong growth and improve its standing within the OECD as a means passing on prosperity, from an economic perspective we must:

- + Manage the cyclical imbalances that have emerged through a sustained rebalancing of economic activity and a greater reliance on exports as a key driver of growth; and
- + Lift the long-term productive capacity of the economy.

While the BCA considers that a stronger public consensus for sustaining economic growth as a driver of broader prosperity has emerged, it is important not to take this for granted. Even though more Australians are benefiting directly from economic growth and are more confident and aspirational in terms of economic prospects and opportunities, the ability to sustain a competitive policy environment and therefore a vibrant business sector and economy depends on maintaining a broad consensus for continued growth.

To this end, we must continue to ensure that as many people as possible are benefiting from growth, ideally directly through employment and investment. A strong consensus for growth also requires an understanding and appreciation of the role that business plays in delivering growth and prosperity.

From a policy perspective, therefore, sustaining strong economic growth requires:

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- + A world-class environment for business;
 - + The ability to make the most of new global opportunities and sources of competitive advantage; and
 - + A broadly-based community consensus for sustained growth.

These priorities are central to the BCA's agenda and work program.

A world-class environment for business

Never before has economic prosperity in Australia been more closely linked to the business sector and its performance.

Around 81 per cent of people employed have jobs in the private sector, compared to 73 per cent in 1990. Some 44 per cent of Australians own shares directly – implying a direct interest in the health and performance of listed companies – and 55 per cent own shares directly or indirectly (through superannuation funds).

In addition, corporate tax revenues have been the fastest growing revenue stream in recent years, providing around \$49 billion in revenue in 2005–06 alone. Growth in corporate tax revenues has helped to underwrite the ability of the federal government to fund tax cuts and spending initiatives.

Ensuring that the infrastructure, regulatory and tax environment supports and enables the ongoing productivity, competitiveness and growth of business should therefore be a fundamental goal, as it is one that directly and indirectly delivers benefits for all Australians.

Towards that end, policies adopted must promote the most efficient allocation and use of resources, avoid creating impediments to effective resource allocation, and support measured risk taking and innovation. Business must be able to respond quickly and effectively to changing preferences and market opportunities, new technologies and production processes.

Anti-competitive policies and regulatory barriers and burdens weigh on the ability to achieve such outcomes by:

- + Contributing to misallocations of resources (including through time spent on administration);
- + Increasing costs and inefficiencies;
- + Discouraging risk taking and innovation; and
- + Impeding the diffusion of knowledge and technology.

By seeking to address these issues, past reforms have contributed to a marked improvement in the efficiency of resource allocation and higher levels of productivity in Australia. However, the competitiveness of regulatory, infrastructure and tax systems in Australia has been eroded by a lack of policy discipline and the achievement of only incremental reform in the face of rapid technological change and intensified global competition.

Locking in prosperity agenda

These concerns underpinned the BCA's Locking in Prosperity agenda as announced during the first half of 2005, which consisted of comprehensive reform programs in taxation, business regulation, workplace relations and infrastructure policy. Research undertaken for the BCA has demonstrated that the reforms outlined in each of these areas would deliver improved productivity, stronger economic growth and wealth creation.

The BCA welcomes the progress and policy development made in the two years since its Locking in Prosperity agenda was launched as part of its 2005–06 Budget Submission.

Important reforms to workplace relations regulations have been announced and implemented. Over time, the benefits of these reforms will become very clear in terms of greater flexibility, higher workforce participation and improved productivity.

There have also been significant commitments in respect of regulation and infrastructure. For example, the establishment of an Office of Best Practice Regulation is positive, and the BCA welcomes such advances. However, the broader reforms committed to will have no impact until they are implemented. Until then the opportunity to enhance business performance, productivity and economic growth cannot be utilised. Delaying important policy reforms will make a significant difference to accumulated wealth and prosperity in the future.

