

The Business Council of Australia (BCA) represents the Chief Executives of Australia's 100 leading companies. The BCA's objective is to develop and advocate, on behalf of its Members, public policy reform that positions Australia as a strong and vibrant economy and society. The companies that our Members lead represent a significant share of Australia's domestic and overseas business activity. Therefore, they have a significant interest in the Federal Budget, and more broadly, the relationship between Government policy and the direction and scope of economic reform. The BCA's Budget Submission is divided into two sections. The first deals with recent Government initiatives and commitments that are likely to be the focus of the 2005-06 Budget deliberations, as well as the economic outlook and Budget forecasts. These issues are predominantly short-to-medium term in nature. The second section focuses directly on issues related to Australia's longer-term growth and prosperity – and the pivotal choices the BCA believes the economy is facing. Australia is experiencing one of its most prosperous periods for several decades. This has delivered economic well-being and high living standards to more and more Australians. Nevertheless, behind this comfortable position lie a number of vulnerabilities. Serious constraints and imbalances are emerging within the economy that, in the absence of reform in key areas, will slow growth, limit opportunities and undermine the economy's capacity to deal with longer-term challenges. The challenges of population ageing, and ever-increasing competition from global markets, are but two examples. Economic reform by successive Governments over the last two decades has substantially contributed to our current prosperity. We highlight these reforms, and their benefits, in this Submission. They point to the fact that continual reform, while often difficult to implement, is directly related to a nation's ongoing economic well-being. The BCA's central message is this: Australia must act now to make further fundamental reforms to lock in its current prosperity and create the conditions for sustainable growth over the long term. To help achieve this goal, the BCA is proposing an integrated agenda for reform in four areas: tax, competition, regulation and infrastructure development. Each will play a major role in determining the future of Australia's future, and no one government on its own can deliver the answer. Only a combination of these reforms can maximise Australia's economic standing in the long run. The BCA will be submitting specific policy analyses and recommendations for each of these areas over the next three months. Together they will constitute a far-reaching agenda for long-term reform. The primary case for reform contained in this Submission, is the first step in opening the public debate on how Australia can take charge of its economic destiny, rather than letting prosperity and living standards slide. Within this context, the BCA urges that the Federal Budget avoids measures that might be associated with the economic instability in the rest of the world, and instead focuses on the long-term growth. The underlying theme of the BCA's Budget Submission is that the economic policies since the last election have done well for the last decade has been remarkably robust. The BCA is proud to note that the recent composition of economic growth has been driven by a number of factors that are not sustainable over the long term. In fact, the BCA's four key areas of reform are a direct result of the BCA's belief that the current economic growth is not sustainable and strong consumer confidence in continued growth, has been coupled with an economy that is reaching capacity constraints. The result is a set of economic imbalances, including a large current account deficit, which have increased the economy's susceptibility to a sudden correction of below-par growth. In order to maintain our consistent economic growth based on debt-fuelled consumer spending to grow the process of change is already underway with housing investment in the next period. Soft retail spending in the second half of 2004 consumption. Business investment has also recorded strong growth. Given strong profits, low inflation and high levels of

# Action Plan for Future Prosperity

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2005-06

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# Introduction

The Business Council of Australia (BCA) represents the Chief Executives of Australia's 100 leading companies. The BCA's objective is to develop and advocate, on behalf of its Members, public policy reform that positions Australia as a strong and vibrant economy and society. The companies that our Members lead represent a significant share of Australia's domestic and overseas business activity. Therefore, they have a significant interest in the Federal Budget, and more broadly, the relationship between Government policy and the direction and scope of economic reform.

The BCA's Budget Submission is divided into two sections. The first deals with recent Government initiatives and commitments that are likely to be the focus of the 2005-06 Budget deliberations, as well as the economic outlook and Budget forecasts. These issues are predominantly short-to-medium term in nature.

Constraints and imbalances are emerging that, in the absence of reform in key areas of the economy, will slow growth, limit opportunities and undermine the economy's capacity to deal with longer-term challenges.

The second section focuses directly on issues related to Australia's longer-term growth and prosperity – and the pivotal choices the BCA believes the economy is facing.

Australia is experiencing one of its most prosperous periods for several decades. This has delivered economic well-being and high living standards to more and more Australians. Nevertheless, behind this comfortable position lie a number of

vulnerabilities. Serious constraints and imbalances are emerging within the economy that, in the absence of reform in key areas, will slow growth, limit opportunities and undermine the economy's capacity to deal with longer-term challenges. The challenges of population ageing, and ever-increasing competition from global markets, are but two examples.

Economic reform by successive Governments over the last two decades has substantially contributed to our current prosperity. We highlight these reforms, and their benefits, in this Submission. They point to the fact that continual reform, while often difficult to implement, is directly related to a nation's ongoing economic well-being.

The BCA's central message is this: Australia must act now to make further fundamental reforms to lock in its current prosperity and create the conditions for sustainable growth over the long term.

To help achieve this goal, the BCA is proposing an integrated agenda for action focused on four areas – workplace relations, taxation, regulation and infrastructure development. Each will play a major role in determining the rate of Australia's future growth; however each on its own cannot deliver the answer. Only a combination of these reforms can maximise Australia's economic standing in the long run.

The BCA will be submitting specific policy analyses and recommendations for each of these areas over the next three months. Together they will constitute a far-reaching agenda for long-term reform. The primary case for reform, contained in this Submission, is the first step in hastening the public debate on how Australia can take charge of its economic destiny rather than letting prosperity and living standards slide. Within this context, the BCA urges that the Federal Budget avoids measures that might unreasonably restrict the Government's ability to implement the sorts of reforms required for sustainable economic growth.

## 1.1 Economic and Budget Outlook

The underlying theme in the BCA's Budget Submission is that while the economic performance of the Australian economy over the last decade has been remarkably robust, the BCA is concerned that the recent composition of economic growth is based on drivers that are not sustainable over the longer term.

In the last three to four years, strong domestic demand fed by beneficial terms of trade, the housing price boom and strong consumer confidence in continued growth, has been coupled with an economy that is reaching capacity constraints. The result is a set of economic imbalances, including a large current account deficit, which have increased the economy's susceptibility to a sudden correction of below-par growth.

In order to maintain our consistent economic performance over the next 12 to 24 months and beyond, an adjustment from growth based on debt-fuelled consumer spending to growth based on business investment and external demand is required.

To an extent, this process of change is already underway with housing investment and house prices cooling in 2004 – a trend that is expected to continue over the next period. Soft retail spending in the second half of 2004 indicates that this slowing in the housing market is beginning to feed through to weaker consumption. Business investment has also recorded strong recent growth – rising 1.2 per cent in Q3 2004 to be 8.1 per cent higher through the year. Given strong profits, low inflation and high levels of capacity use, the outlook for business investment remains favourable.

An orderly shift in the composition of growth is not a fait accompli – for example, despite strong world growth over the last year, Australia's export recovery has been subdued. As a result, Government policy makers must ensure that the rebalancing of economic growth is smooth and has a minimal effect on long-term growth.

Such a transition will require the implementation of appropriate macroeconomic policies as well as further microeconomic reforms. This is especially important given that many of the risks to the economic outlook are on the downside. A sharper than expected slowdown in the housing market could have a significantly negative impact on consumption. Meanwhile, the possibilities of renewed oil price shocks in a fragile world geo-political environment and/or a disorderly \$US depreciation pose a risk to the outlook of a strong world economy.

These considerations have important implications for the Budget outlook. Though economic growth is expected to moderate only slightly over the coming year, downside risks to this outlook point to the need for fiscal discipline to prevent inefficient expenditure, and flexibility in policy should these risks come to bear.

While recent experience with the Budget outlook suggests that the economy will provide positive revenue upsides, this is not always the case and downside risks to Budget forecasts can and do eventuate.

## 1.2 Future Fund

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The BCA supports initiatives to ensure sustainable Government finances, particularly given the future fiscal implications of an ageing population. The announced establishment of a Future Fund to fully fund the Government's superannuation liabilities by 2020 is an important step in maintaining a sustainable balance sheet.

However, more information on the operation of the Future Fund is required, preferably before the release of the 2005-06 Budget, including information on the detailed mechanics of the Future Fund. Timely information on issues such as how the Fund will accumulate and draw down assets, the process of outsourcing of funds management, and the investment objectives and mandate of the Fund will be important given the Fund's expected start date of 2005-06.

