FULL REPORT

Action Plan for Enduring Prosperity

Business Council of Australia

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Contents

About this publication

The Business Council of Australia (BCA) brings together the chief executives of more than 100 of Australia's leading companies, whose vision is for Australia to be the best place in the world in which to live, learn, work and do business.

This is the Business Council of Australia's *Action Plan for Enduring Prosperity*. This and the overview brochure, summary report and list of recommendations are available as separate publications and can be downloaded from the BCA website at **www.bca.com.au**.

Introduction

This action plan is for Australia's future.

It addresses the question of whether the future can be prosperous for all Australians and whether things will live up to our expectations.

Australia's future can be prosperous but this will depend on maintaining strong economic growth and an environment that supports businesses to do well. The actions, decisions and choices we make now will either support or inhibit Australia's prospects.

Australia has experienced a very successful growth period and we continue to have many intrinsic strengths, but we are a small economy in a fiercely competitive global environment. We do many things well and lead the world in areas like mining, agriculture and various services industries. However, with a small local market we lack the scale and expertise needed to exploit opportunities in many sectors of our economy, particularly manufacturing.

On a frank assessment, it's clear we've taken our eye off the ball when it comes to Australia's economic challenges and complacency has crept in. The benefits of a terms-of-trade boom have masked emerging cracks.

» We've been fiscally strong in the past (this strength got us through the global financial crisis), but in recent years the government has failed to execute a responsible fiscal strategy. As a consequence, our fiscal position is not as robust as it should be given the economic growth we've continued to record over the past four years.

» We haven't invested enough in infrastructure and the community and business are suffering the consequences. Infrastructure shortcomings are diminishing our quality of life, reducing our competitiveness and eroding community support for growth.

» Our system of workplace relations is much less flexible than it needs to be and more heavily regulated than it was in the past. It does not support high-performing, modern workplaces and is reducing our capacity to adapt to competitive pressures and a changing global economy.

» Regulatory overreach has occurred at all levels of government. Politicians – often at the community's behest – are intent on introducing new laws and regulations as the immediate solution to every problem. For example, overlap between the Commonwealth and the states is slowing development approvals and holding up investment in important major projects.

» We are not making the most of our comparative advantage in energy – either its delivery domestically or in terms of export opportunities.

» Our federation is not operating properly, with the Commonwealth and the states in constant conflict on many important policies and a lack of national cohesion.

» Our education and training system is not producing the skills we need to service a changing economy.

The sum of all this is that our competitiveness has declined and our chances of maintaining the rates of economic growth that we need are far less certain. This matters. It matters for what our future will look like, the number and quality of jobs we can create, the wages Australians will earn, the profits businesses will generate and the taxes governments will collect.

The impediment is a lack of focus on the long-term national interest. It is making it harder to take the tough structural reform decisions needed to support growth. Politicians are reacting to the community's expectations that governments will provide more and more, and with the growing pressures of an ageing population. But there's little discussion of the need to change other spending priorities or raise taxes to accommodate this.

We are operating in a more complex and challenging global environment that finds Australia more interconnected, but also exposed to greater volatility.

Our own economy is going through a major period of transition. Some sectors have boomed and others are doing it tough. This has significant implications for many people's jobs.

The question is how can we deal with this?

We believe it's possible to restore confidence and growth and create more jobs by squaring up to the situation and bringing the community along. If we are prepared to take a broad-ranging and comprehensive approach – with some 'give and take' all round – there is no reason why Australia can't overcome the challenges before us.

The solutions are straightforward but it is less clear how we will arrive at where we need to be and how we can achieve consensus.

We are proud of the crucial role that businesses play in creating jobs and wealth, and contributing to community prosperity. We recognise that in a modern market economy there is a significant role for government and the community sector.

The Business Council of Australia has prepared this action plan with the overarching vision of securing enduring prosperity for all Australians. It is designed to help initiate discussion about key domestic reforms affecting us all. We are mindful of the costs to all of us of not getting right Australia's approach to public policy and our economic settings.

The plan indentifies a set of recommended actions across nine critical areas that, if implemented, will help set Australia on the right track.

These are the nine areas that we believe require action:

01. Australia's fiscal policy settings and long-term budget discipline must be strengthened, we have to adopt a more competitive and sustainable tax system and provide for a fairer sharing of money between the Commonwealth and the states.

02. We must continue – and continue to plan for – sustainable population growth in our cities and regions.

03. We must provide the right infrastructure for a modern, liveable and productive economy.

04. We must equip all Australians with the right skills and education and boost labour-force participation so that we have more productive and innovative workplaces and a better workplace relations system that strengthens the relationship between employer and employee.

05. We must rethink our approach to regulation and strengthen our institutions and governance arrangements with greater accountability and transparency from our regulators.

06. We must realise a deeper engagement with the world both economically and politically.

07. We must preserve a strong and stable financial system and make it more competitive and capable of funding our future growth.

08. We must adopt a coherent and comprehensive energy policy that enhances Australia's competitive advantage.

09. We must create the right environment and systems to foster and drive innovation, diversify our economy and play to our strengths.

This report outlines 93 actionable recommendations across these nine areas. Some recommendations are directed to immediate issues and near-term actions while others are intended to help us transition towards longer-term aspirations.

This document should not be viewed as a type of master plan for Australia or as a blueprint for society. We can't predict all future challenges. Instead we have to place a premium on policies and institutions that foster anticipation, flexibility and discovery.

Our action plan sets out a range of recommendations that can be pursued to this end and have the effect of improving incentives and widening the choices available to people and businesses.

This action plan recognises that prosperity is strengthened when everyone has the capacity to participate effectively in the economy and when the benefits of growth are widely shared.

The overarching framework of this plan is that maintaining strong growth requires a growing population of workers, continuing investment and a capacity to embrace and create new technologies and innovations.

It is underpinned by a fundamental free-market philosophy supported by sensible rules and regulations, an openness to the world and the retention of strong institutions and institutional settings.

This plan sets out how well-managed growth can deliver a goal of enduring prosperity for all Australians.

Part One outlines the Business Council's goal and vision for Australia and why well-managed growth drives prosperity.

Part Two is the case for economic growth. It highlights the drivers of growth, the vital role of business in creating wealth and jobs and sets out Australia's growth story.

Part Three outlines the challenges of growing the economy at a time of significant change both internationally and domestically.

Part Four discusses what is required to deliver growth and prosperity. It analyses nine areas of critical importance if Australia is to remain successful and prosperous, identifies what needs to be done, why it needs to be done and most importantly identifies actions on how it can be done. An approach to prioritising and phasing the implementation of these actions is also identified.

Part Five describes the indicators and measures of success that should be used to assess how Australia is tracking against its goal of enduring prosperity.

This plan and vision for enduring prosperity is intended to be comprehensive but by no means exhaustive. It entails achieving three interconnected goals around: a strong, growing economy with full employment; a strong, cohesive society with improving living standards; and success in growing our economy efficiently and sustainably.

It acknowledges the range of important issues in play and that it would not be feasible to undertake, or deliver, everything at once.

We have, however, identified the crucial areas of policy and made suggestions on where the greatest priorities should lie.

Few would argue against an aspiration to lock in prosperity for all Australians. The issue is how we reach this goal. This plan outlines an approach that will help us get there.

Part One: Vision and goals

The goal of enduring prosperity

We believe in an Australia which aspires for enduring prosperity for all of its citizens. This should be founded on core values that integrate economic and social policy. It rests on the creation of wealth on an inclusive and sustainable basis.

This vision is based on open, honest consideration of the opportunities and the risks we face as a nation, and on the imperative of having institutions, policy processes and policy settings that operate efficiently and effectively.

Our values

This vision for the nation is underpinned by a set of core values that can help guide the identification and consideration of the issues and the prioritisation of policies.

Our values-driven approach includes that:

» We believe in shared prosperity and that all Australians should benefit from the wealth we create as a nation.

» We advocate reward for effort, innovation, ambition, and for risk taking and enterprise.

» We believe in a society that encourages Australians to aspire to improving their own wealth and quality of life, and those of their children and grandchildren.

» We are committed to equality of opportunity through freedom of choice and fairness as fundamental principles that support Australians to pursue their aspirations.

» We believe in a globally connected world where Australia plays a significant, respected role in the international community, both economically and strategically.

» We are committed to maintaining honesty, trust and integrity in our public and private institutions.

» We want safe, productive and high-quality workplaces that provide social and economic advancement, and a sense of identity and belonging.

» We value and respect Australia's unique environment and natural resources, and are committed to their efficient and sustainable use.

The hallmarks of a prosperous society

Goals and aspirations

A prosperous society is one that helps create better conditions for its citizens. It recognises that a major driving force in human activity is the desire for good health, for better living conditions and improved quality of life. A prosperous society improves the prospects of individuals achieving this for themselves, for their family and for the communities of which they are a part. A prosperous, confident society is also one that believes strongly in the generations that follow.

Prosperity brings out the essential ingredients of a good society. A society in which jobs are plentiful and wealth can be created. Where most people are healthy and where social exclusion is minimised.

Exhibit 1: The hallmarks of a prosperous society

A prosperous society is one where people:

» can have a good and rewarding job which provides an opportunity for advancement, and where they feel valued and are rewarded fairly for their efforts

» have good health and access to high-quality health services that allow them to lead fulfilling lives

» have access to education and training that allows them to realise their full potential and make positive choices about their own careers and lifestyles. It also allows them to contribute and participate fully in the social and cultural fabric of society

» experience high levels of personal safety and protection from crime

» have the time and opportunity to enjoy family life and leisure activities.

A prosperous society is one where communities have:

» successful businesses and enterprises that provide job opportunities and create wealth that spills over to the wider community and individuals within it

» economic resilience through accumulated wealth in superannuation, the banking system, government assets and individual savings

» well-planned, liveable cities and regions, and quality infrastructure which fosters vibrant, connected places for people to live and work

» a capacity to invest in the environment, and maintain and enhance public open spaces and amenities

» a sense of community optimism and ambition afforded through the collective impact of good health, education and other services

» a capacity to invest in the arts, culture, sports, community connectivity and the social fabric of the community more generally

» a ‘prosperity–inclusiveness compact’ that provides a foundation stone for how the community operates.

Why well-managed growth matters for prosperity

Well-managed economic growth is the key to achieving many of the things that deliver a prosperous society.

Prosperity has many dimensions, and means different things to different people. Personal prosperity for individuals typically requires a capacity for people to meet their own human needs along with the ability to pursue their own goals, and to feel satisfied with their life.

Having enough income provides people and societies with access to many of the things they want to consume in daily life. But as well as a material dimension to wellbeing, it also depends on health, education, our social relationships, our leisure choices and so on.

Prosperity and the wealth it creates can have an influence on happiness. Indeed, one of the strongest correlations with happiness is the perception that an individual has control over his or her life. The achievement of economic growth, including growth in GDP or national income per capita, is central to this (although not exclusively so).

Economic growth is also central to the ability of government to fund social services and support creative endeavours.

To the extent that successful economies support a vibrant business sector that creates employment opportunities there are likely to be substantial consequences of wider importance for the community. As outlined above and noted elsewhere, paid work matters for quality of life not only for the income it provides to people but also because it provides identity to people and opportunities to socialise with others.

Equally, education also matters for quality of life independently of its effects on people's earnings and productivity. Better educated people typically have better health status, lower unemployment, more social connections and greater engagement in civic and political life.

The importance of growth as a national policy objective for Australia has been recognised for many years. In the mid-1960s the Australian Government commissioned the Vernon Committee to inquire into the importance of growth as a national policy objective for Australia. The committee emphasised that growth provides the means of raising living standards and of promoting national security. It noted that growth is self-generating, stimulating enterprise, encouraging innovation and providing a constant spur to technical and managerial efficiency. A growing economy facilitates economic and social mobility; economic mobility because changes in the pattern of industry can occur through the flow of new recruits to the workforce and the flow of new investment; and social mobility because economic expansion widens the range of opportunities to enterprising and imaginative members of the community. The commission found that growth endows the community with a sense of vigour and social purpose.

The value of a rising standard of living lies not just in the concrete improvements it brings to how individuals live, but in how it shapes the social, political and ultimately the moral character of a society.

Wealthy countries have more resources to devote to maintaining a clean environment and they tend to have better air and water quality than poor and middle-income countries, notwithstanding the fact that wealthy countries by definition produce more goods and services.

Wealthy countries also generally provide people with more leisure time, less physically exhausting and more interesting work, higher education levels, greater ability to travel, and more funding for arts and culture.

These linkages, together with the benefits of enjoying a wide variety of goods and services, are the reason that economic policymakers – at the behest of the community – usually put heavy emphasis on job creation and growth.

Economic growth more often than not fosters greater opportunity, tolerance of diversity, social mobility and a commitment to fairness.

But growth needs to be well managed and this means remaining conscious of how the proceeds from growth are shared and therefore being aware of trends in the distribution of income. Some measure of income inequality is inevitable in any society as rewards must flow to the innovators and to those who take risks, have greater responsibility and work hard for their success. But people take fairness seriously and too much inequality can undermine social cohesion and undermine opportunity.

If growth is to be well managed, and embraced by the community, then it must also be sustainable in the sense that it can meet the needs of the present generation without compromising the ability of future generations to meet their own needs.

Whether levels of wellbeing can be sustained over time depends on the extent to which an economy's productive base – the various stocks of capital – are passed on in good repair to future generations. These capital stocks include physical or manufactured capital, human capital, natural capital and our social capital including our institutions.

The prosperity compact

A prosperous society is inevitably underpinned by a national compact around prosperity and inclusiveness.

Such a compact is predicated on the acceptance within the community of the legitimacy of enterprise and business in creating wealth on the one hand, and an acceptance of some level of wealth redistribution on the other.

Figure 1: The prosperity compact: Virtuous circle to create shared value

Source: BCA

This involves a broad approach to wealth creation so that it occurs in a way that serves society well.

Businesses should be allowed to generate wealth for the community and should be free to make profits, they should be regulated efficiently, taxed fairly, and be able to trade and make contracts freely. In return, businesses have a responsibility to act ethically, honestly and transparently with their shareholders, customers and employees and with a focus on long-term wealth creation.

We accept, however, that while allowing people and enterprises to pursue their own interests, a market-based economy may not always meet the needs of everyone within the community.

This gives rise to legitimate considerations around providing a social safety net, and being aware of and willing to address income inequality.

Inequality of outcome can have a strong bearing on equality of opportunity. Income gaps, if they get wide enough, can lead to less equality of opportunity especially when it comes to education. It is far more difficult to obtain a decent start in life when a child is raised in an environment of entrenched disadvantage.

The tax and transfer system administered by governments is the primary mechanism by which some of the gains obtained through market activities are redistributed.

Well-managed growth, therefore, requires that the right balance be struck by providing the necessary property rights and curbs on excessive taxation so that economic growth can be pursued but not to the extent that growth produces extreme inequalities of wealth that are sufficient to create social and political instability.

Striking this right balance poses considerable challenges. This reflects the fact that there are many complex forces which contribute to rising inequality including the process of globalisation, technological change, the emergence of new industries and the inevitable decline of others. A progressive, but competitive, tax system and targeted welfare arrangements can boost growth and mitigate against extreme inequality.

Exhibit 2: Addressing Indigenous disadvantage

Despite Australia's prosperity, significant disparities remain between Aboriginal and Torres Strait Islander peoples and the rest of the population in measures of health, education and economic and social inclusion.

Australia has laid some strong foundations for closing the gaps and despite the common perception of failure, the last 40 years has seen a slow improvement in most socio-economic outcomes for Indigenous Australians. The underpinnings of progress have included strategies to improve access to and quality of education, enhance economic participation along with efforts to acknowledge and repair the discriminatory policies and practices of the past.

Closing the gap is a challenging area with complex threads of causality, and not a task for governments alone. It is necessary to strengthen the capacity of local and regional Indigenous organisations and representative bodies to lead the design and implementation of place-based approaches through appropriate funding for governance, development and training and streamlined funding agreements that reduce the red-tape burden on Indigenous organisations.

Continuing to grow private and public sector Indigenous employment is likewise critical. In addition, focusing on increasing labour force participation will permit greater numbers of Indigenous Australians currently not in the labour force to participate and connect with training and employment opportunities.

Part Two: Why grow the economy: The vital role of business and growth

What drives well-managed growth

The distinctive, defining characteristic of a successful market economy and economic development is enterprise.

Enterprise is a uniquely human trait. More often than not it is harnessed in productive business and commerce. It is underpinned by our capacity to invent, to innovate, to discover, and to organise in new and cooperative ways.

It is about creating value from a new way of doing things. It ensures that new and better products and services are brought to the market at the right price and to the widest number of people possible.

In a market-based economy, it is important to recognise that prosperity is driven by business enterprises and their people. Growth and wealth are not driven by the state.

It is the job of governments to facilitate an environment in which wealth is created and distributed – thereby creating societal wealth.

A host of factors and influences combine to determine how economic growth takes place, but, fundamentally, new capital investment and advances in technology are the key to growth.

Accumulating capital more rapidly – by encouraging investment both from domestic residents and from abroad – will raise the growth rate (when the rate of return is greater than the cost of capital). Growth is also affected by the generation of new ideas, institutions, openness to world trade and through knowledge flows.

Workers become more productive when they have more and better capital equipment to work with and as they improve their own skills and expertise, including through on-the-job training.

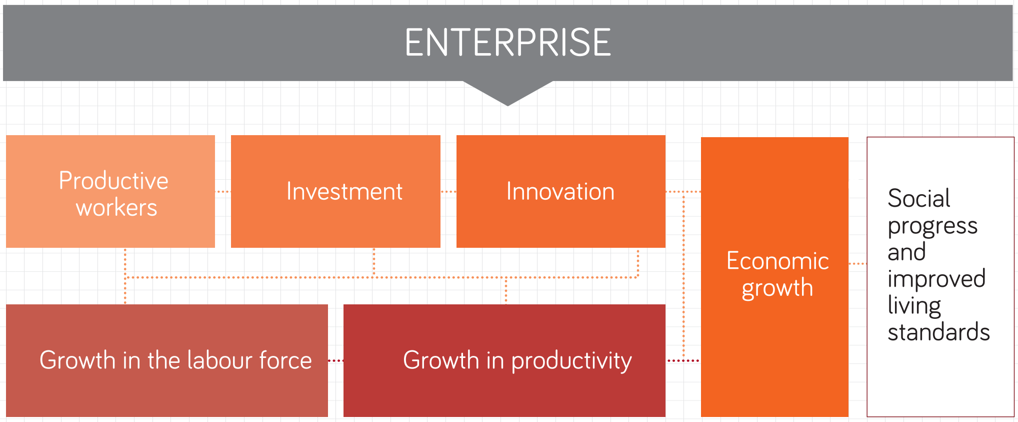
But there are limits to how much a person can produce simply by working with more and more capital. Unless some type of technological progress takes place, it's hard to keep producing more with each additional unit of effort.

Technological progress largely comes from innovations – including those made by individuals and profit-seeking firms. Innovation itself is a broad concept. It is more than just research and development and invention. Innovation can entail these features, but it also includes the process of adopting and adapting technologies and products and services that have been invented by others. Innovation also takes place through businesses introducing new organisational and operational processes and through better marketing which allows them to add more value.

The association between innovation and competition has been contentious with the original (Schumpeterian) view being that increased competition leads to less innovation. However, there is mounting practical evidence which demonstrates that strong competition is typically associated with a higher propensity for firms to innovate.

Firms in highly competitive markets must innovate in order to avoid being left behind and ultimately failing. There is also evidence that businesses with large market share and large firm size, as well those who export, tend to have a greater innovation effort.

Figure 2: What drives growth and improved living standards



Source: BCA

The process of economic growth and the design of policies that underpin growth need to support the three elements – a productive, skilled and creative workforce; ongoing investment; and innovation. This has many dimensions.

There is a crucial role for incentives to influence innovation and investment as well as decisions on labour force participation. The discipline of competitive markets as well as having in place the right tax settings matter when it comes to incentive.

Economies also need to be supported by a range of institutions which include the rules and regulations influencing how the economy works and how they relate to the incentives that motivate people and firms. These institutions include:

» a robust and stable system of property rights

» appropriate institutions that regulate conduct in markets for goods and services, labour markets and financial markets

» fiscal and monetary institutions that can help stabilise fluctuations in the economic cycle

» institutions that support publicly provided welfare arrangements which help underpin social stability and social cohesion

» institutions that help manage conflict including sound rule of law, an independent judiciary, representative political institutions, free elections and so on.

A well-functioning financial system plays a fundamental role in the growth process by ensuring that new and expanding firms and industries are able to access credit.

Education systems and training arrangements provide workers with higher levels of education or skills (that is, higher levels of human capital) thereby allowing them to be more productive, inventive and innovative.

Openness to trade and investment has important consequences for productivity growth and innovation. It increases the size of markets that can be exploited by successful innovative firms and it allows for increased scale of production. Trade liberalisation enhances product market competition by allowing foreign producers to compete with domestic producers. It forces unproductive firms out of the market and forces domestic firms to innovate to keep pace with new foreign competitors.

International engagement also provides a vital channel for the diffusion of technology across countries. This occurs both through the technology embodied in imported goods and the direct transfer of technology through foreign direct investment as firm-specific technology is shared among multinational companies and their subsidiaries.

The role of business in growth and wealth creation

By its nature entrepreneurial activity is inherently risky so those who put their capital at risk need to be able to capture the rewards that ensue from success. Companies, and listed public companies in particular, provide an effective mechanism to aggregate large amounts of capital for investment, to efficiently allocate and manage risk, accumulate expertise and knowledge and minimise the costs of doing business.

The prosperity that comes from enterprise arises from the energy and vigour of small, medium and large enterprises. There are more than 800,000 small and medium employing enterprises in Australia and some 6,000 or more large ones.

In 2010–11 Australian private sector enterprises created more than $920 billion in wealth.

In doing this, more than ten and a half million Australians were employed and they were paid, collectively, almost $440 billion in wages and salaries. Operating profit of all companies was $340 billion, generated from sales of $2.8 trillion.

Small businesses contributed about a third to overall sales and profits, medium businesses a quarter and large businesses just over 40 per cent. In a competitive market, businesses compete for customers and business with the aim of generating profits and wealth. There are differences and tensions between businesses of varying sizes but the success of one sector need not be at the expense of the other.

There are deep connections between large and small businesses and a sizeable part of the incomes of each are generated through their interactions with each other. Some $475 billion of transactions are estimated to occur directly between large businesses and small and medium businesses each year.

Exhibit 3: The nature and importance of enterprise

Work previously commissioned by the Business Council from Fred Hilmer has examined the nature and importance of enterprise in Australia.

"To define enterprise, we must begin by saying what business is all about. The purpose of business is to add value – to provide customers with services or products for which they will pay enough to justify the time and effort of the people involved and the other costs and assets that are used. Customers are free agents in free markets. They choose the products or services of a particular business over those of competitors because the preferred business provides better value. Businesses mainly exist to service customers definitely not just to make profits. Profits should follow when customers are prepared to pay and keep paying an organisation adequate prices for the value it adds.

A business has three essential ingredients: customers, resources (one or a combination of people, finance, plant and equipment, and ideas) and a way of adding value through a business system.

Enterprises are critical to national prosperity because these are the units that combine the skills of people, technology, ideas and money in ways that induce customers to buy. Economies grow and jobs are created when their enterprises grow and when new enterprises are formed. Economies stagnate when their enterprises are beaten by those of other countries in the contest for winning customers.

An enterprise succeeds when it provides distinctive value to its customers while maintaining a balance between the legitimate aspirations of the people who invest in it, work in, deal with and live with the enterprise.

Enterprises that are able to do well over time not only do the basics well – low-cost efficient production and service – but in addition build a reputation, usually captured in a brand name or enterprise name, that customers recognise and trust.

The value of the brand or name comes from the benefits that the enterprise is consistently able to provide to customers including design and features of its products and services, quality, service – courtesy, friendliness, having what the customer needs when needed – and image. Value is real and hard won: it is not created by advertising campaigns or hype.

Successful enterprises provide these benefits to customers in a form or way that is distinctive in the sense of being different and in the eyes of customers better than the benefits provided by competing enterprises.

Finally, even where an enterprise is efficient and provides distinctive benefits to customers it will not succeed unless it can change and adapt more quickly than competitors."

Australia's growth story

Australia's economic growth story is an enormously successful one.

We have succeeded as a fundamentally market-oriented economy with our wealth and prosperity driven by businesses. We have made the most of our international linkages by being open to trade and investment, which has provided both a discipline and a source of great opportunity to exploit our advantages.

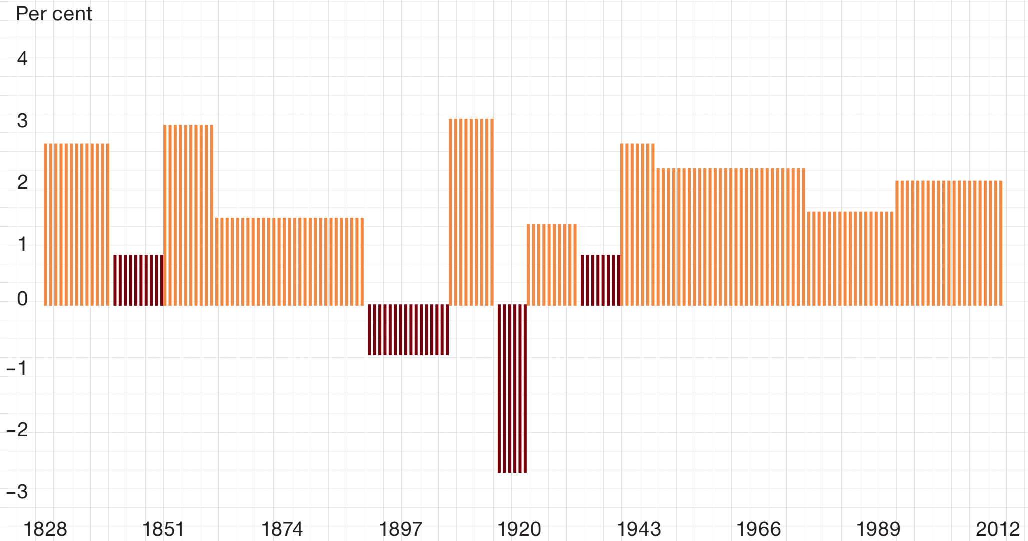
We have made good use of our natural resources and generally had a good capacity to manage many of the shocks that have come our way.

Australia and its people became rich relatively quickly and we have been able to remain prosperous. Economic historians have suggested that at the core of Australia's story lies a policy and institutional adaptability in the face of markedly changing economic conditions that ensured enhanced living standards for a rapidly growing population over most of the past two centuries.

The chart below provides a snapshot of Australia's economic development since 1828 as measured by average rates of growth in real GDP per capita during various growth episodes.

In the past 180 years real GDP per capita in Australia has risen by an average of 1½ per cent per year and in the period since the end of the Second World War, the average performance has been stronger with per capita GDP rising by an average of 2 per cent per year.

Figure 3: Growth in real GDP per capita



Source: ABS, 2013b; McLean, 2004

Our economic development has been characterised by three episodes of sustained growth and prosperity:

» a 40-year expansion between 1850 and 1889 associated with a gold and pastoral boom during which Australia became wealthy

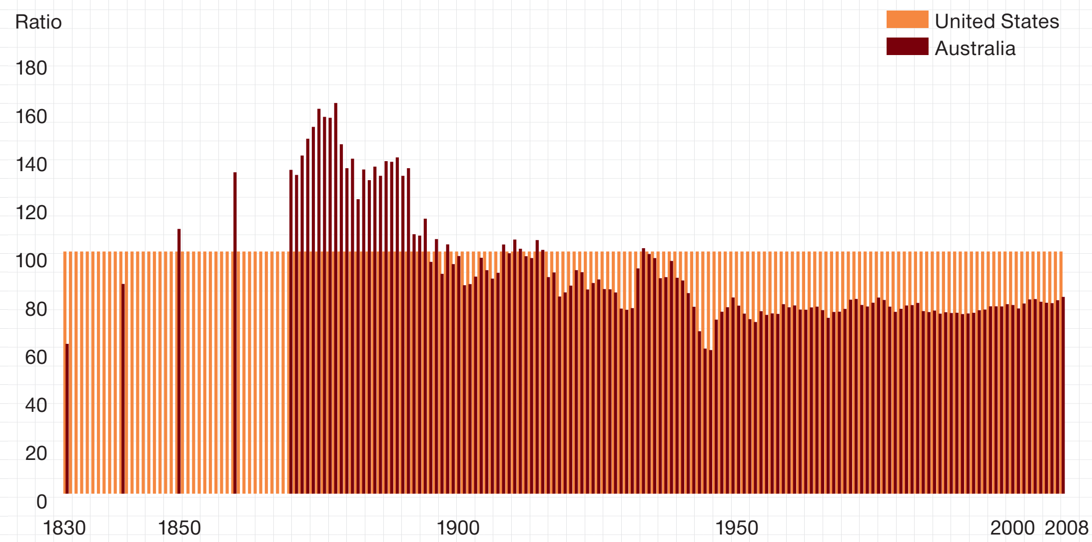
» a 30-year expansion from the end of the Second World War through to the early 1970s coinciding with a long boom in the world economy and supported by a prolonged surge in immigration and large inflows of foreign investment

» the current 22-year expansion that has extended, uninterrupted from 1992 as underpinned by a program of reforms from the mid-1980s which improved the flexibility, openness and responsiveness of the economy.

The period from 1860 to 1890 was not only characterised as an era in which Australia became rich, but in fact for a time Australia was the most economically prosperous country in the world.

During that period Australia's GDP per capita exceeded that of the United Kingdom and the United States.

Figure 4: Relative GDP per capita: Australia vs United States



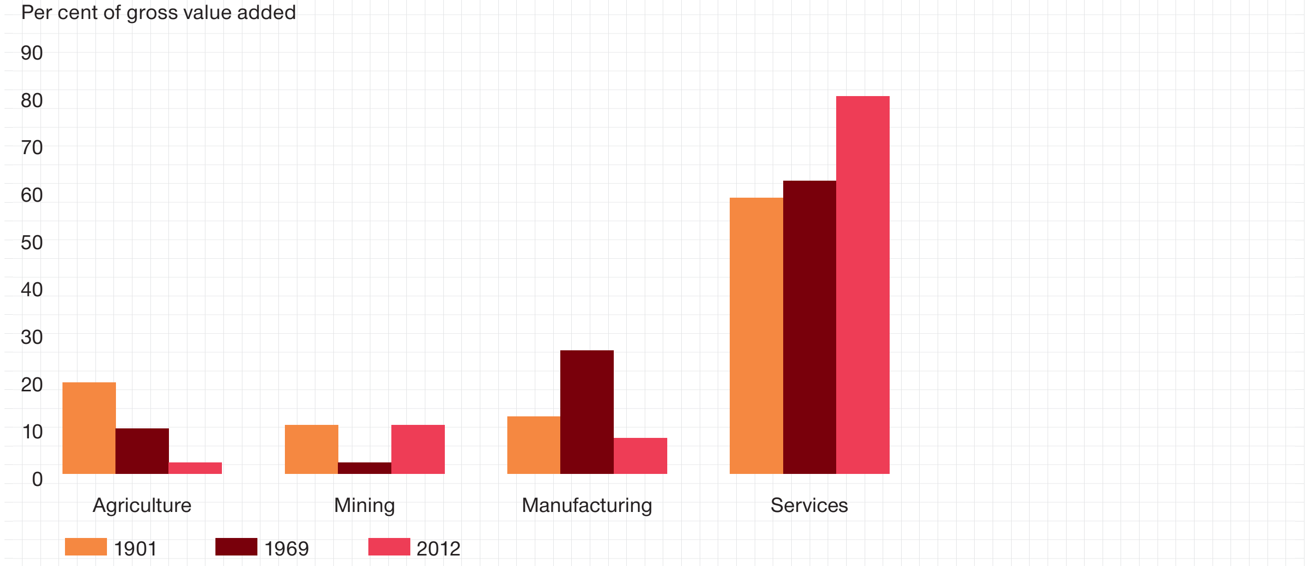
Source: Maddison, 2004

Australia's industrial structure has evolved over the past century or so. The main changes evident in the chart below are a relative decline in the share of wealth generated by the agricultural sector and the more recent decline in wealth from the manufacturing sector. The share of services in wealth creation has continued to rise.

At Federation, the structure of the Australian economy included a relatively large services sector which represented almost 60 per cent of the economy (something unusual at the time and more in keeping with what would typically be expected of a modern industrial economy).

The success of the mining and agricultural sectors delivered high standards of living for Australians, which in turn generated strong demand for services including in the areas of building and construction, transport, financial services, retailing and government administration.

Figure 5: Australia's changing industry structure



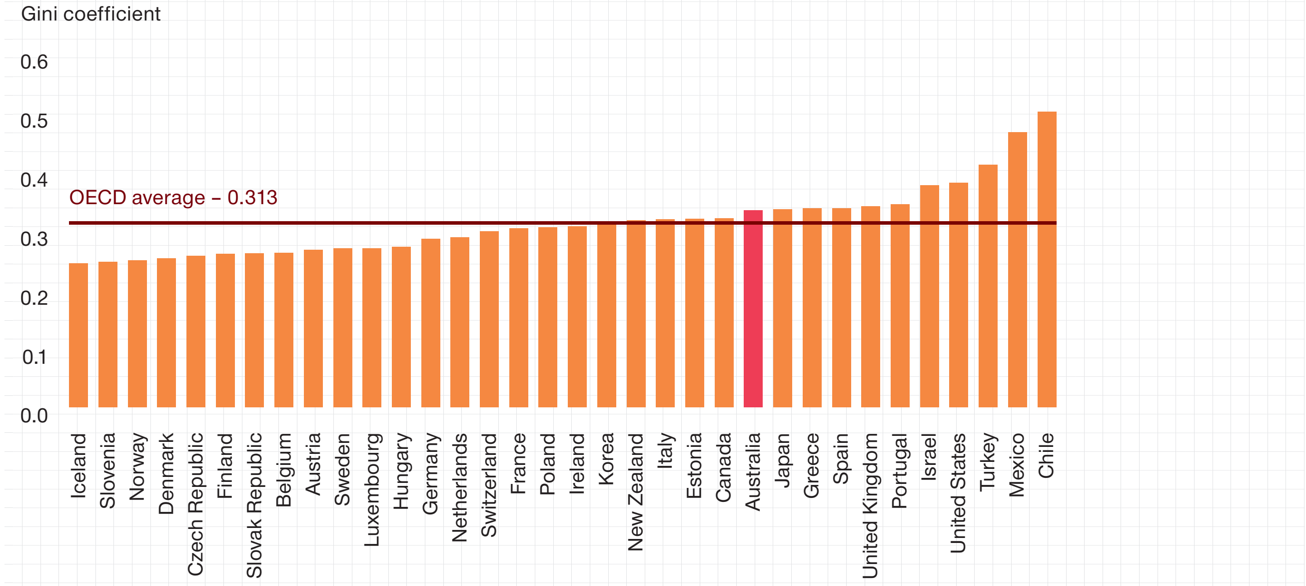
Source: ABS, 2012c; Maddock & McLean, 1987

Note: years refer to financial years.

While it is difficult to obtain reliable historical information on the distribution of income and wealth in Australia, the available evidence suggests that through a large part of the 20th century inequality narrowed. In 1922 the share of income that went to the top 5 per cent of income earners was estimated to be 42 per cent. By 1973 this share was 16 per cent. Today the share of income earned by the top 5 per cent stands at around 20 per cent.

Australia's tax and transfer system has been the principal mechanism used to deal with income inequality. Data from the OECD suggests that Australia's tax and benefits system reduces income inequality by 23 per cent, which is around the average for developed countries. Income distribution in Australia is, overall, around the OECD average.

Figure 6: Income distribution, OECD



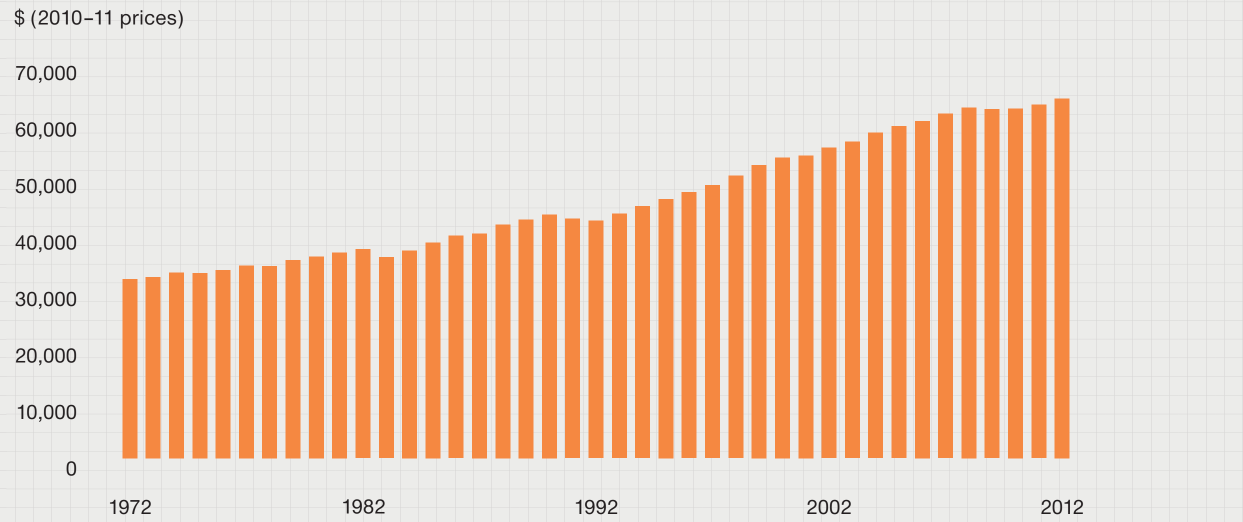
Source: OECD.StatExtracts database

Exhibit 4: A doubling of real incomes

It is a testament to Australia's economic success that we have succeeded in doubling real incomes in per capita terms over the past 40 years or so.