The key outcomes the BCA will pursue during the next 12 months include timely and effective implementation of the policy commitments made, in particular:

- + Advancing the COAG-agreed National Reform Agenda (which includes a revitalised competition policy agenda and renewed focus on infrastructure);
- + Implementing the recommendations of the Banks Taskforce report quickly and effectively; and
- + Strengthening regulation-making processes in practice.

While these reforms must form a necessary backbone for sustaining growth and prosperity, there is unfinished business in respect of the BCA's Locking in Prosperity agenda, and two additional issues have emerged that potentially have a significant impact on business competitiveness in Australia.

Genuine business tax reform is unfinished business in Australia and needs to be added to the government's reform agenda.

With respect to new issues, the BCA's research into Australia's regulatory, tax, infrastructure and workplace relations frameworks has highlighted an important underlying issue: the need for a genuine common market in Australia. Secondly, there is a need for an appropriate response to the issue of climate change that deals with the risks in a way that recognises Australia's comparative advantages. This must involve the removal of inconsistent state policies and the development of a market response that will not disadvantage Australia.

Some of these issues fall outside of 'traditional' budget policies, but they all have a bearing on economic performance and therefore on budget settings and outcomes. Each is discussed further below.

Tax reform

The BCA has undertaken in-depth research into taxation, including studying the tax reform programs of competitor nations. Using this research and through monitoring of policy development over time, it is fair to say that the progress of tax reform has been of an incremental nature.

Despite the introduction of the GST and a series of personal tax cuts, the reliance on income tax remains broadly unchanged from a decade ago. Furthermore, despite the reforms to business taxation implemented in the late 1990s, the share of corporate income tax has risen sharply in recent years, which is of significant concern to the BCA.

In 2005–06, the corporate tax burden in Australia was around 6 per cent of GDP, close to the pre-Ralph Review level of 6.3 per cent. The latest internationally comparable figures for corporate taxation show that Australia has close to the highest corporate tax burden in the OECD. Revenue forecasts point to some slowing of corporate tax collections in future years, but not to an extent that will fundamentally reverse recent trends.

The BCA believes the total tax burden borne by business in Australia (taking account of federal and state taxes and taxes collected for governments) and the cost and complexity of the business tax system are poorly understood.

Business is underwriting tax collections to a far greater extent than many realise and in what is arguably a highly inefficient manner. The BCA's priority in the year ahead will be to shed further light on the total tax burden borne by business and the implications of the structure and magnitude of business taxation in Australia.

In the face of recent reforms aimed at lowering corporate tax burdens by many of Australia's economic peers – including Denmark, Germany, New Zealand, Singapore, and the Netherlands⁵ – and the generally lower level of business taxation that applies in many of the countries with which we are increasingly competing, the BCA considers Australia must look to structurally reform its taxation system.

In light of these trends and the impending fiscal pressures associated with population ageing, a major re-think of tax arrangements, including major sources of revenue as well as revenue sharing agreements, cannot be avoided indefinitely. The growing public calls and proposals for reform highlight the fact that others share this view.⁶

The case for a common market

As the BCA progressed its research on improving regulatory, workplace relations, infrastructure and taxation systems in Australia, it became clear that the problems and dysfunctions of the current system of federal–state relations now represent major barriers to future prosperity. In order to achieve significant reform, improvements in the operation of Australia's federal system of government are urgently required.

Two issues in particular stand out. First, there is evidence of growing costs in our federal system associated with duplication, inefficiencies and overlap across jurisdictions – costs that have recently been estimated to amount to \$1,100 per annum for each Australian household.⁷ Second, any hope of achieving genuine reform depends on far greater and deeper cooperation and coordination across all levels of government.

Unfortunately, the history of effective government cooperation in Australia is patchy at best. Recent developments in respect of workplace relations and efforts to establish a national system, which has seen state governments seeking to undermine the federal legislation however possible, do not bode well for those seeking reliable and effective cooperation in policy making.