In this respect, the BCA considers that the financial risk guidelines of the Fund (for example, in relation to diversification, risk and foreign exchange exposure) should be determined by independent asset consultants. This advice should be guided by Government directives to maximise returns and minimise market disruption in the investment of funds.

Furthermore, the BCA would like the 2005-06 Budget to further articulate how the operation of the Future Fund interacts with the medium-term fiscal strategy of the Government. For example, such an assessment could address issues like the medium-term Government balance sheet implications of investing year-to-year surpluses in the Future Fund while still achieving the medium-term objective of Budget balance over the economic cycle.

## 1.3 Election Commitments

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The BCA expects that a key focus of the 2005-06 Budget will be on implementation and funding of the Government's Election commitments. Many of these commitments are not directly related to the BCA's agenda and will not directly impact our Members. Nonetheless, it is important that these policy commitments – many of which have been made at only a high level – are clearly articulated in the Budget and implemented as effectively as possible.

In terms of specific issues, the BCA acknowledges the Government's support for trade skills as evidenced by the announcement of support for increasing apprenticeships. The Government's focus on literacy is also significant. That said, the BCA considers that there is still a need for greater recognition of the importance of comprehensive ongoing skilling of workers to achieve long-term participation in the workforce, particularly in the context of changing business demands for skills, and population ageing. In addition, the BCA believes that Government programs to address school leaving could be more effectively targeted to individuals at risk of leaving school early with articulated action plans to address their needs.

The BCA commends the Government's attention to issues of infrastructure and natural resource management. However, the task in these areas is larger than the measures announced to date. It will be important to ensure that recent initiatives are consistent with and support further progress and policy development in these important areas. A comprehensive ongoing strategy involving all tiers of Government to better manage Australia's physical and natural infrastructure is required and will be a key focus of the BCA's work in coming months.

# The Case for Action

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Australia is experiencing one of its most prosperous periods for several decades. For many Australian businesses, workers and families, the economy has never performed better or more reliably. Profitability is high, unemployment and inflation are low, income growth is strong and asset prices are rising.

Our current position has allowed Australia to respond quickly and effectively to unforeseen events. Australia's recent response to the humanitarian crisis resulting from the Asian tsunami disaster is a case in point. It underlines the nation's strong capacity to provide economic support and leadership to the region as a result of high levels of prosperity and security. This begs the question: why propose or advocate changes to an economy that is running so well?

The BCA represents the Chief Executives of many of Australia's most successful large enterprises. Collectively, the companies they run account for more than \$338 billion in revenues a year, over a third of Australia's exports, and are responsible for the employment of nearly 1 million Australians directly and many more indirectly through the businesses that supply them.

There is a growing view among experts and commentators that the process of tackling these emerging impediments needs to start now if we are to lock in our outstanding economic success for the long term.

Our Members are concerned that beneath the surface of prosperity and continuing economic expansion there are a number of blockages and imbalances which are emerging. Left unaddressed, they are likely to become major roadblocks to future prosperity and growth. They include:

- a tax system that discourages people from entering the workforce, distorts business and investment decision-making, and impacts on our ability to attract and retain investment and skilled labour;
- growing gaps and inefficiencies in our transport, energy and water systems;
- an increasing tangle of red tape that is placing real limits on business innovation, entrepreneurship and investment;
- a system of labour market regulation that is complex and inhibits job creation, skill formation and flexibility; and
- a system of Federal-State relations that is complicating almost every aspect of policy-making, inhibiting transparency, increasing costs and reducing accountability and effective decision-making.

Echoing the concerns of the BCA and its Members, there is a growing view among experts and commentators that the process of tackling these emerging impediments needs to start now if we are to lock in our outstanding economic success for the long term.

With inflation and unemployment largely under control, Australia is well placed to find new ways to make our economy more productive to meet future challenges and demands, particularly associated with population ageing and an increasingly competitive global market.

The Federal Government has undertaken a number of notable actions in addressing these future challenges. They include strong leadership in securing bilateral trade agreements with key trading partners which will help position Australia in major markets over the long term. Reforms to Australia's competition laws, higher education structures, as well as reforms to personal, business and international tax arrangements have all played a major role in Australia achieving its current strong economic and fiscal position.

Comprehensive, not piecemeal, reform is required if we are to live up to our expectations and potential.

A carefully considered action plan, which builds on our strengths and successes, will give Australia the scope to grow and prosper in the long term. At the same time, it will help to avoid the prospect of sharp downturns that have plagued countries, like Japan, that have failed to sustain reform momentum.

The BCA has identified four key areas where there is an opportunity to implement change that will deliver the prosperity that Australians want and have come to expect for themselves well into the future.

They are:

- WORKPLACE RELATIONS
- TAXATION
- REGULATION
- INFRASTRUCTURE

Over the next six months, the BCA will actively promote a major public debate on these issues to foster a greater understanding and awareness of why these areas are important for Australia's future growth, and what changes are needed so that Australia can achieve its full potential in the long term.

The current reforms in policy areas such as education, training and trade must continue in parallel with a reinvigorated reform agenda in the areas noted above.

The BCA will continue to play a central role in ongoing reforms in these areas, which are important in their own right but also because they interact with and enable progress elsewhere.

Education, training and skill formation are the cornerstone to sustaining productivity growth, enabling ongoing workforce participation, and supporting a more efficient and competitive economy. Improving access to global markets and investment exposes business to new ideas and opportunities, that in turn supports innovation and competitiveness. This underscores a key theme for the BCA – comprehensive, not piecemeal, reform is required if we are to live up to our expectations and potential.

## 2.1 The Benefits of Growth

Sustained strong economic, employment and profit growth against the backdrop of low and stable inflation and interest rates have delivered improved wealth and prosperity for the majority of Australians.

The BCA's overriding objective is to maintain and build on this prosperity. This can only be achieved through a policy agenda that continues to support enhanced competitiveness and improved productivity. A strong, dynamic and competitive business sector is needed to provide the foundations for strong sustainable growth through job creation and income growth, investment, and the provision of the goods and services that maintain and improve living standards. This in turn leads to an increasing source of tax revenues needed to fund public services such as health and education and help for those not able to benefit directly from our economic success.

The BCA's policy objective is to raise Australia's future rate of sustainable economic growth.

In short, the BCA's policy objective is to raise Australia's future rate of sustainable economic growth. Internal and external pressures have now made this goal an absolute imperative.

Some will debate the merits of the BCA's focus on sustaining strong economic growth – arguing for example that higher per capita income is too narrow a definition of prosperity or standards of living. The BCA considers, however, that sustainable business and economic growth will deliver the resources that will enable society to address and invest in wider social and environmental improvement.

While not often discussed by those critical of the pursuit of stronger economic growth, it is important to acknowledge that a future of low or stagnant economic and business growth presents its own challenges for Australia, including:

- how to financially support an ageing population that itself is increasingly dependent on the returns of private business to fund its retirement;
- higher levels of unemployment than would otherwise be the case;
- supporting investment in new technologies, which in turn can enhance living standards; and
- how to support the environment.

There are choices associated with both a high or low growth future for Australia.

The challenge for Australia is to reach the right balance – that is, to achieve a level of economic growth that can be sustained, quite literally, for decades and which positions Australia as the best place to live, work, learn and do business.

The BCA is undertaking an analysis that will look at the outcomes for Australian society from varying growth paths in the future. In particular, this analysis will examine the implications for Australia arising from sustained growth of 2 per cent a year, compared with 4 per cent a year over the next 20 years. The initial findings, which will be released by the BCA in the coming months, will highlight the costs to Australia of growing slowly, in terms of jobs, investment and living standards as well as the challenges and opportunities of a higher growth scenario.

## 2.2 The Path to Success

Over the last decade the Australian economy has grown at a remarkably strong and consistent pace. From 1994 to 2003 annual GDP growth averaged 3.9 per cent. The rate of growth has not only been extraordinarily strong but also consistent. Australia has recorded only one quarter of negative growth over this period, while the lowest annual growth rate recorded during that period was 1.5 per cent.

This performance is even more impressive given that it was achieved despite major international shocks such as the Asian financial crisis of the late 1990s, the global slowdown induced by the tech-bust of the early 2000s, terrorism, the war in Iraq, and the SARS epidemic. As a result, many have labelled Australia the 'miracle' economy.