» Between 1972 and 2012, real GDP per capita in Australia increased from around $30,000 to $60,000.

Figure 7: Doubling of real GDP per capita, 1972–2012



Source: ABS, 2013b

Note: years refer to financial years.

» This doubling of real per capita incomes over the period occurred off the back of average economic growth of 3¼ per cent per year.

» This growth is itself explained by ongoing growth in the size of the labour force of over 1½ per cent per year.

» At the same time Australian businesses and workers have become more productive. Labour productivity has increased by an average of 1.6 per cent per year.

» A feature of the economic landscape over this period has been increased competition and in particular greater international competition.

» This increased competition served as a spur to lifting national economic performance toward global best practice by focusing investment on the things we do best and providing incentives to actually do them well.

Part Three: Growth in a changing environment

Well-managed growth matters because a growing society will be more resilient and a growing economy makes it easier to deal with the challenges affecting generational fairness.

At the heart of Australia's story has been our adaptability in the face of markedly changed economic conditions and that as a small, open economy we have been successful in capturing opportunities from the global economy.

The Australian economy is currently experiencing a major structural transition – adjusting to a number of profound developments, including in recent years an unprecedented terms-of-trade boom, a persistently high exchange rate and ongoing shifts in the allocation of labour and capital across the country.

Moreover, major shifts are occurring as countries around us grow richer and present new opportunities as well as greater competition. Our population continues to grow and change. We are getting older but also more diverse. There is a greater expectation that Australia should look after its natural environment and better manage its resources. Technology is also transforming the way many of us work, the way we run our businesses and the way we go about our everyday lives.

These forces are discussed further below. How our country responds to these and other forces is central to whether Australia remains prosperous.

As the resources investment boom eases in Australia, questions remain about the capacity of other sectors to take over as principal drivers of the growth needed to sustain our prosperity. We cannot take for granted that this growth will eventuate.

Australia's economic fundamentals

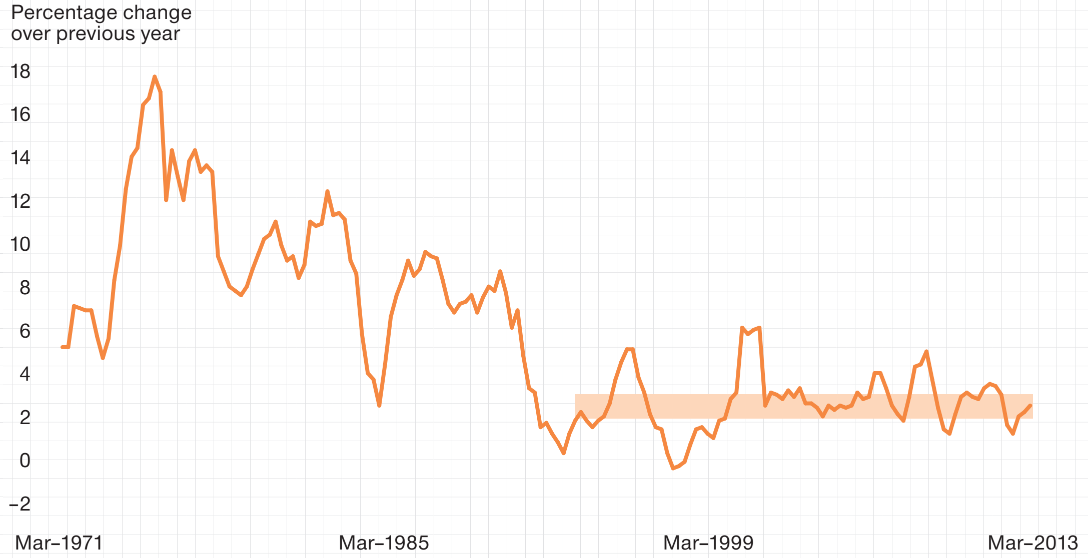
Australia is currently enjoying its 22nd year in a row of economic growth without a recession. This is a significant achievement. It reflects a combination of factors including past policy reforms which have improved the flexibility and adaptability of the economy. It also reflects our adjacency to the fast-growing developed economies within the region and Australia's sound fundamentals.

The last recession in the early 1990s helped wrestle out of the system the high inflation that took hold and harmed Australia in the 1970s.

Together with a move to make the labour market more flexible – through a move to enterprise bargaining – along with other productivity and competition-enhancing reforms, Australia was set up for the sustained period of low-inflationary growth that we have subsequently enjoyed.

As of June 2013 inflation (and both the headline and underlying measures) is running at around 2½ per cent, real economic growth is around 2½ per cent and the unemployment rate is around 5½ per cent.

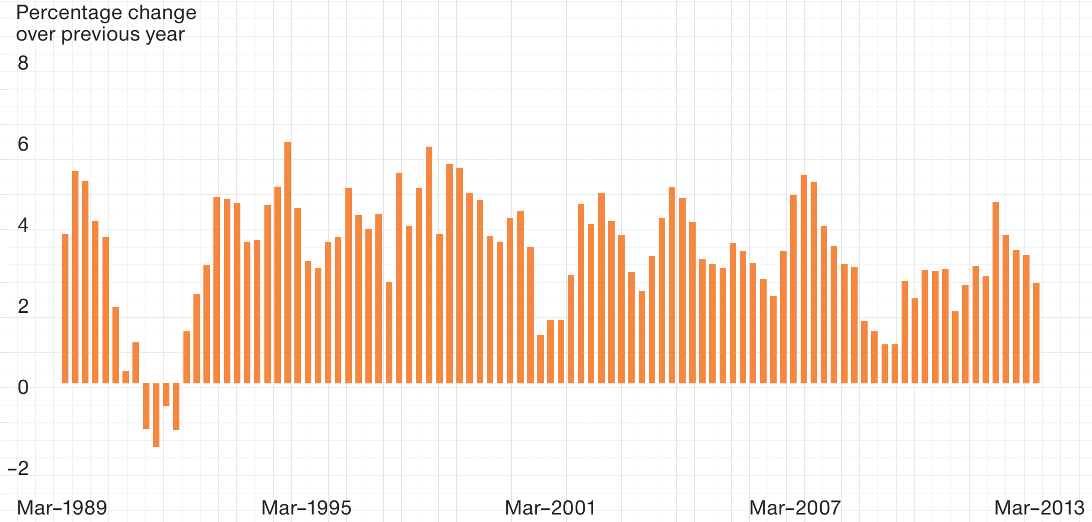
Figure 8: Inflation: Consumer Price Index



Source: ABS, 2013e; BCA

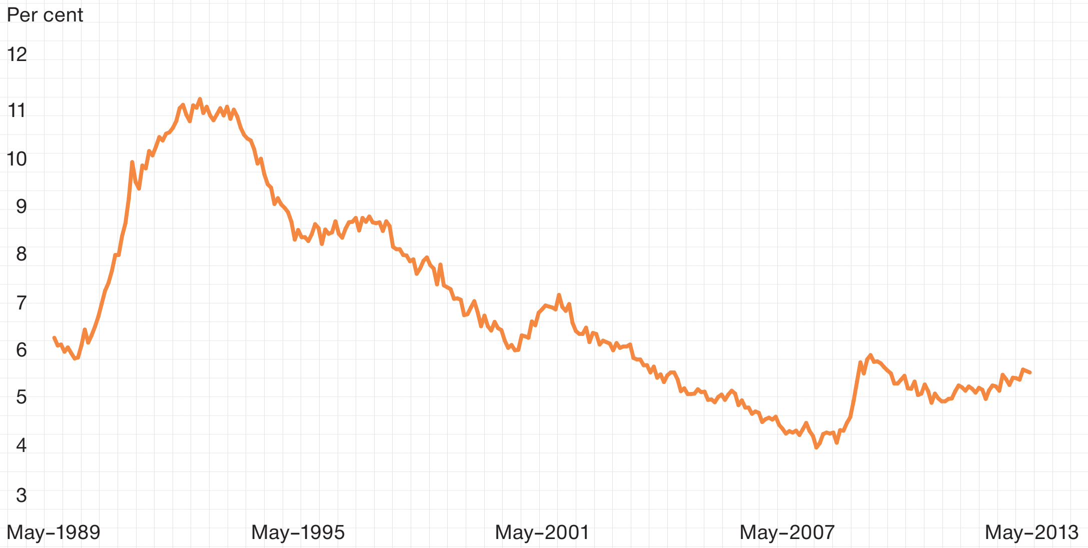
Note: shaded area refers to the RBA inflation target of 2 to 3 per cent.

Figure 9: Economic growth: Real GDP



Source: ABS, 2013b

Figure 10: Unemployment rate



Source: ABS, 2013k

Confidence

Notwithstanding Australia's sound fundamentals, confidence levels throughout the economy have been subdued for the past two years.

The aftermath of the global financial crisis and a sustained period of deleveraging have doubtless been contributing factors.

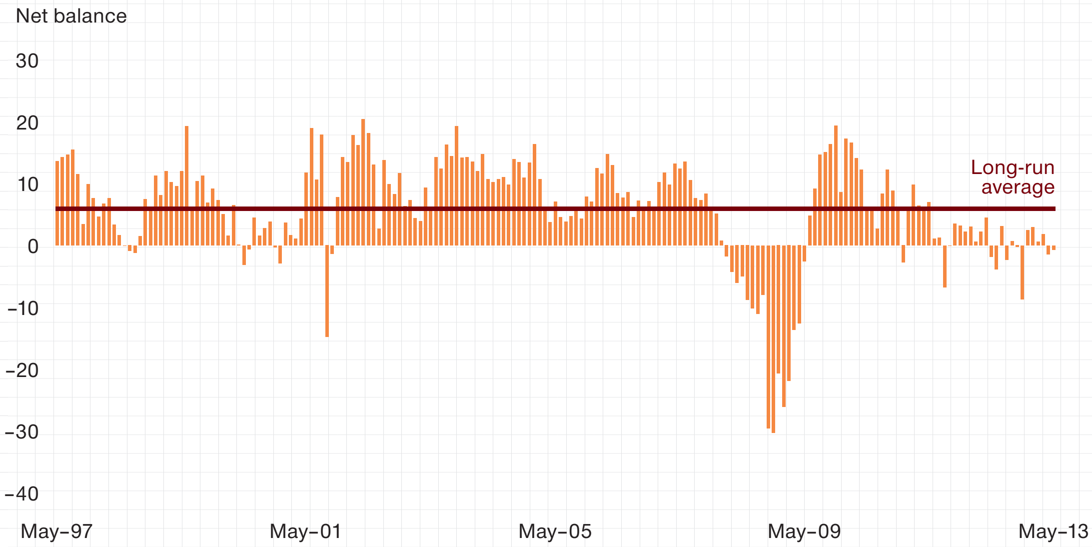
However, from a business perspective the impact of policy uncertainty and regulatory overreach has also played a role.

A strong and credible approach to policymaking can reduce uncertainty and help contribute to a stable environment conducive to investment and innovation. Regulatory interventions and new tax imposts have been introduced without the necessary consultation and this has added to perceptions around country or regulatory risk when it comes to Australia.

From a consumer confidence perspective there have been recent signs of an uptick reflecting previous interest rate reductions, a strong equity market and a recovery in house prices. However, levels remain well down on the historical average and the average level through the past 10 years or so.

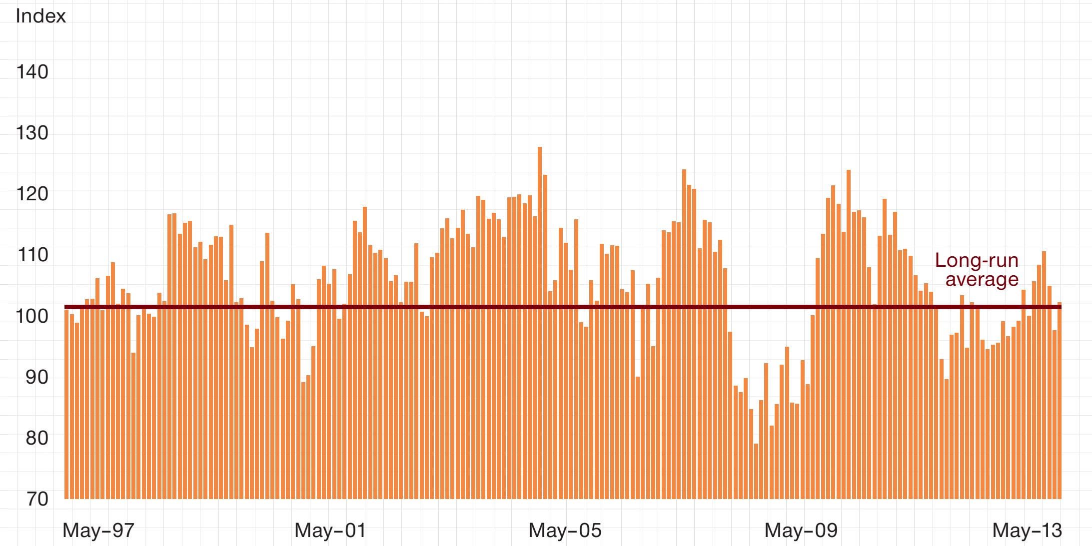
As outlined above, confidence matters when it comes to encouraging people and business to put capital at risk to exploit good ideas and opportunities that can generate wealth. A lack of incentive – including from an uncompetitive tax system – as well as too much regulation and red tape are key factors in holding confidence back.

Figure 11: Business confidence



Source: NAB Monthly Business Survey

Figure 12: Consumer confidence



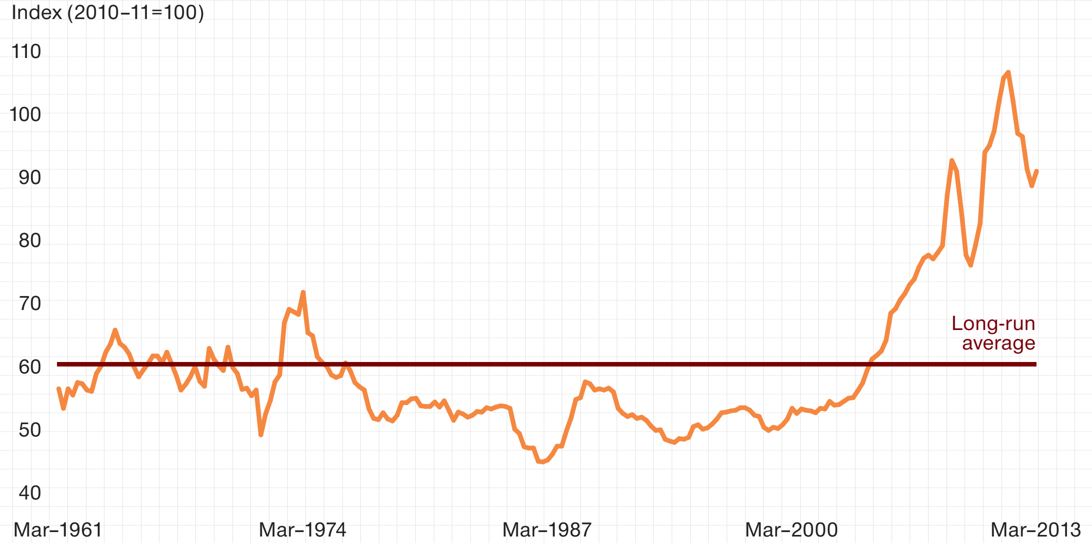
Source: Westpac–Melbourne Institute Survey of Consumer Sentiment

An economy in transition

In recent years there have been a number of factors at play that have both contributed to rising national incomes, but which have also made economic management far more difficult.

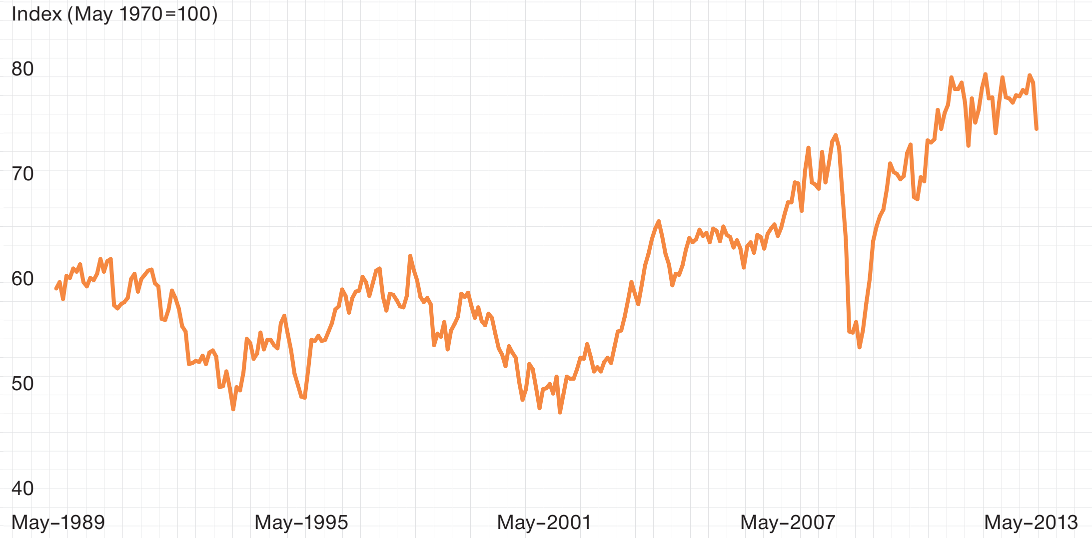
The dominant influence has been the extraordinary resources boom that commenced around 2003–04. This resources boom has been associated with an unprecedented increase in the terms of trade. It has resulted in a large boost to Australia's national income, has been the primary driver of a strong appreciation of the exchange rate and has driven an investment surge.

Figure 13: Terms of trade



Source: ABS, 2013b

Figure 14: Exchange rate: Trade-weighted index



Source: RBA Exchange Rate, Monthly Data

Figure 15: New business investment

Source: ABS, 2013b

Australia's terms of trade have fallen by 15 per cent from their peak in the September quarter 2011. Notwithstanding this recent fall, the current level remains around 50 per cent higher than the historical average.

The resource boom has had a profound effect on Australia's economy as it moves through a number of phases including the increase in the terms of trade, a substantial resources-related investment response and lastly a significant increase in resources-related exports.

In recent years Australia has also been required to deal with the so-called Dutch Disease – with the resources boom and subsequent exchange rate appreciation reducing the profitability and output of other export and import competing industries.

Economists have shown that the consequence of the resources boom is typically threefold: to benefit the 'booming' mining and resources sector and related industries (such as mining and professional services); to hinder the lagging trade-exposed sectors hit by the high dollar (such as manufacturing, agriculture, tourism and international education); and to help the non-tradeable sector including the domestic services industries that benefit from the income gains that come from the terms-of-trade boom.

While the high dollar has made life considerably more difficult for many businesses, it has nonetheless played a role in facilitating some important structural change across the economy.

Structural adjustment

Vibrant, dynamic economies will inevitably be characterised by ongoing structural changes as workers and capital move from lower-value uses to higher value add. There is little to fear from high jobs turnover if fast-growing, higher-productivity jobs replace lower-paid ones. These structural changes must also be seen as an acceleration of well-established long-term structural trends such as the relative decline in manufacturing and growth in services.

The response to a higher dollar should not be government interventions to put a floor or ceiling on the exchange rate or the imposition of new import tariffs, but rather policy interventions that facilitate the adjustment process. Protective policies that insulate domestic firms from international competition can be particularly problematic in relatively small economies like Australia.

While structural adjustment will bring benefits to the economy and community more broadly, there will inevitably be short-term losses and adjustment pressures felt more acutely by certain groups. The tax and transfer system should be the primary avenue to assist with immediate dislocation. However, in facilitating the adjustment process, the main role of governments should be to reduce the extent of short-term economic disruption during transition, particularly in reducing the possibility of long-term and structural unemployment.

This includes fostering flexibility, improving the skills of labour force participants and providing retraining opportunities, removing obstacles to labour mobility, providing some temporary adjustment assistance and improving infrastructure. It is fairly well acknowledged that previous efforts to improve the flexibility and adaptability of the Australian economy through market reforms have had an effect on alleviating adjustment costs.

In fact Australia's institutional settings – which include a market-determined exchange rate, medium-term monetary and fiscal policy frameworks as well as a flexible labour market – have given the economy the flexibility needed to deal with different economic shocks and helped to largely avoid problems that arose in previous terms-of-trade booms such as extreme inflation outcomes.

Assistance measures directed at particular businesses or regions under competitive pressure need to be carefully assessed according to their duration and their effects on the wider economy. Any compensation provided should facilitate adjustment rather than provide passive support. Experience in many developed countries suggests that selective industry assistance can impede or delay adjustment and is ultimately ineffective in protecting jobs. Assistance will be best targeted at displaced employees through retraining and relocation assistance.

A phasing of policies changes can also be an effective means of easing adjustment pressures.

Structural adjustment in the economy has had a concentrated impact on manufacturing given its trade exposure, small scale and relatively high costs in global terms. It is noteworthy that recent modelling undertaken by the Productivity Commission shows that while manufacturing's share of employment and output in the economy will decline further, value added and employment in the sector is expected to grow in absolute terms through to 2050.

The future competitiveness of manufacturing will be closely tied to the competitiveness of the Australian economy more broadly. The best policy response from governments, as ever, will be to focus on initiatives that boost the productive capacity of the economy and encourage investment, including via a lower corporate tax burden, efficient regulation, ongoing investment in skills, and greater labour market flexibility. This will give all firms, including those in the manufacturing sector, the best chance of adapting to structural pressures and increasing their international competitiveness.

Productivity and unit labour costs

There has been a significant focus on Australia's productivity performance in recent years with a particular focus on the lack of growth in the multifactor productivity measure (the efficiency with which labour and capital inputs are combined).

Whereas multifactor productivity growth in the market sector of Australia's economy has typically averaged around 1 per cent per year, since 2003–04 it has averaged –0.5 per cent per year (with six of the past eight years recording negative growth). This is unprecedented.

Resolving issues around productivity is not straightforward because of inherent complexities in ascertaining the precise influences on productivity.

Firm-level developments are fundamental to understanding productivity and it is well established that there are enormous and persistent differences in the performance of businesses (including those that are otherwise seemingly similar).

Possible causes of these performance differences include differences in management practice; higher-quality labour and capital; differential investment in information technology and research and development; firm structure; productivity spillovers; regulatory behaviour; and differences in the competitive regime that companies face.

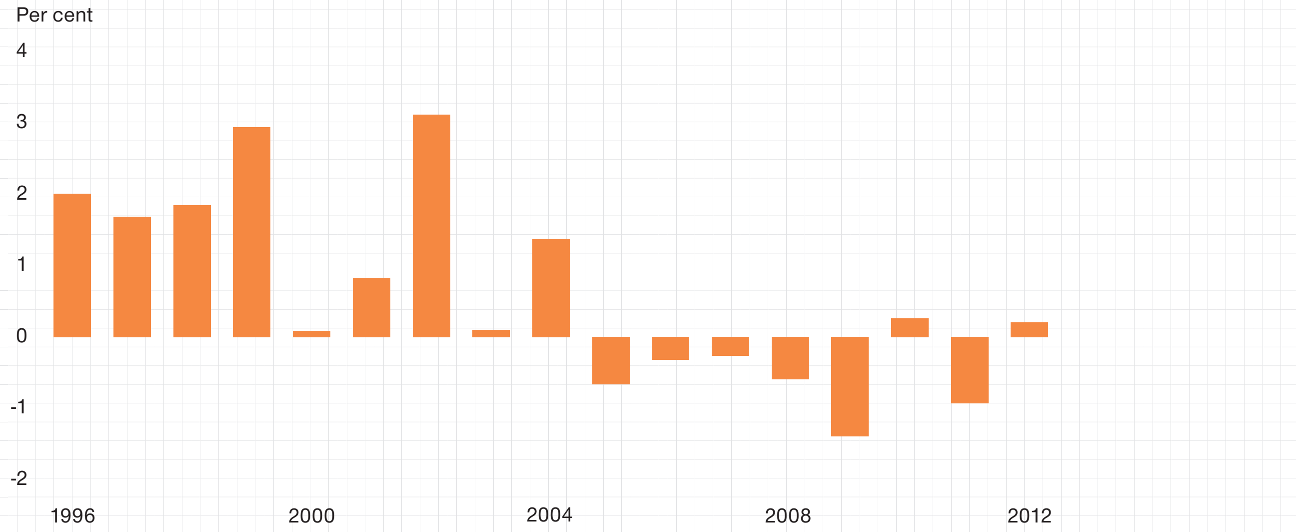
A fundamental point is whether managers can control the factors that influence productivity or whether they are merely products of the external environment. In considering this point it is helpful to isolate two influences:

» the influences on productivity at the firm level comprising the 'levers' that the managers can pull to improve performance

» the influence of the market in which the firms and managers operate.

Naturally the two interact but the critical issue is the extent to which managers are induced or incentivised to pull the levers – as well as their ability or freedom to pull the levers they want (i.e. the regulatory or other policy-induced impediments that may prevent them from doing so).

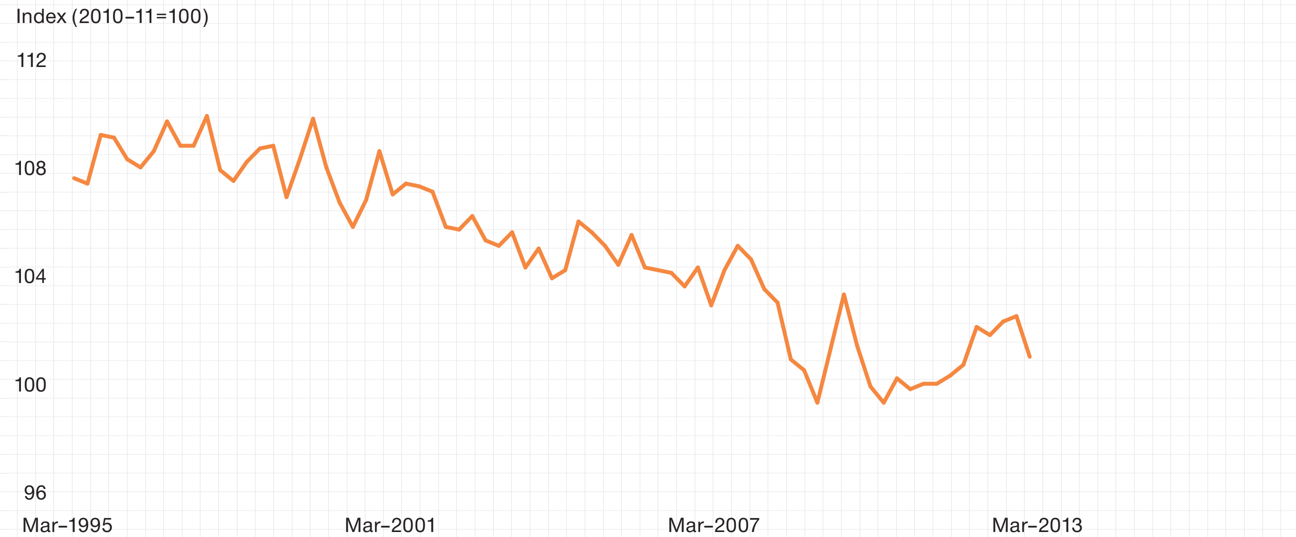
Figure 65: Multifactor productivity growth



Source: ABS, 2012d

Note: years refer to financial years.

Figure 17: Non-farm real unit labour costs



Source: ABS, 2013b

Whether a lack of policy reforms is responsible for the drop-off in productivity growth or whether recent trends reflect special factors, sectoral changes and cyclical fluctuations in the economy, it is clear that the business environment matters for productivity.

Associated with this view is the suggestion that there are no direct policy levers to improve productivity but rather that governments affect productivity through their influence on the business environment.

A key indicator of business competitiveness – and a measure closely related to productivity performance – is the measure of real unit labour costs. Simply the cost of labour adjusted for labour productivity.

Unit labour costs will decrease (or increase by less) as workers are supported by more capital (i.e. capital deepening occurs) and as multifactor productivity increases.

Over the past 25 years or so real unit labour costs in Australia have fallen by an average of around 0.3 per cent per year for an 18-month period. However, more recently the trend has been for real unit labour costs to rise. This rise has since abated but nonetheless developments around unit labour costs remain a fundamental watchpoint for businesses. This reinforces the need for a concerted focus on competitiveness and productivity.

After the resource investment boom

As outlined above, resources-related investment has been a major driver of economic growth in Australia in recent years. But with this investment peaking and expected to detract from growth, a critical question arises as to the new sources of growth.

Both the Treasury and the Reserve Bank have highlighted recently expectations that a gradual shift will occur – with the economy rebalanced towards a greater reliance on exports, non-resource investment (including housing) and household spending.

While there is a good prospect that a higher level of exports will eventuate as the resource investment projects move to the production phase, this alone is unlikely to fill the breach.

Investment in infrastructure has the potential to help fill the gap left by declining resource investment and could utilise some of the skilled workers who complete their work on mining and gas construction projects. However, this will not occur automatically. For growth in the level of infrastructure investment to be actually achieved, new projects will need to be designed, approved, financed and delivered. With household saving rates holding up (reflecting a 'new normal' as households deleverage) and the housing sector and non-residential construction yet to fully recover, the rebalancing of the economy is far from assured.

Strong national leadership and a bold and credible approach to managing the economy are essential for restoring the confidence needed for this to occur.

The rise of the emerging economies

The emergence over the past decade of the developing countries and their influence on the global economic landscape has been profound. Global economic power has shifted away from the United States and Europe toward a handful of fast-growing and large developing countries – effecting shifts in global trade and finance and providing the rising economic powers with greater levels of influence.

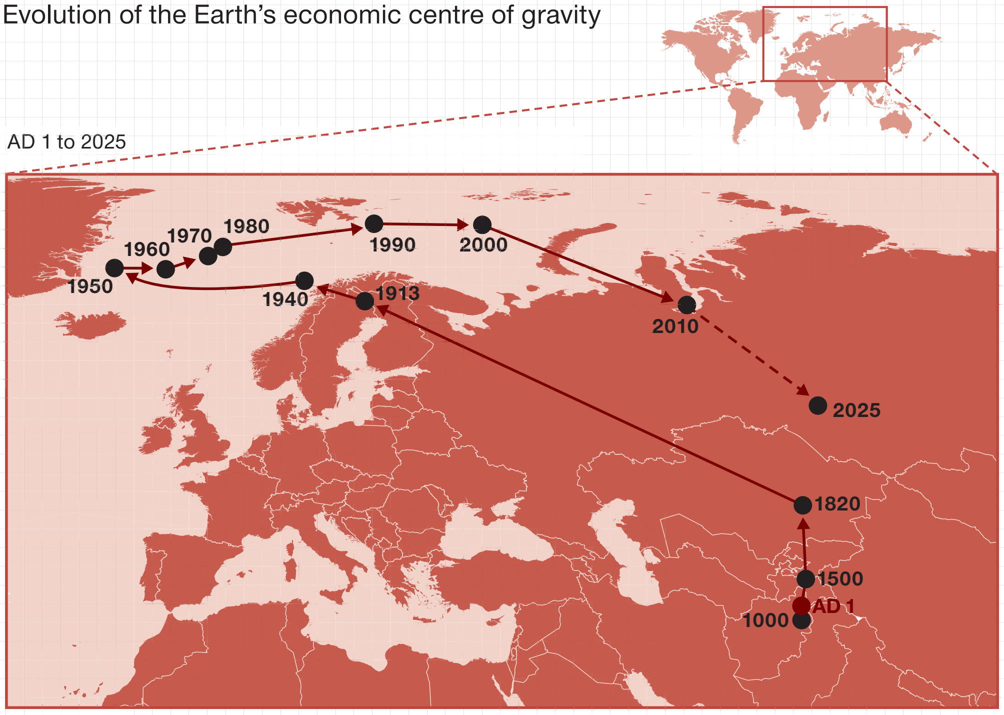
Emerging markets are now increasingly important drivers of global economic growth and could account for as much as 75 per cent of global GDP growth by 2025.

A rapidly growing middle class in emerging economies could see these markets rival developed economies as the major global consumers accounting for almost half, or $30 trillion, of global consumption by 2025.

Emerging economies are home to an increasingly larger pool of global wealth, with financial assets held by investors in developing nations growing from 7 per cent to 21 per cent of global financial wealth over the past decade and expectations that this growth is likely to continue.

Figure 18: The balance of economic power is increasingly shifting east

Evolution of the Earth's economic centre of gravity



Source: McKinsey Global Institute

Note: economic centre of gravity is calculated by weighting locations by GDP in three dimensions and projected to the nearest point on the Earth's surface. The surface projection of the centre of gravity shifts north over the course of the century, reflecting the fact that in three-dimensional space America and Asia are not only 'next' to each other, but also 'across' from each other.

Australia has been very successful at capturing growth from China, which now represents over 29 per cent of Australian exports in 2011–12, up from just 2.4 per cent in 1990–91. Connections with India and South East Asia are less developed.

Despite our growing presence in the region, our experience and understanding of the cultures, languages, behaviours and customs of emerging economies in Asia requires continual deepening.

The World Bank has further noted that the shift in economic and financial power is having important implications for the global corporate environment. Emerging market firms have become an important force behind new foreign direct investment (FDI) flows in terms of both cross-border acquisitions and greenfield investments and are growing participants in international capital markets. Moving forward, multinational firms based in emerging markets will become important agents of change on a global scale, pushing for more open policies at home and abroad and posing greater competition to advanced country firms.

The increased number of middle-class individuals with rising disposable incomes will provide an opportunity to extend our exports, beyond our current focus on resources, into a wider range of goods and services.

Closer economic ties will lead to deeper investment from, and into, emerging economies and result in greater diversity at board and management level.

The restructuring of global financial markets

In the wake of the global financial crisis, global capital flows have been more constrained, with cross-border capital flows in 2012 still 60 per cent below their 2007 peak of $11.8 trillion.

A global repricing of risk and greater scrutiny and regulation of financial institutions has seen capital ratios at banks in OECD countries increase since 2008, a trend that is being mirrored around the world.

In many countries around the world, trust in the financial sector has been eroded with fundamental questions about the robustness of global banks' risk assessment processes as they consistently underpriced risk and increased leverage in the lead-up to the financial crisis. Financial institutions are also increasing their liquidity along with the quantity and quality of capital they hold, as a result of both regulation and market expectations.

This trend has also seen a global deleveraging by households and corporates since 2009, with domestic credit to private sectors in OECD countries falling since 2009. In contrast, public sector debt as a proportion of GDP has been rising in much of the developed world since 2007.

Figure 19: Global cross-border capital flows

Source: McKinsey & Company

Note: includes foreign direct investment, purchases of foreign bonds and equities, and cross-border loans and deposits. Data for 2012 are estimated.

Despite global volatility, Australia continues to be an attractive destination for global cross-border capital, drawing US$65.8 billion in 2011, more than double the foreign direct investment inflows of 2009.

Australian banking asset quality remains among the highest in the world with non-performing loans of under 1.5 per cent, considerably lower than other developed markets such as the US (4.8 per cent) and UK (7.5 per cent).

Total debt as a percentage of GDP in Australia, while still below 2009 levels, has been rising since 2010 driven by household and public sectors. Financial and corporate sector debt, however, continue to decline.

Deleveraging by banks may lead to alternative sources of funding. Emerging market state-run enterprises and sovereign wealth funds may take on a greater role in Australian investment.

Australia's long-term dependence on global capital is raising legitimate questions about Australia's future funding model and whether Australian banks will in fact have sufficient money to lend if economic conditions improve.