While Australia has the national COAG process in place to progress these issues, in practice it is not possible to achieve the real progress needed when COAG meets only occasionally, for typically short consultations, and when the agenda is so often captured by parochial interests.

For business, the impact of poor federal–state relations manifests itself clearly through the absence of a common market. As competitive pressures have intensified, the BCA and its Members have become increasingly aware of the costs this brings. Businesses operating across jurisdictions face differing rules and regulations, individuals with recognised qualifications in one state can be unable to practise in others, and so on. In many areas of regulation Australia’s 20 million residents face greater duplication and overlap than Europe’s 457 million residents.

If Australia is to remain competitive this situation cannot prevail. As it is, Australia faces significant hurdles as a result of its distance from global markets.⁹ This is exacerbated by the geographical dispersion of our major domestic markets.

COAG has been given something of a new lease on life over the past year. This is a positive development. However, in order for business to have confidence that COAG can produce the desired results in a timely and ongoing way, COAG must deliver substantial progress against its current agenda by the end of 2007. This, in turn, will require the resources and commitment of state and federal governments.

In the meantime, the BCA will lead a more open and proactive debate about enhancing the effectiveness of Australia’s federal system.⁹ This will include articulation of the case for the fast-tracked introduction of a common market, including through the development of national business schemes, should COAG fail to make sufficient progress over the next 12 months.

Improving the operation of our federal system will not be easy, but the BCA considers that achieving such an outcome is capable of delivering the types of benefits to growth and productivity that flowed from the major reforms and deregulation undertaken throughout the 1980s.

Any hope of achieving genuine economic reform depends on far greater and deeper cooperation and coordination across all levels of government

Climate change

While recognising that there is a wide range of predictions regarding climate change and its impacts, the BCA believes it is necessary to take precautionary actions to avoid possible damage from climate change.

The BCA considers that climate change is an issue that requires a global response if we are to prevent the projected damaging effects on world economies. This global response should be multifaceted. There must continue to be a focus on the development and deployment of new, low-emissions technologies and technology transfer along with greater energy efficiency and substitution, as well as a global market mechanism.

The basis for a long-term solution to reducing carbon emissions is a market-driven global compact. It has to be global because climate does not acknowledge national boundaries, and to ensure a sustainable solution.

Against this background, the BCA welcomes the establishment of the federal government's Task Group on Emissions Trading as an important forum to discuss how Australia can participate in a global agreement on reducing carbon emissions without threatening our economic competitiveness or wellbeing, and what transition arrangements will be required at a national level to ensure this.

The BCA will be undertaking its own research into the guiding business and economic principles required to underpin a global agreement on reducing carbon emissions, and will release that work as soon as possible in the first half of 2007.

However, while Australia can take a leading role in developing a global response to climate change including finding technological solutions to reduce emissions, it should not act unilaterally in a way that disadvantages our competitive position or standards of living.

In the meantime, the BCA considers that the federal government should continue to assist and encourage business to find technological solutions to climate change.



New opportunities and competitive advantages

Australia, like most advanced economies, is facing increasingly intense competition from developing economies with abundant labour and low-cost structures. In the face of this competition, Australia's ability to compete will increasingly be defined by the ability of its businesses to add value in areas of demand. In this context, policies that create a competitive business environment are important, but policy debate and development also need to be informed by an understanding of new and emerging market opportunities and drivers of competitive advantage.

It is against this background that the BCA has focused more attention on the issues of innovation and trade and investment liberalisation, and is also turning its resources to promoting a better understanding of the importance of services to Australia's future competitiveness and prosperity.

Expanding our services economy

Historically, Australia's economic competitiveness and success has been built around manufacturing, mining and agriculture. These sectors have come to dominate public and policy debate, for example in the context of industry and trade policy.