As much as we might welcome the 'miracle economy' tag, it is misleading and reinforces the complacency associated with the 'lucky country' mantra. Our recent success has

had little to do with miracles or luck, but a lot to do with hard work and reform.

Until the early 1980s, Australia's economy was characterised by high tariffs, which stifled competitiveness and the export potential of key industries; an overly-regulated banking and financial system that constrained investment;

and inflexible workplace arrangements that gave rise to high levels of industrial conflict and less than competitive levels of productivity.

Responding to the pressing issues of high inflation, record unemployment, declining living standards and a growing sense of economic malaise, Australia worked to put in place a series of policy reforms that addressed these problems (see Table 1, page 10 for a chronology of key reforms).

These reforms focused on increasing openness to international trade and investment, deregulation and enhancing competition in domestic markets. Such reforms have been important in delivering one-off increases in the level of productivity by improving the allocation of labour and capital throughout the economy; ensuring greater flexibility in the use of resources; and encouraging greater efficiency through competitive pressures. They have also fostered an improved culture of dynamism and innovativeness that is likely to have increased the ongoing rate of productivity growth.<sup>1</sup>

Australia's recent success has had little to do with miracles or luck, but a lot to do with hard work and reform.

<sup>1</sup> There is strong agreement that past economic reforms, implemented largely from the mid 1980s to late 1990s, have played a central role in Australia's recent productivity performance. See Productivity Commission (1999) *Microeconomic Reforms and Australian Productivity: Exploring the Links*; Commission Research Paper; Bean, C. (2000) 'The Australian Economic Miracle,' in D. Gruen and S. Shrestha (eds), *The Australian Economy in the 1990s*, Reserve Bank of Australia; Parham, D (2002) 'Microeconomic Reforms and the Revival in Australia's Growth in Productivity and Living Standards,' *Conference of Economists*, Adelaide, October 2002; Parham, D (2004) 'Sources of Australia's Productivity Revival,' *The Economic Record*, 80 (249), 239-257.

## 2.2 The Path to Success

Table 1 ECONOMIC REFORM – THE LAST 30 YEARS

### Industry Assistance (including Tariff Reform)

- Major tariff reductions in 1973 and 1977, as well as in the 1988 May Economic Statement and the 1991 Building a Competitive Australia Statement
- Implementation of a number of industry restructuring plans over the period in sectors such as motor vehicles; textiles, clothing and footwear (TCF); steel; agriculture; and ships

### Financial Sector Reform

- Deregulation of controls on financial institution assets and interest rates from 1980 to 1986
- Removal of controls on international capital flows from 1983 to 1993
- Reforms to the prudential and regulatory systems of the finance sector following the recommendations of the Wallis Inquiry Report in 1997

### Labour Market Reform

- Implementation and amendment of the Commonwealth's Industrial Relations Act 1988
- Introduction of the Workplace Relations Act 1996

### Taxation Reform

- Reforms implemented following the 1985 National Tax Summit
- Various fine-tuning reforms throughout the 1990s
- Implementation of A New Tax System (ANTS) in 2000

### Competition Policy and Business Reform

- Implementation of various competition-related policies over the period such as airline and telecommunications reform beginning in 1990, and the Government Business Enterprise (GBE) reforms announced in the 1988 May Economic Statement
- The application of the Commonwealth National Competition Policy Reform Act 1995
- The Corporations Law Economic Reform Program (CLERP) since 1997

### Skill Formation

- Establishment of a national system for Vocational Education and Training (VET) in 1992

Taking charge of our destiny is preferable to letting prosperity and living standards slide.

The result has been an Australian economy freed to become

more competitive and more dynamic, in turn providing it with the capacity to build and extend into new markets. These reforms functioned as ‘stepping stones’ on the path to success, allowing Australia to arrive at its current level of growth.

The story of Australia’s strong growth over the past decade has been the story of its impressive productivity growth. This performance has not been matched in recent Australian economic history. Labour productivity in the last complete productivity cycle (1993-94 to 1998-99) grew at an annual rate of 3.2 per cent, compared with 2.0 per cent in the previous cycle, and stronger than even the average growth rates achieved in the ‘golden age’ from the 1950s to mid 1970s.<sup>2</sup>

Australia’s productivity performance has been particularly impressive by international standards. From 1990 to 2003 labour productivity in Australia grew at an average annual rate of 2.3 per cent, compared to Germany, France, and the much-acclaimed US economy whose productivity growth over the period averaged around 2 per cent.

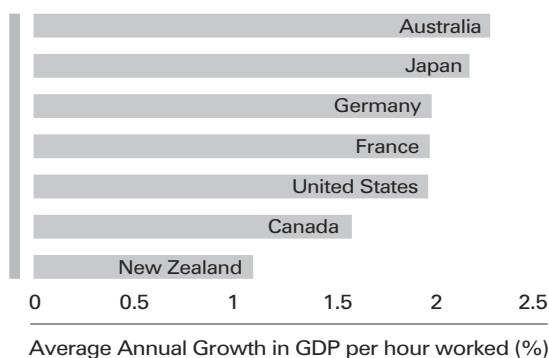
Australia’s improved productivity performance has underpinned strong growth in profits and incomes – average real wages grew by 27 per cent from 1990 to 2003. Productivity gains have also been passed on through lower relative prices to consumers – inflation over the last decade has been substantially lower than in the two previous decades.

In other words, productivity growth has meant that Australia has been able to sustain strong economic growth with little fear of a pick up in inflation. This has allowed a gradual reduction of interest rates. This environment has facilitated falling unemployment and high levels of business and consumer confidence, and has provided a sound environment for long-term business investment and growth.

Opening our economy to international and domestic competition and implementing reforms to support this were not easy policy or political choices; there were costs, and some individuals and businesses were adversely affected, at least for a time. But it had become clear that the costs of not acting were far greater. It was this widespread recognition and a belief that taking charge of our economic destiny was preferable to letting prosperity and living standards slide, which supported the commitment to reform across the Australian community. In politics, business, the union movement and more broadly, individuals and Governments not only recognised the need for change but had the courage to make it.

There is a growing recognition among business leaders, policy makers and many others that Australia is now at a similar crossroads.

CHART 1  
AVERAGE ANNUAL LABOUR PRODUCTIVITY GROWTH 1990-2003



Source: OECD

<sup>2</sup> Productivity cycles are determined by the ABS and capture growth from productivity peak to productivity peak.

## 2.3 Locking In Growth and Prosperity

Given Australia's current growth and prosperity, the question asked by the BCA is: how can we both lock in and improve upon this performance?

Experience elsewhere tells us that other countries have faced this opportunity on the back of similar robust economic performance and have failed to cement past success.

Australia is approaching constraints in its capacity to sustain growth.

### CASE STUDY A Tale of Three Recessions

This case study details similarities between three recessions: those in Japan and the United Kingdom in the early 1990s and in the United States in the early 2000s.

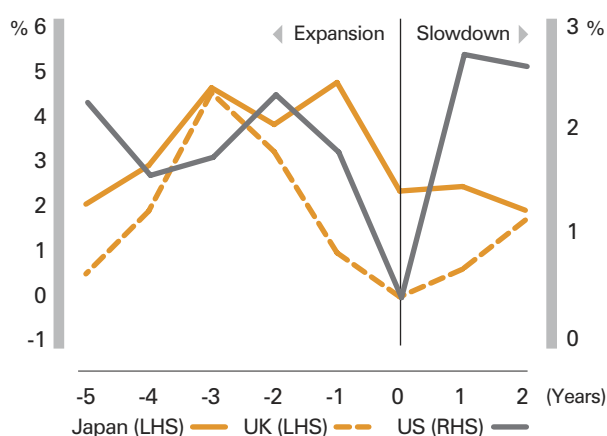
All three economies experienced strong productivity growth in the years prior to recession: Japan and the UK from the mid 1980s, and the US from the mid 1990s.

As a result, all three economies experienced strong economic growth and low inflation.

Similar to Australia's recent growth performance.

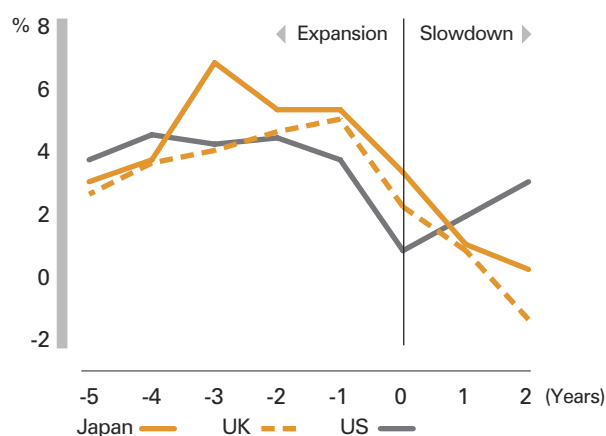
Australia has experienced strong productivity growth since the mid 1990s.