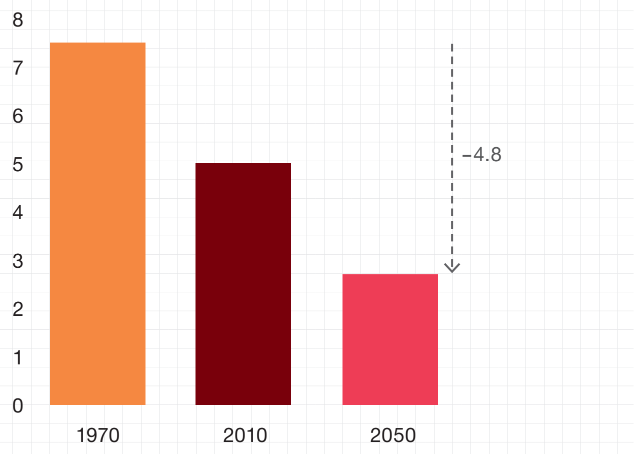
The growth and ageing of our population

An ageing population is one of our biggest economic challenges. This population ageing is occurring as a combination of declining fertility rates (down to 2 births per woman in 2010, from 3.5 in 1961) and falling mortality rates (down to 6.7 in 1000 in 2008, from 9.1 in 1968) has seen the proportion of Australians aged 65 and older increase from 13.3 per cent in 1970 to 20 per cent in 2010.

The ratio of working-age people to those aged 65 and above has declined from 7.5 in 1970, to 5 in 2010 and is predicted to fall to just 2.7 by 2050.

Despite an increased labour participation for persons aged 65 and over, which has almost doubled in the 10 years to February 2013, and a median age of net overseas migrants of 27, compared to a population mean of 37.4, these factors will not be sufficient to meaningfully alleviate the ageing of our population.

Figure 20: Age dependency ratio



Source: Commonwealth of Australia, 2010

The first of the baby boomers reached the age of 65 in January 2011, and over the next 20 years more than 4.2 million people currently in the Australian labour force will reach the age of 65.

Superannuation balances are still well below the estimated balance of $600,000 required to support a comfortable standard of living from the age of 65, with median balances for those aged 55–59 and 60–64 estimated at just $77,100 and $109,400 respectively.

Companies will move towards retaining their workforces into older age to make use of their valuable skills. The retirement age is likely to increase to provide incentives for workers to remain in the labour force. Fiscal pressures will increase as the tax base will be reduced and there is an increase in demand for age-related services.

The rise of technology and digitisation

Technological developments and digitisation represent a force that is bringing an increasingly powerful change in the structure of the economy, the way we do business and the way we live our lives.

These developments can create new possibilities, and open up new markets to competition that were previously unavailable. How firms and nations embrace technology is a key determinant of how they compete in the world and ultimately whether or not they prosper.

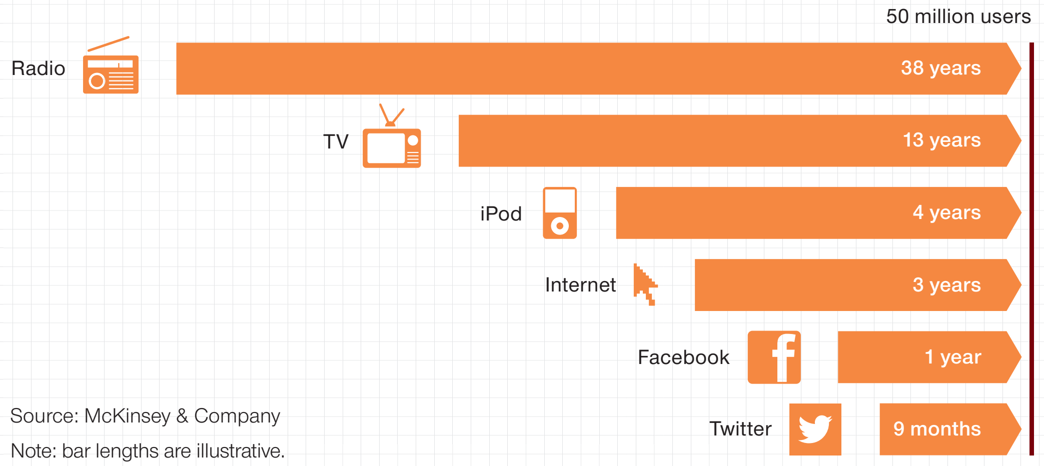
The internet has had a tremendous impact on global productivity and economic growth, accounting for approximately 20 per cent of GDP growth in a recent survey of developed economies and creating 2.6 jobs for every job that is eliminated through productivity gains. This impact is set to rise globally as emerging markets continue to develop their internet ecosystems and achieve similar benefits experienced by developed nations.

Companies around the world are increasingly using online technologies as a source of competitive advantage and those that employ a larger number of internet technologies with higher adoption rates have recorded three times as much revenue growth as their competitors.

Social networking technologies continue to gain in popularity with over 1.5 billion global users and rising, driving a shift towards replacing communications by email and instant messaging with social networking.

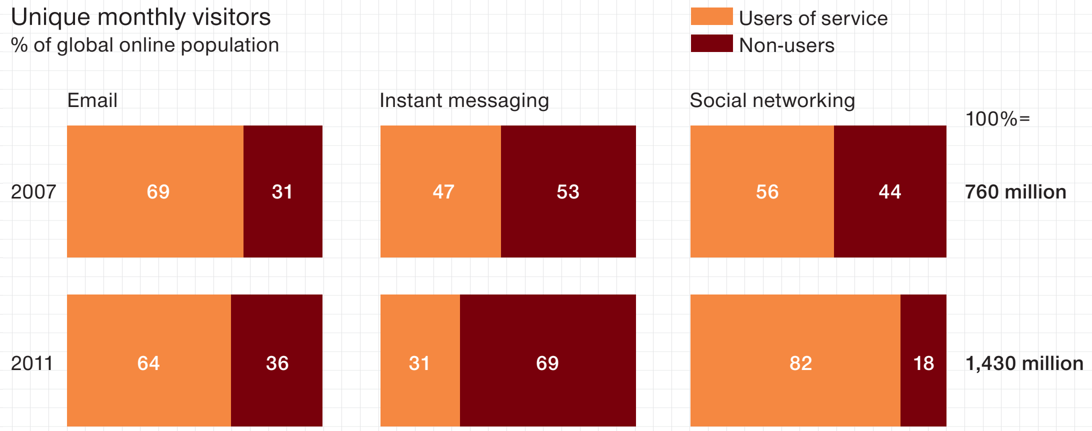
Businesses have only just begun adopting social technologies but the potential benefits to improved collaboration could be worth as much as $1.9 trillion.

Figure 21: Social technologies are being adopted at record speed
Time to reach 50 million users



Source: McKinsey & Company
Note: bar lengths are illustrative.

Figure 22: Shifting communication patterns



Source: McKinsey & Company

Australia is at an early stage towards providing super high-speed internet to all Australians.

Australia ranks 18th in the World Economic Forum's 2013 Networked Readiness Index Rankings, a measure of information and communication technology (ICT) readiness and usage.

Technological innovation and digitisation will continue to drive improved productivity but require a more dynamic and flexible economy with adequate infrastructure and sufficient workers with ICT skills. Adjustments will occur that will disrupt industries and have employment consequences.

The efficiency and sustainability of natural resource consumption

Demand for natural resources is increasing as the world's population grows and becomes more prosperous and yet many natural resources are fixed or limited in supply.

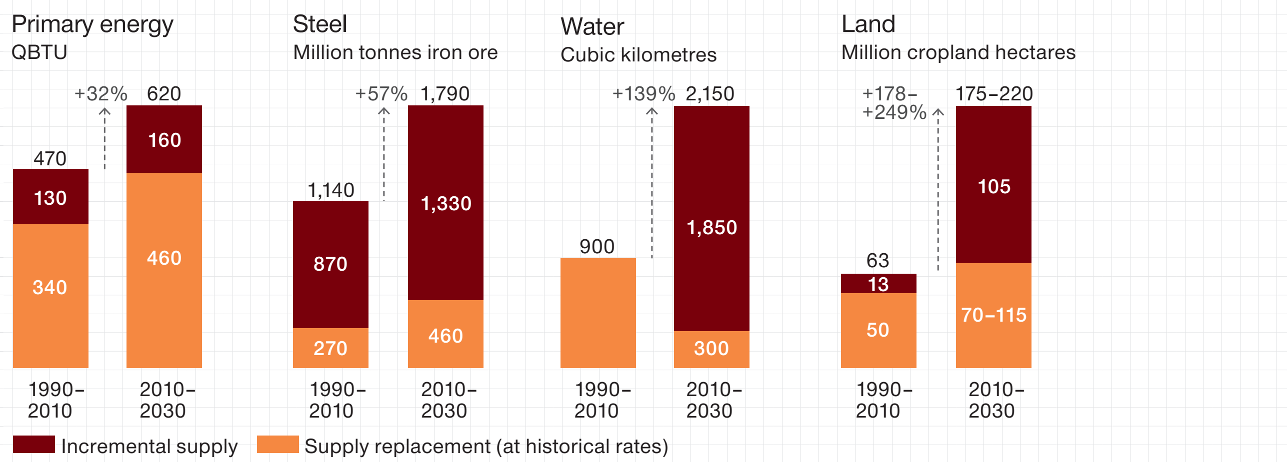
This raises two fundamental issues: first, how resources can be used more efficiently in the production process and, second, how each generation can ensure that its use of natural resources is sustainable and does not deprive future generations from accessing these resources.

With as many as three billion more middle-class consumers set to be added by 2030, demand for resources to support this consumption is expected to escalate rapidly.

Over the next 20 years, the rate at which supply of water and land is added globally would have to increase by 140 per cent and 250 per cent respectively, compared to the past 20 years.

Recognising the difficulties of achieving this supply increase, and the associated environmental consequences (which would require between 140 and 175 million hectares of added deforestation to provide required supply of land), there is a growing focus on the efficient and sustainable use of natural resources.

Figure 23: Additional supply needed over 20-year timeframe



Source: McKinsey & Company

Note: additional supply calculated as incremental supply plus replacement rate; does not tie to total demand.

The recognition across corporate Australia, as well as the wider community, of the importance of efficient resource use is increasing.

Australia's consumption of natural resources on a per capita basis is high, with energy consumption per capita 30 per cent above the OECD average and triple the global average; however, this figure has been falling since 2009.

Resource scarcity could heighten geopolitical tensions as well as have economic growth implications.

Businesses will need to adapt to policy responses aimed at promoting sustainable use and supply of natural resources.

Business decisions will be subjected to greater scrutiny, with companies expected to have plans for sustainability.

Australia's strengths and weaknesses

As we look ahead to an approach that can lock in growth and prosperity, we need to take stock of where Australia currently sits. We do have considerable strengths which will assist in tackling the challenges that lie ahead.

But we should also be aware of areas where we are less strong. Some of these strengths and weaknesses have been highlighted and are summarised below. Dealing with these issues is fundamental to this action plan and are discussed in the next part.

Our strengths are:

Good public and private institutions	» Australia has a low level of corruption and strong democratic institutions » We have strong corporate governance and private institutions	But corporate governance is under pressure and governance of the federation is not effective ↓
Natural and intellectual endowments	» Australia has very large mineral and energy resources and is able to produce and export these resources » Higher education is a cornerstone of Australian exports, and a driver of innovation	But educational standing is falling – we are now ranked 7th and 13th for reading and mathematical literacy, respectively, in the OECD ↓
Early adoption of technology	» Businesses and individuals adopt new technologies faster and in greater numbers than elsewhere	Australians continue to be enthusiastic adopters of new technology, but we are slow to bring local innovation to market →
Adjacency to emerging economies	» Emerging markets are projected to account for up to 75% of global GDP growth by 2025 » Developing nations' financial assets are projected to grow from 7% to 21% of global financial wealth over the next decade	But the ease of doing business is declining and our regulatory burden is increasing ↓
Social cohesion	» Australia has a long and successful record of integrating new migrants » The rule of law is entrenched in the Australian way of life and business practices	Rhetoric on skilled migration and refugees, and changes to student and skilled worker visa arrangements, challenge integration ↓
Continued economic growth	» Australia has had two decades of uninterrupted economic growth	But GDP growth is now below trend ↓

But we are becoming increasingly uncompetitive, our regulatory practices have declined and there is a structural problem in the operation of our federation. These weaknesses need to be tackled.

Our weaknesses are:

Poor-functioning federation	» Commonwealth–state duplication is as bad as ever, in spite of funding reforms » Regulatory reforms are delivered too slowly and not focused on big issues that could lift productivity	Intergovernmental relations are getting worse – now 125 National Partnerships ↓
Tendency to over-regulate	» Governments do not adhere to their own processes » Regulations are not introduced in proportion to risk	Over-regulation is getting worse – almost 100 major regulatory changes have been exempt from the Regulation Impact Statement process since 2010 ↓
Weakening fiscal position	» Structural deficit has not been tackled » Expenditure is unsustainable over the long term	We are in a fiscal recovery phase having accumulated deficits of 12 per cent of GDP, with the prospect of further deficits in coming years ↓
High costs and uncompetitive	» Government estimates that over $150 billion of resources projects have been delayed or deferred » Vital infrastructure is becoming unaffordable	Competitiveness is declining – Australia has slipped five places to 20th in the World Economic Forum Global Competitiveness Index ranking ↓
Low productivity	» Since 2004–05, multifactor productivity has recorded negative growth in most years	In 2011–12 Australia's multifactor productivity grew by just 0.3% →

Part Four: What's required for growth and prosperity

Charting the course

The previous sections have highlighted the importance of broadly based and inclusive economic growth as underpinning our national prosperity.

Having an appreciation for what has driven growth in the past, as well as identification of the changing landscape and some of the challenges that lie ahead leads us to the question: what do we need to do if we are to lock in a goal of enduring prosperity for all Australians?

The answer to this is to be sure of where we want to head as a nation and to consider how we intend to get there. We also need to identify what is likely to prevent us from achieving this vision.

Responsibility for delivering enduring prosperity is a shared endeavour – one that is driven by enterprising Australians and Australian businesses who create wealth, as supported by strong public institutions, an efficient public service and credible and responsible policies of government.

For Australia to be successful in the future, policy settings and reform directions need to be implemented in a way that is consistent with the core fundamentals and philosophies that drive or enable well-managed growth. Adherence to these fundamentals has served us well in the past and by retaining consistency with them we will be better able to adapt to a rapidly changing world.

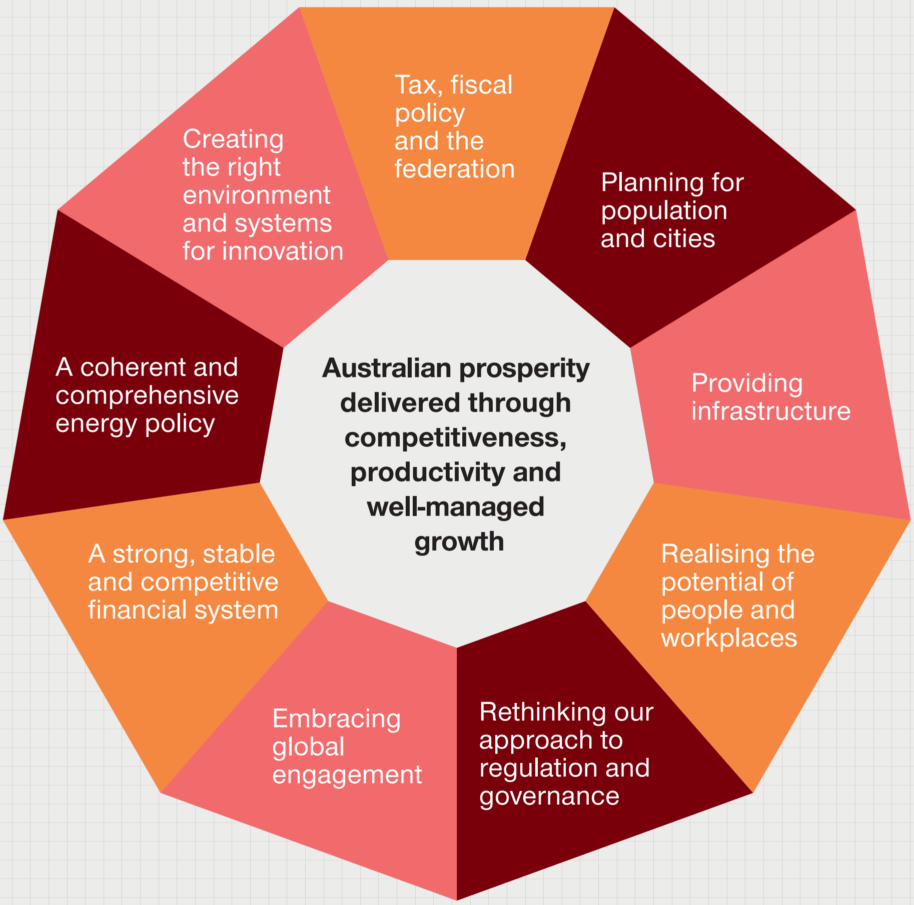
These principles include: the maintenance of open markets and an open economy; continuing enhancements to Australia's productive capacity, including through the upgrading of the skills of our workers and through greater levels of workforce participation; the pursuit of more efficient regulation; good government; a sound and well-functioning financial sector; and a balanced approach to sustainability. (A more detailed discussion of these fundamental principles is contained in Appendix 1.)

Within this architecture, however, a renewed reform agenda is required comprising a suite of specific priorities for policies. The pursuit of these reforms and their staged implementation are essential to supporting the role that business plays in creating wealth and ensuring that the benefits of growth are shared throughout the community.

9 things to get right

Nine areas have been identified as requiring specific attention. Each of these nine areas matters if we are to secure enduring prosperity. They all have crucial influence on at least one of the drivers of growth – investment, innovation and growth in the workforce. There are also significant interdependencies between the prescriptions that have been outlined.

These nine policy areas will help chart the course that will better ensure that Australia can continue to grow at a pace that is fast enough to maintain and improve living standards. They will also help deliver well-managed growth that, at the same time, allows us to preserve our natural environment and maintain Australia's social fabric. They will contribute to a restoration of Australian competitiveness and to higher productivity.



01

Put tax and fiscal policy settings and the operation of the federation on a sustainable footing

What do we have to get right?

Australia's fiscal policy settings need to be strengthened to place them on a more sustainable footing for the long run. Our tax system has to be reformed to keep pace with the changing global economy and to keep us competitive. We need the federation to function more smoothly with less argument between the national and state and territory governments and better financial relations between the different levels of government.

Key facts at a glance

Australia will not be able to deliver on the prosperity–inclusiveness compact that underpins well-managed growth if we don't put government spending on a more sustainable footing.

A major fiscal challenge is unfolding and unless we take action now, the combined fiscal deficit across all levels of government in Australia could reach 5 per cent of GDP by 2050.

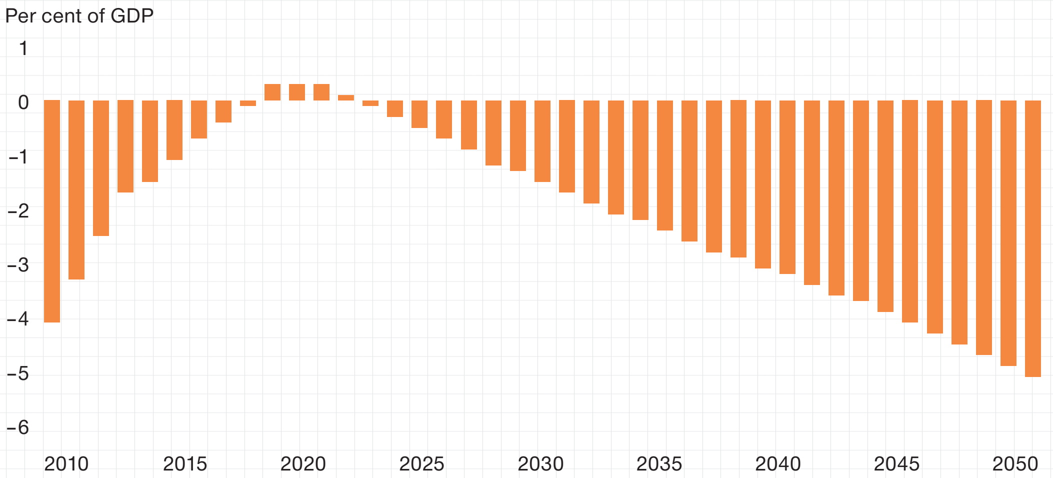
Australia has too many taxes that are detracting from the overall efficiency of economy. Our overall tax mix is not right for a small, open economy and does not offer the right incentives.

Our national prospects would be better if we could reconfigure the tax system to make it more competitive. This can be done in a way that still raises enough revenue but is less harmful to economic growth and the climate for enterprise.

The allocation of Australia's taxing and spending responsibilities is highly imbalanced across different levels of government, compared to other federations.

Better alignment could enhance governments' accountability to citizens and improve government service delivery.

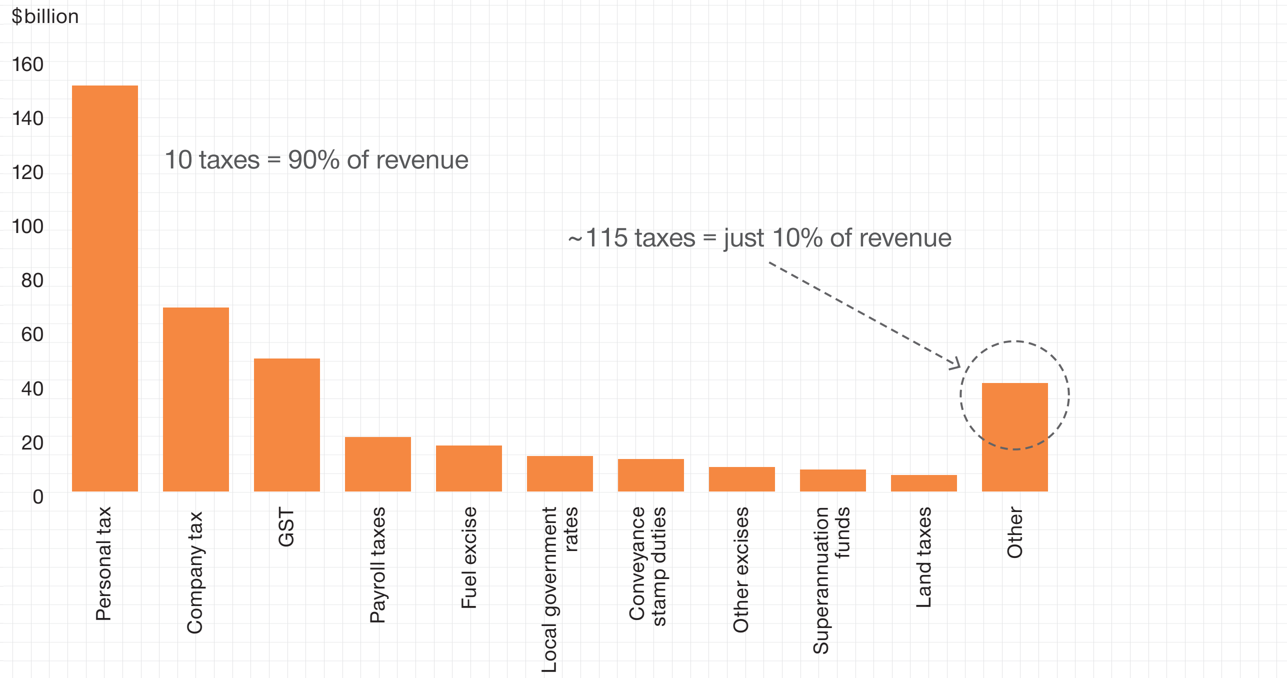
Figure 24: Projected fiscal balance: All governments



Source: Deloitte Access Economics, 2011a

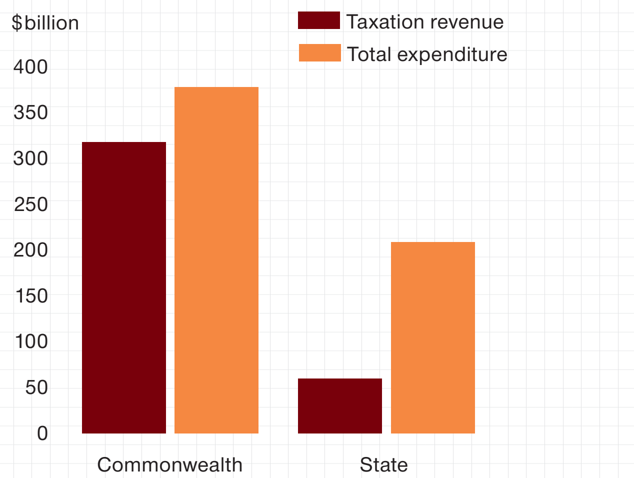
Note: years refer to financial years.

Figure 25: Australian taxes by revenue, 2011–12



Source: ABS, 2013m

Figure 26: Imbalances in the federation, 2011–12



Source: ABS, 2013g; ABS, 2013m

Fiscal policy

Why do we need to strengthen Australia's fiscal policy settings?

Fiscal policy is the backbone of Australia's public policy architecture. Fiscal policy determines the size of government and how governments raise and spend money. It plays an essential role in providing a policy buffer to protect us from major economic shocks.

Policy that delivers a stable and predictable macroeconomic environment contributes to economic growth. Disciplined fiscal policy helps underpin an attractive environment for businesses and allows firms to make investment decisions with greater confidence.

Keeping fiscal policy in good order means that it can be used effectively and aggressively in response to major economic downturns (as occurred at the time of the global financial crisis) and thereby lessen the impacts on economic activity and unemployment. As the international economic environment becomes more volatile and as Australia is more exposed to movements in global commodity prices the risks of such shocks occurring is only likely to rise.

Too much public debt carried by governments leaves countries exposed to shifting sentiment in financial markets and unsustainable debt levels can bring countries unstuck very quickly with dramatic consequences for social cohesion.

On the other hand, strong and prudently managed public finances also play a wider role in helping to build confidence within the community both among households and businesses.

Australia will not be able to deliver on the prosperity–inclusiveness compact if we don't put government spending (including the various entitlement programs that underpin our safety net) on a more sustainable footing. Strong and disciplined fiscal policy ensures that we will be better placed to deal with the consequences of demographic ageing on public finances.

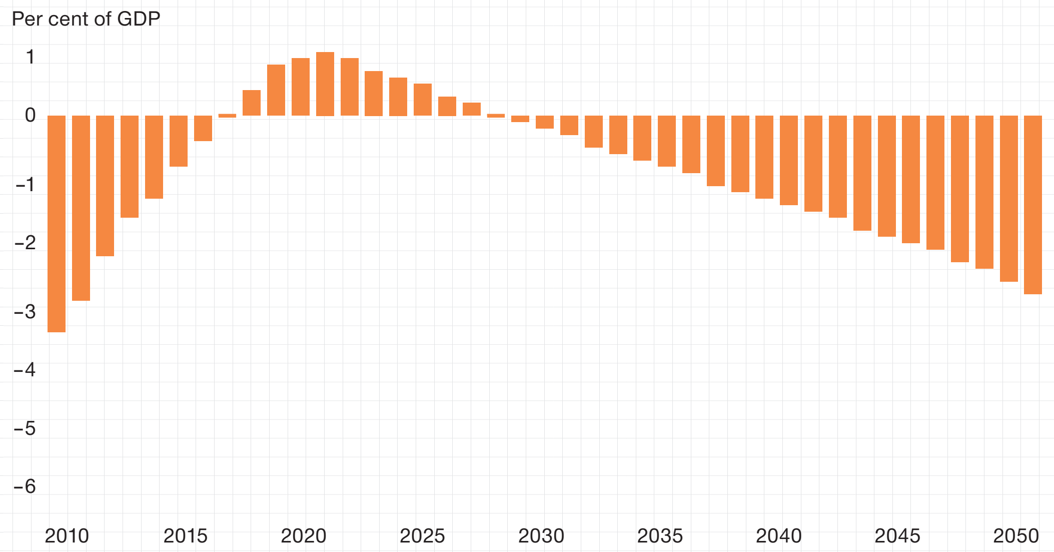
Australia has relatively good public finances, but we also have a good appreciation of the challenges that lie ahead. Increased demand for age-related payments and services along with expected technological advancement in health and demand for higher-quality health services will create substantial pressure on government's fiscal balances at both the Commonwealth and state levels.

The 2010 Intergenerational Report suggested that by 2050 total Commonwealth spending as a share of GDP would increase significantly, resulting in a projected primary fiscal gap (excluding interest payments) of around 2¾ per cent of GDP by that time.

With state and territory governments also exposed to significant obligations in the delivery of healthcare services they will also bear a heavy load on their budgets from health costs. Over the longer term, the shortfall on state and territory finances from rising intergenerational spending pressures is expected to reach 2½ per cent of GDP by 2050, a shortfall much the same size as that of the Commonwealth.

In total, therefore, the combined fiscal challenge at all levels of government across Australia will be to address an overall budget shortfall that could be over 5 per cent of GDP by 2050. Today, a budget deficit of this size would be equivalent to around $75 billion.

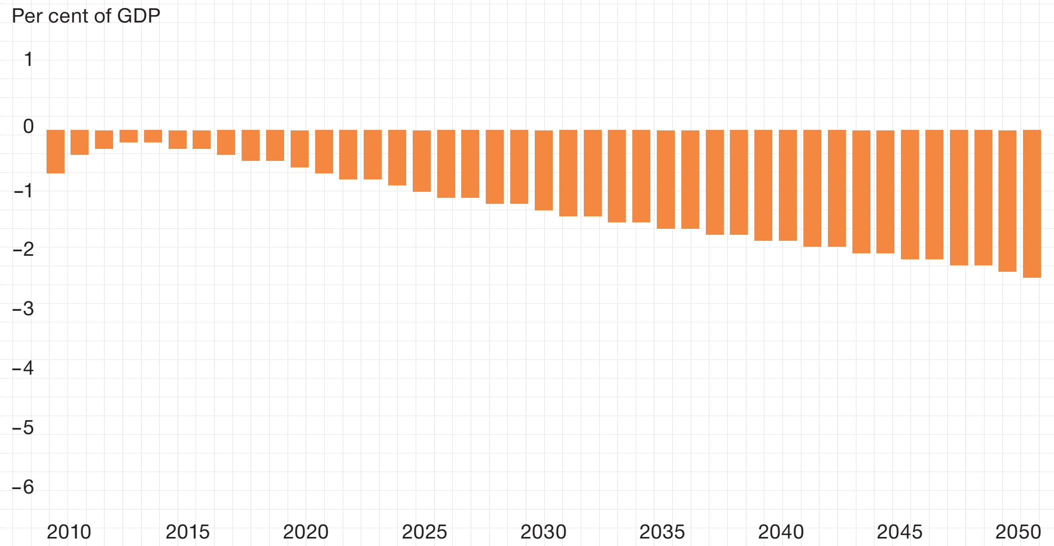
Figure 27: Projected fiscal balance: Commonwealth



Source: Deloitte Access Economics, 2011a

Note: years refer to financial years.

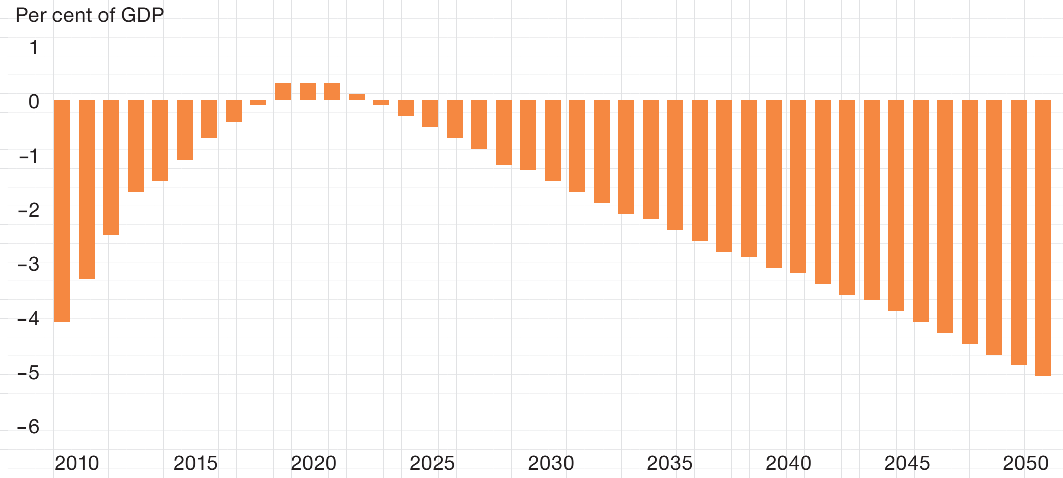
Figure 28: Projected fiscal balance: States and territories



Source: Deloitte Access Economics, 2011a

Note: years refer to financial years.

Figure 29: Projected fiscal balance: All governments



Source: Deloitte Access Economics, 2011a

Note: years refer to financial years.

If forced to deal with a shortfall of this size today, it would be necessary to take drastic and difficult decisions. By way of illustration, a gap that size could be filled by raising the company tax rate from 30 per cent to 67 per cent; or lifting the GST to 25 per cent or by increasing all marginal personal tax rates by almost a half.

Or on the spending size, plugging a gap that size could be done by eliminating all pensions and family benefits; or by eliminating all Commonwealth payments for health and to the disabled; or eliminating all Commonwealth payments for education, defence and hospitals.

Clearly such an outcome would present Australia with some stark choices and as a nation we will have to decide what we can do about this now. If we don't then future generations of Australians will be required to bear a disproportionate burden.

Exhibit 5: Projected growth in government expenditure on health and ageing

The share of government expenditure on health and ageing would increase substantially from around a quarter to a half over the next 40 years if current health and ageing policies continue.

As this increased expenditure would need to be funded by more government debt, tax or a combination, it is projected that by 2050

» close to half of total Australian government expenditure would be allocated to health and ageing

» the proportion of state territory expenditures allocated to health and ageing would increase to around 40 per cent.

Projected government spending on health and ageing as percentage of total government spending

	Australian Government		All state and territory governments	
	2009–10	2049–50	2009–10	2049–50
Health	12.5%	20.7%	25.2%	40.0%
Ageing	15.4%	25.1%	0.7%	1.0%
Total	27.9%	45.8%	25.9%	41.0%

The higher proportion of Australian Government expenditure projected to be spent on health and ageing is because it is responsible for age pensions and most government aged care expenditure.

The state and territory shares of government expenditure allocated to health and ageing vary to some extent with differences in their demographic profiles and health and ageing policies.

Private expenditure on health (not ageing), which is health expenditure by individuals and insurers, is projected to stay around 2.8 to 2.9 per cent of GDP over the next 40 years, assuming current patient co-contribution rules continue.

Source: Deloitte Access Economics, 2012

How do we strengthen Australia's fiscal policy settings?

Fiscal policy in Australia should be predicated on a strategy that delivers budget surpluses on average over the medium term. Australia's finances are in better shape than other economies but we should be doing more now to build up the nation's long-term financial strength and resilience. We cannot afford for Australia to squander its relative fiscal advantage in the future.

Instead, a deliberate and steady fiscal path must be set that ensures that barring economic shocks, governments do not stray from the central task of improving the budget bottom line over time, paying down debt and beginning to provision for future budgetary pressures.

What is needed is a clear strategy for repairing and strengthening Australia's fiscal position over the medium term.

The strategy will be assisted by governments holding to commitments to restrain growth in expenditures, without slippage. Holding to a commitment to cap the annual growth in government spending to 2 per cent of GDP in real terms consistently would go a long way to strengthening the nation's finances.

Governments also need to make inroads into structural savings and be prepared to make changes to arrangements that underpin many of Australia's entitlement programs. We need to make sure that Australia's welfare system remains sustainable and that means ensuring it is appropriately targeted to those who need assistance most.

Improving the efficiency and effectiveness of government spending is no easy task. Piecemeal and ad hoc examination of spending and administration are unlikely to provide the depth of structural savings required to place finances on a sustainable footing over the longer term. Short-term budgetary fixes involving timing changes or exploiting deft accounting treatments only serve to undermine the very credibility and certainty that fiscal policy should promote.

A comprehensive audit on the size, scope and efficiency of government spending should be undertaken. Such a review is needed because already existing long-term fiscal pressures are being compounded by community expectations that governments will provide new services and spend more on existing ones.

This audit, consistent with those done in the past, should assess whether there is in fact a role for government in certain areas of service delivery, and where there is, which level of government should provide the services. Assessments are also needed on the effectiveness with which government services are being delivered and how to better prioritise the spending that occurs.

We need to get a better handle on which level of government is best placed to deliver services and make sure there is appropriate funding support. The overlap of the Commonwealth and state and territory governments must be addressed.

Having a well-based and widely accepted set of fiscal rules can help ensure that the government's fiscal strategy is better anchored and more likely to deliver sustainable outcomes over the medium term.

They do this by preventing excessive spending and the build-up of unsustainable debt.

Australia has been a pioneer in introducing reforms to fiscal policy and in the past adherence to fiscal rules has served us well. Improving and enhancing our fiscal rules would, however, be timely given the consequences of undisciplined fiscal policy that are currently playing out in many developed countries.

Strengthened fiscal rules would also allow governments to better deliver on future fiscal policy objectives against the background of an economy in transition and the growing intergenerational pressures.