While Australia's capacity to maintain competitiveness in manufacturing, agriculture and mining remains important, it is time to recognise that our economic success and prosperity are increasingly linked to the competitiveness of our services sector. Services industries dominate economic activity and employment in Australia, and are becoming increasingly important around the world and in global trade and investment flows.

Failure to recognise the importance of the services sector to current economic growth and prosperity means that we are likely to miss signs of weakness in these industries, and fail to make the most of opportunities for services growth. This, in turn, raises concerns about our ability to sustain strong growth and prosperity. The BCA considers that signs of limits on the competitiveness of, and therefore future growth prospects for, Australia's services industries have emerged.

Recent trends in the productivity performance of key services industries domestically raise concerns about the quality, effectiveness and competitiveness of services now and into the future. In addition, an examination of trends in services trade and investment flows shows our performance has been far from outstanding. Continued strength in global demand for resources and therefore commodity prices and the A\$ add a further dimension to the challenges for sustained competitiveness in services for Australia.

Policy development and design must better reflect the nature and characteristics of services industries and the drivers of competitiveness. This is not an argument in favour of a targeted 'services' industry policy. It is an argument in favour of ensuring that more traditional industries and activities do not come to dominate policy thinking and development to the detriment of services opportunities. It is also an argument for ensuring that there is a better understanding of the globalisation of services, including offshoring, and a more balanced commentary and approach to developments and opportunities related to services trade.

During the next 12 months the BCA will promote debate on services sector developments and opportunities and potential policy implications.

Innovation

In broad terms, innovation can be defined as the application of knowledge to create additional value and wealth. In this context, it is clear that Australia's capacity to innovate will be an increasingly important catalyst for sustaining economic growth, capitalising on future opportunities, and meeting the challenges presented by an increasingly connected and competitive global economy.

Innovation is about much more than invention. Through the application of knowledge and technology to create new products and services and to improve production processes, innovation allows Australia to increase its competitiveness, create high-quality jobs, and achieve greater value for what we make and export. Our capacity to innovate is directly linked to the knowledge, skills and broader capabilities of people at all levels.

Earlier this year the BCA released research which highlighted that the current framework for advancing innovation in Australia is too narrowly focused on science and technology policy and that a broader approach is needed. While the BCA recognises the important contribution that science and research make to innovation, it is just one of many sets of activities that can contribute to innovative outcomes.

More recently the BCA, together with the Society for Knowledge Economics, outlined the case for the establishment of a National Innovation Framework to address weaknesses in Australia's current innovation system. The framework identified five key priorities:

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- + Recognition of innovation as a critical national priority.
 - + Strengthening of the linkages and collaboration between all elements of the innovation system.
 - + Implementation of specific policy and investment measures to strengthen research networks and institutions.
 - + Development of a culture of innovation through strategic investment in education and skills and the further development of leadership and management skills in order to lift overall innovation capabilities.
 - + Continuation of microeconomic reforms to improve and sustain a business environment suitable for innovation.

The BCA calls on the federal government to lead and implement a National Innovation Framework and to fund the establishment of a new central body 'Innovation Australia' to take responsibility for providing whole-of-government policy coordination. Australia is too small a country and market to not prioritise and coordinate innovation policy on a national basis.

Skills

In response to international competitive pressures, businesses are looking for higher-level skills to drive innovation and growth.

Likewise, the attainment of skills is a key determinant of the employment and career prospects of individuals. Those who obtain a Year 12 qualification or its vocational equivalent can look forward to better career prospects, higher wages and a lower likelihood of being unemployed. The attainment of post-Year 12 qualifications further increases job prospects and earnings capacity.