CHART 2  
PRODUCTIVITY GROWTH IN THE YEARS BEFORE AND AFTER ECONOMIC SLOWDOWN



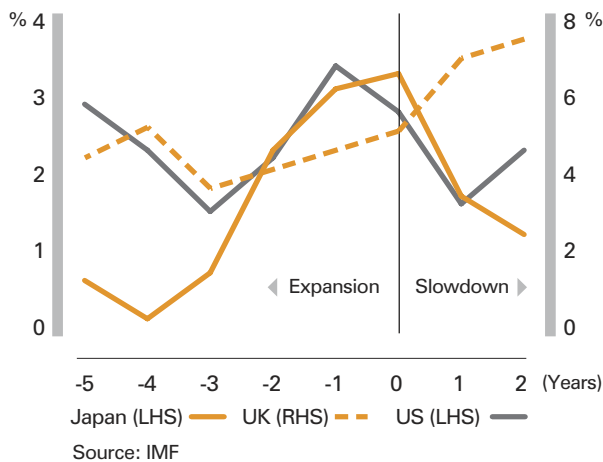
Source: Groningen Growth and Development Centre Database

CHART 3  
GDP GROWTH IN THE YEARS BEFORE AND AFTER ECONOMIC SLOWDOWN



Source: International Monetary Fund (IMF)

CHART 4  
INFLATION IN THE YEARS BEFORE AND AFTER  
ECONOMIC SLOWDOWN

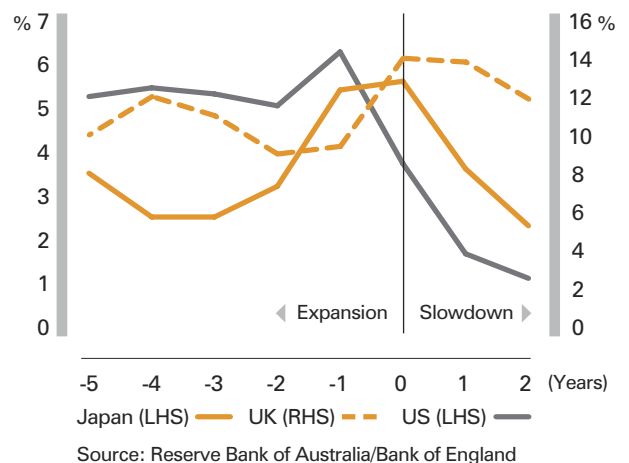


Low inflation enabled expansionary monetary policy in all three economies. Moreover, in each of these 'miracle' growth episodes, monetary policy remained more expansionary than might have otherwise been the case because of international developments.

In the UK the unofficial exchange rate policy obliged the Bank of England to keep low interest rates to shadow the Deutsche Mark.<sup>3</sup> Interest rates in Japan were kept low because of international agreements calling for Japan to maintain a stimulative policy and the stock market crash of October 1987.<sup>4</sup> In the US the Federal Reserve kept interest rates low because of events such as the Asian financial crisis and the Long-Term Capital Management debacle.

In Australia, interest rates have been low for a number of years. In particular they have been kept lower by international developments such as the US tech-wreck, SARS, terrorism and the Iraq War – all of which have weighed on external growth and demand – despite concerns expressed by the Reserve Bank of Australia (RBA) regarding household credit growth and the housing boom.

CHART 5  
INTEREST RATES IN THE YEARS BEFORE  
AND AFTER ECONOMIC SLOWDOWN



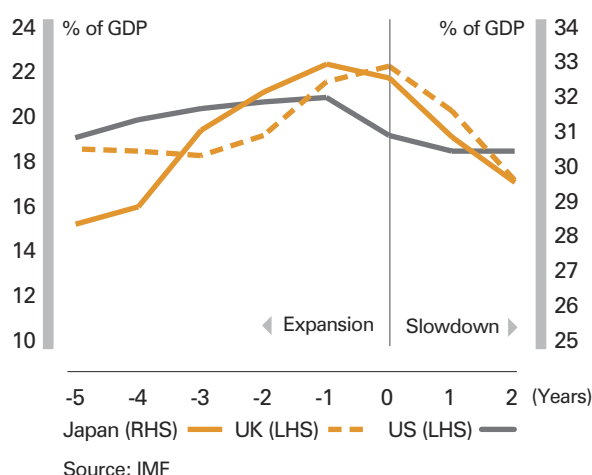
- 3 Following the abandonment of monetary targeting in 1986, The Bank of England moved – for a period – to an unofficial policy of 'shadowing the Deutsche Mark.' The policy was implemented with the aim of holding down inflation by anchoring the British currency to the Deutsche Mark (DM) without actually becoming a member of the Exchange Rate Mechanism. Over the period 1987-88, this policy required a reduction of interest rates in the UK to prevent the pound appreciating above DM 3.00. By the time the exchange rate cap was lifted in the spring of 1988, the economic boom was already well underway.
- 4 Monetary policy in Japan throughout 1986 and 1987 was heavily influenced by the Plaza Agreement of September 1985. In particular, the Agreement requested countries with current account surpluses, such as Japan and Germany, to boost domestic demand to correct international imbalances caused by the excessive appreciation of the US dollar.

## 2.3 Locking In Growth and Prosperity

Easy monetary conditions and strong growth – as well as expectations of continued growth – led to strong increases in investment in all three economies. In the US and Japan there was strong corporate investment, in the UK and Japan the investment focused on the property market.

Such investment was based on unrealistic assessments of the productive capacity of the economy, and thus future income growth and asset-price valuation – leading to asset-price bubbles in the housing market in the UK and Japan, and the stock market in the US and Japan.

CHART 6  
INVESTMENT IN THE YEARS BEFORE  
AND AFTER ECONOMIC SLOWDOWN



In Australia there has been extraordinarily strong investment in housing, based on easy access to credit and expectations of future income growth. The boom in housing prices has been claimed by many to be a bubble.

The UK, Japan and US economies all finally came up against capacity constraints and inflation started to rise (see Chart 4). Inflation in all three episodes was also affected by oil price shocks at the beginning of both the 1990s and 2000s. Capacity constraints were reached in the UK as the one-off productivity level effects of Thatcher industrial relations reforms in the 1980s failed to continue to support productivity growth; in Japan because of the failure of the traditional economic model to adapt to the requirements of a more deregulated and competitive world economy; and in the US because of the irrational expectations afforded to the productivity benefits of the IT revolution.

In Australia, the RBA has recently claimed that the economy may be reaching capacity constraints. This may be the result of the dwindling one-off productivity level effects of microeconomic reform in Australia – as seen in the recent deceleration of multi-factor productivity (MFP) growth. It should also be noted that recent oil price movements are also likely to have placed upward pressure on inflation.

In Australia, households have funded their consumption and investment by accumulating a large amount of debt. If the housing bubble was to burst – perhaps because of tighter monetary policy – households could no longer sustain their contribution to economic growth as they would be forced to increase their savings in order to adjust their balance sheets.

In all three countries, tightening monetary policy – due to capacity constraints – led to the crashing of asset-price bubbles (see Chart 5). The bursting of the bubbles led to debt/investment overhang in various parts of the economy: in Japan in the banks and corporates; in the US in corporates; and in the UK in households (see Chart 6).

As these sectors dealt with excess capacity and debt, they could no longer provide continuing sources of economic growth.

In Australia, households have funded their consumption and investment by accumulating a large amount of debt.

It should be noted that a comparison of the large recessions experienced by Japan and the UK in the early 1990s with the small recession experienced by the US in the early 2000s does suggest that reforms aimed at producing flexible and robust financial markets and economies, as well as appropriately implemented macroeconomic policies, may reduce the severity of economic slowdowns.

## 2.3 Locking In Growth and Prosperity

These experiences highlight that continued success is not guaranteed, and that failure to address challenges and weaknesses at a time of robust performance usually results in an often lengthy period of stagnation and decline, resulting in job losses, falling asset prices, low levels of investment, etc.