Recommended actions

Fiscal policy

Action 1.1

A 'whole-of-nation' Intergenerational Report should be prepared. The analysis outlined in the action plan highlights the full cost of government at a Commonwealth, state and territory level and the potential for a very large fiscal challenge to unfold over coming decades if action is not taken now.

» The federal Treasury, in cooperation with representatives from the states and territories, would prepare the report, which should be completed within 12 to 18 months of being commissioned.

Action 1.2

An independent, whole-of-government audit should be commissioned to examine government spending and program efficiency. This audit must come to terms with the appropriate size of government. A fundamental issue to be examined must also be the roles and responsibilities of the Commonwealth and the states and territories. The audit should: identify current activities that should not be performed by government; recognise the need for stability and certainty for some programs (including defence); and address the level of debt that could be sustained, including to fund productive infrastructure.

» The review would be undertaken by an independent panel and conducted in a number of stages comprising near-term actions and recommendations, medium-term actions and institutional reforms.

» It would investigate and identify any overlap between the Commonwealth and the states in health and education, aged care, Indigenous welfare and environmental approvals.

» It would also be required to identify options for a clearer delineation of responsibilities for policy and service delivery.

Action 1.3

Australia's existing fiscal rules should be refreshed and further strengthened. New rules could in effect define a set of boundaries in which fiscal policy will work – and provide a corridor of stability for the longer-term budget position. The rules would continue to provide for flexibility in the annual budget process, but give certainty that, barring major shocks, the government would not stray markedly from the central task of improving the budget bottom line over time, paying down debt and beginning to provision for future pressures. Improved reporting arrangements should be put in place to properly and transparently account for the full assets and liabilities of the government.

Australia's fiscal rules would be strengthened at the federal level by:

» placing a hard cap on the size of the federal government by holding tax as a share of GDP below 23.7 per cent, such that future budgets do not see any slippage

» specifying a new objective that targets a percentage surplus based on 'recharging' fiscal readiness around every 13 years such that fiscal policy is able to make a 3 per cent of GDP contribution to the economy should the need arise

» targeting a modest proportion of the surplus – to be known as an 'intergenerational surplus' – to provision for the projected fiscal gap that is expected to arise as a consequence of demographic pressures.

Action 1.4

State and territory governments should introduce or recommit to fiscal rules directed towards delivering prudent net operating balance outcomes as well as stabilising net financial liabilities.

Taxation framework

Why do we need to adopt a more competitive tax system?

The tax system plays a vital role underpinning fiscal policy and provides the revenue that helps support Australia's broader social fabric.

However, the imposition of taxes affects the choices people and businesses make by altering their incentives to work, save, invest and consume certain goods and services. To the extent that taxes influence incentives they have the potential to significantly impact productivity and economic growth, which in turn have material consequences for living standards.

Another important dimension to the tax debate is the ongoing structural change to the economy that sees it now more exposed to movements in commodity prices and the terms of trade than was the case in the past. A consequence of this is a potential for greater volatility including in the budget position. Australia's fiscal policy and tax settings need to be set in a way that can better accommodate this volatility.

The vast bulk of taxes that are raised depends on the successful operation of businesses and enterprises in Australia. Businesses employ workers, pay wages, supply goods and services and process transactions – all of which gives rise to tax obligations that generate revenue for the government (from income tax, company tax, payroll tax, GST, excise, fringe benefits tax and so on).

A fundamental requirement therefore is to ensure that Australia's tax system can raise sufficient revenue to fund government, but it should do so in a way that is least harmful to economic growth and better able to contain inevitable volatility.

As the Henry review noted, Australia has too many taxes and too many complicated ways of delivering multiple policy objectives through the tax system. With around 90 per cent of Australia's tax revenue raised through just 10 taxes and 115 other taxes levied on businesses and individuals accounting for the remaining 10 per cent, there is considerable scope for reform of the system to make it more competitive and less onerous.

While we do want a more simple and competitive tax system, taxation arrangements need to have the support of the local community. The tax system should be fair and should be seen to be fair. This means that people and businesses who are in similar circumstances should be treated in a similar way and that there is an element of progressivity such that those individuals who earn more should pay relatively higher rates of tax than those who earn less.

The challenges of an ageing population highlight the importance of maintaining an efficient tax system, particularly as it affects incentives to work in the face of a relative decline in the working population. Fairness concerns will also arise both in relation to sharing the costs of an ageing population – particularly between generations – as well as who will bear the burden of the costs of an ageing population among the working population.

The process of globalisation also brings sharp relief to the urgency of getting our tax system right. In particular this process of globalisation has resulted in an environment of increasing mobility of economic activity and mobility of workers and investment.

As a result, countries like Australia that are small and open have to deal with the reality that their tax base will be mobile. In these circumstances, there is intuitive logic to move to a tax system that relies less on taxing the more mobile factors of production through income taxes and more on taxes that target the less mobile factors – that is, indirect taxes.

At a broader level, for many businesses location choices, activity levels and taxable incomes are sensitive to local tax rates so governments around the world are under intensifying international pressure to reduce tax burdens on business activities and investors.

We are also seeing today that multinational corporations are playing an increasingly prominent role in the international economy (accounting for a quarter of global GDP) as are intangible assets including brands, intellectual property, customer lists and internal business processes.

This is posing particular challenges as previously accepted international tax standards have not kept pace with changes in global business practices. The current 'source' based system of corporate tax – predicated on where a company's assets or production activities are located – is under pressure especially from those companies which rely heavily on intellectual property.

Moving to a system which taxes company earnings based on where its products and services are sold – a so-called destination-based system – may be a better approach to taxing the earnings of some multinational companies. An approach to dealing with base erosion and profit-shifting strategies needs to be developed in a comprehensive and coordinated way. As the OECD has noted, because of the interface between the tax rules of different countries it is difficult for any single country acting alone to fully address the issue. Unilateral and uncoordinated actions by governments responding in isolation could result in the risk of double taxation for business and would have a negative impact on investment, growth and employment globally.

How can we move to a more competitive tax system?

Australia needs a tax system that is able to meet future revenue requirements yet one that fosters economic growth by ensuring that tax rates and our tax bases keep us competitive and minimise the extent of distortions.

Improving our current arrangements will be difficult and require the broader support of the community. A more competitive tax system can be achieved if we are prepared to take a principles-based approach to tax reform and if we can have a mature debate within the community in accepting that trade-offs will be required. Reform to get a more competitive tax system can be achieved by recognising and meeting a number of tax policy fundamentals.

» The tax system must support and complement overall fiscal policy.

» Ensuring that the overall tax system raises enough revenue must be the highest priority. But also, governments at all levels must be efficient in their spending, recognising that the tax system alone won't be able to meet the growth in government expenditures that is currently projected.

» The tax system must be configured to promote productivity, competitiveness and economic growth.

» The tax system must continue to be progressive and based on the capacity to pay.

» Efforts must be made to improve the simplicity, certainty and transparency of the system.

» Those taxes directed at addressing social and environmental issues should actually bring about changes in behaviour, rather than having revenue raising or income redistribution as their main objective.

Moving to a more competitive tax system will require coordinated action on a number of fronts. This means being prepared to control growth in government spending, addressing major fiscal imbalances in the federation and being prepared to embark on a process that comprehensively overhauls the tax system in Australia over time.

The new architecture of a reformed tax system should recognise that a system whereby the most inefficient state taxes are abolished has the potential to deliver significant increases in productivity. But if these taxes are to be abolished then alternative revenue sources will be needed. To ensure that the states and territories have access to adequate revenue, consideration needs to be given to raising more revenue from other more efficient tax bases such as consumption and land.

Moving to a tax system architecture broadly in the direction of the Henry review will be in Australia's long-term national interests. The new tax system architecture needs to be one with a different mix of taxes. We need to vastly reduce the number of taxes and also seek to reduce our reliance on direct taxes and over time increase reliance on indirect taxes including the GST.

Recommended actions

Tax policy

Action 1.5

The Australian Government should undertake a comprehensive overhaul of Australia's taxation system.

» The tax system needs to be reconfigured in a way that is able to raise sufficient revenue and better accommodate the inherent volatility in the economy and budget.

» A forward work program for long-term tax reform should be determined in support of this aim with all options open for consideration.

» The tax system should be made more competitive through the replacement of those taxes that impose the largest distortions on economic activity, including many state taxes such as stamp duties, payroll tax and insurance levies. Alternative sources of revenue to the states will need to be identified as part of this process.

» An objective should be to reduce the number of taxes in Australia and simplify the tax system.

» The overhaul should consider how to improve the tax mix with a view to moving, over time, to a system where there is less reliance on capital and income taxes and more reliance on efficient and less volatile indirect taxes. Business tax concessions should be re-examined.

» Consideration should be given to raising the rate of GST as well as broadening its base as a means of providing additional revenue to replace revenue forgone from the abolition and reduction of other taxes. This process should include arrangements to provide appropriate compensation for households.

» An examination of the interaction between the tax system and the transfer system should be undertaken with a view to reducing complexity and disincentive effects that may impede workforce-participation decisions.

Action 1.6

The government should commit to lower the company tax rate to 25 per cent as a priority as and when fiscal circumstances permit. This recognises that the growing mobility of investment and increasing sensitivity of capital flows to tax settings have important implications for Australia's long-term growth prospects.

Action 1.7

Australia should participate in global discussions on international tax issues, including around base erosion and profit shifting, through our participation in the G20. However, Australia should not seek to be a world leader in combating base erosion and profit shifting, reflecting the difficulty for any single country acting alone to fully address the issue. While there is little evidence to suggest that base erosion and profit shifting are significant issues for Australian tax collections at present, the Australian Taxation Office should keep the issue under review.

Action 1.8

A process should commence immediately to progress administrative simplification of the tax system, including making personal income tax returns optional for the majority of taxpayers. There should be a concerted effort to reduce the cost and complexity of the community's interface with the tax system. Actions should also be taken to simplify the company tax system, including the requirement to pay monthly.

Fixing the federation

Why do we have to place the federation on a more sustainable footing?

There are growing fiscal pressures on all levels of government. This has significant implications for the functioning of the federation.

With the states having responsibility for delivering many high-demand services including health care over the decades ahead, they will need more predictable and stable sources of funding. This should facilitate and encourage efficient service delivery.

The states also need to see more of the fiscal dividends that come from putting in place reform policies that grow their economies and allow them to deliver services more efficiently.

Our system of federal–state financial relations sees the Commonwealth collect over 80 per cent of tax revenues, while the states have responsibility for delivery of services in the fastest-growing areas of expenditure such as health and education.

The extent of this vertical fiscal imbalance and the effectiveness of mechanisms in place to address it have a significant impact on the incentives and accountability of governments across the federation to their citizens. It also has major implications for their capacity to addressing future budgetary challenges.

Firstly, vertical fiscal imbalance runs the risk that the accountability mechanisms between the raising of revenue and the way money is spent can become blurred. This is, in effect, the source of the 'blame game' that is often observed in Commonwealth–state relations. For example, the Commonwealth could avoid accountability for expenditure of funds because it is the states that have actual responsibility for disbursing the funds. Similarly, states could argue that they are not able to deliver services adequately due to a lack of funding from the Commonwealth.

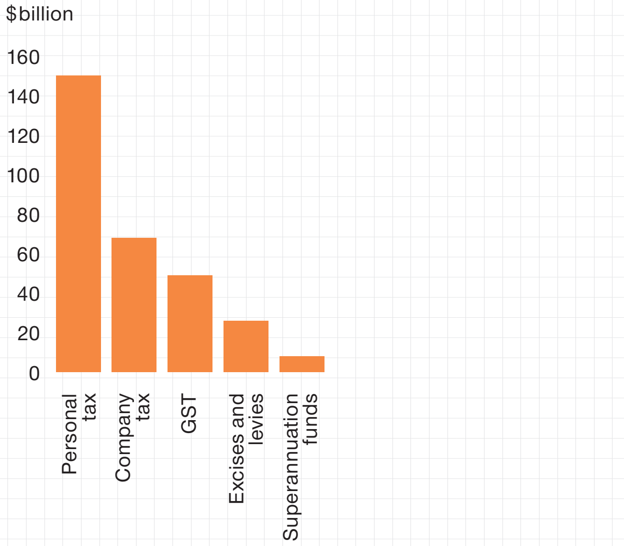
If a government is not accountable for the revenue it raises, it may not face the full cost of how it spends the revenue and may have less incentive to be disciplined in how it spends that revenue.

Secondly, the current mechanisms applied to address vertical fiscal imbalance – namely a redistribution of GST revenues to the states and direct payments to support specific services provided by state governments – are not working as effectively as they could be. The arrangements should be ensuring that states have appropriate flexibility and autonomy in discharging their responsibilities but are at the same time held accountable.

If states are to be encouraged to do everything they can to pursue sensible reforms and facilitate economic growth – and put themselves in the best position to address future challenges – then they will need greater autonomy over revenues. They should also be able to reap the dividend of increased tax revenues that arise from a stronger economy which follows successful economic reform.

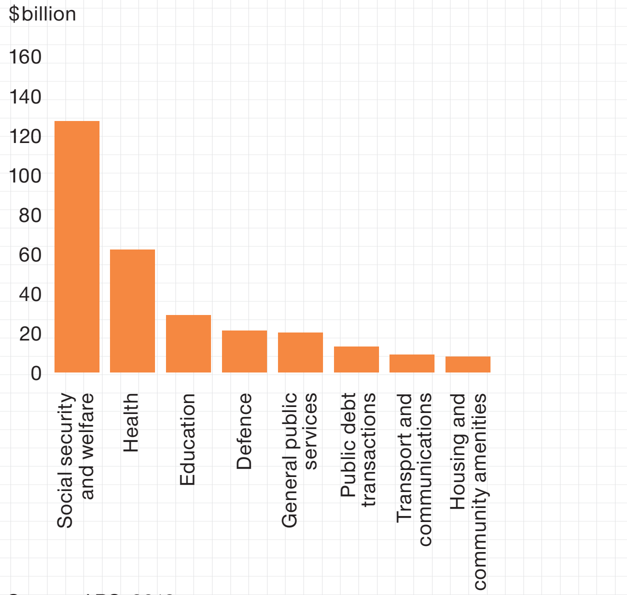
Vertical fiscal imbalance in Australia

Figure 30: Commonwealth taxes



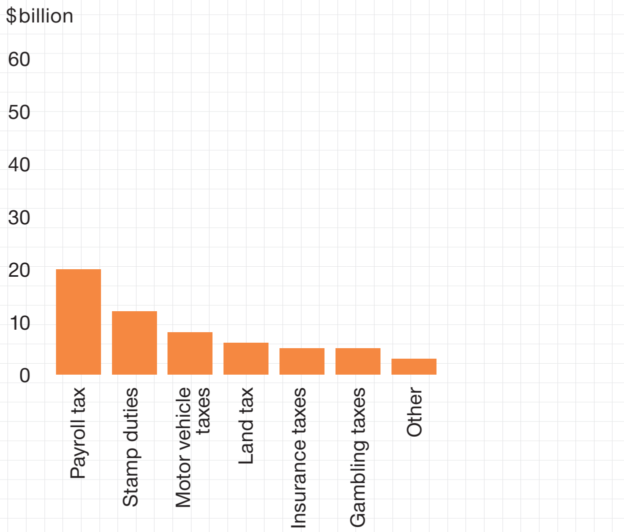
Source: ABS, 2013m

Figure 31: Commonwealth expenditures



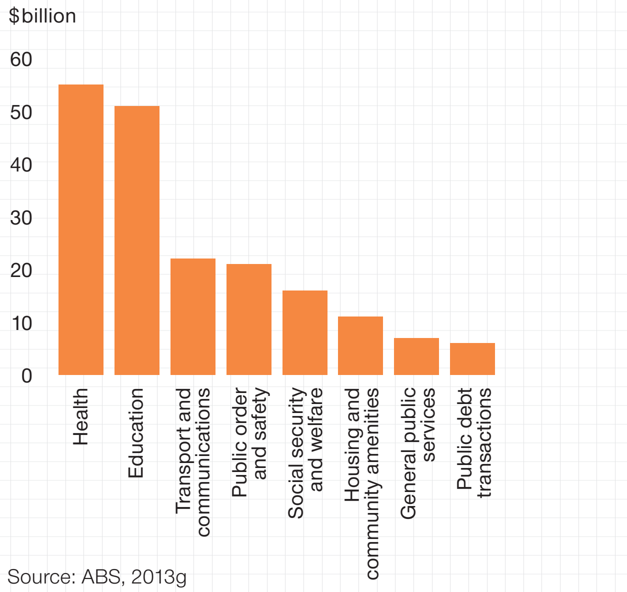
Source: ABS, 2013g

Figure 32: State taxes



Source: ABS, 2013m

Figure 33: State expenditures



Source: ABS, 2013g

At the present time, fiscal equalisation through the redistribution of the GST does not provide adequate revenue autonomy. Australia has a very detailed and sophisticated process of fiscal equalisation to equalise just over 1 per cent of all tax revenues in Australia, yet it has multiple shortcomings.

It can hamper the incentive for states to undertake reforms to improve service delivery and boost economic growth, by distributing gains away to other states. The current process can also result in unexpected shocks to state finances, undermining the ability of states to plan their budgets on the basis of stable revenues; and the methodology underpinning the process is complex and not easily understood by taxpayers.

The other mechanism to address fiscal imbalances – direct payments to support specific state services – represents the largest expenditure program in the federal budget and it is projected to stay that way for the foreseeable future.

The conditions under which these payments are administered is critical to states delivering services with the maximum level of autonomy and in the most efficient manner possible, with significant implications for the long-term strength of all governments' budget positions and the quality of services delivered to the community.

Despite reforms to the architecture for these payments in 2008 directed at reducing prescriptions on states and clarifying the roles and responsibilities of the Commonwealth and the states, a high degree of Commonwealth direction over funding remains. This has a number of implications:

» There is increased potential for duplication of effort, with a prescriptive and detailed approach to administering funds at the Commonwealth level likely to be much more resource-intensive than a high-level outcomes and outputs monitoring approach.

» There is likely to be inefficient administration. A prescriptive approach to funding results in a proliferation of intergovernmental bodies and agreements – since 2008 we have seen 125 national partnership agreements formed and the formation of four to five new intergovernmental bodies each year.

» By prescribing services and inputs rather than outcomes, there is a risk that states lack the flexibility to deliver services in a way that meets local community expectations and which utilises more efficient service delivery models.

While a level of imbalance between access to tax bases and expenditure responsibilities is a reality in all federations, the imbalance in Australia's case is relatively high by international standards. Regardless of their effectiveness, the mechanisms addressing this imbalance will always be a poor substitute for greater fiscal autonomy and clearer accountability to taxpayers for the services that governments provide.

The states are relatively constrained in their ability to effect substantial reform of their taxes, with the possible exception of a small number of relatively efficient tax bases that could be applied more broadly. In the absence of access to income and sales taxes, the states have limited effective tax levers that they can utilise to replace inefficient taxes or fund an increasing level of services in their own right.

How to place the federation on a more sustainable footing

It will be necessary to reconfigure arrangements associated with the federation to ensure that Commonwealth and state government roles, responsibilities and fiscal arrangements do not act as a handbrake on growth and prosperity.

We must also ensure that there are appropriate institutional arrangements so that governments can focus on, and deliver on, the most important challenges facing the nation and not just be seen to be responding to the pressing topic of the moment.

If taxes are better aligned with expenditure responsibilities, then efficient service delivery becomes institutionalised as business-as-usual, with intergovernmental relations focusing less on micromanagement of service delivery and more on meaningful periodic reform in the national interest.

Before actions to address these areas can be undertaken, a whole-of-government audit must be undertaken as a basis for identifying options for a clearer delineation of responsibilities for policy and service delivery. Once this is complete, it becomes easier to configure the tax system to more evenly match those responsibilities across the federation, creating the right system for more effectively institutionalised efficient service delivery.

Recommended actions

Operation of the federation

Action 1.9

Roles and responsibilities within the federation, the Council of Australian Governments (COAG) and federal fiscal relations should be reviewed and put on a sustainable footing.

Action 1.10

The revenue-sharing arrangements among the states and territories should be changed by moving to an equal per capita distribution of GST. This would be done progressively over time with a floor placed on distributions to recipient states and distributions grown in ways that would be consistent with realising an equal per capita distribution within 10 years. This recommendation must be actioned in tandem with comprehensive reform of the tax system.

Action 1.11

Introduce a new system of National Productivity Payments to the states and territories to progress critical reforms across the federation. These payments would be made available as an incentive for the states and territories to progress difficult but nationally significant structural reform, including further competition and regulatory reform. The National Productivity Payments Scheme would be established by way of an intergovernmental agreement between the Commonwealth and the states and territories.

02

Pursue sustainable population growth in our cities and regions

What do we have to get right?

Australia needs to commit to well-managed population growth and plan now for the changes in the size and the demographic mix of our population that will occur in the future. Australia's economy will double in size and be home to more than 35 million people by mid-century. How well we manage that pathway of population and growth will determine the quality and sustainability of our economy, our societies and our environment. The reasons in support of well-managed population growth need to be explained to the community.

Key facts at a glance

Australia's population growth is an important element in ensuring our long-term economic growth and prosperity.

On current projections the rate of our population growth is set to slow, although it will likely reach 30 million by 2030 and 35 million by 2050.

The inevitable growth in our population will be coupled with challenges associated with an ageing population.

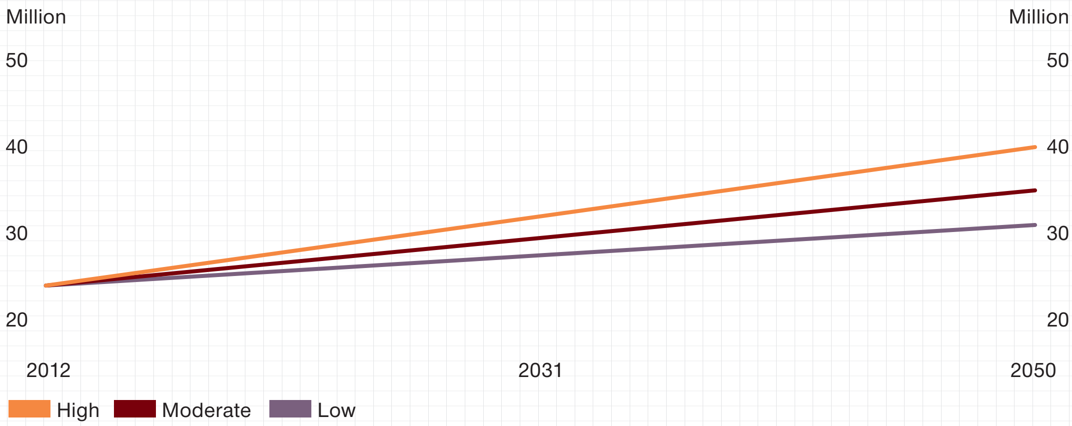
Without some profound changes, the share of population that is of working age is projected to fall from around 67 per cent today to 61 per cent by 2050.

Well-planned and functioning cities play a significant role in supporting economic growth. To the extent they can foster connections and networks and continue to attract people, cities are very much engines of commerce, science, innovation and progress.

By 2050 the share of the population living in Australia's capital cities is projected to reach 70 per cent up from 60 per cent today.

Figure 34: Australia's population will continue to grow

Possible growth scenarios



Source: ABS, 2008; ABS, 2013a; BCA

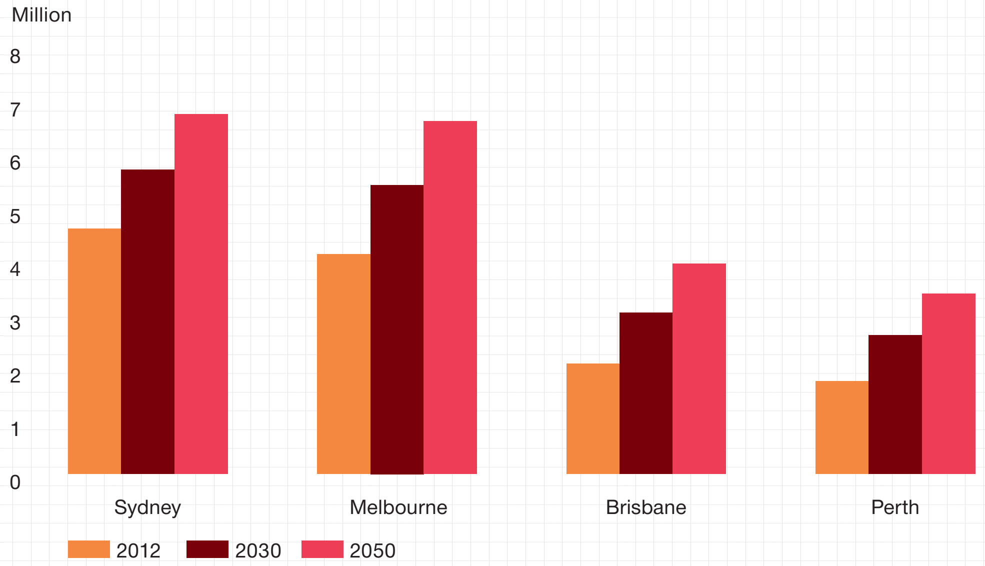
Note: years refer to financial years.

Figure 35: And our population will keep getting older

Source: ABS, 2008; ABS, 2013a; BCA

Note: years refer to financial years.

Figure 36: Our cities will keep growing



Source: ABS, 2008; ABS, 2013a; BCA

Note: years refer to financial years.

Why do we need to pursue sustainable population growth?

Population growth will enable us to grow the economy and earn the higher incomes necessary to afford a better standard of living. By doing so it will enable us to invest in building social and natural capital and provide security. Population growth is the best strategic option for Australia if we want to grow the quality of life for this generation of Australians and the next, but it comes with challenges and must be properly planned for.

There is confusion and uncertainty about population policy in Australia today and the community wants national leadership on this issue – there are different views in the community about the merits of population growth and a need for national leadership to explain the benefits of growth.

Businesses, individuals and governments need to know that the Commonwealth is committed to growing our population and economy so they can plan and invest for growth. It is the Commonwealth that has the most influence over national population outcomes via its migration policies and to a lesser extent its impact on natural increase due to its management of the tax–transfer system as it applies to families.

Population growth that is well managed will deliver:

» a larger, more dynamic, resilient and diverse economy that is better integrated with the global economy and our region

» more revenue to fund government services including health, education and infrastructure, as well as protecting our environment

» better-designed cities that can accommodate more people while improving liveability and sustainability

» low environmental impact achieved through explicit policies and increased investment in sustainability

» migrants bringing new ideas, innovations and cultures to Australia and growing our trade and investment links

» better-funded retirement and access for older Australians to properly funded, quality health and aged care

» stronger relationships, connections and influence with other growing countries in our region.

If we fail to plan for population growth we will experience worsening congestion, environmental degradation and other negative consequences that will detract from liveability and sustainability and increase opposition to population growth in the community.

There are some who argue that low or no population growth is the better option and say it would not hamper our economy because we could still be productive while also limiting negative impacts from poorly managed growth on our cities, regions and environment.

This is a very different model for our economy and for Australians to take on. And it presents risks the BCA believes outweigh potential benefits:

» slowdown in economic activity and loss of economic confidence, leading to investor withdrawal and 'brain drain'

» less funding for services, including health and aged care, as our tax base decreases and the population ages

» higher deficits and higher public debt due to fewer workers available to deliver services and to pay taxes; this would occur against the backdrop of Australia's already substantial debt obligations today

» a less influential nation in global and regional affairs and a less diverse economy functioning more as a 'branch economy' of the region.

Taking the low population growth path is high risk and not the panacea some think it is for dealing with problems like congestion and harm to the environment.

Figure 37 summarises the expected outcomes under scenarios of moderate versus low population growth and good-quality government policy versus poor government policy.

Figure 37: Weighing up our population choices

	POOR GOVERNMENT POLICY	GOOD GOVERNMENT POLICY
MODERATE POPULATION GROWTH	Lagging productivity and economic growth, with high unemployment Declining standing in international community Poorly planned and congested cities Environmental degradation Housing shortages and poor affordability	Strong, more resilient and diversified economy Growing global connections and influence, enhanced security capability Diverse communities in well-planned, higher-density cities and regions Stable public and external finances Effective management of natural resources and greenhouse gas emissions
LOW POPULATION GROWTH	A smaller economy, with an ageing workforce and low productivity Inadequate health, education, aged care and welfare services Urban decay, deteriorating infrastructure Unstable public finances and poor international credit rating Weak international standing, national security risks, branch office economy of the region	Narrow economic base vulnerable to workforce ageing and global demand shifts Less congestion and environmental impact in our cities Reduced capacity for funding public services and retirements Niche global player, low capacity to influence, limited national security capability Potential to lose job-creating foreign investment

Source: Business Council of Australia, 2010

How can we get population policy right?

Australia is more likely to get its population policies right by following a two-pronged approach that sets a long-term strategic direction for well-managed population growth based on evidence of what is in the best long-term interests of Australians.

We also need to develop strategic long-term planning for population growth and demographic change to ensure the adequate provision of infrastructure and services in our cities and regions.

The right approach to population policy involves:

» setting a long-term strategic direction for well-managed population growth based on evidence of what is in the best long-term interests of Australians – two key government reports where this is done are the Intergenerational Report and the National Population Strategy

» setting migration policies and family policies in line with the strategic direction for population growth, as these are the tools that most influence population outcomes.

Australia's migration policies should also support our sustainable population growth strategy and build Australia's position as an open and competitive participant in the global economy.

Migration policy should ensure maximum flexibility, with appropriate safeguards, to support Australians and non-Australians to move in and out of Australia to work and live, thereby realising gains for the wider community.

Our permanent and temporary migration programs are highly interdependent. The permanent migration program currently accepts 190,000 people a year with two-thirds of those skilled migrants. Many of the people applying for permanent residency are already in Australia on a temporary work visa.

Our temporary visa programs, notably the 457 visa, should remain highly flexible. Our economy increasingly benefits from transient flows of people who come here for defined periods of time to work, study and to consume services like education and tourism, a key feature of globalisation. By growing economic activity and bringing new skills and knowledge to Australia, the 457 visa scheme boosts economic activity, enables skills development and creates better and higher-paying employment opportunities for local workers. Australian employers overwhelmingly prefer to hire locally because it is cheaper and easier to do so, but need to be able to access foreign workers when there are skill shortages.

Our migration policies should work to facilitate skilled migration movements through more flexible criteria and faster visa processing, and we need to better plan for this type of transient population. The same is true in reverse. Australians benefit from enjoying the same opportunities in other countries and many return with new skills and perspectives.

Natural increase in the population will continue to rise in the near term but will be a declining component of long-term population growth. Despite the perception of a 'baby boom' the reality is that current birth rates are below the replacement rate. Maintaining Australia's birth rates at or near the replacement rate will in part require policies and programs that support families wishing to raise children (e.g. via appropriate tax and family payment structures, flexible workplaces and childcare services) and maintaining high levels of confidence that Australians have in their economic prospects.

Recommended actions

Action 2.1

The Council of Australian Governments (COAG) should commit to well-managed population growth as a strategic imperative for Australia.

Action 2.2

Prepare a new National Population Strategy to complement the updated Intergenerational Report. The National Population Strategy should:

» set out a long-term strategic path for population growth that will give us the best opportunity to meet national goals for sustainable growth

» design population policies to achieve the strategic population growth path (and meet the immediate and future needs of the economy) through natural increase and migration

» set out a comprehensive policy to plan and invest for future population growth and to support growth in living standards.

Action 2.3

Australia should maintain current migration policy settings.

» The permanent migration program should remain at least at current levels of 190,000 per annum with two-thirds of the program filled by skilled migrants. (These levels may need to be increased following the findings of the next Intergenerational Report and the new National Population Strategy.)

» The flexibility of Australia's temporary migration program should be maintained by preserving the demand-driven and uncapped nature of the 457 visa scheme and the scheme safeguards that were in operation before the Migration Amendment (Temporary Sponsored Visas) Bill 2013. Labour market testing should be abolished.

Sustainable growth in our cities and regions

Why do we need to get cities and regional planning right?

There are a number of important considerations that relate to the management of the growth in our cities and regions. Cities contribute 80 per cent of Australia's GDP growth and employ 75 per cent of the workforce and are where most of Australia's knowledge-intensive businesses and workers are located.

The consequences of failure to invest in our growing cities will be congestion, unaffordable housing, low productivity and poor urban amenity. There are also agglomeration benefits from city development with studies showing that for every doubling of job concentration there is a 5 to 13 per cent increase in labour productivity.

The provision of infrastructure, housing and other services in Australia's fast-growing cities and regional centres needs to keep pace with economic activity. As such, investments in cities and regions need to be planned many years in advance.

The growth in our cities and regions must also be consistent with proper valuation and care for our natural environment and the need to manage it on behalf of future generations.

Communities are concerned that governments do not have adequate strategies for managing the impact of change on them and ensuring that they are broadly benefiting. Instead in many cases they see a lack of strategic planning and an absence of supporting development in local infrastructure and provision of services.

Many in the community are concerned about the impact of growth on the environment. Policies need to get the incentives to drive efficient resource use and give communities the comfort that these issues are being sensibly addressed and in an economically responsible way.

How do we get well-managed growth in our cities and regions?

A well-managed growth agenda in our cities and regions is needed to make sure we plan and invest to support population growth. It would focus on reforms to implement:

» improved cities and regional governance arrangements across the federation

» better long-term integrated planning processes and project approvals

» investment in housing, services and infrastructure.

As most Australian cities will grow strongly in the period ahead, governments will need to grapple with how that growth will be implemented and address critical questions, such as whether it will occur at the urban fringe or by carefully planned urban in-fill.

Fundamentally, strategic city planning needs to ensure that we identify the future jobs, transport and housing corridors and invest in the housing, infrastructure and other services needed to ensure that population growth is consistent with positive outcomes for communities.

Better integrated cities and regional governance are key things for Australia to get right. All three levels of government have policy roles in cities. State governments and metropolitan local councils are primarily accountable for city development. The federal government has sought to play a larger role through establishment of a Major Cities Unit and the release of a National Urban Policy.

A key question for the federation is what role each tier of government should play and how they should collaborate better and with communities and the private sector to develop cities in the future. A second question is whether there should be for each major city a single authority charged with bringing together a comprehensive metropolitan-wide growth strategy for design and implementation. With numerous local government areas in most cities, the states are probably best placed to serve this leading role.

Outside our major cities, state and local governments should work better together on regional planning. Local government authorities should come together and make decisions at a regional level through regional planning authorities.

Many regional areas where large projects are being commissioned and delivered are going through significant changes to their economies and communities. Communities are concerned that governments do not have adequate strategies for managing the impact of that change on them and ensuring that they are broadly benefiting. Instead in many cases they see a lack of strategic planning and an absence of supporting development in local infrastructure and provision of services. Regional development plans in fast-growing regional areas should be carried out by state governments. Special development zones could be established to expedite approvals of land use for local infrastructure.

Nationally, there will be a need for leadership at the Commonwealth level for putting in place a strategy for the long-term development of Australia's northern regions to begin to unlock the large potential economic and social benefits. The Commonwealth should be heavily involved in developing these plans given the significant resources that will be required along with the need to coordinate multiple state, territory and local government jurisdictions.

Amalgamation of local government authorities in cities and regions is another option that should be strongly considered to allow for more resources to be allocated to strategic planning of a wider economic area.

Better strategic planning of cities and regions should assist in speeding up project development assessment and approvals and help to lift the quality of projects. They will also give the community the confidence that city development is being well managed.

Governments should adopt strategic planning processes that:

» build a 'vision' of the future development of a city or of a regional area in which the community can see how major projects and other significant changes to the status quo will fit

» reform strategic planning of cities and regions to fully integrate land use, transport and social infrastructure and access to natural resources, and to better resolve land use and ownership conflicts

» provide population projections by city/region in the next 10, 20 and 40 years

» identify urban and regional growth corridors and future housing and future infrastructure needs associated with population and economic growth

» identify and place a high priority on developing major freight routes and international gateways

» set clear rules for land use by zoning land for residential, commercial or exploration purposes and reserving areas for designated activity – that is, mining exploration, primary production activities – which are then permissible.

The speed and cost of Australia's project approvals processes impact on the timeliness of infrastructure provision needed for well-managed growth. One of the problems with the long time taken to make a decision and its variability is the inherent uncertainty for investors – not knowing how long the approval process will take is a big deterrent to business investment. Australia's governments should better coordinate and streamline their approval processes.

Sustainability

Sustainability in our cities and regional development needs to be achieved through applying broad objectives for creating value in the economy, community and the natural environment.

The environmental focus should be on the efficient use of our natural resources and investments in improving our natural capital that can only come from a strong economy. Businesses will be at the forefront of lifting sustainability because efficient use of resources is entirely consistent with creating value.

The planning acts of the states should promote sustainable growth as their objective and facilitate the development of natural resources in an efficient way.

Achieving successful growth outcomes will require roles of all three tiers of government, private businesses and the community.

Recommended actions

Action 2.4

The federation roles and responsibilities review should explicitly test the adequacy of current governance arrangements for major cities and accountabilities for developing metropolitan areas.