The BCA considers that the following policy priorities are necessary to lift Australia's skills base:

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- + Increasing the overall participation of young people in education through to the completion of Year 12 or the training equivalent of Year 12.¹⁰
 - + Ensuring that a high-quality education is provided to all students.
 - The role of teachers is vital, and greater attention should be paid to policies that support teachers in their professional and career development.
 - A policy requiring the immediate grading (or processing) and publication of all national school literacy and numeracy test results compared against national standards should be implemented as a matter of priority.
 - + Increasing participation in post-Year 12 education and training (that is, increased university and vocational education and training participation).
 - + Ensuring that the education and training system provides students with general foundation skills or employability skills.
 - Employability skills include the ability to work as a member of a team, problem solving skills, the ability to effectively communicate ideas and information, leadership, planning and organisational skills.
 - + Further supporting skills development and the attainment of higher-level skills by existing workers.
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Employability skills have long been recognised by many in business as a desirable addition to technical qualifications. In recent times they have come to be even more highly valued.

People with both strong technical skills and general skills are capable of contributing to, and driving innovation within an organisation.

The BCA also advocates lifting the number of students doing maths, science and technology subjects in Years 11 and 12. Achieving this objective will require encouraging the interest of students from a much younger age as well as supporting teachers in these disciplines.

Skills policies should be based on the emerging and future requirements of employers to ensure the availability of people with the skills required to remain competitive. In doing so, such policies will equip individuals with the skills that will enable them to seek and obtain ongoing employment including through the capacity to adapt to changing workplace environments.

Improved opportunities in and from global markets

If Australia is to sustain strong growth in coming decades it must be able to take full advantage of the opportunities made available by more open global markets and the freer movement of goods, services, capital and people. Recently, Australia has not made the most of global opportunities and its share of global export markets, in terms of both goods and services, has been declining.

The ability of Australian businesses to be competitive in global markets is of paramount importance, but so is improved access to these markets.

Against the backdrop of the stalling of the World Trade Organization (WTO) Doha trade talks, it is essential that Australia explores other avenues through which to promote and achieve liberalisation. In addition to pursuing comprehensive free trade agreements, Australia should look to use its leadership within other organisations and groupings such as the G-20 and APEC to build momentum for further liberalisation. More effective services liberalisation must be a priority at all levels of negotiation.

A strong consensus for sustained growth

The ability to sustain reforms necessary to support ongoing growth depends on a strong public consensus that a vibrant business sector and strong economic growth deliver the outcomes desired by the broader community.

To the extent that people are not benefiting from growth or not are perceived to be benefiting sufficiently, this undermines a preparedness to support further reforms. It is important to ensure that as many people as possible are benefiting from growth, ideally directly through employment and investment. Where that is not possible, appropriate safety nets are required. Importantly, the more successful efforts are to increase participation, the smaller will be the call on income support and broader safety net spending.

A strong consensus for sustained growth also requires an understanding and appreciation of the role that business plays in delivering growth and prosperity. Given the still relatively poor standing of business in the community, the BCA recognises that it needs to do more to build a better understanding of the benefits that a strong and competitive business sector bring to the wider community.

Lifting participation and engagement, and building a better understanding of the role and contribution of business in the economy and community, represent two important areas of work for the BCA over the coming year.

Locking in higher and broader rates of participation

It is now well recognised that increasing workforce participation rates can have an important effect on stemming the impact of population ageing on labour supply in Australia.

While marked improvements in workforce participation rates have been achieved, there is scope to increase participation further (as highlighted by the OECD comparisons above). This is underscored by the fact that, in addition to the approximately 500,000 people unemployed, according to the ABS, around one in three Australians aged over 15 years (that is, around 5.5 million people) are not in the labour force (that is, neither working or looking for work). Around 21 per cent of those not in the labour force – that is, 1.2 million people – want to work.¹¹

While there is a direct economic imperative to increasing participation rates – as this will lessen the economic impact of population ageing – there is an additional pressing reason to lift participation. Paid employment enables people to benefit directly from economic growth and to share in the prosperity delivered by sustained growth. In contrast, the inability to sustain paid employment is a key predictor of poverty and disadvantage.¹²

Notwithstanding a very strong labour market in Australia, there are entrenched patterns of relatively low workforce participation and employment rates among a range of groups including Indigenous Australians, individuals with caring responsibilities, individuals with disabilities, the low-skilled generally, and the mature-aged.