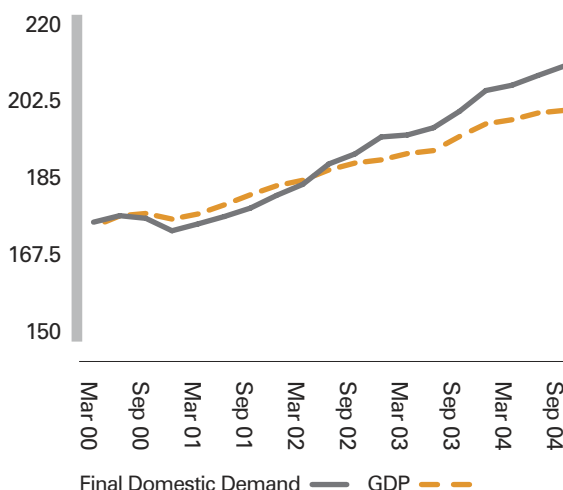
There are a number of challenges to future growth that Australia must respond to in order to sustain success and prosperity.

In terms of the immediate outlook, it seems clear that Australia is approaching constraints in its capacity to sustain growth. While past reforms are likely to have improved the underlying rate of productivity growth, and thus the rate of sustainable economic growth in Australia, some portion of the productivity acceleration over the last decade is due to the one-off productivity level benefits delivered by reforms. We now look to be reaching the limits of those benefits, as has been well articulated recently by the Deputy Governor of the RBA.<sup>5</sup>

Growth in domestic demand is exceeding growth in total income/output. This 'excess demand' has been met by borrowing and increased imports.

The strong and sustained economic growth of the last decade has imbued a confidence among consumers that favourable income and employment growth will continue into the future. As a result, growth in domestic demand is exceeding growth in total income/output. This 'excess demand' has been met by borrowing and increased imports.

CHART 7  
FINAL DOMESTIC DEMAND vs GDP  
\$2002-03b

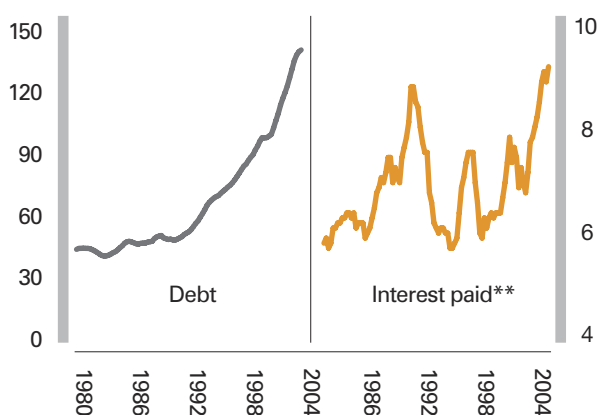


Source: ABS

<sup>5</sup> Address by Glenn Stevens, Deputy Governor, Reserve Bank of Australia to the Australian Business Economists and the Economic Society of Australia (NSW Branch) Annual Forecasting Conference Dinner, 14 December 2004

However, the contribution to economic growth from domestic consumption, which has been underpinned by a sharp jump in the rate of debt accumulation, cannot be maintained. Household debt-servicing ratios are at record highs, and regardless of the sustainability of the current levels of indebtedness (an issue around which there is always healthy debate), a further ratcheting up in leveraging seems neither sustainable nor desirable.

CHART 8  
HOUSEHOLD DEBT AND INTEREST\*  
Per cent of Household Disposable Income



\* Household sector excludes unincorporated enterprises. Disposable income is after tax and before the deduction of interest payments.

\*\*Included imputed financial intermediation service charge.

Sources: ABS; RBA

Our current account deficit is approaching levels that have in the past signalled significant imbalances in our economic performance.

The rapid rise in household debt in recent years has been accompanied by an increase in household assets, in particular housing assets. This situation has led many to comment that household balance sheets are still solid and thus their financial position is not as unsustainable as the increase in debt would suggest.

While the BCA acknowledges that there is a healthy debate around the balance sheet implications for household financial sustainability, a number of points need to be noted.

Firstly, the net balance sheet result is not as important as the composition of this balance sheet when determining financial vulnerability.

The issue is therefore not the level of household debt, it is that the accumulation of this debt has made households more susceptible to falls in income and/or asset prices, which would cause a sudden deterioration in household balance sheets.

This is particularly the case if the asset portfolio of households is not sufficiently diversified, making them more vulnerable to price shifts in a particular asset class, for example housing.

While imports have surged in line with strong domestic demand, exports have languished. As a result, our current account deficit is approaching levels that have in the past signalled significant imbalances in our economic performance and have raised concerns in international financial markets. To some extent poor export performance reflects a number of 'special' one-off constraints, including drought, temporary capacity constraints in the resources sector, a sharp appreciation of the \$A, and stronger selling into domestic markets at the expense of overseas markets.

## 2.3 Locking In Growth and Prosperity

However, there is little doubt that in the future there are likely to be a number of structural factors working against the competitiveness of Australia's exports – such as the medium-term US current account adjustment and the long-run prospect of increased export competition in some areas from the industrialising economies in Asia including China and India.

### OUR EXPORT COMPETITIVENESS Trends in \$A, Terms of Trade and Competitiveness

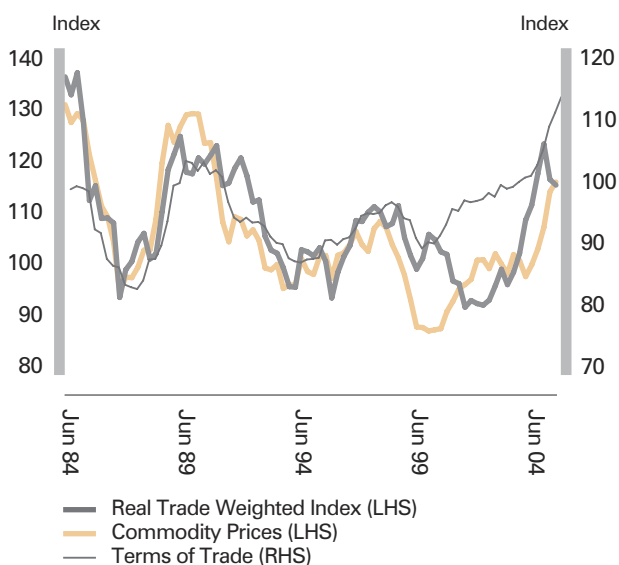
Unlike many other advanced economies, a significant amount of Australia's exports are commodity products – due to Australia's large land and resource base assets. As a result, Australia's terms of trade (TOT) and real exchange rate have traditionally been heavily influenced by movements in world commodity prices. A key challenge for the economy is how to respond to currency movements driven by commodity cycles rather than other fundamentals.

Although the sustainability of China's current growth and the supply response to high commodity demand remain downside risks to commodity prices in the short run, the long-term growth prospects for industrialising giants such as China and India suggest that the outlook for commodity prices remains robust.

Such an outlook will have implications for non-commodity exporters who have recently struggled to maintain competitiveness in the face of strong commodity demand and an appreciating \$A.

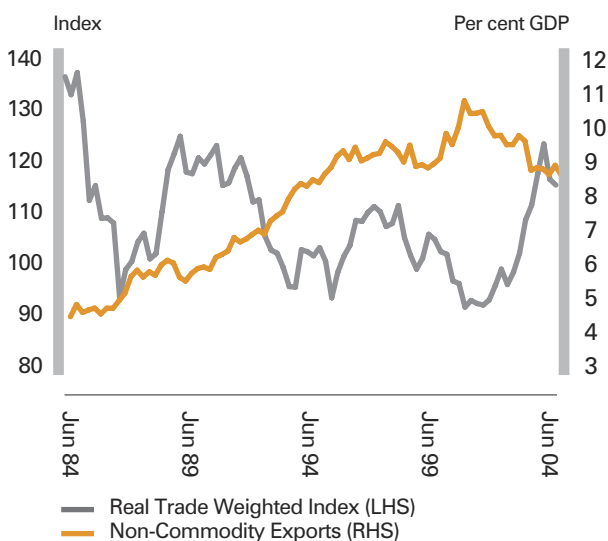
Non-commodity exporters are unlikely to gain temporary 'competitive' benefits from a favourable exchange rate over the medium term and will thus have to 'generate' sustained competitiveness internally through improving productivity. This highlights the importance of reforms aimed at improving resource flexibility, reducing cost structures and encouraging innovativeness, all of which will aid Australian exporters to compete in the global marketplace. The economies of our trading partners are highly dynamic; we cannot afford to stand still.