» The federal government should continue to have a national cities policy designed to improve the competitiveness of major cities, but be clear about its role (and keep the National Housing Supply Council in Treasury).

» States should produce regular metropolitan development strategies and assign clear ministerial accountability for whole-of-metropolitan development.

» Local councils that do not have sufficient scale for efficient operations or for undertaking strategic planning should be amalgamated.

This is not about the Commonwealth playing a direct role in planning, but should be focused on aligning Commonwealth responsibilities, particularly migration, with state government efforts around housing supply and providing infrastructure for population growth.

Action 2.5

The purpose of strategic planning by state governments should be to resolve land-use conflicts strategically rather than on a development-by-development basis. State governments should reform their strategic planning processes for growth to ensure that they:

» fully integrate land use, transport and social infrastructure

» identify transport, employment and housing growth corridors and strictly adhere to associated land reservation and protection policies and practices

» identify associated future infrastructure needs, prioritising the development of international gateways and the completion of major road and rail networks, which then become the major strategic input into state infrastructure plans

» resolve land use and ownership conflicts

» facilitate private investment by having more complying development and allow for more unsolicited proposals from the private sector

» ensure access to natural resources by setting clear rules for land use and energy and water resource development

» ensure timely release of land for new housing, reduce the harmful impacts of excessive or complex developer levies on new housing investment and reduce the amount of reservation and ownership of land and investment in new housing supply by state-owned development agencies

» invite participation in the development of the strategy by business and the community.

Action 2.6

Cities planning should focus on creating more liveable and efficient cities through long-term metropolitan strategic plans that:

» present a vision of sustainable urban growth of the city and improvements in urban amenity

» prioritise productivity and competitiveness rather than spatial planning

» designate areas of higher density and compact activity

» prioritise the development of, and reserve, international gateways and transport, employment and housing corridors

» identify major infrastructure needs that then become the major strategic input into state infrastructure plans

» set out plans for guaranteeing land release to grow supply of land for housing, industrial and commercial use.

Action 2.7

Regional development plans around major resource projects should be carried out by state governments, including provision of housing and economic and social infrastructure. Special development zones should be established to expedite approvals of land use.

Action 2.8

The Commonwealth, with Queensland, Western Australia and the Northern Territory, should collaborate on an economic development strategy for the north of Australia.

Action 2.9

COAG should reform development assessment systems by removing duplication between the Commonwealth and the states (including through bilateral agreements for states to approve proposals under the Environment Protection and Biodiversity Conservation Act, initially for low-risk, low-impact proposals in environmentally well-understood areas), establishing single-approvals authorities and moving to deemed approvals for complying developments. The federal government should make productivity payments conditional on states agreeing to reform their development assessment and approval processes to make greater use of zoning and complying development, consistent with long-term integrated strategic plans. Eliminate multiple regulatory approvals processes for individual projects to remove the double-handling by state government agencies, and report publicly on progress.

Action 2.10

Governments should prioritise the funding of infrastructure projects with high net economic and social benefits. They should use rigorous and transparent evaluation models to assess the economic costs and benefits of development proposals. Project evaluation models should be designed to take into account population and economic growth as well as the dynamic impacts and wider economic benefits of projects.

Action 2.11

Planning agencies within governments should be seen as economic agencies with an objective to promote private investment and sustainable economic development. They should be properly resourced and have clear key performance indicators for the efficient planning and approval of projects, against which they report publicly and benchmark performance.

03

The provision of infrastructure for a modern, liveable, productive economy

What do we have to get right?

If our cities and regions are to be more liveable, more productive and sustainable in the future then the provision of infrastructure must keep pace with population growth. Infrastructure provides the essential transport, water, energy, communications and social services that determine the quality of life for citizens and the competitiveness of our businesses. These services should be reliable, accessible and of high quality and be equal to anywhere else in the world.

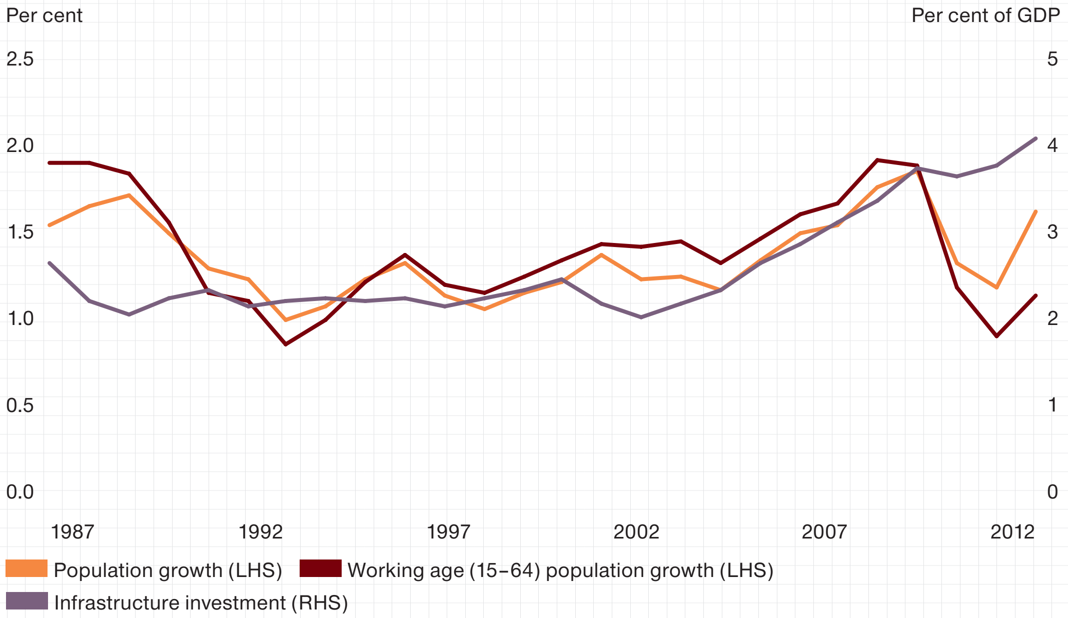
Key facts at a glance

Infrastructure investment is vital to support economic growth. We need to keep investing at a rate of around 4 per cent of GDP if we are to meet Australia's infrastructure backlog and the legitimate expectations of the community.

The private sector provides the greatest share of infrastructure today at almost 50 per cent of the total annual spend.

Private ownership of infrastructure should be preferred although there will be a role for government where a public benefit test demonstrates it is necessary for achieving social objectives.

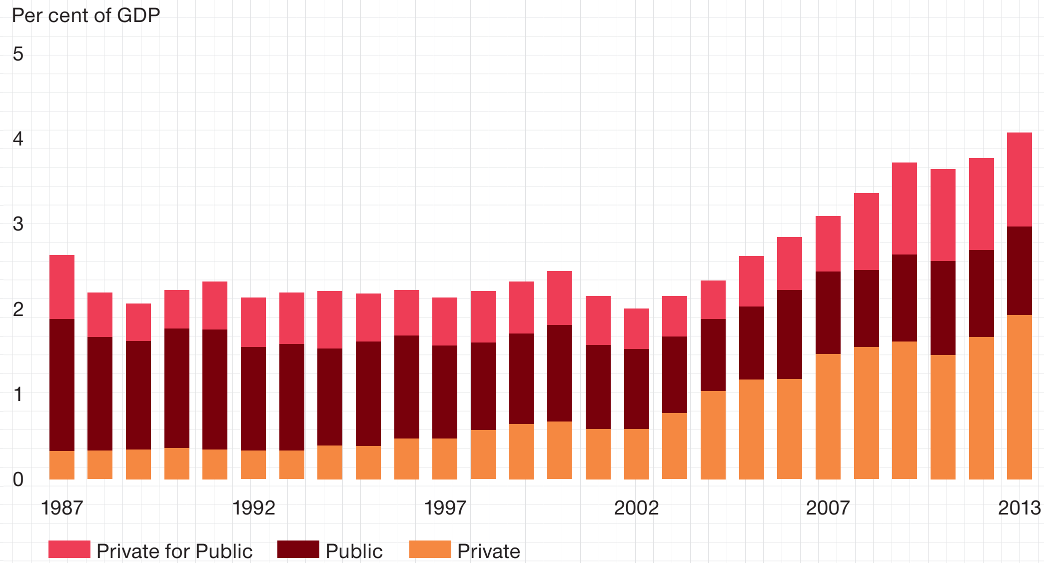
Figure 38: Infrastructure investment and population growth



Source: ABS, 2013a; ABS, 2013b; ABS, 2013f; BCA

Note: years refer to financial years.

Figure 39: Composition of infrastructure investment by sector



Source: ABS, 2013b; ABS, 2013f; BCA

Note: years refer to financial years.

Why do we have to get the provision of infrastructure right?

Infrastructure provision plays a central role in a successful economic growth strategy by lifting productive capacity and contributing to higher productivity and greater competitiveness.

The importance of infrastructure can be seen across the economy including its role in facilitating the movement of people and goods across our cities and the transport of exports to international markets, its role in the provision of energy and water to consumers and businesses and the role it plays in underpinning telecommunication networks.

If Australia doesn't get its future infrastructure investment right, there are likely to be two major impacts:

» The liveability of our communities will be affected, with this in turn likely to result in pushback from many sections of the community about economic and population growth.

» Failing infrastructure will undermine Australia's economic growth prospects by constraining efficiency, particularly in our ports and freight network.

It will also be fundamental to the provision of an efficient national freight system focusing on our strategic port and airport gateways and the road and rail corridors needed to accommodate the near doubling of freight traffic that is forecast to occur by 2030 – as well as the growth in exports driven by the resources boom.

High-quality transport, water, energy, communications and social infrastructure services will also be needed to service an Australian population that is likely to be some 60 per cent higher in 40 years. Sydney and Melbourne are each projected to grow to around seven million people by 2050, Brisbane to four million people.

Without the right investment in roads, traffic congestion will increase, with associated costs that on some measures could reach as much as $20 billion by 2020. Investment is also required to accommodate the shift towards efficient and reliable public transport that will be essential for our cities in future.

There are also important spillover benefits from the efficient provision of transport infrastructure through reductions in transport costs, which can help create new markets and realise the returns to agglomeration. In turn this fosters competition, spurs innovation, lowers prices and raises productivity. A sound infrastructure base can also be a crucial factor in attracting overseas investment.

In terms of economic benefits, research from the Brookings Institute suggests that a 10 per cent increase in the stock of a country's infrastructure assets can increase GDP per capita by 0.7 to 1.0 per cent. The OECD has estimated that each additional dollar of investment in infrastructure can increase economic output by $1.10 to $1.30, while the IMF has estimated a wider range of between $0.50 and $1.80.

International evidence indicates that historically global investment in roads, rail, ports, airports, power, water and telecommunications infrastructure has averaged around 3½ per cent of global GDP each year. In Australia infrastructure spending has been running at a similar level, of around 4 per cent per year.

Maintaining total infrastructure investment at 4 per cent of GDP or more would equate to over $750 billion over the next decade. This would be desirable for economic growth (particularly given a decline in resources investment) and to overcome infrastructure shortages, if the right projects are developed. Much of the investment will come from private and public infrastructure businesses, with governments continuing to directly plan and develop some projects, for example, those not fully commercial but with wider societal benefits.

It is imperative that governments prioritise public infrastructure investments with the highest economic and social returns. Projects with low or negative social returns effectively hold back sustainable growth in the economy.

How can we get the provision of infrastructure right?

Australia, like most other countries around the world, will need to shift the emphasis from public to private investment with a greater proportion of funding for infrastructure coming from direct user charges.

Governments will of course continue to have an essential role to play but their role will need to be redefined. In general, instead of directly owning and providing the infrastructure to citizens, they should be encouraging the development of infrastructure markets and planning for and facilitating infrastructure investments by the private sector. The exception will continue to be a need for governments to directly plan and develop projects with high economic and social benefits but which are not practical for the private sector to develop, whether for commercial or other reasons (the majority of these will be transport projects). Governments will also need to work together to produce more coherent and comprehensive national infrastructure policies.

Australia has gone a long way down this path over the past 20 years but more needs to be done.

To get infrastructure policy and the provision of infrastructure right, we need governments to do a number of things:

» set long-term infrastructure policy frameworks for effective and sustainable infrastructure systems that will meet the future needs of Australians

» improve planning and project prioritisation

» improve funding and financing models

» enable better project delivery to get better value for money.

A long-term infrastructure policy framework

Long-term infrastructure policy frameworks should be designed that will enable the best decisions about infrastructure provision for the future to be made without unduly being affected by shorter-term business cycles, political cycles and budget cycles.

The long-term policy frameworks should redefine the role of governments to enable higher private investment and user pays while also ensuring adequate market regulation and public infrastructure planning, prioritisation and funding. It should ensure better coordination of infrastructure responsibilities across the federation. It is also important to set out clear long-term policies for each infrastructure sector to recognise their unique attributes – urban transport, road, rail, ports and freight, telecommunications, energy and water.

A long-term and comprehensive infrastructure policy should commit governments to strengthening their policy, planning and funding roles and engaging less in ownership and management of infrastructure, especially mature infrastructure businesses.

Governments have a role to play in establishing infrastructure markets and procurement models that promote private provision of infrastructure – on the principle that the private sector will provide infrastructure where it can make a return on investment commensurate with level of risk (in principle, the same rule applies for publicly owned infrastructure businesses).

There will be instances where governments may have some direct involvement in early stages of greenfield projects – this could be through public–private partnerships (PPPs) or, in appropriate cases, setting up new government businesses. However, government should sell these assets and businesses once they are mature and commitments to the eventual sale of the assets and businesses should be legislated upfront.

Exhibit 6: Principles for infrastructure ownership, regulation and pricing

The following criteria should determine whether an asset is owned privately or by governments, and how that asset should be operated:

1. Governments should sell infrastructure assets where the private sector already owns other like assets and provides other like services (this effectively demonstrates adequate policies are already in place to protect consumers).
2. Private ownership should be preferred where an appropriate and transparent price can be established for the infrastructure service in any of these three ways:

» there is a market price set by an effective and contestable market for the infrastructure service

» there is a regulated price that allows an adequate return on an efficient investment while also protecting the interests of consumers

» there is an implicit contract price that a government agrees with the owner of the infrastructure on behalf of public users (includes community service obligations).

3. Government ownership should only be preferred where it can be demonstrated that it is necessary for achieving the community's objectives with respect to infrastructure provision, for example, demand risk on some new greenfield projects.

These businesses should be sold once the business has matured.

Government-owned infrastructure should outsource delivery and operations based on competitive long-term contracts.

With the federal government taking a greater interest in infrastructure provision in recent years there is a need to now set clear roles for the three tiers of government to aid collaboration and avoid duplication and confusion.

As a guide, the following division of responsibilities could be appropriate:

» Commonwealth level – development of a national policy and nationally consistent regulation; some funding and financing role for nationally significant projects; project prioritisation by Infrastructure Australia, and planning and development of national infrastructure projects in some cases

» states – long-term strategic infrastructure planning; develop infrastructure policy; project funding, planning and prioritisation; direct involvement in greenfield projects; infrastructure performance measurement

» local government – planning and approvals processes.

A key outcome of Australia's infrastructure planning system should be a rolling pipeline of high-quality, public infrastructure projects made ready for the private sector to invest in and deliver.

The public infrastructure project 'pipeline' should continually evolve and consist at any one point in time of all the projects being developed by governments working independently or together, or in collaboration with the private sector. Projects in the pipeline should be prioritised according to their economic and social impacts and their fit with long-term strategic planning. Opportunities for the private sector to nominate projects for inclusion in the pipeline should be pursued.

The national infrastructure policy should also include a commitment by governments to lift the amount of investment in infrastructure projects in the pipeline when responding to periods of economic downturn.

Better planning and project prioritisation

Australia's governments should prioritise a coordinated approach to long-term strategic infrastructure planning. Predominantly this is the role of the states; however, the federal government can play a role to identify nationally significant infrastructures.

Infrastructure Australia critically assesses infrastructure proposals for federal funding. Its role should be strengthened to conduct regular strategic assessments and recommend new infrastructure projects and policy reforms to federal and state governments. This should lead to a comprehensive national infrastructure priority list of high net-benefit projects and policy reforms that will lift productivity and competitiveness. The private sector should be able to contribute new ideas for infrastructure investment through governments adopting processes for unsolicited proposals.

As part of their responsibilities, state governments should produce regular 15-year infrastructure plans that provide a pipeline for private investment, linked to their fiscal strategies. The plans should include both fully funded projects for the first five years as well as commitments for project investments through the outer years. These plans should be legislated.

Long-term infrastructure plans should include both investments in new infrastructure and upgrades or improvements of existing infrastructure. Regional economic development strategies should be fast-tracked to identify and prioritise social and economic infrastructure requirements.

Australia's development assessment and approvals processes for infrastructure projects need to be more efficient to reduce costs, delays and uncertainties. Investment projects that are consistent with a long-term strategic infrastructure plan should be deemed to be a complying development and receive concept approval, with full approval subject only to completion of an Environment Impact Statement.

The states should ensure the primacy of the planning act over other legislation in deciding land use and establish a single agency or 'one stop shop' for major project approvals.

Funding and financing of infrastructure

Overcoming funding constraints is a key challenge for infrastructure provision. Funding constraints in Australia, as elsewhere, are driven by stretched public budgets, a lack of appetite for expanding user-pays principles and uncertain private investment conditions. This is a critical issue for Australia to get right.

From a policy perspective it is important to distinguish between the funding and financing of infrastructure. Financing is the source of upfront capital for the investment itself. It is the means of sourcing cash to cover the timing mismatches between the costs and revenues of a project.

It does not provide the fundamental solution to the funding problem. The funding of infrastructure concerns the issue of who ultimately pays for its provision – whether users through user charges, taxpayers through taxes or government borrowing or some combination. An alternative way to describe funding is that it effectively represents the revenue stream for a project.

It should be noted that in Australia today the communications sector, energy sector and increasingly the water sector are typically characterised by full cost recovery, with users paying for historic and future investment and operational costs. The same applies with ports and many other freight infrastructures. However, there is still a need to remove barriers to efficient full cost pricing in these sectors, for example, in the regulation of retail electricity charges. There is a also an ongoing need for regulators to appropriately weigh up the risks to investors in infrastructure and the need to encourage new investment to support growth when setting regulated returns on investment.

Against this background the public funding problem is largely related to road and rail transport provision as well as social infrastructure such as schools and hospitals. These are the infrastructure services where governments typically make direct payments towards new infrastructure build or make ongoing payments under community service obligations.

User-charge arrangements should be promoted wherever possible. It is also acknowledged that governments should continue to pay for some of infrastructure provision where there are equity considerations or substantial benefits to the wider community that can't be recovered through user charges alone or where there is considerable public demand risk for new projects that private companies will not bear. Consideration therefore also needs to be given to how government can best serve its role as a funder of infrastructure.

There would be merit in developing a new federal–state long-term infrastructure funding agreement. Within the public sector, the federal government probably has a greater capacity to fund new infrastructure than the states (partly reflecting its AAA rated borrowing capacity).

In the funding agreement, governments should set out principles for promptly determining the appropriate mix of funding for approved infrastructure projects and agreeing to those. This would avoid the protracted debates that occur over funding shares. The principles should be used to allocate the proportions of funding from user pays and from each tier of government.

The Commonwealth should explore ways to diversify project funding sources by developing domestic capital markets and investment products that grow demand by investment funds and superannuation funds for project debt.

Governments can grow debt markets by issuing 30 and 50-year bonds that help to establish a long-term price for longer-term project debt. Governments could also explore whether initiatives to encourage the greater take-up of annuities by retirees might also lead to altered asset allocation by super funds in a way that grows demand for debt.

Project delivery

Governments should prioritise policies and new institutional arrangements in general that will support the efficient delivery of major capital projects. For example, this could be done by ensuring that governments have a minister who is a champion for investment at the Cabinet table.

Major new public infrastructure should be provided under procurement models that prioritise efficient project delivery, such as the PPP approach, to ensure scarce public funds can stretch across a wider portfolio of projects.

Governments should reduce the considerable cost and time of PPPs by reducing bid costs to the extent possible, and Australia's planning and development approvals systems need to be made more effective.

More generally, there is a need for governments to properly assess the reasons for Australia's high construction costs and identify ways to lift productivity and improve value for money on major projects.

Recommended actions

Action 3.1

The federal government should collaborate with the states to produce a new national infrastructure policy that:

» clarifies the roles and responsibilities of each level of government (with the federal government continuing to play a substantive, and clearly defined, role)

» prioritises infrastructure market development, private investment in infrastructure and the application of user pays wherever possible

» commits to delivery models using appropriate risk-sharing arrangements as a means of delivering projects with the private sector

» sets out arrangements for long-term investment needs planning across the federation, in collaboration with industry, that consistently produce a rolling pipeline of 'ready-to-go' infrastructure projects capable of private sector investment and delivery

» promotes within government the use of infrastructure funds with legislated rules that spending should be allocated to projects with high net economic benefits, established through cost–benefit analysis

» assesses Australia's infrastructure priorities for the next 10 years and outlines a broad strategy for how to plan, fund and deliver them

» commits to new sectoral infrastructure policies for the development of national water, energy, transport and communications markets.

Action 3.2

Governments should agree to lift spending on the pipeline of 'ready-to-go' infrastructure projects when responding to periods of economic downturn.

Action 3.3

Australia's infrastructure competition regulations should be reviewed and updated to reflect developments since the Hilmer review. This should lead to refreshed positions on access regulation, competitive neutrality, infrastructure asset ownership and infrastructure pricing appropriate for Australia's future as a high-investment economy with strong growth prospects.

Action 3.4

Prioritise the implementation of COAG's Heavy Vehicle Charging and Investment scheme and work with the states to apply the principles in that scheme more widely toward the development of a nationally consistent approach to road pricing and road funding.

Action 3.5

All governments should prioritise the improved long-term planning of Australia's infrastructure investment needs. The states should continue to provide Infrastructure Australia with high-quality infrastructure investment proposals backed by cost–benefit analyses and which arise from their long-term strategic growth plans. The states' proposals to Infrastructure Australia should include new projects and upgrades to existing infrastructure as well as regulatory reforms to better use existing infrastructure. The federal government should play an enhanced role coordinating planning and development of nationally significant projects.

Action 3.6

Infrastructure Australia, as the independent authority staffed with relevant experts with industry experience, should be asked to enhance its role to form its own view on new infrastructure projects and policies it considers to be of national significance (in addition to its current focus on evaluating project proposals from the states). Infrastructure Australia should then advise the state and federal governments on these infrastructure priorities and work with them to consider including these projects and policies in its comprehensive list of national infrastructure priorities. Infrastructure Australia should prioritise competitiveness and productivity criteria when identifying new national projects and policies.

Action 3.7

There should be a new, long-term federal–state government infrastructure funding agreement that spells out how funding will be allocated to Infrastructure Australia-approved infrastructure projects. The agreement should include principles that detail how project funding will be broken down between user charges and state and federal contributions, as well as the types of funding support that might be offered (block grants, availability payments, concessional loans, loan guarantees, etc.). Under the agreement states that continue to own mature infrastructure businesses should have to justify to Infrastructure Australia why they cannot first source funds from divesting those businesses before receiving federal funding.

Action 3.8

States should produce regular 15-year infrastructure plans that provide a pipeline of projects for private investment, linked to their fiscal strategies. The plans should:

» include projects approved by Infrastructure Australia for federal funding

» include other projects that have arisen from a strategic plan of state governments or be an unsolicited proposal from the private sector

» include spending on the maintenance or upgrade of existing infrastructure

» include commitments to regulatory reforms that can raise the efficient use of existing infrastructure

» have funding guarantees for the first five years of the plan, with longer-term commitments to infrastructure provision over the remaining 15 years.

Action 3.9

State governments should introduce an effective process for considering unsolicited proposals for new infrastructure from the private sector, based on the New South Wales model.

Action 3.10

The federal government should make the Building Australia Fund the centrepiece of infrastructure funding policy. Federal infrastructure spending should be allocated to the fund in the first instance and then be allocated only to projects independently assessed as a high priority by Infrastructure Australia. Funding commitments from the fund should only be announced once a project is fully approved by Infrastructure Australia, and not before.

Action 3.11

To pay for our future public infrastructure needs, governments should commit to implementing dedicated infrastructure funds and to broadening project funding sources from:

» recycled capital from hypothecation of infrastructure asset sales by governments

» user charges, primarily from greater application of user pays in the transport sector

» value capture initiatives on individual projects, for example, area levies (preferably moving to land taxes over time)

» reprioritising federal expenditure so that a minimum amount of federal expenditure is allocated to infrastructure investment annually (and deposited in the Building Australia Fund)

» considering federal borrowing (or types of guarantees and risk sharing) that is ring-fenced for high-quality, productive infrastructure projects (by issuing general treasury bonds within the AAA-rated borrowing limit, deposited in the Building Australia Fund and strictly for Infrastructure Australia-approved projects only).

Action 3.12

Governments should adopt explicit infrastructure ownership policies whereby they limit ownership to selected greenfield projects where there is sufficient early demand risk and, for mature businesses, only where there is a demonstrated net public benefit. Otherwise, governments should sell all of their mature infrastructure assets, subject to appropriate regulatory frameworks being in place to safeguard consumers and efficient investment where needed. Funds raised from asset sales should be placed in a fund hypothecated towards new projects, for example, the Building Australia Fund or the New South Wales Restart Fund.

Action 3.13

Governments should contract in, or develop internally, specialist infrastructure expertise within government to provide advice for each project on the best model for sharing risk and delivering the infrastructure, with an emphasis on involving the private sector through greater use of public–private partnerships (PPPs) and competitive tendering wherever possible. This internal expertise should also be tasked with advising government on ways to reduce the costs and risks associated with PPP processes.

Action 3.14

Restore the previous regulatory environment prior to the abolition of the Australian Building and Construction Commission by:

» bringing the Australian Government Implementation Guidelines for the National Code of Practice for the Construction Industry into line with the Victorian Implementation Guidelines for the Victorian Code of Practice for the Building and Construction Industry, including by making any statutory amendments to the Fair Work Act necessary for the guidelines to have their full intended effect

» reinstating the Australian Building and Construction Commission and tasking it with implementing and enforcing the guidelines

» commissioning an independent inquiry into construction costs.

Action 3.15

The Productivity Commission should be tasked to undertake a strategic assessment of national infrastructure policies and recommend reforms – and repeat every five years.

04

Realising the potential of people and labour markets

What do we have to get right?

Education and skills are the foundation for growth and prosperity. To compete internationally, our education and training systems need to be preparing people with the competencies, skills and attitudes that make them ready for work. We have to continue to build and grow a skilled and innovative workforce by increasing rates of labour force participation so that we have enough workers with suitable skills and capabilities to meet the demands of a growing economy. The labour market and especially workplace relations arrangements must permit businesses to grow, innovate and manage their workforce and capital effectively.

Key facts at a glance

Education and skills are the foundation for growth and prosperity.

Currently more than 7 per cent of Australians aged 15 to 24 are not in the labour force or in full-time education. We need to equip all Australians and especially young Australians with the right skills and best education.

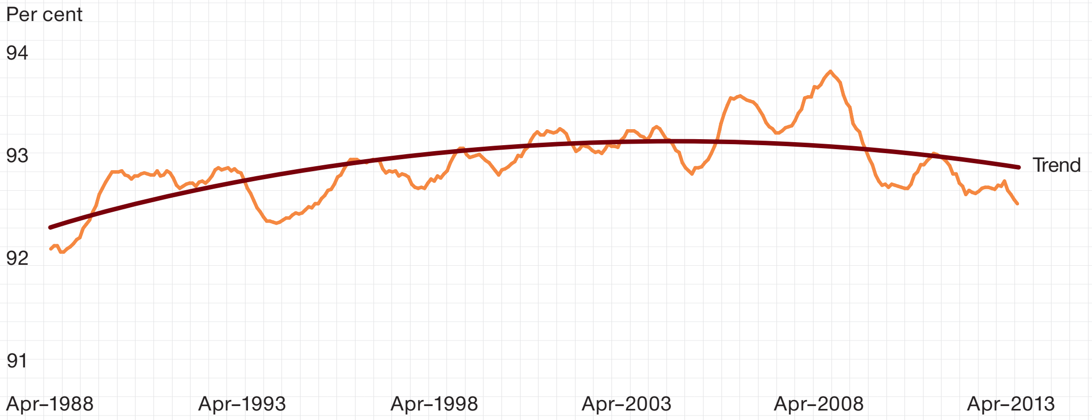
Policies to raise Australia's labour force participation will have a substantial impact on our future prosperity and can play a role in offsetting the impacts of an ageing population.

Increasing the participation of women with children and older Australians to world-leading rates could bring more than 700,000 workers into the labour market and boost our overall participation rate by 4 percentage points.

Australia's labour market and workplace relations arrangements must allow businesses to grow, innovate and manage their workforce and capital effectively.

Workplace relations regulations need to strike the appropriate balance in allowing managers and workers to engage effectively.

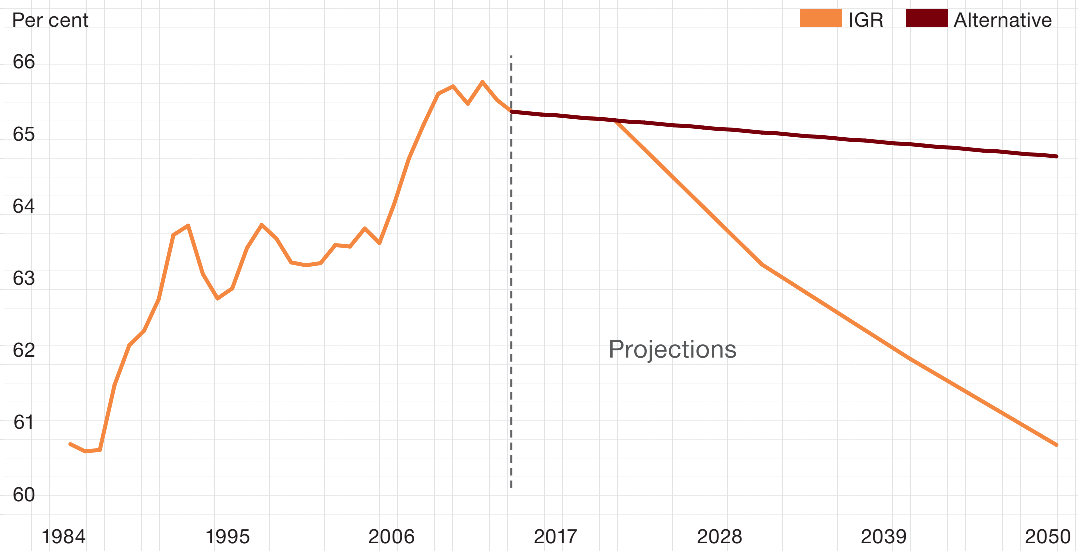
Figure 40: Young Australians in education, training or labour force



Source: ABS, 2013j; BCA

Note: 12-month rolling average.

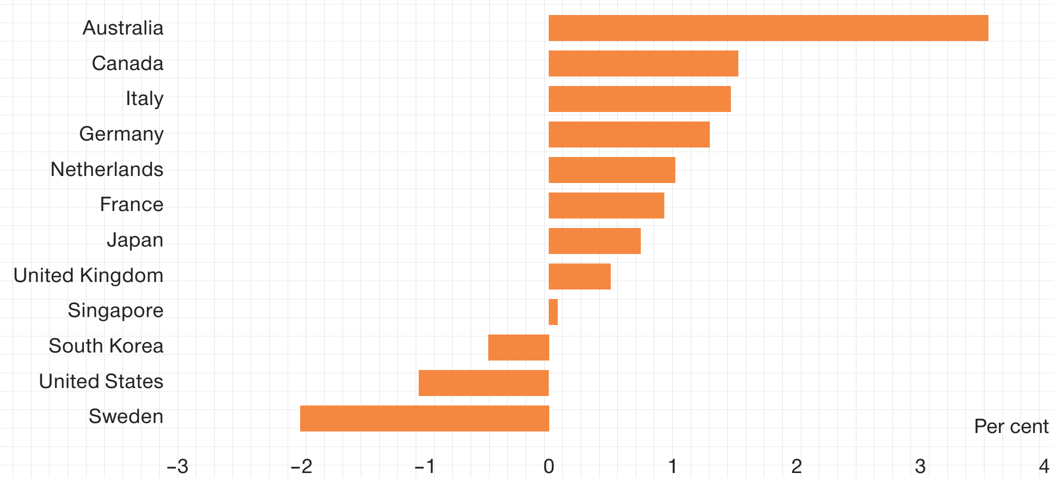
Figure 41: Labour force participation: What could be?



Source: ABS, 2013k; Commonwealth of Australia, 2010; BCA

Note: projections begin from 2013.

Figure 42: Manufacturing unit labour costs: Average annual growth, 1990–2011



Source: Bureau of Labor Statistics, 2012; BCA

Note: US dollar basis.

Why do we need to equip Australians with the right skills and best education?

Getting the education and skills system right is important so that all Australians have the opportunity to realise their potential in work and participate effectively in the life of the community. Education and skills are fundamental in ensuring that people's opportunities are not limited by the circumstances of their early life and that people can adapt and change through their lives. And a skilled and educated population that meets the needs of industry is necessary to help us to compete internationally and maintain our standard of living.

We need to get foundation skills right because they are important for almost every sphere of life. A modern economy requires a higher level of foundation skills than in the past, including higher-order reading, writing and mathematical skills, as well as digital literacy and broader employability skills. Improved literacy and numeracy have a positive and statistically significant effect on labour force participation and wages.

Australia's levels of literacy and numeracy, however, are not as good as they could be. The numeracy standards of Australian school students are significantly lower than students in many of our major trading partners, including Singapore and Hong Kong. For Australian adults of working age, around half have literacy and numeracy skills at levels that are considered inadequate for most jobs. We need to improve in these areas.

As well as improving the foundation skills, it is important that we continue to press for improvements in educational attainment. Although Australia's average level of educational attainment is increasing and is as high as it has ever been, with close to two-thirds of 20 to 64-year-olds having a post-school qualification, it remains lower than that of many other countries, including those with which we compete, such as the United States, Canada, Japan and Korea. Higher average levels of education are needed to help us prepare for a future where a smaller proportion of lower-skilled jobs will be available for those with limited education.

Educational attainment serves an important purpose in social mobility. There is a strong correlation between higher levels of education and employment. Unemployed Australians are the least likely to report satisfaction with their life, unsurprising given the role of unemployment in causing financial stress, reduced social connections and self-esteem. For this reason, we need to raise the education performance of students from lower socio-economic backgrounds, who are around 13 per cent less likely to meet the national minimum reading standards than students from high socio-economic backgrounds. We also need to improve communication to parents who may not themselves have had good opportunities, nor fully appreciate the value of education for their children.

Educational attainment alone, however, provides no guarantee that people can put their skills and training to best use. It is important that we get skills utilisation right. For example, the transition into work for the first time is especially important for young people moving out of study, and any failure to carry the transition can have substantial and lasting impacts on the employment opportunities of the young person left behind. Improving the movement into work from study or from breaks in employment is critical to enabling people to make productive use of the skills they have attained through education and training.

In addition, it is a concern that vocational education and training (VET) may not be equipping students as well as it could to use their qualifications in work. While the main reason for pursuing VET-related education is to obtain job-related benefits after training, well over a third of students do not report any improved employment status after completing their courses.

On a related issue, it is important to get the systems right to support occupational mobility because of the inherent difficulty of predicting what occupations and skills will be in demand in the future. Rigid pathways into trades, professions and occupations are a barrier to people who want to change career direction, increase their skills, or find work that suits them better in some way. More part-time training options, better information for students about the employment outcomes of courses, innovative use of information technology to deliver training, and different types of work-integrated learning would help make occupational and job mobility easier.

How do we equip Australians with the right skills and best education?

Getting foundational skills right can be achieved through a number of channels. For children currently at school it can be done through measures to improve teacher quality. In many studies, the evidence suggests that, after parental influence, teacher quality is the most important determinant of educational outcomes for students. Comparisons with other OECD countries indicates that success in providing high-quality schooling to all students regardless of their background results in higher proportions of students from families with low levels of education entering tertiary education.

For the high proportion of people of working age with inadequate foundation skills, addressing these problems can be more difficult, but workplace-based approaches can be helpful, as can using existing programs available through the VET system.

The educational attainment of Australians can be maintained and enhanced through improving the quality of the school, VET and higher education systems and by ensuring smooth interfaces between them.

School quality could be enhanced through offering greater autonomy to school principals to make decisions on staffing and resources within a school.

The VET system would meet emerging needs in the economy better if it had better incentives to be more responsive to industry and enterprise needs and was more integrated with other parts of secondary and tertiary education.

Our system of higher education could be improved by offering more differentiated and niche courses and by uncapping the course fees that institutions can charge students (alongside the uncapping of student places).

Improving the interfaces between school, VET and other higher education providers is likely to occur if a more consistent funding and regulatory framework were applied that encourages education providers to better adapt to changing economic and industry conditions.