Bolder strategic action, together with a renewed partnership across business, government and key stakeholders, is called for if we are to extend prosperity to those who are still missing out

For example, based on the latest publicly available data (for 2002), labour force participation rates for Indigenous people aged 18 to 64 are around 15 percentage points lower than for all Australians, while the unemployment rate is markedly higher.¹³

After 15 years of sustained growth and at record low rates of unemployment, we should be doing better on this front. Failure to do so means we run the risk of losing support for a pro-growth reform agenda.

The BCA recognises that the federal government has sought to address this issue through a number of reforms and investments. It is not clear that these measures are having enough of an impact, and further attention and action is needed in areas such as the interaction of tax and welfare policies, the cost and availability of care for dependants, and skills development.

Business recognises that it must also play an important role by addressing issues of job design and workplace flexibility that can contribute to creating new opportunities.

Bolder strategic action, together with a renewed partnership across business, government and key stakeholders, is called for if we are to extend prosperity to those who are still missing out.

Business investment in the community

As noted earlier, never before has broader prosperity been so closely linked to the health and performance of the business sector. Despite this fact, the standing of business remains low in the community. This makes it all too easy for governments to excessively regulate business activity across a range of fronts, to the detriment of the broader economy and community.

More needs to be done to enhance understanding of the benefits of a vibrant business sector that flow directly through employment and investment, and indirectly including through business investment in the community. In addition to continuing to articulate the direct economic benefits of a robust business sector, during the next 12 months the BCA will be seeking to generate a greater understanding of the level and scope of corporate social involvement in the community. A more considered view of business should enable and support a more considered approach to policy making.

CONCLUSION

Recent economic experience and conventional economic wisdom suggest Australia faces a future of slower economic growth.

This is not a future Australia should settle for. We need a bolder aspiration for our economy.

Australia's policymakers should challenge conventional wisdom and set their sights on something greater:

By 2012, Australia should be among the top five countries in the OECD in terms of per capita GDP.

This is not an unrealistic dream. Australia has been there before, and can get there again.

Achieving this goal requires policymakers to commit to a clearly articulated vision and a series of reforms that will sustain higher growth as a means of locking in and passing on the prosperity to which we have become accustomed.

Achieving this goal requires reforms that establish and maintain:

- + A world-class environment for business;
- + The capacity to make the most of new opportunities and sources of competitive advantage; and
- + A strong community consensus in favour of sustained growth.

The BCA believes the comprehensive and detailed policy agenda outlined in this submission will enable Australia to achieve that success. Specifically, this agenda includes:

- + The implementation of key reform programs already committed to in business regulation and infrastructure to help lock in prosperity;

- + The development of a comprehensive and genuine program of taxation reform, particularly in relation to business taxation;
- + Reforms to Australia's federal system, including the development of a common market for Australia; and
- + Contributing to the development of an effective global response to the challenge of climate change.

This is the agenda the BCA will pursue throughout the coming year. As part of this process, the BCA will release a set of economic reform standards that must be met if Australia is to achieve a ranking within the top five in the OECD in terms of living standards by 2012.

Importantly, the BCA also intends to promote a broader debate about how Australia can sustain a commitment to reform that will cement in place its prosperity and competitiveness while allowing us to take advantage of global opportunities, even as new competitors and challengers emerge.

This debate will focus on making the most of new opportunities through innovation, a greater focus on the competitiveness of our services sector, and increasing global market opportunities, and will be underpinned by efforts to build and maintain a strong consensus in favour of sustained growth.

Further debate will be vital to ensuring Australia's prosperity will benefit all Australians.

The federal government should use the 2007–08 Budget to map out a strategic plan for long-term reform and sustained growth.

Any new tax or spending initiatives should be consistent with this plan.