CHART 9  
RELATIONSHIP BETWEEN COMMODITY PRICES,  
TOT AND REAL EXCHANGE RATE



Source: RBA

CHART 10  
THE REAL EXCHANGE RATE  
vs NON-COMMODITY EXPORTS



Source: RBA

In addition, the longer-term demographic outlook will create headwinds for the Australian economy. The ageing of the baby-boomer generation has contributed to the strong growth in Australia's working age population. However, we are about to experience the reverse impact as the baby-boomers approach retirement age. Declining and low birth rates will slow growth in the working age population. Further compounding this impact is the

The long-term demographic outlook will create headwinds for the Australian economy.

relatively low workforce participation rates of Australians aged over 50 and the limited improvement in education and training participation rates of young people. The net result will be a sharp fall in Australia's employment to population ratio.

Against this backdrop the BCA considers that our focus should be on how we build on our current strengths and prosperity so as to:

- ensure that households can continue to meet their debt servicing;
- position individuals and the economy to support an ageing population;
- ensure individuals and the economy have the skills and capabilities required to sustain economic growth; and
- respond effectively to both the short and long-term factors necessary to strengthen our current account position and international competitiveness more broadly.

## 2.4 A Framework for Strong Growth – Trends, Opportunities and Challenges

The solution to these challenges is to sustain strong income growth, low unemployment, low interest rates, strong investment returns, and a shift in the composition of growth from domestic to external sources.

Achieving this outcome will entail skilful management of monetary and fiscal policy. Most importantly, it will require a commitment to a revitalised long-term reform and growth agenda focused on mitigating the adverse labour supply impacts associated with population ageing; raising labour productivity; and positioning business to make the most of the opportunities presented by globalisation.

To some, achieving further improvement on the shoulders of our already strong performance may seem unrealistic. However, notwithstanding the progress we have made, there is scope for advancement. In some areas performance has been unbalanced (as noted above) and in others, international comparisons highlight that we are still some way from global ‘best practice’.

To guide better understanding of past success and the development of a policy agenda to secure future prosperity, it is useful to break down and assess those factors that have delivered sustained growth for the past 10 years.

Sustained growth will require a commitment to a revitalised long-term reform and growth agenda.

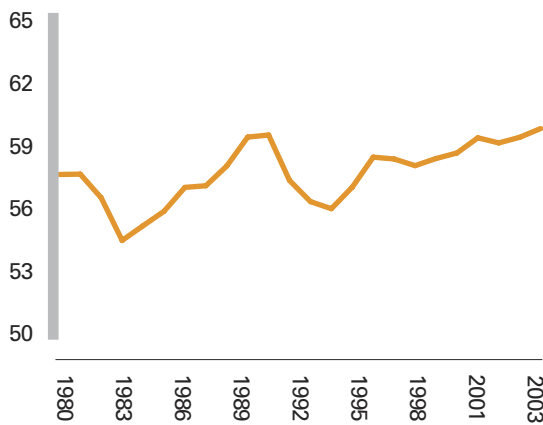
Economic growth is determined by two broad factors: labour supply and the productivity of labour.<sup>6</sup>

When we talk of **labour supply** in the context of economic growth, we are really talking about the total number of hours worked over a particular period of time. Total hours of work in turn is a function of the number of people available to work (the size of the working age population); whether they are prepared to work or are actually working (the participation and unemployment rates respectively); and the average hours each employee tends to work.

<sup>6</sup> This discussion is based on a growth accounting framework. This approach has become increasingly popular in the development and presentation of economic trends and policies. Treasury refers to this approach as the ‘3Ps’ and numerous presentations on this topic are available at [www.treasury.gov.au](http://www.treasury.gov.au).

Since 1990, labour supply factors have made a significant contribution to economic growth. From 1990 to 2003 the working age population – ie the population aged 15 years and over – increased by 2.8 million people, and the share of working age people in the total population increased from 77.5 per cent to 79.9 per cent.

CHART 11  
EMPLOYMENT TO POPULATION RATIO (%)



Source: ABS

Strong business growth, combined with greater flexibility created through labour market reforms have meant that most potential new workers seeking employment were able to obtain jobs, while others already in the workforce have been able to find new jobs.<sup>7</sup> Since 1990, over 2 million jobs have been created and the unemployment rate has fallen from 11 per cent to below 5.5 per cent.

As a result, the ratio of those employed relative to the total working age population increased from 55.9 per cent in 1993 to 59.8 per cent in 2003. In short, population growth provided more potential workers, and past reforms meant businesses had the incentives to hire them.

However, while Australia's employment to population ratio has risen and is above the OECD average, there is still scope for improvement.

<sup>7</sup> Assuming that the 2.8 million person increase in the working age population over the last 13 years occurred in the 15 to 24 years age group, the participation rate of 68 per cent for this age cohort suggests that around 1.9 million people entered the workforce. The increase in employment by 2 million over the period is therefore enough to completely employ those entering the workforce as a result of population growth and a further 100,000 Australians.

## 2.4 A Framework for Strong Growth – Trends, Opportunities and Challenges

In 2003, Australia had only the 10th highest employment to population ratio among OECD countries. Australia's employment to population ratio is marginally lower than other Anglo-American economies of the United States, the United Kingdom, Canada and New Zealand. It is significantly lower than countries such as Switzerland, Norway and Sweden.

Furthermore, Australia has significantly lower participation rates for men aged

over 55 years and most women, compared to those achieved in other OECD countries.

These trends are obvious in the charts below which compare Australian participation rates with the 80th percentile participation rates of OECD members.

In particular, these factors will have worrying implications for the employment to population ratio as the future effects of population ageing take hold.

CHART 12  
AUSTRALIA vs OECD PARTICIPATION RATES  
MALES

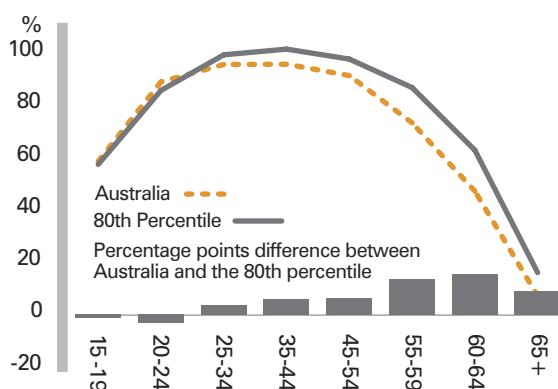
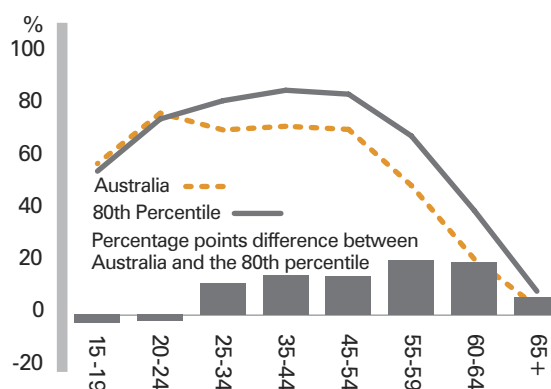


CHART 13  
AUSTRALIA vs OECD PARTICIPATION RATES  
FEMALES

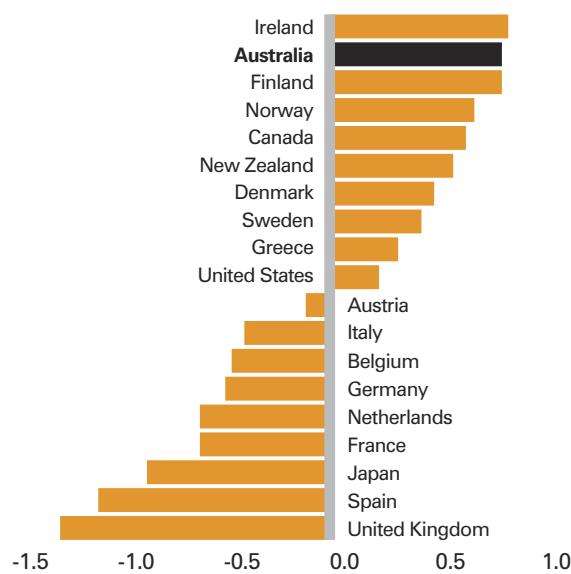


Source: Gruen, D. and Garbutt, M (2003) 'The Output Implications of Higher Labour Force Participation,' *Treasury Working Paper*, 2003:02

Finally, while we have sustained strong employment growth and made significant inroads in terms of the unemployment rate, Australia still has very high youth unemployment rates compared to many OECD countries – in 2003 Australia had only the 12th lowest unemployment rate in the OECD for persons aged between 15 and 24 years old.