Educating to specified skill standards with external student assessment to test skill competence would further reduce the link between skill attainment and course duration. Enabling individual public education providers (including VET, universities and schools) to negotiate directly with their employees would help them better reward and retain high-performing teachers that could help improve education and employment outcomes.

Skills utilisation can be advanced through course design that facilitates the movement into work from study or from breaks in employment. Greater use of ‘work-integrated’ learning, that is, learning through engagement with industry and community partners in structured activities that are planned for and assessed, should enable people to make productive use of the skills they have attained through education and training and improve their job readiness.

Occupational mobility can be enhanced through the recognition that people want and need to change their trade, profession or occupation during their working life, and the education and skills system can support that by offering top-up training, better recognition of prior learning and more flexible delivery of course elements.

Recommended actions

Action 4.1

We should ensure that literacy and numeracy deficiencies in school students are addressed early by requiring, as a condition of Commonwealth funding, that state governments ensure primary students meet minimum standards before entering secondary school. We should address deficiencies in literacy, numeracy and other foundation skills in employees by raising the profile of Workplace English Language and Literacy program brokers and other proponents of foundation skills, particularly with small business; by testing foundation skills in schools; and by continuing the Language, Literacy and Numeracy Practitioner Scholarships program so as to build the capacity to teach foundation skills.

Action 4.2

Build on Australia's strength as an education exporter by implementing the recommendations of the International Education Advisory Council. This should focus on:

» improving quality in education offerings

» improving the student experience, including student accommodation

» establishing strong partnerships between Australian educational institutions and those in Asia and other parts of the world.

Action 4.3

We should encourage and support excellence in school teaching through:

» raising the entry requirement for teachers, through a restriction of the Commonwealth tertiary education subsidies for teacher education to those with demonstrated high educational ability

» the Commonwealth offering teachers a training guarantee to support ongoing professional development in their subject matter area and/or teaching practice, and including, over time, master's-level qualifications where these best equip the teacher to teach effectively

» state governments empowering school principals to differentiate teacher pay according to the teacher's performance, including the application of relevant expertise in the classroom

» state governments allowing, as a condition of receiving their Commonwealth funding, school principals to have greater autonomy over resource allocation decisions – including hiring and firing – and school finances and facilities, alongside greater accountability for student outcomes.

Action 4.4

State governments should encourage a greater proportion of young people to undertake education and training up until at least Year 12 or the equivalent, by encouraging a broader range of educational pathways and greater specialisation of vocational subject offerings between schools, and greater student choice of schools.

Action 4.5

Reform the funding arrangements for all schools to a new 'per-student' funding model that is appropriately weighted to account for the increased costs associated with teaching disadvantaged students, having regard to budgetary constraints.

Action 4.6

Market arrangements should be further embedded in universities to create the environment for world-class and more differentiated specialist university courses.

» This could include further deregulating the fees paid by university students, so as to enable institutions to move away from the incentive to get high numbers of students through price-capped courses.

» It could also include allowing universities to focus on their core business by reducing the red tape required of them in their relationship with government funding bodies and education-quality regulators; for instance, data reporting requirements could be more standardised to reduce the number of data sets required by government departments from the current level of over 100 per annum.

Action 4.7

A priority medium-term agenda for COAG should be to improve the focus of vocational education and training (VET) to:

» strengthen Commonwealth strategic oversight of VET to be comparable to the oversight of higher education

» subsidise VET students comparably to higher education students

» remove gaps and duplication between the Commonwealth and the states to increase education provider autonomy within a rigorous quality framework.

Action 4.8

The Commonwealth and state governments should examine the incentives for education providers to improve the transition of young people into the labour force by:

» increased use of work-integrated learning such as internships and cadetships

» increased focus in secondary and tertiary education vocationally oriented courses on employability skills, such as team-work, problem-solving and effective communication.

Why do we need to boost labour force participation in Australia?

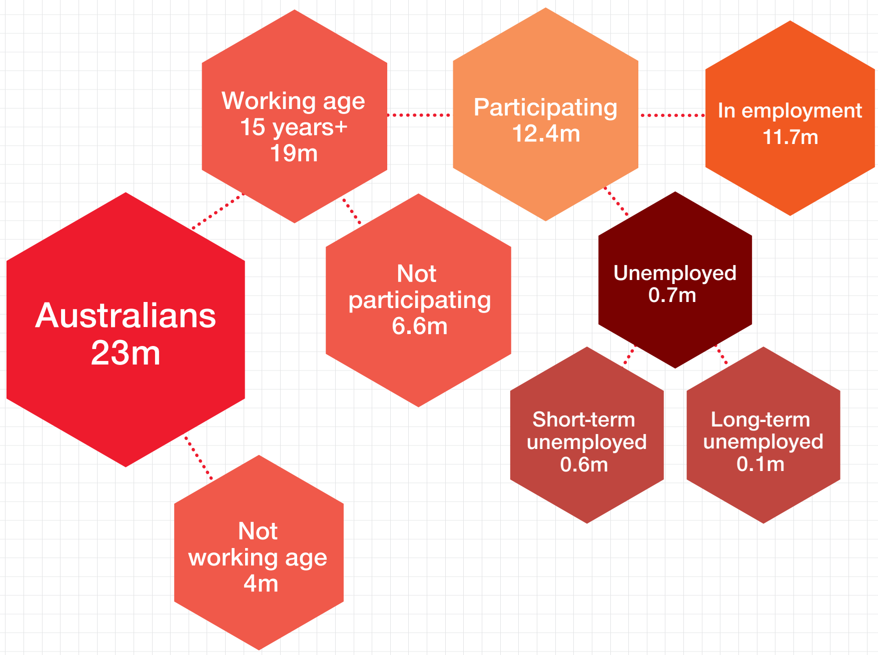
Policies to raise labour force participation have the potential to make an important contribution to Australia's future prosperity as well as to the wellbeing of individuals. As highlighted above, it is the combination of growth in the labour force with growth in productivity that drives overall economic growth.

The policy settings we have in the labour market need to recognise its importance in our prosperity, and be resilient both to the conditions we face today and those that may occur in the future.

In facing the current and projected population pressures, this means engaging those who are not currently in the workforce but who are able and willing to work, as well those who are in the labour force but are underutilised – including the unemployed and underemployed (i.e. those workers who want and are available to do more hours of work than they currently have).

Improving workforce participation rates is one of the most powerful ways that we can offset the impacts of our ageing population.

Figure 43: Labour force participation in Australia



Source: ABS, 2013a; ABS, 2013j; ABS, 2013k; BCA

Australia's overall labour force participation rate has increased over the past 30 years from around 60 per cent to 65 per cent with the participation rates of women increasing by some 15 percentage points over this period.

While Australia's aggregate participation rates for males and females were above the OECD average in 2012, we fare less well in certain demographic groups: males aged 25 to 54 years; women aged 25 to 44 years and people aged 55 to 64 years.

As the Productivity Commission has noted, replicating the labour force participation rates for the highest-performing comparable OECD countries for each of these groups points to the potential for a significant increase in Australia's aggregate labour force participation rate.

» For males aged 25 to 54 years, in participation to the OECD leading rate (New Zealand) would increase the workforce by around 68,000.

» For females aged 25 to 44 years, an increase in participation to the OECD leading rate (Canada) would increase the workforce by some 240,000.

» For people aged 55 to 64 years, an increase in participation to the OECD leading rate (New Zealand) would increase the workforce by some 400,000.

In all, closing the observed gaps could see the number of people participating in the Australian workforce growing by some 700,000 workers, thereby raising Australia's aggregate participation rate by almost 4 percentage points.

In addition, there are a number of disadvantaged groups in the community where workforce participation rates remain particularly low. This includes people with disability, some migrants from non-English speaking backgrounds, Indigenous Australians and people with low education and skills. Increasing the workforce participation of people who are able to work, including those who experience multiple disadvantage, will help maintain or increase the level of income we are all able to enjoy and will contribute to greater social inclusion.

Minimising unemployment is important, given its well-known substantial costs. This includes not only the hardship faced by the unemployed and their families but the harm done to the vitality and productive potential of an economy as a whole. Lengthy periods of unemployment and under-employment can erode workers' skills and attachment to the labour force. They prevent young people from gaining skills and experience in the first place – a development that could significantly reduce their productivity and earnings in the longer term. Loss of output and earnings associated with higher unemployment also reduces government revenues and increases spending, thereby leading to larger deficits and higher debt.

How do we boost labour force participation in Australia?

In considering meaningful strategies to address gaps in labour force participation, action is required across a number of fronts.

A concerted effort is required to raise aggregate levels of participation. Achieving the greatest improvement in aggregate participation (and therefore the most significant economic impact) can occur through targeting the largest groups of non-participants who are able to join the labour force in the near term. Targeting should include both financial and non-financial considerations. The financial incentives for older people and primary carers should ensure that people do not lose too much of their wage in tax and payment withdrawal, as many would only ever expect to work part time, and tend to be very responsive to the net effect of tax and payment withdrawal. This contrasts with those expected to work full time, who are typically much less responsive, and can reasonably face steeper withdrawal of payments.

The most likely target groups in this context are mature-aged individuals and parents with primary responsibility for children, who are not currently participating.

For mature-aged individuals the key issues inhibiting higher rates of participation include:

» financial incentives to retire related to pension and superannuation benefits (e.g. the relatively generous tax, transfer payment and superannuation policy settings that make retirement an attractive option for many people with a potential ongoing contribution to make in the workplace)

» age discrimination restrictions on workers' compensation payments and insurance cover

» applicability of the skills and experience of those who have been out of the workforce for some time.

It will also be important to maintain participation and focus on retaining people currently in the labour force particularly as they approach retirement age.

» Financial incentives related to superannuation and government benefits, poor health, and skill redundancy (and retrenchment) can all significantly influence decisions to retire early and permanently from the workforce.

» Recent policy changes and the impact of the global financial crisis on superannuation balances have helped to improve participation rates among mature-aged individuals, especially men. These developments have also been supported by improved health among older groups.

For parents with primary caring responsibilities, mainly mothers, the main issues inhibiting participation include the following:

» financial incentives resulting from the interaction between the tax and benefits systems that result in relatively little net financial return for work (medium to high effective marginal tax rates, known as EMTRs)

» availability, cost, quality and flexibility of child care

» limited availability of respite care for those who have responsibility for a person with disability or who is elderly

» limitations in job design and workplace flexibility, specifically the lack of flexible employment options, including in terms of parental and carers leave provisions.

Women returning to work from caring may face similar issues to some mature-aged workers such as the relevance of skills and experience, and self-confidence.

In order for the increase in participation rates to be maintained over time it is important to ensure that available incentives continue to support participation and that workers have the skills relevant to rapidly changing technologies and market conditions.

Training and skills development via flexible training pathways, whether on or off-the-job, is vital. Improving training take-up and completion rates among mature-aged workers will not only support greater retention, but will also help to maintain productivity and employability.

A flexible and responsive education and training system that recognises the needs of mature learners is essential, as is employer recognition of the benefits of education and training.

Geographic mobility is likewise important in matching people who want to work with the locations where the jobs exist. By international standards, Australia has a reasonable level of geographic mobility. However, in such a large and sparsely populated country, the more quickly and easily people can move to where good work opportunities are, the better Australian businesses will be able to compete internationally.

Many of the disadvantaged groups facing multiple or significant barriers to participation and employment are small in absolute numbers. From an economic or labour force perspective, this can mean that they are often overlooked. The costs associated with achieving sustained improvements in participation and employment outcomes, and an often narrow consideration or perception of the benefits that flow from this, can reinforce this tendency.

However, considered from the perspective of inclusiveness and the link with disadvantage, the compounded costs of inaction over time, the impact that even ‘isolated’ community dysfunction can have more broadly, and the aggregate costs across all such groups, the case for action becomes compelling.

These actions need to be centred on addressing deficiencies in relevant education, skills and training; dealing with poor incentives or lack of financial returns for work effort; improving health; addressing limited job availability; and in some instances overcoming a lack of adequate and stable accommodation.

Recommended actions

Action 4.9

Increase the participation rate of older Australians through improved financial incentives, which should also be considered in the reviews of the tax and transfer system, and the scope and size of government.

Action 4.10

The Commonwealth and state governments should encourage older Australians to keep working or re-enter the workforce by:

» removing age-based restrictions on workers' compensation and insurance cover that limit the employability of older workers

» encouraging tertiary education providers to support 'whole-of-life' learning and up-skilling to enable workers of all ages to retain and develop the skills needed for workplaces of the future.

Action 4.11

The Commonwealth should increase the participation rates of mothers and other primary carers (especially of young children), taking this into account in the review of the tax and transfer system and the audit of the scope and size of government.

» Consideration should be given to the combined impact of income support, family assistance and personal income tax on decisions to re-enter or increase hours of work, recognising that many primary carers are relatively responsive to financial disincentives.

» Consideration should also be given to the impact of rebalancing family assistance in favour of greater childcare subsidies that specifically support work, study and training and less untied cash payments in the form of family payments.

Action 4.12

Workplace relations and family assistance law should encourage more flexible work arrangements and supportive cultures for working parents and improve the flexibility of hours that can attract Commonwealth childcare subsidies.

Action 4.13

The Commonwealth should better assist people who are disadvantaged in the labour market by:

» making employment placement services easier for employers and jobseekers to use

» aligning incentives for Job Services Australia's employment placement services with successfully meeting the needs of employers and jobseekers, including by taking greater account of the actual jobs on offer by employers

» removing unnecessary regulation by amending the Job Services Australia rules and the Department of Education, Employment and Workplace Relations contract.

Action 4.14

Limit the structural incentives for unemployed people who are disadvantaged in the labour market to withdraw completely from the labour market via a pension payment.

» This should be done by lessening the differences between the pension system (Disability Support Pension) and the allowance system (Newstart Allowance) for people with some work capacity; specifically, this should encompass reducing the differential in the indexation arrangements, the free areas, the taper rates, and the activity testing arrangements.

» It should also lessen the difference in payment rates by increasing the rate of Newstart and related allowance payments to ensure a minimum decent standard of living for those temporarily without adequate personal resources, as fiscal circumstances permit.

» These changes should occur as part of a comprehensive review of Australia's taxation and transfer system and be designed to provide incentives for people to participate in the workforce where they can, while ensuring that income support is adequate and targeted to those in greatest need.

Action 4.15

Support geographic mobility by:

» nationally recognising trade licences regardless of the jurisdiction in which they are obtained

» reducing or removing transactional taxes on property transfer (house sale) in favour of less distortionary tax bases

» working towards a common school starting age and national curriculum

» maintaining policy settings that minimise costs to employers who have staff on fly-in/fly-out work arrangements.

Why do we need more productive and innovative workplaces and a workplace relations system that supports this?

If we are to boost our growth prospects we need to continue to improve our national productivity performance. But productivity improvements for the most part occur at the workplace level.

Efficiency and effectiveness improvements come about from managers and workers striving to improve their firms' performance. They arise from enterprise or workplace-level decisions that individuals and businesses make about investment, effort, priorities and innovation.

The influences on productivity at the firm level comprise both the levers that managers and employees can pull to improve performance as well as wider market and policy influences which affect the environment in which firms and their managers operate.

The nature of the workplace will often determine how well technology is adopted, what improvements are made in business practices, and how well businesses train their workers and how they innovate. In particular, the nature of the workplace determines how adaptable it is and how quickly it can adjust to change.

Workplaces are also facing other pressures for change. A key development is the widespread adoption of mobile communications devices, and the profound change this implies for many traditional workplaces. Workers can be 'at work' at any time, with the resultant benefits of flexibility for them operating in tension with the pressure to be switched on all the time. Workers can also be 'at work' from any location in an increasing number of jobs, with the resultant competitive pressure from workers overseas, and non-traditional employees such as crowd-sourced contributors.

Competitive pressures are challenging for workers, with many highly qualified people overseas potentially interested in Australian jobs, whether located in this country or not. These pressures are also very challenging for business, with barriers to entry being lower in many parts of all industries and sectors. For established businesses to remain competitive against new entrants, and for new entrants seeking to establish themselves, an ability to adapt rapidly is fundamental. Rapid adaptation requires flexibility in how work is organised, an ability to modify the business model quickly, and nimbleness in responding to a changing environment.

Australia's future competitiveness will depend in large part on the extent to which businesses can respond effectively to these changes.

Industrial relations regulations have a rightful role to play in addressing legitimate community concerns about workers' basic rights. But equally they have to balance this against the desirability of enabling businesses to engage effectively with their employees to change work arrangements in response to commercial imperatives.

The Productivity Commission has outlined how flexible workplace arrangements enable firms to adapt more readily to changing circumstances, for example, to meet changes in demand by:

» adjusting the workforce size either through engaging or dismissing employees, the short-term use of casuals or contracting out of functions traditionally performed in-house

» varying the scheduling and intensity of use of the existing workforce strategies include flexible rostering for overtime and shiftwork and scheduling rostered days off and annual leave to coincide with low demand (and for employees, the ability to reconcile work and non-work commitments by adjusting the timing and duration of work)

» moving labour between functional areas – this strategy requires that workers have both the skills and willingness to move between tasks and requires the removal or reduction of any barriers that may exist

» linking remuneration, and therefore unit labour costs, to product demand/output rather than hours worked – approaches include sales commissions or incentives and bonus or profit-sharing schemes

» providing the incentive, in other ways, for employees to offer outstanding customer service, or other operational efficiencies.

How do we foster more productive and innovative workplaces and what type of workplace relations system will support this?

There are two distinct strands to improving the productivity and innovation in Australian workplaces.

One is to create the institutional, policy and regulatory environment in which businesses can respond effectively to competitive pressures. These settings will largely apply across the economy. Settings will need to foster productivity through:

» supporting direct engagement between employers and employees at the enterprise level

» creating an environment that reduces unnecessary uncertainty and risk

- » removing or not creating barriers to job creation
- » not creating excessive barriers to new labour market entrants gaining initial experience
- » creating incentives for collaboration and minimising industrial conflict
- » delivering fair remuneration outcomes that reward effort, alongside a safety net to protect more vulnerable workers
- » promoting healthy and safe workplaces.

A second strand to fostering more innovative and productive workplaces is through improved management capabilities and management practices.

It is up to firms to improve their management capabilities, leadership and culture, so as to create the environment in which staff can perform at a high level. These practices are far more variable and contingent on a number of factors.

These include the size of the enterprise and its overseas links, given the well-documented challenges and lower average performance of smaller and medium enterprises in instituting high-performance management practices.

The degree of competition in the industry or sector is also important, given the pressures that competition brings to improve management practices and the possible demise of firms that do not manage their human resources as effectively as their competitors.

It will also depend on the prevailing incentives to improve the work environment, given findings that the returns to high-performance management systems are greater in some types of firms than others. A key aspect of the work environment will be a workplace relations system that does not create excessive incentives for risk aversion or place barriers in the way of driving innovation.

Recent evidence from companies suggests that essential elements of a modern-day high-performance work system will include:

- » the implementation of effective incentive systems, including incentive pay, employment security, merit-based promotions and reduced status distinctions
- » an attention to skills development, including skills training, selective recruiting and flexible job assignment
- » effective teamwork, good communication and information sharing, a devolvement of decision rights and a culture of problem solving.

Workplace relations regulations need to ensure that the appropriate balance is struck in allowing managers and workers to engage effectively in achieving these objectives.

Recommended actions

Action 4.16

The Treasurer should commission the Productivity Commission to conduct an inquiry into the workplace relations system, including examining:

- the system's impact on productivity and competitiveness
- the extent to which the high minimum wage prevents new labour market entrants from gaining initial experience, to inform future wages policy directions
- the impact of penalty rates on business competitiveness and employment growth, particularly in the retail and hospitality sectors
- the role of individual agreements and their influence on productivity at the firm level
- workplace arrangements in the market and non-market sectors, and identifying arrangements that increase the take-up of innovative practices that make fuller use of workers' skills and expertise.

Action 4.17

The Commonwealth should introduce a number of immediate changes to the Fair Work Act that aim to foster greater flexibility and innovation, and constrain business costs. These changes would include:

- reducing the range of matters that can be bargained over to ensure they are directly related to wages and conditions in the employment relationship
- providing access to employer-only greenfield agreements
- enhancing the capacity to agree to flexibility arrangements with employees including through individual flexibility arrangements
- reducing the scope of the adverse actions provisions
- limiting access to protected industrial action where there has been unreasonable or capricious use of such action
- limiting union entry rights to employer premises
- making unlawful clauses that exclude the engagement of contractors or labour hire companies
- modifying the 'better off overall test' to provide for a broadening of matters that may be taken into account in the application of the test
- modifying provisions relating to majority support determinations
- amending the transfer of business arrangements to include a sunset clause after 12 months.

05

Dramatically rethink our approach to regulation and strengthen governance and institutions

What do we have to get right?

We need to rethink our approach to regulation while maintaining and improving the strength and independence of Australia's institutions and governance arrangements in order to make our markets work better.

Key facts at a glance

Throughout our history, Australia's institutions and overall governance arrangements – including an independent judiciary, strong rule of law and entrenched system of Westminster government – have served us well. But in recent times, there has been a deterioration of good policy process and sound governance arrangements with a resulting increase in adverse unintended consequences. This is affecting our national competitiveness and resulting in growing perceptions of regulatory risk when it comes to investing in Australia.

Australia has a substantial stock of regulations – with well over half a million pages of regulation and more than 24,000 licences.

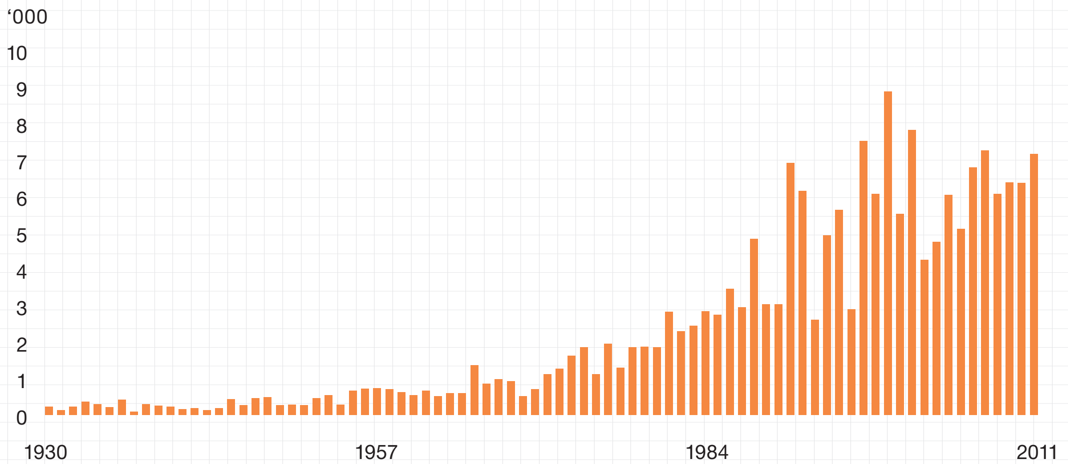
We are continuing to add to this stock at a substantial pace.

In 2011 the federal government introduced just over 7,000 pages of new legislation. Over the past decade, the federal parliament has introduced over 6,000 pages of new rules each year.

Increasing regulation is placing pressure on Australia's competitiveness. In 2012 the World Economic Forum's Global Competitiveness Index ranked Australia 96th out of 144 nations for regulatory burden, down 21 places from the previous year.

Significant new regulations are being introduced in Australia without being subject to due process and increasingly governments are not taking full account of the costs of new regulations being introduced.

Figure 44: Commonwealth Government: Pages of new legislation introduced



Source: Deloitte Access Economics, 2011b

Why do we need to rethink our approach to regulation and strengthen our institutions and governance arrangements?

Over recent decades Australia's economic strength has been underpinned by open and competitive markets that have become more dynamic, bringing with them many new products and services and also new competitors.

A major factor influencing this outcome is the quality and strength of Australia's regulatory system, governance and institutions.

They have played an essential role in setting and oversighting the rules that influence how the economy works and the incentives that motivate people. Sound institutions and strong governance arrangements allow markets to perform well.

Adequate property rights underpinned by efficient regulation ensure that enterprising individuals and businesses have the incentive to innovate because they allow them to have some control over the rewards that are produced from their efforts.

In practice every successful market economy is overseen by a range of institutions that regulate conduct in goods and services markets, labour markets and asset and financial markets.

Independent institutions such as the RBA and the Productivity Commission contribute to Australia's economic performance through enhanced scrutiny, oversight and advice on our market system, both inside and outside government. As illustrated in Figure 45, these types of institutions and other governance arrangements have been built up over a series of decades.

Figure 45: Chronology of recent regulatory, governance and institutional reforms

Recent history of critical regulatory, governance and institutional reforms

1960s

- RBA established (1960)
- Bank lending regulations eased (1965)

1970s

- Tariff review initiated (1971)
- Tariff reform (1973)
- Asprey tax review (1975)
- Australian Financial System Inquiry (1979)
- Deregulation allowing market-determined interest rates (1979)

1980s

- Foreign bank entry (1983)
- Explicit fiscal policy rules (1984)
- Commonwealth Government Regulatory Impact Assessment process adopted (1985)
- Capital adequacy rules for banks (1988)
- Tariff reform (1988)

1990s

- Commonwealth Bank of Australia privatised (1991)
- Telecommunications deregulation (1992)
- Council of Australian Governments (COAG) established (1992)
- Inquiry into National Competition Policy established (1992)
- RBA 2–3% inflation target (1993)
- Australian Competition and Consumer Commission formed (1995)
- Independence of RBA (1996)
- Charter of Budget Honesty (1996)
- Privatisation of Telstra commences (1997)
- Australian Prudential Regulation Authority and Australian Securities and Investments Commission established (1998)

2000s

- State referral of corporations' regulatory powers (2001)
- Review of Trade Practices Act (2002)
- United States Free Trade Agreement (2004)
- COAG Reform Council established (2006)
- Infrastructure Australia established (2008)
- New Federal Financial Relations Intergovernmental Agreement (2008)

Source: Mercer, 2012; BCA

These institutions contribute to good policy governance at a national level and help contribute to public and business trust and to confidence. They can only do so durably if they enjoy respect within government through reliable adherence to orderly process, which is central to effective influence and impact.

Having confident businesses and individuals contributing to a growing economy through investment, saving, employment and innovation in the future will be underpinned by regulatory, institutional and governance arrangements that support:

» a reasonable level of macroeconomic stability and certainty of policy settings upon which to base long-term decisions

» confidence in the government's ability to pursue and successfully implement policy reforms that are, on evidence-based analysis, defensibly in the long-term public interest

» regulations that are clearly expressed and that are administered efficiently to protect legitimate rights

» the ability of governments to perform critical functions in the most efficient and effective manner possible, with appropriate checks and balances including impact assessments as central disciplines in decision making.

When business refers to policy predictability and stability, it is these factors that are most important. Stability is essential if we are to inject confidence into the economy. When investors put capital at risk for 5, 10 and even 20-year projects they want to know that the rules of the game are not going to change materially. Strong and robust rules and institutions are key underpinnings of any country's competitive success.

The business community accepts that rules have a legitimate place in our society, but we are concerned about the rigour of our rule-making processes. Having well-targeted regulatory, institutional and governance arrangements can help us to compete more effectively.

Having well-targeted arrangements also reduces the risk of unintended consequences. For example, the government often introduces price restrictions with the worthy objective of protecting consumers. However, in the long term more often than not they hurt consumers by either restricting the level of investment by business or by being set at a higher level than would prevail without the restrictions.

Australia's regulatory system may be relatively well evolved and sophisticated on some measures, but this does not mean that it is delivering efficient regulatory outcomes. Australia has well-established regulatory mechanisms such as the Regulation Impact Statement, but they are not being used to their full potential in creating an efficient regulatory system.

It will be increasingly important that the regulatory system gets the balance right in dealing with significant changes in the economy.

For example, in an economy in transition it will be important that regulation does not become a barrier to businesses being able to quickly adjust to structural pressures and for resources to flow to areas and activities where they can be put to best use. Similarly, factors like demographic and technological change will demand the most efficient policy and regulatory responses if we are to manage these changes effectively and grow the economy.

Structural adjustment will also place pressure on the role of institutions like the RBA along with increasing pressure on governments to intervene and support sectors under pressure from the high exchange rate.

Despite considerable market reforms and deregulation, Australia still has a considerable stock of regulation and it is inevitable that some regulation is impeding economic growth. Ongoing efforts to increase competition and deregulate markets have delivered considerable gains to the Australian community.

For example, National Competition Policy saw Australian governments identify about 1,800 pieces of regulation in order to review and remove as necessary restrictions that didn't provide a net benefit to the public. As the Productivity Commission suggests, this policy contributed to Australia's long record of unbroken growth along with strong growth in household incomes while delivering reduced prices of everyday goods like milk and electricity.

Exhibit 7: Examples of overly burdensome regulation

Environmental assessment and approvals

» The Business Council has previously cited an environmental assessment process that took more than two years, involved more than 4,000 meetings, produced a 12,000-page report and resulted in 1,500 conditions and 8,000 sub-conditions attached to approval. In total, the company invested more than $25 million in the environmental impact assessment.

Corporate governance regulation

» Even if governments implement recent proposals for directors' liability reform, there will still be over 200 Acts with provisions making directors liable for thousands of offences.

» Current provisions under section 249D of the Corporations Act allow just 100 shareholders to require that directors convene an extraordinary general meeting. For some large Australian companies, this can involve a cost of up to $1 million on account of the wishes of less than 0.01 per cent of shareholders.

Retail restrictions

» Most states persist with highly restrictive and inconsistent trading hours restrictions. In one state alone this represents a $200 million a year cost to the economy.

Product approvals

» For medical device manufacturer Cochlear, a recent approval for an important product innovation took 14 months longer in Australia than in Europe, delaying its product getting to key export markets ahead of international competitors.

How should we rethink our approach to regulation and strengthen our institutions and governance arrangements?

A clear strength of Australia has been the high standard of our institutions and governance arrangements over many years.

Having appropriately robust and flexible governance and institutions to underpin continuing economic growth will require the continual enhancement of current arrangements.

In previous chapters, this plan has focused on improvements to governance and institutions in areas such as fiscal policy, the federation and infrastructure. Therefore, this chapter focuses on how to strengthen Australia's approach more broadly to the governance and institutions involving policy and regulation making by government and the ongoing administration of our regulatory system.

In this context, the particular policy priorities should be to:

» maintain Australia's commitment to market-based economic principles, underpinned by the continuing strength and independence of institutions such as the RBA that are free from political interference to assess economic conditions and intervene as they see fit

- improve the performance of our policymaking processes to ensure that governments progress policy changes and new regulatory interventions in a way that, to the extent possible, they produce net benefits to the community and are in the long-term national interest
- strengthen the accountability, transparency and legislative frameworks for our regulators to ensure that they are protecting legitimate rights and supporting markets without impeding economic progress
- continually review and streamline as far as possible our existing stock of regulation
- enhance policymakers' and regulators' understanding of business.

Maintaining the strength and independence of our institutions

The Business Council of Australia does not see the need for wholesale changes to the well-established market institutions that have served Australia well over recent decades.

It is understandable, however, that structural change in the Australian economy and pressures from global economic circumstances will bring calls from some for fundamental changes to these institutions.

As Australia approaches the 30th anniversary of the floating of the Australian dollar, there are suggestions in some quarters that currency intervention may be warranted in the face of a continued high Australian dollar, which is putting pressure on trade-exposed industries. There are also various calls and proposals for increased subsidies or increasing tariffs for trade-exposed sectors like manufacturing, tourism and agriculture.

There is no doubt that macroeconomic policy setting in Australia has become more challenging in light of structural pressures and global policy settings of zero interest rates in many advanced economies. Despite this, the Business Council does not see a strong case at this stage for the government deviating from the policy settings that have served the Australian economy well over two decades of continued growth.

In particular, the government should continue to leave the RBA to apply its independent expert judgement on the setting of interest rates (taking into account its inflation target and economic risks) and any need for direct currency intervention. It is noteworthy that the Australian dollar has eased somewhat in recent months as global economic circumstances change.

The government should also resist calls for the application of tariffs and other protections for trade-exposed sectors.

Not engaging in protection does not mean that the government should do nothing. It should instead foster the flexibility and productive capacity of the economy as outlined throughout this plan. This includes improving the skills of the labour force, removing obstacles to the movement of labour across geographic and occupational boundaries, providing temporary transitional assistance to impacted workers and companies and improving infrastructure.

The government can also run disciplined fiscal policy to reduce its impact on inflationary pressures in the economy, giving the RBA room to ease monetary policy as it sees fit.

Policy and regulation-making processes

There is generally a well-acknowledged sense of what constitutes best practice policy and regulation making, but with governments confronting considerable pressure to make policy quickly to deal with issues of the day, implementation in practice falls short.

Adherence to the Cabinet process by Australian governments underpins Westminster-style government. As the Cabinet Handbook suggests, it reflects the democratic principle that parliament expresses its confidence in the collective whole-of-government rather than in individual ministers.

This is underpinned by effective and timely information, as noted in the handbook:

> *The principle of collective responsibility can only operate effectively if all members of the Cabinet are well informed and well advised (including by their departmental officials) about the decisions they are being asked to make. Timely and thoughtful consultation is the only way to ensure that there are no surprises and each minister has the opportunity to inform the discussion, bringing to the table his or her portfolio knowledge and political judgement. Good policy requires informed decisions.*

Adherence to these processes that have served Australia well cannot be taken for granted. An increasing desire from the community for timely policy interventions and the need to handle very sensitive decisions can place pressure on the traditional Cabinet process, including the need for timely consultation.

In setting policy, governments should be increasingly cognisant that in addition to regulatory and government devices, there are a range of non-regulatory and informal devices that underpin the ethical and efficient conduct of businesses in markets.

In some instances, encouragement of these devices may be more effective and less costly than black-letter law. For example, non-regulatory devices such as the ASX Corporate Governance Council have a significant bearing on the accepted governance practices of ASX companies. Companies and their directors also have a very strong interest in upholding their reputation and professionalism, particularly given the intense scrutiny and analysis that comes from increased financial analysis and commentary in the electronic media.

Having a high-performing regulatory system means that greater regulatory restraint and rigorous policymaking processes must become business-as-usual, institutionalised through a dedicated culture among ministers and public servants.

Recognising that there are already regulatory guidance materials for governments, there would be merit in governments committing to the following principles of a high-performing regulatory system:

» Before government seeks to regulate, it must understand the problem or policy priority in depth and test the case for regulation, along with the risks and consequences of not regulating a particular activity.

» The costs of new regulation are thoroughly assessed and tested with the community through cost–benefit analysis, which includes an explicit understanding of the costs to the community including business.

» Regulation is carefully targeted to achieve its stated objectives and minimise the cost impacts on the community including business.

» Regulation is administered by regulators in the most efficient manner possible to facilitate economic progress.

» Existing regulation is constantly reviewed from first principles through new Regulation Impact Statements, with regulations amended or removed if it cannot be established that they are appropriately targeted to an ongoing risk or problem.

In addition to these general principles for our regulatory system, governments should take particular care when setting competition policies, which can have a profound impact on the effective operation of markets across the economy. There would be merit here also in adhering to some fundamental principles around competition law such as those previously outlined by the Business Council (see Exhibit 8).

Strengthening the accountability of regulators

It will also be necessary to ensure that regulators who administer regulation have the right incentives to balance risk with costs imposed and to ensure that they have the flexibility to discharge their responsibilities in the most cost-effective way.

This would involve establishing a more effective performance framework for assessing performance and keeping regulators accountable, including periodic reviews and dedicated independent oversight for the largest and most critical economic regulators.

Clearly the creation of a new body to oversee regulators would need to avoid the pitfalls of duplication and the creation of another layer of bureaucracy that fails to deliver improvements to government regulation. Such a body would need to have a very clear and differentiated mandate from existing bodies.

Its role would need to involve critically reviewing the performance of regulators, with the objective of driving better regulator performance and also driving streamlined regulation where poor regulator performance and unnecessary costs are the direct result of poorly designed regulation. This could have the useful benefit of better integrating oversight of the entire regulatory system – with a body that has oversight of the regulatory system at the regulator interface where the practical impact of regulation begins to materialise. An independent and empowered body would have an incentive to drive change and suggest improvements in the design of regulations and practice of regulators based on practical and objective experience.

The proposal to improve the performance and accountability of regulators in this way is not new. Almost a decade ago the Uhrig review recommended that the Commonwealth establish an Inspector-General of Regulation with a view to providing the community with a mechanism to ensure that regulators are being held accountable, and as a matter of good governance.

Investing resources in such a body is justified on the basis of the considerable cost of poorly designed and administered regulation on the community. Eliminating just a fraction of this cost each year may derive a net benefit. In addition, active oversight may ultimately reduce expenditure on regulatory bodies by helping them to operate more efficiently.

Exhibit 8: Competition policy principles

A market-based system promotes growth and raises living standards.

For markets to work, the system must have a strong legal underpinning that inspires trust. Information must be readily available, and both individuals and businesses should be able to reap the rewards of their efforts.