Furthermore, there is evidence to suggest that less progress has been made in terms of underemployment. In September 2003 (the most recent data available), at a time when the unemployment rate stood at 5.9 per cent, the ABS defined 6 per cent of workers in Australia as underemployed. That is, these were either part-time workers who wanted and were available to work more hours, or workers who usually worked full-time but were currently working part-time hours due to economic reasons (such as being stood down or having insufficient work).

CHART 14  
ACCELERATION OF MULTI-FACTOR PRODUCTIVITY  
(MFP) GROWTH IN THE 1990s



Percentage points change in average annual MFP growth  
(1980-1990 to 1990-2000)

Source: OECD

**Labour productivity**, that is the efficiency of our workforce, is the second main driver of economic growth and the key driver of competitiveness. It is determined by:

- the skills and quality of the workforce;
- the amount of capital each worker has available to them – ie capital deepening – put simply the more capital a worker has the more they are potentially able to do and produce; and
- the effectiveness with which we combine capital and labour in producing goods and services – ie multi-factor productivity.

As previously noted, Australia's growth in labour productivity has increased significantly over the last decade and has provided a primary source for strong economic growth. This acceleration in labour productivity growth can be almost wholly attributed to improvements in multi-factor productivity (which may in part reflect higher skills and higher labour quality – it is difficult in practice to separate these) rather than increasing capital deepening.

Over the 1990s, Australia recorded the second largest acceleration in multi-factor productivity growth in the OECD.

## 2.4 A Framework for Strong Growth – Trends, Opportunities and Challenges

However, notwithstanding this strong productivity growth, the level of labour productivity in Australia remains lower than a significant number of our economic peers. Given that our level of productivity compared to others ultimately determines our competitiveness and relative standard of living, the gap between Australia and its peers highlights the scope for improvement or catch-up with best practice. This means that change is now imperative.

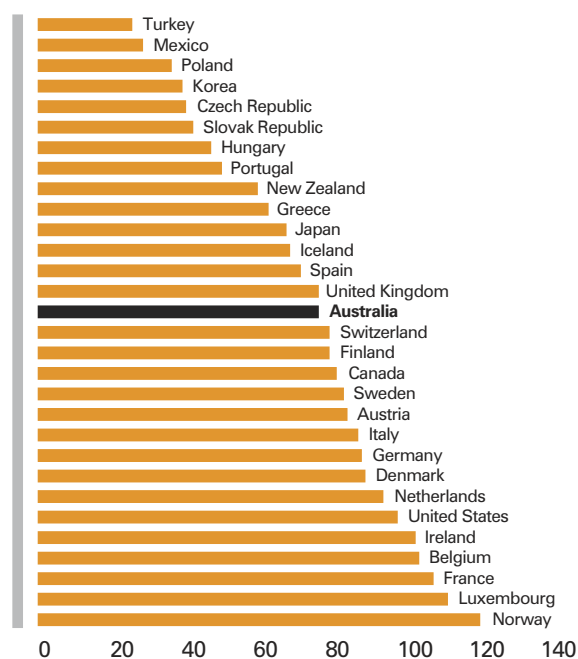
Improving Australia's relative position of labour productivity will require sustained rates of growth above those achieved by our peers. For example, despite strong labour productivity growth over the period 1990-2003, Australia improved by only one ranking among the OECD in terms of the level of labour productivity.

This is because countries such as the United States, Japan, Germany and France had rates of growth only marginally below Australia's, while countries such as the United Kingdom, Norway, Finland and Ireland performed better.

The level of labour productivity in Australia remains lower than a significant number of our economic peers.

Furthermore, we need to be conscious of the fact that other less productive countries are catching up to us. Over 1990-2003, countries such as Korea, the Czech Republic, Hungary and Portugal all achieved significantly faster rates of labour productivity growth/improvement than Australia.

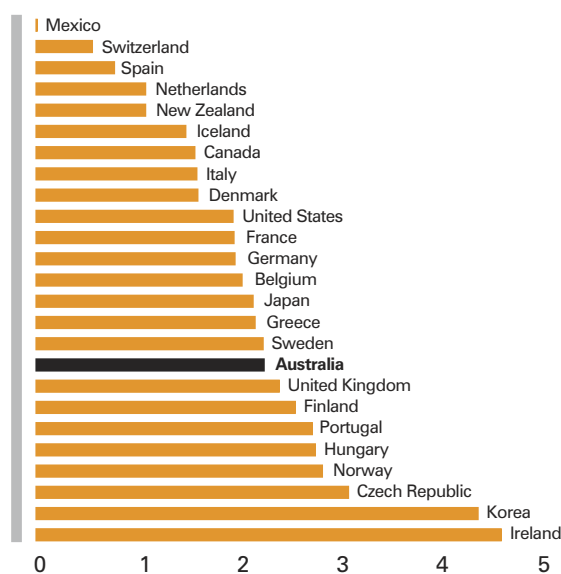
CHART 15  
LEVEL OF LABOUR PRODUCTIVITY -  
OECD COUNTRIES



GDP per hour worked as % of US level - 2003

Source: OECD

CHART 16  
LABOUR PRODUCTIVITY GROWTH -  
OECD COUNTRIES



Average Annual Growth in GDP per hour worked (%) (1990-2003)

Source: OECD

## 2.5 Agenda for Action

Australia's economic performance over the last decade has been impressive, but the above analysis shows that there is still much room for improvement. Indeed, it illustrates that change is imperative, not optional.

Strong, competitive labour supply and productivity will be critically important.

Australia is far from achieving world's best practice in a number of areas

which are vital to sustaining our current levels of economic growth. Achieving strong and competitive outcomes for labour supply and productivity in the future will be critical for ensuring international competitiveness, improving living standards and helping to mitigate the effects of population ageing.

However, such outcomes will not materialise by resting on our laurels. As discussed above, some of the productivity growth benefits of past reforms are beginning to dissipate, while the labour supply implications of population ageing will be significant without action. Like the widespread economic reform that underpinned the growth performance of the past decade, what is needed now is the implementation of a comprehensive new reform agenda. Such an agenda should be aimed at enhancing labour supply and productivity outcomes.

What are the priorities for action that can achieve such outcomes?

## 2.5.1 Labour Supply

Labour supply in Australia is currently being hampered by poor participation rates among some sections of the population and unacceptable levels of underemployment and high youth unemployment. Furthermore, population ageing, caused by low fertility and declining mortality rates, will not only slow the rate of growth in the working age population but also reduce the proportion of that population that will participate in the workforce.

As a result, Australia needs to achieve the largest possible workforce with the capacity to gain and retain employment in an increasingly dynamic labour market and in the face of demographic trends.

The agenda for action should aim at achieving the largest possible workforce.

The implementation of policies designed to increase the number of young people completing at least twelve years of education and training and provide older people with access to ongoing training must continue.

There are additional priorities to achieve this goal. Australia must:

- ensure the taxation and welfare systems do not impose high effective marginal rates of taxation around the decision to participate in the workforce;
- support the working age population by increasing immigration numbers and ensuring that the taxation system remains internationally competitive to attract and retain highly mobile skilled workers;
- encourage higher levels of workforce participation, particularly amongst women and mature-aged individuals, through workplace reform to support more flexible employment options; and
- enhance education and skills development to support individuals' abilities to sustain participation.

## 2.5.2 Labour Productivity

Australia has experienced strong productivity growth in the last decade, underpinned by past economic reforms. However, we still lag well behind many of our economic peers in terms of the level of labour productivity, which is a vital determinant of an economy's relative competitiveness and living standards.

Furthermore, the strong growth in multi-factor productivity is likely to ease somewhat in the future as the one-off

static efficiency gains of economic reform on the level of labour productivity are realised and productivity growth begins to only reflect the dynamic efficiency benefits of reform.

Labour productivity is a key determinant of an economy's relative competitiveness and living standards.