Competition laws should protect the competitive process rather than particular competitors.

Competition laws should not be used to deliver broader social objectives, such as preserving domestic firms or employment.

Government businesses should not receive undue competitive advantage.

Better choices and outcomes for consumers should be the overriding goal, recognising that consumers' interests can be met when there are many competitors or in markets with a smaller number of large and efficient firms.

Competition laws should prohibit misconduct that seriously weakens the competitive process, including predatory pricing and collusive cartel conduct.

While instances of market failure will occur from time to time and require regulatory intervention, it should be evidence-based and only introduced after broad consultation with stakeholders.

Competition regulation targeting a particular sector should only be introduced where there is clear evidence of market failure that requires it. Addressing industry-specific issues by introducing competition laws that affect the rest of the economy should be avoided.

Competition laws should be applied consistently, transparently and in a timely way to avoid creating unnecessary uncertainty.

Streamlining the stock of regulation

Governments must also modernise Australia's stock of regulation and tackle the outcomes of historic poorly disciplined regulation making.

Proper management of the stock of regulation is absolutely critical for Australia's regulatory system to take the next step towards what the OECD refers to as 'an embedded program of continuous improvement in regulation'.

On this basis, there are two key fronts upon which efforts to streamline the existing stock of regulation should proceed:

» embedding systematic processes and mechanisms that encourage the removal of outdated regulation and require continual evaluation and review of existing regulation, with the findings of these reviews implemented by government as a matter of priority

» undertaking targeted reviews of areas of regulation that are critical to future economic growth and meeting looming challenges.

Enhancing the performance of government

If critical government institutions, regulators and policymakers are to perform these roles effectively to underpin economic growth, then there will need to be a better level of exchange and understanding between the public and private sectors.

It will also be important to better measure the productivity of the public sector, recognising that this will not be as straightforward as it is for the private sector. The government should also institute merit-based selection processes for senior appointments to all government bodies, including regulators.

Recommended actions

Action 5.1

Australia should maintain the market approach to critical institutions that has served it so well over recent decades, including the absolute independence of the Reserve Bank of Australia, and market determination of the exchange rate. Governments should also strongly resist the introduction of tariffs and other market restrictions unless they can be shown to provide a net benefit to the Australian community. At a minimum, any new regulation should comply with the rule of law.

Action 5.2

The Commonwealth Government should substantially strengthen the quality and transparency of its decision-making processes. This will be achieved by:

» reinstating strict adherence to the processes set out in the Cabinet Handbook for a well-functioning Cabinet system. This includes high-quality and timely documentation along with detailed public consultation to ensure well-informed collective decision making.

Action 5.3

Make the preparation of Regulation Impact Statements a statutory requirement for all new regulations with a significant impact, with exemptions strictly limited to issues of national security and emergency.

» In line with the BCA's Standards for Rule Making, the Regulation Impact Statements should have an eye to evaluation and review by establishing an evaluation plan and objective, and measurable key performance indicators.

» The recently implemented two-step Regulation Impact Statement, which requires the need for regulation to be established first before proceeding to the second step of detailed analysis, should be utilised.

» Genuine consultation should be undertaken at relevant stages of the rule-making process, with a minimum consultation period of eight weeks at each stage.

» Green paper–white paper processes should be adopted for major whole-of-economy reforms.

Action 5.4

Before seeking to introduce any new corporate governance regulation, governments should consult with the ASX Corporate Governance Council to assess whether the particular issue can be addressed by the council utilising its principles and recommendations.

Action 5.5

Establish a new performance and accountability code for major regulators – such as the Australian Taxation Office – which is enshrined in law. The code would be supported by provisions for:

» the establishment of an Inspector-General of Regulation to provide additional oversight of regulators, including undertaking biennial performance audits of major regulators and responding to systemic issues identified by regulated parties. Such a body could be established within the Productivity Commission with a clear mandate to take active steps to improve regulator performance and recommend the streamlining of regulation where it is impeding the efficiency of regulators and placing unnecessary costs on regulated parties

» a balanced performance-reporting framework that assesses not only enforcement and compliance activities but the extent to which these are undertaken efficiently

» regulators to prepare annual Statements of Accountability that outline the basis for measuring the success of the regulator, to be approved by Portfolio Ministers and the Inspector-General of Regulation

» regulators to establish public targets on streamlining their processes to reduce regulatory burden each year

» regulators to document, regularly update and adhere to a risk-based approach to compliance and enforcement activities.

Action 5.6

Request the National Competition Council to undertake a stocktake of National Competition Policy to build the case for further microeconomic reform. Reform should target those sectors where the National Competition Council's original recommendations still have not been taken up and those sectors dominated by government service provision and highly restrictive regulation that would benefit from greater competition.

Action 5.7

Establish a comprehensive framework for the regular review and updating of the stock of regulation. Such a framework should include:

» implementing all of the 155 recommendations from the Productivity Commission's annual programs of benchmarking and reviewing regulation that have been undertaken since 2007

» extending the Productivity Commission's ongoing annual benchmarking program by establishing rolling audits of the cumulative regulatory burden in each industry sector at least every five years, with recommendations for streamlining

» requiring all new regulations that will have a significant increase in burden to have an equivalent offsetting red-tape reduction in the same portfolio. It may take some time for governments to establish both a meaningful and workable offsetting regime. Therefore, less sophisticated interim measures such as 'one-in one-out' within the same portfolio may have to be employed to even out the bias toward increasing the stock of regulation in the short term

» institutionalising a regular refresh of significant regulations from first principles by requiring a statutory review every five years and sunsetting of significant regulations and legislation (where practicable) at least every 10 years. The terms of reference for such reviews should be set out clearly in legislation.

Action 5.8

In introducing National Productivity Payments from the Commonwealth to the states (see Action 1.11), priorities for state-led regulatory reform should be:

» removing duplication in environmental approvals under the Environment Protection and Biodiversity Conservation Act

» consolidating small regulators and licensing bodies

» streamlining planning and zoning requirements

» streamlining retail sector regulations, including trading hour restrictions.

Action 5.9

Establish a number of mechanisms to improve government's understanding of business and incentives to reduce regulation. Mechanisms should include:

» linking ministerial remits as well as senior executive performance indicators and remuneration to the need for demonstrating efficient regulatory outcomes in their portfolios through compliance with Regulation Impact Statement requirements, as well as identifying and supporting ministers in implementing proposals to streamline existing regulatory burdens

» requiring senior executive staff to complete the Company Directors Course offered by the Australian Institute of Company Directors as a mandatory professional development activity under their performance plans

» facilitating the exchange of staff between the public and private sectors by establishing agency secondment programs, building on the secondment program adopted by the Commonwealth Treasury.

Action 5.10

The Commonwealth Government should charge the Department of Finance and Deregulation, Australian Bureau of Statistics and Productivity Commission with developing a framework for measuring productivity in the public sector. This could be applied as government agencies progressively adopt integrated reporting.

06

Realising deeper global engagement

What do we have to get right?

Australia needs to engage effectively with other countries in the region and with the rest of the world – recognising that the strength of the economy is underpinned by openness. A deepening of Australia's international engagement will rely on the free movement of goods, services, people and capital. We have to maximise the opportunities that arise from our engagement with the global economy by lifting the competitiveness of our domestic firms and markets and by fostering openness and reciprocity on the part of our global partners.

Key facts at a glance

Australia remains a medium-sized, open economy. Our trade exposure has improved over the past few decades and is expected to pick up further in coming years as the resource investments move into a production and export phase.

One in five Australian jobs is related to trade.

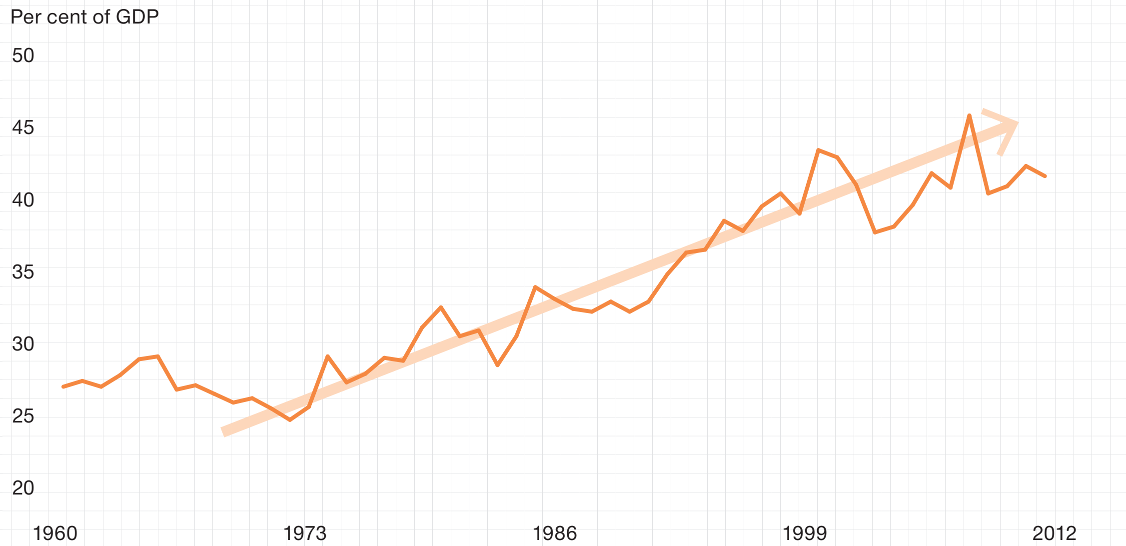
Growth in direct investment flows usually follows a step-up in trade flows.

Australia's economic success has always been reliant on inbound foreign investment, but more recently a growing amount of outbound investment is occurring as Australian firms expand their operations abroad.

People-to-people links are essential to deeper international engagement and educational connections have possibly the greatest benefits.

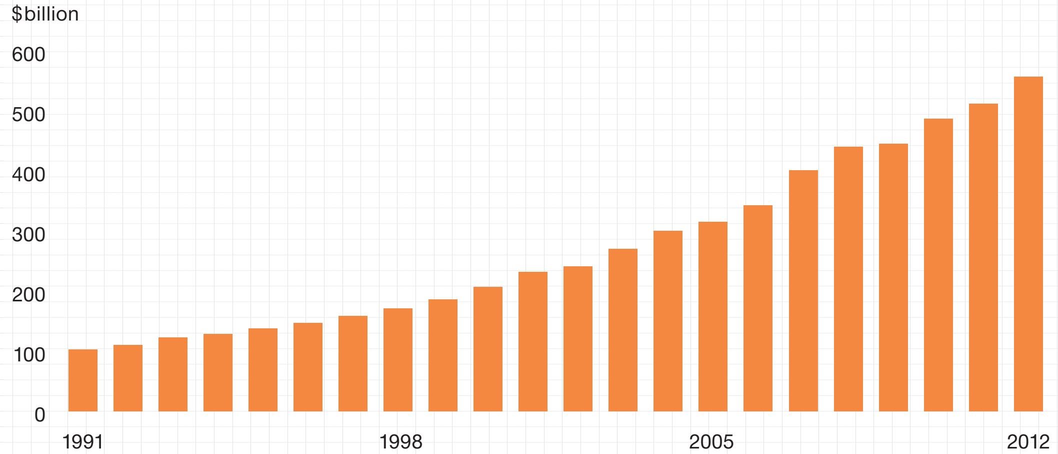
Over the past 30 years some 2½ million international students have benefited from an Australian education.

Figure 46: Trade share of GDP



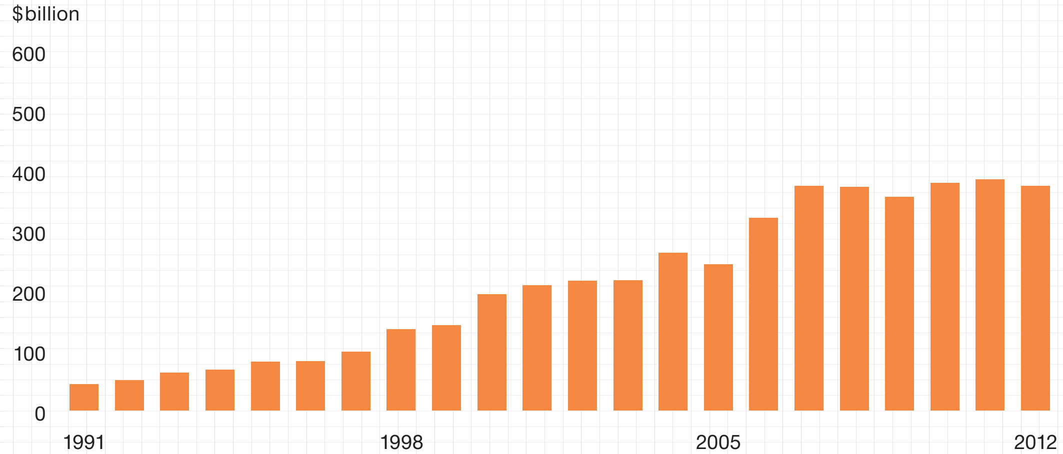
Source: ABS, 2013b; BCA

Figure 47: Inward foreign direct investment



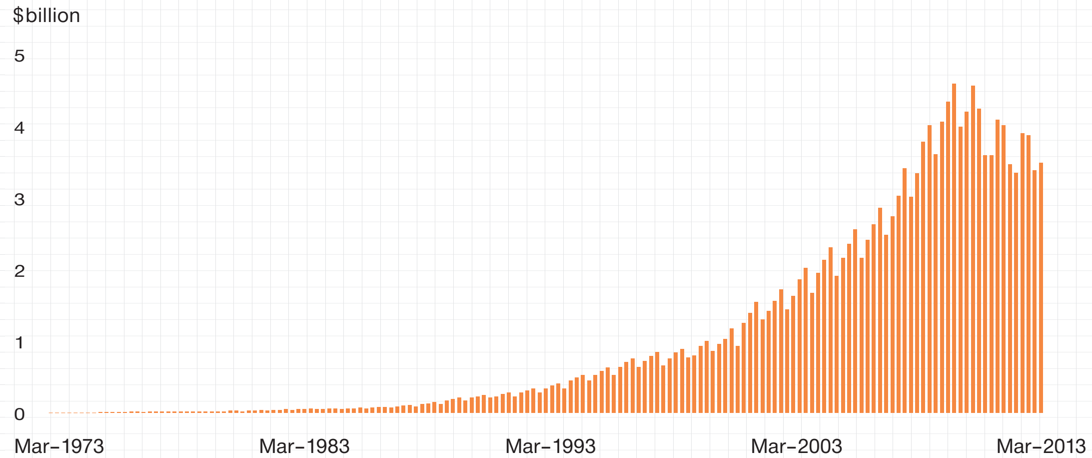
Source: ABS, 2013d Note: years refer to financial years.

Figure 48: Australian direct investment abroad



Source: ABS, 2013d Note: years refer to financial years.

Figure 49: People-to-people links: Australian education exports



Source: ABS, 2013i

Why do we need to realise deeper global engagement?

Deeper global engagement will increase prosperity and raise living standards in Australia. The simple reality is that the new world order requires openness and the more open we are the more successful our economy will be. The capacity of Australian businesses to become more integrated in the regional and global economy will heavily influence their success, and will also influence wealth and job creation in Australia.

The economic reforms that have underpinned the past two decades of economic growth have been centred on building open and competitive markets, as well as promoting trade and globalisation. Over recent decades Australia's economy has become more open, interconnected and integrated with the world economy. Changes that have occurred in the global economy have in turn generated competitive pressures on many parts of the Australian economy.

Australia's trading performance – across both goods and services – has provided enormous economic benefits. There has been a natural complementarity between many Asian countries' requirements for a stable supply of commodities and Australia's abundance of competitively priced, high-quality resources and proven export performance. We have also developed our services exports. In the case of the export of education services the benefits of creating enduring people-to-people links have matched the direct financial gains.

The changing global economic landscape characterised by the rise of developing economies and rapid emergence of new markets is presenting both new opportunities and greater competition for Australia's economy.

This opportunity is widely recognised and there has been an awakening of the importance to Australia of greater integration with the global economy and the Asian region more specifically. The *Australia in the Asian Century White Paper* recognises a fundamental point: that deeper connections with the region can also broaden the flow of ideas and help us acquire new knowledge and access to the new technologies that will improve the living standards of our citizens.

As noted earlier, fostering competitive domestic markets is fundamental to enhancing the productivity performance of firms, and exposure to international competition is perhaps the most important area of all as it compels local businesses to strive for world's best practice.

Deeper international connections are also cemented through people-to-people links, including educational and cultural links. Over the past 30 years, some 2½ million international students have benefited from an Australian education, and we have gained an extensive alumni network of Australian-educated leaders in Asia and beyond.

Separately, Australia's standard of living owes much to our continued ability to attract and utilise foreign investment. Through most of Australia's history, access to overseas capital has helped foster higher rates of economic growth, develop new industries and infrastructure and strengthen our trade and economic linkages with the world.

By continuing to attract high levels of foreign investment we can underpin higher levels of income and bring world-leading technologies to Australia, helping to raise productivity and support and sustain our growth prospects. Previous investment waves from the UK, the US and Japan mirrored the strong trade relationships established with those countries over various stages of Australia's economic development. Given China's industrialisation and growth pathway, its demand for Australia's resources, agriproducts, services and know-how will drive the next large cross-border investment wave from overseas.

The shift of global economic power towards the Asian region highlights the need to get Australia's global engagement and foreign investment policies right.

Sovereign wealth funds and state-owned enterprises have become major sources of global capital and an increasingly important part of the international financial system. The rapid emergence of new foreign investment sources has historically led to a raised level of community concerns. We should respond to any new community concerns about future investment waves through increasing transparency of investment outcomes, and addressing any perceptions about non-commercial investment motives.

How can Australia realise deeper global engagement?

A strategy to deepen Australia's global engagement is best built around two approaches: first by addressing domestic impediments to global engagement, and second through a strategy that targets external impediments to our engagement abroad.

But for us to be successful with our engagement we need to:

» improve our business-to-business and cultural links

» continue with our policy of open and competitive markets

» recognise that new business models will evolve and allow us to take better advantage of emerging investment and partnership prospects

» recognise the importance of displaying a mutual respect for other countries' cultures and business practices while upholding Australia's rigorous corporate governance standards.

Improving the competitiveness of the Australian economy will be fundamental to making the most of opportunities for deeper engagement with the world. Action needs to be pursued across a range of areas to improve the overall operating environment for businesses – especially those exposed to international competition.

A key goal should be to promote a policy environment that is consistent, coherent, stable and predictable. Without this, issues around regulatory risk or country risk can arise in the eyes of global investors and firms when it comes to doing business in Australia.

A more open labour market that is responsive to the structural changes affecting the Australian economy is an essential feature. This requires enhancement of workforce skills and greater flexibility in the labour market.

The skilled migration program is a key feature of a national migration program and adds considerable flexibility to the business operating environment. It gives businesses the ability to access external sources of labour to relieve shortages of particular workforce skills from time to time.

In addition, temporary skilled work visas (subclass 457) are instrumental in allowing employers to access the skills they need. More 457 visas need to be provided.

A concerted effort is needed to reduce the regulatory burden in trade-exposed industries. A useful starting point in this regard would be to streamline environmental approvals and reduce the costly and unnecessary overlap between Commonwealth and state requirements.

Australia's business community has a long and successful history of engaging with our region through trade and investment links. The current transformation of the Asian region into a leading economic powerhouse provides another opportunity to reassess and re-engage with the region. In particular, we should prioritise our engagement efforts with five key Asian nations – China, India, Indonesia, Japan and the Republic of Korea – as identified in the Asian Century White Paper. We need to advance work on country-specific plans for promoting our engagement with these priority countries, to ensure that the broad opportunities identified in the Asian Century White Paper are realised.

Substantial opportunities exist for Australia to take advantage of an expected expansion in the global market for agricultural products and an elevated awareness of food security issues. Australia already exports over half of its agrifood production. If Australia is able to double or triple its agricultural exports by 2050, export incomes could rise over the next four decades by between $700 billion and $1.7 trillion. The focus by the National Food Plan on growing agrifood exports and boosting agricultural productivity growth are important steps in this process.

For such outcomes to be achieved it will be necessary to address challenges around attracting investment and reducing farm costs. The sector will need to be receptive to corporate capital from both domestic and foreign sources. Australia's quarantine and biosecurity arrangements should be improved through the implementation of better risk-management strategies. The government should build on its groundbreaking study with China on strengthening investment and technical cooperation on agriculture (*Feeding the Future*), to work with other overseas partners to increase rural production and expand Australia's role in the supply of global food markets.

The services sector is significant as a source of employment and is ripe with potential for trade and investment. The services sector, however, is relatively under-represented in our export profile. While the services sector accounts for around 80 per cent of Australia's economy, it contributes less than 20 per cent of our total exports. We need to reduce and remove regulatory impediments to trade in services in Australia, including in key services industries such as transport services, professional services and international education. In addition, we need to reduce similar barriers in our overseas markets, including through negotiations on the plurilateral Trade in Services Agreement, as well as through regional and bilateral free trade agreements.

More industry linkages and policy discussions with key foreign services sector partners should be developed through the establishment of dedicated services forums, which would help to identify barriers to trade and suggest further ways to boost services exports. Many of Australia's financial and professional services companies are truly world class. With a highly educated and expert talent pool, Australia offers many countries an ideal partnership opportunity to build their own domestic capabilities through access to this talent.

Removing barriers to foreign-qualified professionals working in Australia – in accounting, architecture, engineering and legal services – would improve the international competitiveness of Australia's professional services sector. At the same time, Australia should continue to encourage other countries to remove barriers preventing Australian professionals offering services in their country.

Mutual recognition of professional qualifications through bilateral agreements has proved successful, but is also slow and incremental in delivering outcomes. An alternative strategy is to pursue multi-party mutual recognition arrangements, including those under the auspices of the Asia–Pacific Economic Cooperation forum (APEC). A third option is unilateral recognition of qualifications from countries that have equivalent standards.

There is no better way to strengthen people-to-people links between countries than through educational ties. In 2011, there were more than 550,000 international student enrolments in Australian education institutions.

The tertiary education sector remains highly regulated compared to many other markets in Australia, although there is a trend towards the unbundling of the components of higher education (recruiting and admitting students, designing curriculum, teaching, and assessment). Further reforms which could enhance Australia's higher education services exports include those which make it easier for foreign providers to become accredited as an Australian university, and the deregulation of student fees with a view to addressing the decreased numbers of international students.

The inherent challenges associated with Australia's geography mean that trade logistics frequently impose a higher cost on Australian exporters than they do on many of their international counterparts. Internal logistics costs alone can represent nearly 20 per cent of the value of the merchandise exported from Australia. Much of this cost is domestic transport charges.

Recent changes designed to increase the number of Australian-flagged vessels carrying domestic cargo have had the effect of limiting shipping users' access to foreign vessels on domestic routes, thereby driving costs up. This tightening of cabotage rules reverses a long period of deregulation in domestic maritime transport and should be overturned.

Foreign investment policy

Australia should aim to improve its standing as a destination for foreign investment.

Investment is increasingly becoming more important than trade for international economic engagement. Foreign investment complements cross-border trade in goods and services. With increasing vertical specialisation, global trade in goods is frequently dominated by intra-industry and intra-company trade, which are both typically associated with foreign direct investment. Moreover, global trade in services usually depends on services providers establishing a commercial presence in foreign markets, which also requires foreign direct investment.

Australia's historic reliance on significant levels of foreign investment to supplement domestic savings has been fundamental in meeting investment needs. That need remains. But we have turned this to our advantage by building globally competitive businesses.

Like many other countries, Australia reviews foreign investment proposals on a case-by-case basis to ensure that they are not contrary to the national interest. From a pragmatic perspective, such investment screening by the Foreign Investment Review Board (FIRB) provides the Australian people with confidence that foreign investments are in the national interest.

Nonetheless, Australia's regulation of foreign investment is more onerous than many other developed countries. The OECD rates Australia as having the sixth most restrictive foreign direct investment regime among OECD members. Only Japan, New Zealand, Iceland, Mexico and Korea are considered to have more restrictive regimes.

While retention of some screening is warranted, there would be merit in Australia lifting the general threshold that applies to private investors from the current level of $248 million to $1,078 million (currently enjoyed by only New Zealand and the United States). It is important to recognise that if concerns relating to private foreign investment arise, other mechanisms are available to address them including through existing Trade Practices and Corporations Act laws. Such an increase in the general threshold would send a clear signal of Australia's openness to foreign investment.

At the same time, improved marketing and communications efforts are warranted around Australia's foreign investment policies to promote a wider understanding and acceptance of the policies by prospective investors and by the Australian public.

There would be merit in further clarifying Australia's attitude and approach to investments by foreign governments, sovereign wealth funds and state-owned enterprises. This recognises that in future these investors will be a growing source of funds that are available to provide the capital to help develop good investment opportunities in Australia.

We should also provide more assistance to foreign investors once they have entered our markets, for example, providing advice on corporate social responsibility, environmental requirements and engagement with Indigenous communities.

Strengthening regional and global architecture to promote freer trade and investment

Australia – including Australian businesses – should play an active role influencing global and regional arrangements to promote freer trade and investment. We should remain committed to opening markets through multilateral trade negotiations in the World Trade Organization (WTO), while taking a prioritised approach to trade liberalisation in regional and bilateral negotiations.

It is in Australia's interests for the Asia–Pacific region to continue to grow strongly, and we should support an environment that supports this growth. Australia stands to benefit from vigorously promoting effective governance in Asia–Pacific economies and aiming for a regional architecture that advances more open markets, as well as regulatory models that promote efficiency. We should support greater market integration in the region, including the deepening of the trans-regional financial sector and capital markets, and China's ongoing efforts to internationalise the renminbi (RMB). Recent agreements with China on a bilateral currency swap and on establishing direct trading between the Australian dollar and the RMB are welcome moves in this direction.

Central to this objective is giving a high priority to economic engagement with the economies in the Asia–Pacific region through the APEC forum, the Trans-Pacific Partnership (TPP) and the ASEAN-centred Regional Comprehensive Economic Partnership (RCEP), which brings together nine of Australia's top 12 trading partners, including India.

Australia will also have a timely opportunity to influence the G20 as host in 2014 as it seeks to deliver on the goals of stronger, more sustainable and more balanced growth.

Government resources should be prioritised to focus on negotiating bilateral and regional free trade agreements, which provide the greatest opportunities for the expansion of business and which best serve Australia's long-term economic interests.

Australian businesses also need to engage more fully in the policy development process, including in trade policy, through actively identifying barriers to greater trade and investment in overseas markets, and identifying and supporting behind-the-border reforms in key markets. Australia's hosting of the B20 grouping of business leaders in 2014 provides an opportunity to leverage up our influence on the global stage.

Exhibit 9: Regional trade agreements

Australia is involved in negotiating two separate regional trade agreements that provide pathways to a free trade area of the Asia Pacific. The region provides enormous opportunities for Australian business interests, representing more than half of global GDP, and more than 40 per cent of world trade.

Trans-Pacific Partnership

The Trans-Pacific Partnership negotiations bring together 11 other countries apart from Australia (Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Singapore, Peru, the United States and Vietnam), representing nearly 40 per cent of global GDP.

The TPP is seen as a building block for greater economic integration of the Asia–Pacific region, and will further open regional markets for goods and services by substantially reducing barriers to trade and investment.

» The TPP is considered a '21st-century' trade agreement, in that it deals with behind-the-border impediments to trade and investment and will be a living agreement, capable of bringing in additional members and addressing future issues as they emerge.

» It aims to enhance trade and investment among the TPP-partner countries, promote innovation and economic growth, and support the creation of jobs.

» The expanding markets of the Asia–Pacific region are already key priority destinations for Australian goods, services and investment, and the TPP will serve as a platform for Australian business to access regional markets.

» It will also help Australian businesses access markets where we do not have an existing trade agreement, for example Peru.

Regional Comprehensive Economic Partnership

The Regional Comprehensive Economic Partnership aims to lower barriers to trade and investment in the Asian region, and would be an important step towards achieving a free trade area of the Asia Pacific.

RCEP could become one of the world's largest trading blocs. Together the RCEP countries account for almost half of the world's population, and represent 60 per cent of Australia's two-way trade and 70 per cent of Australia's goods and services exports.

Negotiations were launched in November 2012 and include the 10 ASEAN members and those countries with existing free trade agreements with ASEAN (Australia, China, India, Japan, Korea and New Zealand).

The parties to RCEP want to build a modern and comprehensive trade agreement, covering trade in goods and services, investment, economic and technical cooperation, intellectual property, competition, dispute settlement and a range of other issues.

RCEP will include nine of Australia's top 12 trading partners. Importantly, RCEP would also strengthen global trading rules by being consistent with the WTO.

The parties to RCEP aim to conclude the negotiations by the end of 2015.

Recommended actions

Action 6.1

Australia should place freer trade and investment at the centre of its actions on global economic engagement, including through its leadership of the G20 and B20. Trade facilitation and keeping markets open should be very high among the near-term priorities. Australia should also continue to back the G20 in extending, upgrading and refining the 'standstill agreement' to prevent new barriers to investment and trade in goods and services being raised.

Action 6.2

Australia should intensify efforts to conclude the free trade agreements currently under negotiation, including those with our top four export markets (China, Japan, the Republic of Korea and India). A pragmatic and staged approach to negotiations should be pursued where necessary, around a broad theme of reciprocity, with a particular emphasis on those sectors where Australia has comparative strengths, for example in the services sector. Australia also should lead work to negotiate the WTO-consistent plurilateral Trade in Services Agreement. Australia should continue to proactively support negotiation of the Trans-Pacific Partnership and the Regional Comprehensive Economic Partnership, that could lay the platform for a free trade area of the Asia Pacific.

Action 6.3

Australia should aim to become a world leader in attracting foreign direct investment. We should have a goal of extending the higher foreign investment screening threshold that applies to investors from the United States and New Zealand – currently set at around $1.1 billion – to private sector investors from all other countries.

Action 6.4

Australia should revisit and further clarify the foreign investment policy for investment by sovereign wealth funds and state-owned enterprises.

Action 6.5

Australia should reduce and remove regulatory impediments in key services industries, including transport services, professional services and international education.

- The restrictive coastal shipping changes introduced in 2012 should be repealed immediately with a reinstatement of single-voyage permits and continuous-voyage permits for foreign-flagged vessels operating on domestic routes.
- A priority should be placed on working with professional bodies to negotiate either multi-party or unilateral recognition arrangements for accountants and lawyers, and to agree on a set of principles to govern the recognition of professional qualifications.
- We should seek to include professional services in the plurilateral Trade in Services Agreement.

Action 6.6

We should reduce the regulatory burden on Australia's trade-exposed sectors, including by streamlining the operation of environmental impact assessments and the process for granting approvals and licences. Australia's quarantine and biosecurity arrangements should be improved through the implementation of better risk-management strategies in line with the recommendations of the Beale review.

Action 6.7

Australia should maintain a more internationally open labour market. We should embrace the use of 457 visas to access skilled labour where there is a shortage of particular workforce skills, and implement mutual recognition of qualifications of foreign professionals.

Action 6.8

We should establish high-level CEO dialogues with emerging economic partners in the region, for example Indonesia, to facilitate practical discussions on removing impediments to trade and investment.

07

Preserving a strong, stable and competitive financial system

What do we have to get right?

A stable and well-regulated financial system helps the economy grow and prosper by spreading risks more efficiently and by facilitating the funding of productive investments. Australia's capital markets have a very solid foundation and will provide a strong underpinning to our future growth prospects. We need to maintain confidence in the financial markets and find the right balance between stability and system resilience on the one hand and competition and productivity in the sector on the other.

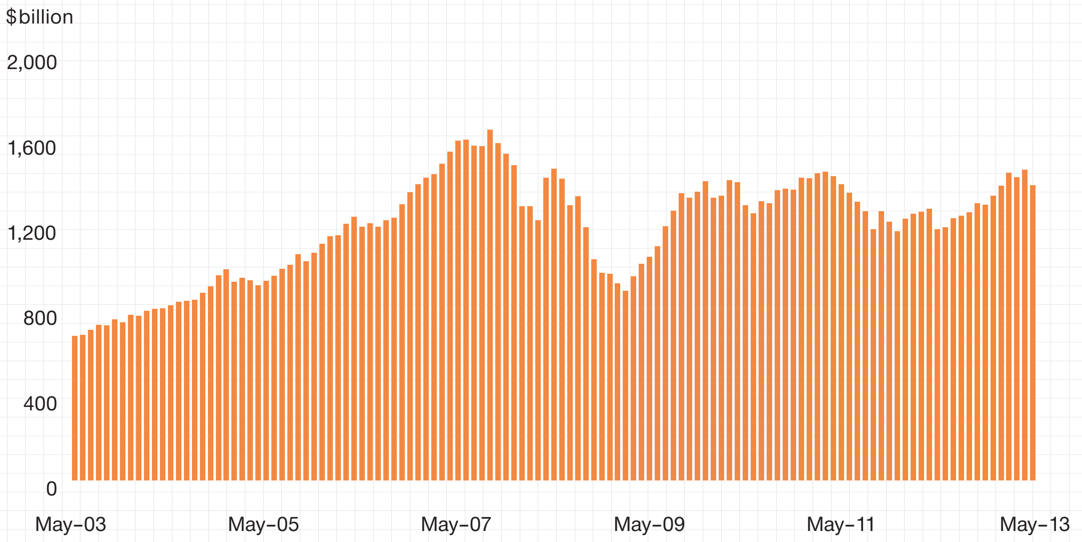
Key facts at a glance

By and large, Australian businesses have effective access to capital. The World Bank ranks Australia second among 31 high-income countries for businesses' ability to access credit.

Australia has one of the top 10 equity markets in the world, with market capitalisation growing considerably over the last decade.

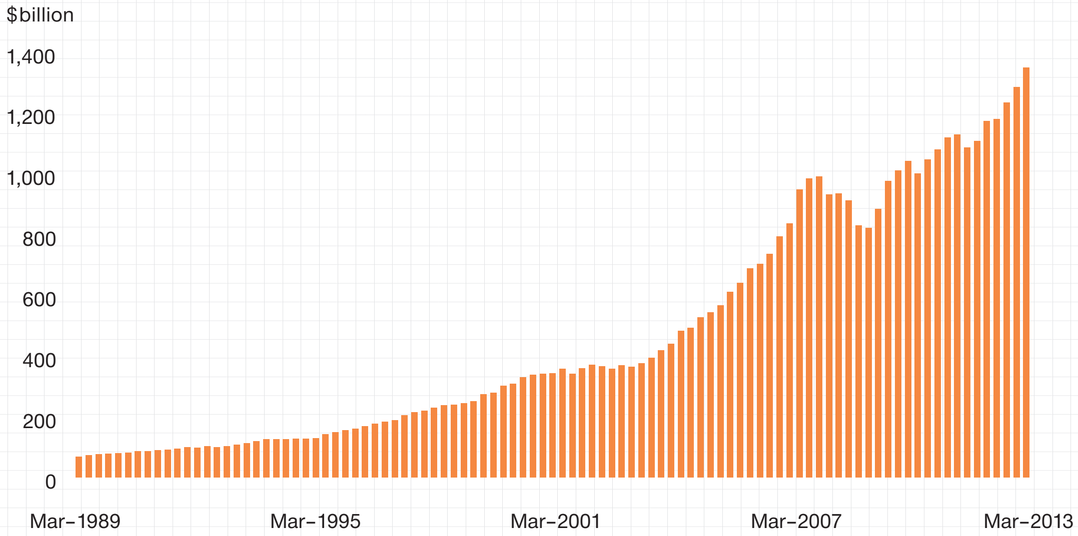
In recent decades, Australia has built up a superannuation savings system that is now worth around $1.3 trillion.

Figure 50: ASX domestic equity market capitalisation



Source: ASX Historical Market Statistics

Figure 51: Superannuation savings



Source: RBA Assets and Liabilities, Superannuation Funds – Outside Life Offices

Why do we need to preserve a strong and stable financial system?

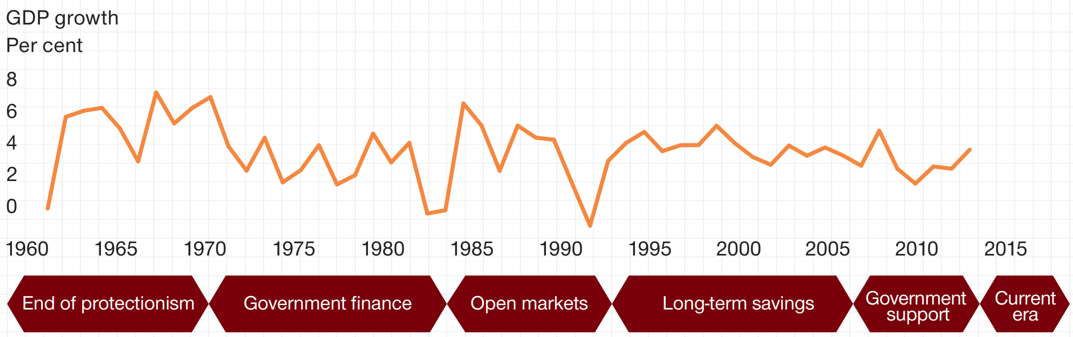
Economic growth demands cost-effective access to capital – both equity and debt – by those institutions, enterprises and individuals who are generating wealth. This capital is needed both for the short term and the long term.