A continued focus on improving education and training outcomes and increased school, Vocational Education and Training (VET) and university flexibility to assist participation in education and training will be important to improving labour productivity and participation, but will not be sufficient to address the core problem.

Australia must maximise labour productivity growth and strengthen the contribution to productivity growth of public and private investment through improvements in the quantity and quality of the capital stock.

However, in the long run, the ever-increasing investment share of GDP needed to ensure a strengthened contribution to labour productivity growth from capital deepening is not sustainable. Therefore, it is also important that an agenda for change also include ongoing economic reforms that can improve labour productivity growth through both one-off multi-factor productivity level improvements in the short run, and dynamic efficiency gains, which increase the rate of underlying labour productivity growth in the long run.

To achieve these goals, Australia must move swiftly to implement reforms that:

- improve the public sector contribution to capital deepening through greater investment in public infrastructure, including improved planning and coordination between levels of Government to ensure the high quality of infrastructure investment;
- promote a conducive environment for private investment that supports domestic investment including in riskier, higher value projects, and our ability to attract and retain capital in an increasingly competitive global marketplace, through taxation and regulation reform. These reforms should aim to reduce high levels of business taxation, eliminating distortions in the tax system which favour certain forms or locations of investment, and alleviating the adverse effects of excessive regulation on risk-taking behaviour;
- achieve static and dynamic efficiency gains through reforms to business regulation, taxation and workplace relations which eliminate impediments to the effective allocation and use of resources in the economy and encourage risk-taking, entrepreneurship and innovation; and
- maximise access to global opportunities for investment and trade which enable greater efficiency by providing scale opportunities, increasing competition and exposing businesses to new ideas, techniques and demands which spark innovation and creativity.

## 2.5.3 Reform Priorities

Consistent with the above challenges and aims, Members of the BCA call on the Government to initiate and/or pursue the following policy objectives for Australia. Singly and in combination these hold immense importance to our future economic well-being and security. They are:

- a flexible and balanced work environment that supports ongoing participation in employment and job creation, and allows people to work to their full potential;
- an internationally competitive taxation system that supports high levels of investment and workforce participation;
- a regulatory system that supports competitiveness, investment and innovation through risk-taking;
- an integrated long-term planning framework across jurisdictions for the coordinated provision of infrastructure and environmental services to underpin sustained strong economic growth;
- an innovative, learning culture that uses knowledge, technology and research to create wealth and employment; and
- enhanced attractiveness of Australia as an investment destination and greater access to all markets for Australian business.

In terms of the policy objectives outlined above, the BCA considers progress is being made in two areas – education, skills and innovation; and trade and investment opportunities – but has identified the need for reinvigorated agendas for action in four key areas if Australia is to lock in the prosperity to which we have become accustomed. These areas are:

- Workplace relations reform
- Infrastructure and improved Federal-State relations
- Regulatory reform
- Tax reform

The BCA will be releasing detailed policy reform papers and agendas addressing each of these areas over the next three months.

## 2.5.4 Reform in Progress

### Education

Education, skills and innovation remains a long-standing policy priority for the BCA.

The BCA argues there is a need to reduce early exits from education and training so as to maximise the potential for this group to participate in the workforce. Currently, at any point in time there is an estimated 40,000 15-19 year olds, who leave school early, do not pursue other forms of education and training and are either not working or working less than 15 hours a week. The figure is higher (50,000) if all young people in casual and part-time work are considered. The capacity of this group to participate in the workplace is limited given their low skill levels.

The BCA has lobbied for increased investment in programs at the State and Federal levels to ensure:

- improved literacy and numeracy skills;
- systematic identification and assistance for possible early leavers;
- availability of flexible options connecting initial education with work or further study or training; and
- increased school, VET and university flexibility to assist participation in education and training.

There have been a number of new programs established at the Federal and State levels to address aspects of the BCA's recommendations. There is still a need to continue efforts in this area, particularly in identifying and assisting potential early school leavers.

Skill development (both technical and generic/employability skills) for both new entrants and the current workforce continues to be a priority for the BCA given the fundamental link between productivity and the quality of labour. Recent work by the BCA has highlighted the potential limitations of the current VET system in providing training relevant to the future needs of business. There has been a renewed focus on trade skill training by Government, however, changes are required to support more flexible and relevant workplace training.

## 2.5.4 Reform in Progress

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The long-term sustainability of the university sector has also been a policy priority for the BCA given the role of universities in developing skills and knowledge. Recent reforms in the financing and governance of universities are a critical first step; however, there is a need for a continued focus on governance structures; on the outcomes of university research and development efforts; and the role of universities in supporting an innovation culture.

Business innovation is a critical contributor to company productivity and competitive advantage. For this reason the BCA is currently examining how public policy frameworks as diverse as workplace relations, access to capital and business regulation act to support or inhibit an enterprise's capacity to innovate cost-effectively in line with its business strategy. It is essential that Government policies continue to focus on maintaining a robust, flexible and strongly growing economy as this will in turn provide the environment for business innovation and investment.

### **International Trade and Investment**

Locking in greater market access for Australian businesses and sustained foreign direct investment in Australia is important in supporting strong investment, further specialisation and productivity. Given the importance of increasing Australia's trade potential, the BCA will continue to pro-actively support the timely pursuit of strategic Free Trade Agreements (FTAs) with important trading partners. The BCA's attention over the coming year will focus on ensuring that business is able to contribute to the development and negotiation of sound and beneficial FTAs in an effective and timely manner, specifically in the context of any negotiations on an FTA with China.

## 2.6 Conclusion

The BCA urges the Government to closely consider the case for action as presented in this Budget Submission.

The Government has previously demonstrated its leadership and capacity to initiate difficult and complex changes that support economic growth. Indeed past economic reforms undertaken by this and previous Governments have been instrumental in placing Australia in its current position of prosperity.

The maintenance of this prosperity over the long term is a goal that the BCA believes is supported across Government and the wider community. A reinvigorated national reform agenda, as outlined above, is now imperative.

The reality is that Australia will eventually find itself on that lower growth path – unless steps are taken now to raise the long-term growth path from that outlined in the Intergenerational Report.

This agenda calls for a substantial rework of our workplace relations, taxation, regulation and infrastructure framework.

The BCA asserts that Australia's future prosperity and growth potential could be in jeopardy unless further economic reforms are made. The case

studies and arguments presented in this Submission bear this out.

The BCA acknowledges that a program of reform, while ultimately beneficial to everyday Australians, is never simple or straightforward to implement.

Nevertheless, a carefully considered reform program which builds on our strengths and successes is now required so Australia can grow and prosper in the long term.

The BCA stands ready to engage and work with Government to progress this critically important objective.

The immediate issues and undertakings outlined by the Government in recent months, particularly during the recent Election campaign, are likely to be the focus of the 2005-06 Federal Budget. However, the BCA believes there is a real need for Government to use the upcoming Federal Budget to clearly and strongly highlight the need for a reinvigorated reform agenda to deliver sustained prosperity for all Australians. It is equally important that the Budget avoids commitments that might limit or inhibit the capacity for Government to implement reform.

While some of the reform agendas and proposals articulated in this Submission are not directly related to the Federal Budget process, each has important implications for economic growth and hence the sustainability of Australia's fiscal position.

## 2.6 Conclusion

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Many of the longer-term challenges facing Australia, particularly the fiscal issues associated with Australia's ageing population, were well articulated in the Intergenerational Report (IGR). The recent Productivity Commission Report on the fiscal implications of population ageing further highlights the need for an integrated policy response that will strengthen Australia's economic position to tackle these new challenges.

The BCA considers that the IGR messages need to be reiterated and brought to bear in the Budget decisions that the Government is making now and in the future, as well as in support of a broader reform agenda.

The tension between the relatively short-term focus of the annual Budget cycle and framework and the longer-term challenges outlined in the IGR is clearly highlighted by discrepancies in the growth forecasts underpinning both. The out-year projections of last year's Budget showed growth of 3½ per cent. The BCA recognises that these are based on fairly simple assumptions and extrapolations of past trends and are not forecasts as such. But neither are the IGR forecasts, which project significantly lower growth of 2½ per cent over the period 2006-07 to 2010-11.

The reality is that Australia will eventually find itself on that lower growth path – unless steps are taken now to raise the long-term growth path from that outlined in the IGR.

The IGR base case of lower growth is not acceptable from the perspective of the BCA Membership. Nor will it enable us to support an ageing population and sustain a dynamic economy capable of maintaining our relevance in global markets.

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