For economic growth to flourish, business, entrepreneurs and investors also need to have confidence in the financial markets, which in turn requires consistency in regulation, security of funds, legal protections and trust in information flows.

The deregulation of Australia's capital markets through the 1980s and beyond improved their competitiveness and the general availability of capital. Australia's capital markets have since matured further to a point where we have the most efficient and competitive 'full-service' financial sector in the Asia–Pacific region.

Our financial sector is characterised by a superannuation savings system worth $1.3 trillion, Australia having a AAA sovereign debt rating, well-capitalised banks, one of the top 10 equity markets in the world, a highly skilled workforce and a first-class regulatory framework that has served us well through the global financial crisis.

Figure 52: Australian capital market interventions, 1960–2012



Key government interventions

Gradual removal of protectionist policies

1960
RBA established as independent entity from Commonwealth Bank of Australia

1961
Introduction of 20/30 rule

1966
AUD introduced and pegged to GBP and USD

1970
Restrictions on bank lending lifted

Growth through infrastructure finance

1971
Australian Industry Development Corporation is established to provide finance to industry

1978
Primary Industry Bank of Australia is established to support the rural sector with development finance

1979
Market-based tender system for Treasury notes (and bonds in 1982)

Move towards market economy

1983
Free float of Australian dollar

Removal of all exchange rate controls

1984
All controls on bank deposit terms and lending rates removed

1985
Foreign banks invited to establish trading operations

Accumulation of wealth

1992
Superannuation Guarantee extended to all employees starting at rate of 3%

2002
Superannuation Guarantee reaches 9%

2006
Future Fund launched

Public finances back to deficit

2008
Government guarantees deposits and allows banks to borrow against Australian AAA rating in response to the global financial crisis

2013
Agreement reached for free exchange of AUD to RMB (to begin in 2014)

Superannuation Guarantee rising to 12%

Source: ABS, 2013b; Booz & Company

Note: the '20/30 rule' refers to Life Insurance and Superannuation having to hold 30 per cent of assets in government securities, two-thirds of which (20 per cent) have to be held in Australian Government securities.

As we stand today, Australia does not face major risks in terms of capital market stability and resilience.

The long-term strength of Australia's economic position, the regulatory priority given to the stability of the capital markets (in particular the banking system), the multiple generations of strong financial institution governance, robust risk-management capabilities and practices in our banks, and relatively consistent, transparent, investor and investee security and protection policies and market conduct laws have all been instrumental to our capital markets' stability and resilience.

Reflecting this, Australian firms are generally able to access bank debt when they require capital. More sophisticated firms can access capital through other vehicles such as public equity, private equity or corporate bonds. At present, Australian banks – which provide capital to the widest range of firms in Australia – also have world-leading credit assessment capabilities which have been developed over a number of decades.

Diversity and resilience

A major lesson relearnt in the last global financial crisis was the value of diversity in sources of capital. Over the last five years our major borrowers, being leading corporates and banks, have significantly diversified their funding sources – reducing their reliance on Australian debt funding and balancing their capital raisings across Europe, the various US debt markets, and some Asian and Middle East markets. We have also seen a handful of Australian corporations with an enterprise value of less than $1 billion access overseas (mainly US) debt markets at a good price and with acceptable covenants.

Despite this positive development Australia's capital market structure is unbalanced in certain areas. There are three specific imbalances in our debt and equity markets that if addressed have the potential to enhance our growth prospects.

First, we have no liquid bond market. We have a very thin government bond market and infant corporate bond market. Less than 10 per cent of all debt issued on the wholesale debt markets was raised by corporates. In fact, New Zealand has a deeper and more liquid bond market than Australia. Over 80 per cent of all debt provided to Australian enterprises is intermediated via the banking system.

Second, there is a lack of longer-dated debt capital, with the majority of debt provided by banks, which are structurally and rationally equipped to support debt up to seven years in duration. However, given maturity mismatches, there is a missing part of the market for longer-dated debt. Players that have longer-term liabilities such as insurance companies, sovereign funds and other long-term investors need to find a way to participate more meaningfully in the market for longer-dated debt.

Third, while the equity markets are generally considered strong, there is a lack of diversity across the risk–return spectrum with only small amounts of venture capital activity compared to other countries. Whether Australia suffers from a lack of early stage funding or lack of entrepreneurial innovation opportunities is unclear but Australia has less venture capital investment than other countries as a proportion of our GDP.

Efficiency

Australian capital markets are reasonably efficient; there are few significant barriers to international capital flows and active competition exists between the major players.

The biggest risk to the continued efficiency of Australia's capital markets is inconsistent or continually changing regulatory requirements. Governments need to legislate and regulate carefully. Consistency and clarity of regulatory intent are essential. Poor regulation simply imposes a significant compliance burden and diverts attention and resources away from other areas of business that are potentially productivity enhancing.

In adopting global regulations we should make sure that while Australia remains in broad step with the rest of the world, we don't get too far ahead of global timelines and unwittingly impose a competitive disadvantage on our own financial players.

What's needed to preserve our strong and stable financial system and make it more competitive?

The strength of our capital markets should be a national asset and something we look to develop and foster. Protecting the strong foundation of our capital markets – stability and system resilience, filling the gaps in diversity and access and continuing to improve efficiency are an imperative.

Maintaining Australia's AAA sovereign credit rating

The strong ratings of our sovereign debt market as well as the strong credit ratings of our banks are key advantages for Australia. However, with a portion of banks' credit rating dependent on the rating of the underlying sovereign debt there are substantial risks for the banks if Australia was to lose its AAA rating. Should this occur, Australian banks and the economy would face slightly higher funding costs and potentially lower availability of funding, which would doubtless reduce their ability to lend to fund growth.

A further consequence of Australia losing its AAA credit rating would be the large losses that Australian banks would have to acknowledge on their holdings of government bonds in their liquidity portfolios.

Australia's AAA credit rating should be preserved at all costs and this underscores the importance of a disciplined approach to fiscal policy outlined elsewhere in this action plan.

Broadening and deepening our domestic debt and equity markets

In terms of further strengthening Australia's financial system, there would be merit in extending the diversity of our capital markets. Action could be taken both in our debt markets and to a lesser extent our equity markets.

In particular, action could be taken to address imbalances that restrict the depth and liquidity in domestic debt markets.

The Australian bond market is smaller than other developed economies. This partly reflects the fact that Australia's corporate bond market is relatively underdeveloped. This issue has been identified as a concern from several quarters for a few years now.

Factors that have been identified as discouraging domestic bond issuance include the traditional reliance on banks to provide most of the borrowing needs of the non-financial corporate sector (albeit with shorter maturities leading to rollover risks) and the fact that larger Australian companies find it relatively straightforward to raise debt in offshore markets at competitive rates (often at lower rates than those offered by banks).

Only large, globally recognised Australian corporates are able to access the corporate bond market. Since the beginning of 2008, some 99 per cent of corporate bonds were issued by companies with market capitalisations of more than $1 billion. Large corporates access the corporate bond market because it offers lower rates and better covenants than those offered by banks.

Limited liquidity also acts as a barrier to investors especially when it comes to smaller or less well-known companies that would like to issue domestically – the shallow markets mean investors are frequently faced with the possibility of having to hold debt to maturity.

Smaller companies are unable to access the corporate bond market in part due to investor reluctance to finance corporate bonds rated below BBB+. In contrast, BBB+ rated companies make up a large proportion of the US bond market.

It is difficult to issue and trade corporate bonds in Australia. There is no standard issuance documentation and the process can be very time consuming. The absence of a proper risk-free rate curve from which to price new issues is also a contributing factor. A long-term yield curve is necessary to accurately price corporate bonds. This could be solved by the issuance of longer-dated government bonds to create a proper risk-free rate or encouraging the use of the credit default swap rate.

In addition, our large local investor base – superannuation funds – has not been focused on fixed interest and debt investments. Their funds have largely been in accumulation phase; our defined contribution long-term savings market is much larger than our defined benefit savings market, which is typically more conservative in its investment approach. We also have the added dimension of dividend imputation, which supports equity yield over bond yield – especially in bank stocks where there is a perception that equity risk is lower.

To address this imbalance, a corporate bond market with simplified issuance processes for smaller companies and sufficient liquidity to encourage the participation of a broad range of retail and wholesale investors is needed.

Strong domestic equity markets

It will be important for Australia to continue to support the development of strong domestic equity markets enabling access for productive businesses along the full risk/return spectrum.

The ASX is among the top 10 exchanges in the world, and there is reasonably good access to listed equity by businesses of all sizes. While there have been a number of recent initiatives to make it easier for smaller companies to raise money on the ASX, relatively few smaller companies are accessing public equity markets. There would be merit in continuing to simplify and lower the cost of entry (particularly for small and medium enterprises) while pursuing high-quality information flows and investor and market liquidity.

A significant factor affecting Australia's equity markets has been the preference of superannuation funds to invest in solid and reputable high-yielding stocks. This has contributed to a significant concentration of investments in the largest Australian companies.

Ensuring our intermediated debt market has adequate access to funds

Australia's banks face certain funding challenges.

Australian banks have traditionally had a high reliance on sourcing their wholesale term funding from offshore, typically raising in excess of $100 billion in any given year.

One important lesson from the global financial crisis was the material risk of an over-reliance on wholesale funding and it was only the introduction of a government guarantee on commercial banks' borrowings that averted a fully blown crisis in Australia.

Australia's banks have significantly reduced their reliance on foreign wholesale funding in recent years, sitting out of offshore markets for extended periods when spreads were wide and credit demand was low. However, our banks remain major players in terms of global issuance.

It is incumbent to further examine our reliance on foreign offshore funding to ensure that our future growth is less exposed to the vagaries of international markets.

As well as expanding the domestic bond market, there would be merit in revisiting the tax treatment of various savings vehicles including on bank deposits. The relatively unfavourable treatment of interest-bearing accounts impacts on the type of saving and investment rather than the quantum of saving and investment. Reforms that better align the tax treatment of different forms of savings can be expected to improve the efficiency of saving decisions, with flow-on benefits in terms of the quality of investment and hence growth. Any such changes, however, would need to be considered in the context of a more comprehensive approach to tax reform.

In the aftermath of the global financial crisis we have seen a shift in banks' sources of funding with a majority of funding sourced through retail deposits and the rest through a mixture of sources including wholesale funding and institutional deposits. The Basel III liquidity requirements are intended to promote higher-quality deposits and or extended deposit maturities. For example, institutional deposits are deemed to have higher run-off reflecting their potential instability at times of financial market stress. To address this issue, banks are either having to increase high-quality deposits, have customers commit funds for lending, or reduce lending. The prospect of banks reducing lending would be an undesirable development as significant amounts of new and replacement lending will be required to support ongoing economic growth.

Maintain regulatory consistency while fostering innovation in capital markets

In the aftermath of the global financial crisis, governments and regulators around the world have been rightly focused on stability in the financial system.

The sector is undergoing change globally with a shift towards more stringent capital requirements and stronger liquidity buffers. Not all proposals from global regulators are necessarily appropriate for Australia. It would be appropriate for Australia to proceed cautiously and with some flexibility in how it implements the Basel III liquidity reforms, recognising the risk of this limiting credit availability in future.

Moreover, at the same time it is important to strike the right balance and not shut down all attempts for further innovation in the financial sector. With a focus of regulators including those in Australia on compliance, progress in gaining approval for some new products and innovations has been slow. For example, financial institutions have identified master trusts and Sukuk bonds as potential sources of capital for the Australian economy but regulators have not had the capacity to fully consider these proposals.

Facilitate movement of capital and reduce market distortions

Consistent with the suggested approach in the chapter on global engagement, Australia should continue to support the free movement of capital and build closer relationships with our Asian trading partners (who are attracted to our strong regulatory system and stable capital markets). Government should encourage international participation in our capital markets and seek opportunities to partner with capital markets in other Asian countries. For instance, many global banks retreated from Australia during the global financial crisis but could be encouraged to restart operations in Australia to boost capital in our markets.

Recommended actions

Action 7.1

The federal government should place the highest priority on maintaining Australia's AAA sovereign credit rating – recognising the broader benefits of this to Australia, including through flow-on effects to the credit rating of Australian banks.

Action 7.2

We should seek to broaden and deepen Australia's domestic debt market. The government should continue to support the development of a corporate bond market, including by creating a proper risk-free rate curve for participants through the issue of government debt with longer maturities (or encourage the use of the credit swap rate as a substitute). Steps should be taken to develop a standardised set of bond issuance documents, along with measures to improve the ease with which corporate bonds can be listed on the ASX.

Action 7.3

As part of comprehensive tax reform, tax biases between different savings and investment options should be addressed.

Action 7.4

It is essential to maintain high standards of regulatory consistency when it comes to Australia's financial markets, while fostering continuing innovation. The Australian Prudential Regulation Authority (APRA) should proceed cautiously and with some flexibility in how it implements the Basel III liquidity reforms in Australia, and high levels of consultation and collaboration should occur between stakeholders when considering further regulatory changes.

Action 7.5

We need to maintain and facilitate movement of capital into and out of Australia and minimise market distortions. This includes continued support for the free flow of international investments and efforts to improve access to overseas capital and, in particular, Asian and Sharia capital.

Action 7.6

Commission a review of the financial services sector to follow on from the Wallis review, including assessment of key structural and technological changes in the financial system and how customers have benefited from them and the effectiveness of the current regulatory model, including APRA and ASIC and the payments system role of the RBA.

08

Adopt a coherent and comprehensive energy policy that maintains Australia's competitive advantage

What do we have to get right?

Australia needs to ensure that it has a comprehensive and coherent national energy policy that drives the development of our energy resources, supports a strong energy export industry, and provides for the reliable and efficient delivery of competitively priced energy to households and businesses.

Australia's energy sector needs to deliver these growth opportunities while meeting best practice environmental standards and seeking to minimise our greenhouse gas emissions in line with global efforts.

Key facts at a glance

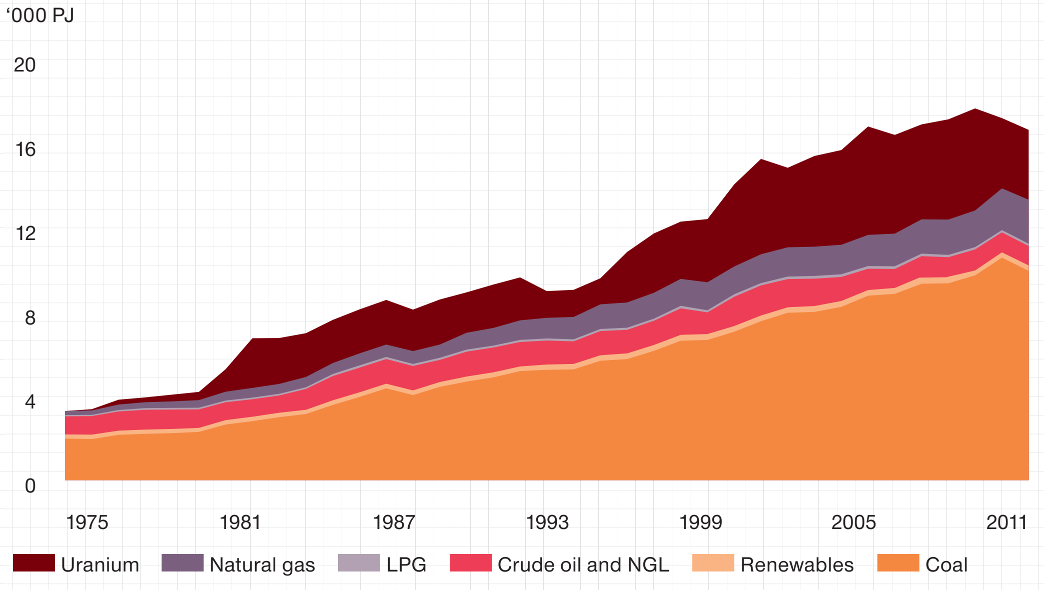
Australia is blessed with large endowments of traditional energy sources, which provide us with a comparative advantage in this area.

Strong economic growth in the developing economies in our region is having material effects on energy demand and Australia's energy exporters are well placed to benefit from these developments.

Substantial opportunities are also emerging in the area of unconventional gas including coal seam gas.

Australia's domestic electricity sector is also experiencing significant changes, reflecting a number of influences including a reduction in overall demand for electricity and the impact of renewable energy and carbon emission policies.

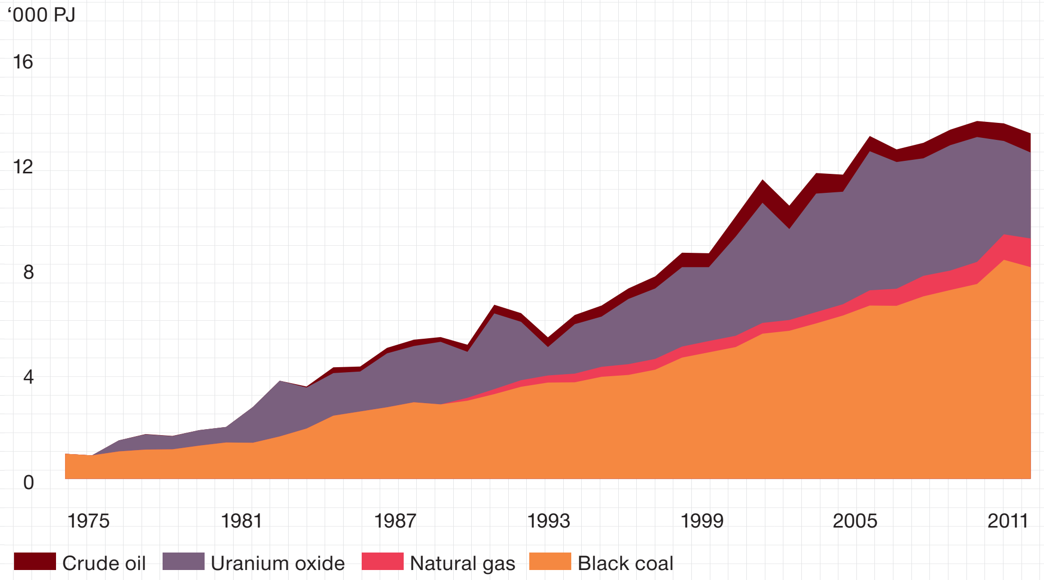
Figure 53: Australian energy production



Source: BREE, 2012a

Note: years refer to financial years.

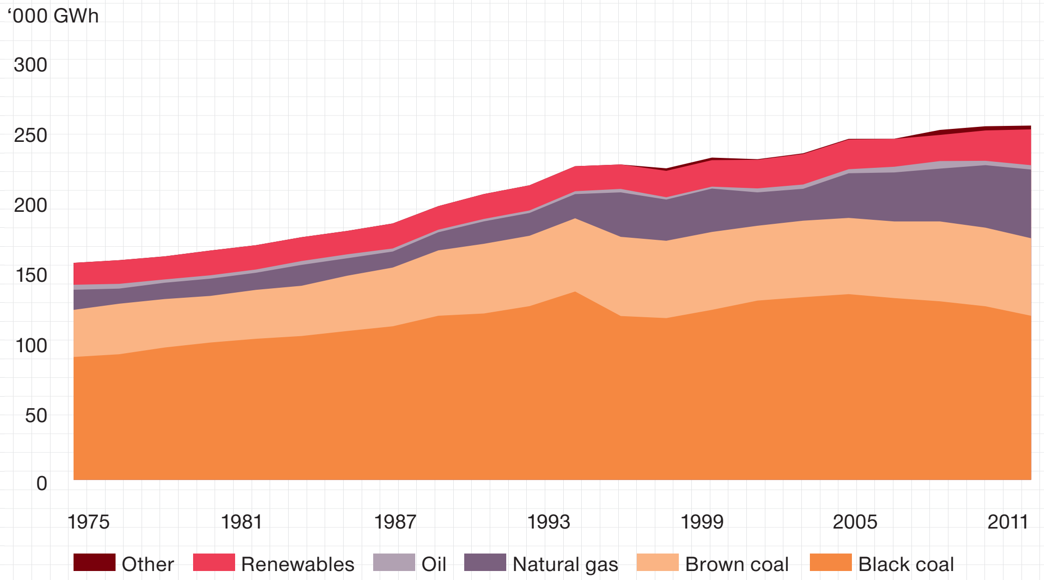
Figure 54: Australian energy exports



Source: BREE, 2012a

Note: years refer to financial years.

Figure 55: Australian electricity generation



Source: BREE, 2012a

Note: years refer to financial years.

Why do we need to adopt a coherent and comprehensive energy policy that maintains Australia's competitive advantage?

The availability of energy fundamentally underpins the entire Australian economy because all Australian businesses and households are consumers of energy.

The energy costs faced by all businesses contribute directly to their competitiveness and ongoing viability. The energy sector itself is also the source of income and jobs for many Australians. For households, having a sound energy policy relates directly to affordability and liveability.

Energy resources are a major export earner for Australia, accounting for about a third of the value of Australia's total exports. This means they are also a big contributor to the wealth of Australians and provide crucial taxation revenue to Australian governments. Not only maintaining this revenue stream, but also growing it, will be essential to the future prosperity of Australians.

Australia has attractive advantages when it comes to resource development, including our close proximity to Asia and our highly prospective and diverse natural resource endowments.

However, these factors alone will not guarantee the future of Australia's energy exports. Our cost competitiveness in terms of delivering resource projects is slipping and for some energy commodities, such as coal, we risk losing global market share.

To ensure that Australian living standards continue to grow we must look at how we can rein in the mounting costs of doing business in Australia and improve productivity. For example, research by McKinsey & Company indicates that the cost of building new liquefied natural gas (LNG) projects in Australia has increased by about 20 to 30 per cent in the last decade compared with international rivals.

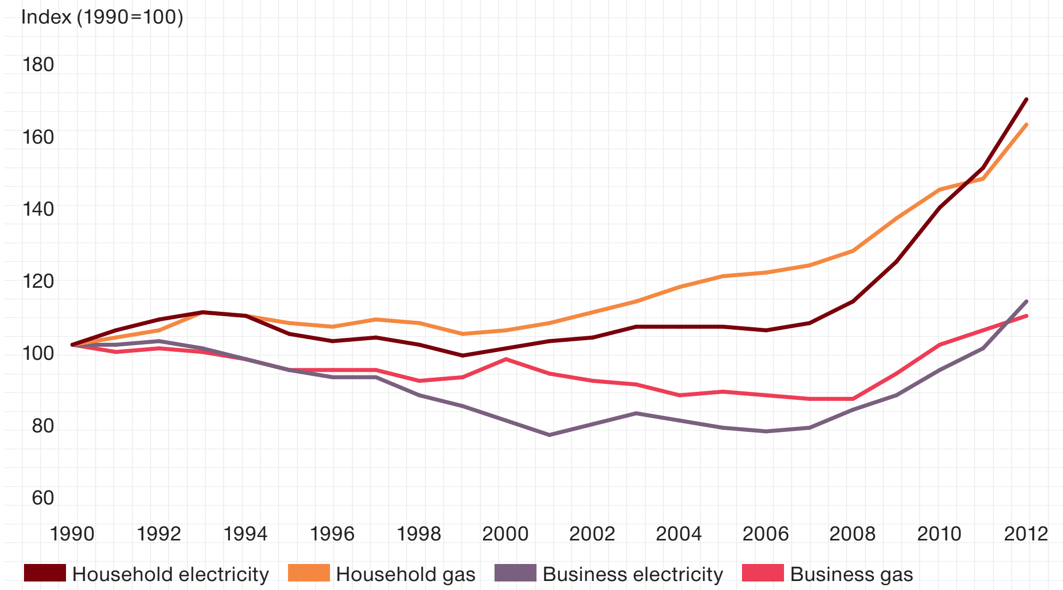
Similarly, the mounting pressures on our electricity and gas markets mean in recent years we have begun to erode the low-cost energy base that has underpinned the competitiveness of the Australian economy.

Historically, the cost of electricity and gas for Australian businesses has trended below inflation; however, since 2011 these costs have begun increasing faster than inflation.

The situation for household electricity costs (where network costs make up a larger proportion of the utility bill) has been more severe, with increases of over 70 per cent in the last four years. While electricity costs look to be stabilising (where state governments have in place cost-reflective pricing), gas prices on the east coast look set to increase from 2014–15 as market conditions tighten in coming years.

Figure 56: Electricity and gas prices growth relative to CPI

Above 100 denotes price growth above CPI



Source: ABS, 2013e; ABS, 2013l; BCA

These higher costs, combined with a restructuring of some energy-intensive sectors of the economy, shifts in consumer behaviour, the growing uptake of renewable energy, increasing imports of liquid fuels and the onset of a major new LNG export industry require us to have in place the appropriate energy policy settings to respond to change and ensure that we have a stable investment environment.

An effective, sustainable response to climate change is part of this. Ultimately this means moving from our current high-emission global economy, of which Australia is part, to a low-emission global economy. A commensurate response by Australia within a global framework will ensure that we remain competitive and promote opportunities for our economic growth.

How can we develop and adopt a coherent and comprehensive energy policy that maintains Australia's competitive advantage?

Return energy to the forefront of energy policy

Before developing any coherent policy, we must be clear about our objective. For too long energy and climate change mitigation policy have tended to be developed in isolation of one another, rather than as part of an overarching policy framework.

This fragmentation leads to an array of policies being implemented that work against the objectives of one another, rather than as complementary elements of a market-based economy.

Instead, Australia needs an integrated approach to energy and climate change mitigation policy that is coherent with our economic goals and recognises our standing internationally.

Australia is a major energy exporter helping to meet growing global demand for energy and a responsible nation doing its part to reduce global greenhouse gas emissions.

We need to recognise the role energy plays in the Australian economy and its importance in delivering substantial wealth and prosperity to all Australians.

An overarching policy objective should recognise that our economic prosperity and energy security are paramount and that we must seek to reduce our greenhouse gas emissions in a way that does not compromise these fundamentals.

Accordingly, we need an overarching policy framework that drives the growth of our energy exports and provides for the reliable and competitively priced supply of energy, while meeting our environmental objectives in a way that does not place Australia at a competitive disadvantage to the rest of the world.

Only when we are clear on the objective can we recognise, and support, the role energy plays in our economy and set a lasting course to efficiently reduce our greenhouse gas emissions.

Lasting policy to reduce emissions at least cost in line with global efforts

If Australia is to put in place enduring policy settings to reduce our greenhouse gas emissions, they must be based on sound economics so the competitiveness of Australian business is not compromised.

In doing so, Australia should act in tandem with other countries as part of a global response to reduce greenhouse gas emissions. This means pursuing a market-based mechanism that enables lowest-cost outcomes commensurate with international action and seeking to ensure equivalent costs on trade-exposed Australian industries as faced by our competitors.

It is important that we don't lose sight of the fact that if emissions-intensive goods become too expensive to produce in Australia, business will simply look to produce their goods overseas – in a country that may not have the same environmental standards as Australia.

Fundamental to a least-cost approach is the principle of technology neutrality. Government policies that favour the deployment of one technology over another, through subsidies or targets, inevitably lead to higher costs for consumers than policies that allow all technologies to compete on an equal footing.

Policy settings should allow all forms of clean energy technologies to succeed based on merit, whether it be carbon capture and storage for coal and gas, geothermal, solar, wave or wind. Nuclear energy as a source of lower emissions technology should also not be ignored.

Accordingly, the BCA calls for the Renewable Energy Target to be removed in the presence of a well-functioning market mechanism that puts a price on greenhouse gas emissions. However, if the Renewable Energy Target is to remain – which does not deliver least-cost abatement and is not technology neutral – then the Australian Government should at least ensure it is responsive to changes in demand for electricity to minimise the cost to consumers and ensure that the target is not exceeded.

When it comes to research and development of clean energy technologies, we need to acknowledge that Australia alone cannot do everything. Australia, like most countries, is largely a technology-taker when it comes to energy technology.

This is not to say that there is no role for Australia. There clearly is, as Australia has some world-class research facilities, for example in solar energy. What it is saying though is that Australia needs to be strategic about the investments we make in clean energy technology.

We can do this by collaborating with key countries and investing in Australian innovations that play to our strengths in the global supply chain. In doing so, we can maximise the value of these investments to the Australian taxpayer.

Complete unfinished energy market reforms

The principles that underpin good energy policy and energy markets need to be adhered to if Australia is to effectively respond to future energy challenges.

The objectives of Australia's energy markets are relatively straightforward. They are to deliver in the long-term interest of consumers. However, putting this objective into practice is often far more difficult to get right.

In any energy market the tension lies in striking the right balance between reliability and cost. Pulling the outcome too far in either direction leads to an undesirable result for consumers as greater reliability comes at cost, and an unreliable energy supply is almost unspeakable in a modern economy like Australia.

The best way to ensure that prices remain as low as possible is through open and competitive energy markets. While networks are natural monopolies and are not subject to competition, they should still be provided with a set of incentives that push them to operate efficiently.

Collectively, Australian governments need to ensure that the institutional and regulatory settings governing our energy markets are operating in the long-term interests of consumers. This means having in place regulation of monopoly network assets that is delivering low-cost electricity to consumers with a level of reliability that accords with consumers' willingness to pay and incentives to address peak demand.

Effective representation of all consumer interests (large or small), as part of the institutional arrangements of Australia's energy markets and a strong and independent regulator, is essential if the regulatory framework is to be enforced effectively.

When it comes to the non-regulated elements of our energy markets, effective competition is central to delivering low-cost energy to consumers.

Energy markets, like most markets, operate most effectively when assets are primarily privately owned, allowing for strong competition to put downward pressure on price. In the case of monopoly assets, the Productivity Commission suggests that privately owned and operated network businesses have improved the efficiency of their operations to deliver lower costs to consumers.

When it comes to retail market settings, full retail price deregulation accompanied by strong consumer protections will also allow competition to deliver more choice and lower costs to consumers.

What needs to be done is well known; it now needs to be delivered. The onus is on state governments to privatise their remaining energy assets and remove retail price caps in order to provide the full benefits of productivity improvements to their state economies, free up government revenue and deliver lower-cost outcomes for consumers.

Importantly, energy policy also needs to be adaptive to change. There are some big changes occurring across Australia's electricity markets.

For the first time in the short history of the National Electricity Market demand for electricity is actually declining and it remains to be seen whether this turnaround since 2009 is a short-term development or part of a broader trend. Further analysis is needed to fully understand the likelihood of this trend continuing and the broader implications for the sustainability of the market and Australia's emissions profile to inform integrated policy development.

Reduce barriers and costs to developing energy resource projects

Energy policies should ensure that the development of energy resources can respond to global and domestic market demand. This response needs to be underpinned by streamlined, transparent and timely environmental, exploration, planning and project approval processes.

Currently planned energy resource projects at the feasibility stage are expected to require over $230 billion of investment if they proceed. These projects could form part of an important pipeline of future capital investment critical to Australia's economic growth.

If Australia is to chase this growth opportunity, it is essential that we continue to be an attractive place to invest.

To do so we must ensure that the costs of major projects in Australia are globally competitive given the mobility of capital and the growing number of alternative locations with energy resources at comparable prices to Australia.

Establishing strong environmental standards for all projects and removing duplicative and at times inconsistent federal, state and local government project assessment and approval processes are important first steps to improving environmental outcomes and managing project costs.

Ensuring a more comprehensive use of strategic planning assessments that assess whole regions and give consideration to environmental and other factors should be a priority.

Investigate gas market development options

Another transformative change in the Australian economy is the burgeoning LNG export industry. In a matter of only a few years, Australia has been successful in securing investment for seven out of the 12 LNG projects under construction globally.

While the industry brings many economic benefits in terms of employment and taxation revenue, it is also brings challenges.

Australia's east coast gas market is expected to triple in size by 2020 once LNG exports from Curtis Island move to full production. As east coast coal seam gas projects ramp up and demand for gas increases, combined with increasing production costs, conditions in Australia's domestic gas market are tightening, and are putting upward pressure on domestic gas prices.

Australia has abundant natural gas reserves – enough to meet both our domestic consumption and an expanding LNG export trade. However, timely development of these resources will be critical to easing tightening market conditions.

Only by allowing the market to work and getting the price response will we see the necessary investment to bring on gas supply. Governments have begun work in this area but we also need to bring governments together with business to develop a clear set of actions to ease the tightening demand–supply situation and remove any constraints on domestic supply availability.

For example, addressing issues such as delays in regulatory approvals and assessing pipeline capacity trading as a matter of priority will be important if Australia is to get more gas to market in the years ahead and attract future investment in gas projects. A national approach is required to effectively overcome these challenges and lay down the policy settings for an integrated, mature and liquid gas market to develop.

Support the transition to greater imports of liquid fuels

Australia's liquid fuel demand is changing. Demand for gasoline is flattening due to improved fuel and engine efficiency, while demand for diesel is growing by about 4 to 6 per cent per year largely due to the increasing number of diesel vehicles employed by the mining and resource sector, but also increasing diesel passenger vehicles. Growth in jet fuel remains solid. The change in fuel mix and demand will require changes to Australia's refining and import infrastructure and support from international supply chains in order for Australia to meet this changing demand profile.

Industry has been effective in responding to these changing market dynamics to date and governments must remain vigilant in ensuring that there are no barriers to continuing to allow the market to effectively respond.

Australia is a net importer of petroleum products and currently imports around 40 per cent of its petroleum needs. Most imports are coming from mega refineries in the Asian region (some of which are twice the size of Australia's total refining capacity). In effect, Australia is now shifting its import focus from a combination of crude and refined petroleum product to a much higher proportion of refined petroleum products to meet demand through well-established, diverse and reliable regional supply chains that enhance our energy security.

With the changing demand trends and greater reliance on imported liquid fuels, it is essential that project approvals are not unduly delayed and project costs are reined in to allow the market to effectively respond and invest in the necessary infrastructure for importation, storage and distribution of liquid fuels.

To ensure a smooth transition to Australia's changing demand for different liquid fuels and greater liquid fuel importation, regular risk assessments of any possible vulnerabilities affecting Australia's liquid fuel supplies should be undertaken.

A technology and fuel neutral approach should also apply to fuel excise in order to ensure the most efficient, and therefore least-cost, distribution of liquid fuels to the Australian consumers.

Recommended actions

Action 8.1

The Australian Government should develop an integrated energy policy that supports:

» Australia's future economic growth and does not compromise Australia's global competitiveness

» a reduction in Australia's greenhouse gas emissions at least cost and commensurate with global action

» the development of our energy exports in a sustainable and responsible manner

» the delivery of reliable and competitively priced energy in the long-term interests of all consumers

» competition through the operation of open and transparent markets with strong consumer protections

» a stable, technology-neutral, long-term investment environment

» Australia's access to diverse energy supply chains to enhance our energy security.

Action 8.2

The Australian Government should take immediate steps to reset our policy settings so that we are reducing our greenhouse gas emissions at least cost and commensurate with global efforts to avoid risking Australia's competitiveness. Accordingly, the Australian Government should:

» ensure that Australia is paying no more than the international price to reduce our greenhouse gas emissions through an immediate reduction in the Australian permit price, and remove the decay rate applied to industry assistance

» move to a true 20 per cent Renewable Energy Target that adjusts with demand

» collaborate globally to develop clean energy technologies and invest in Australian innovations that play to our strengths

» require the Productivity Commission to undertake regular reviews of the impact of emission reduction policies on business costs in Australia and competitor countries with the view to advising on any impacts on Australia's competitiveness at the industry-sector level.

Action 8.3

Australian governments should commission sensitivity analyses to inform the development of an integrated energy and climate change mitigation policy including:

» the Australian Energy Market Operator undertaking an assessment of various electricity-demand scenarios, taking into account potential changes in activity across the economy

» drawing on the Australian Energy Market Operator's demand analysis, commission an independent assessment of the implications for Australia's greenhouse gas emissions under the various scenarios

» the Australian Energy Market Commission undertaking an assessment of the implications of a range of changing market conditions and policy settings on the efficient operation of Australia's energy markets, including:

  › changing trends in the structure of the economy and demand for energy based on the work of the Australian Energy Market Operator

  › climate change policy and renewable energy market interventions

  › examining if there are any barriers to exit from the market for electricity generation.

Action 8.4

State governments should complete the outstanding energy market reforms of:

- removing retail price regulation where effective competition exists
- privatising remaining energy assets and investing the proceeds in critical infrastructure
- institutionalising, with the Australian Government, effective consumer representation into the governance arrangements of Australia's energy markets.

Action 8.5

The federal, state and territory governments should commit to drive growth in our energy resource sector and ensure that it remains globally competitive by streamlining and expediting project planning and environmental approval processes while meeting strong environmental standards.

Action 8.6

The Australian Government, in consultation with state governments, energy market institutions and business, should develop a National Gas Strategy that seeks to increase transparency and competition, sets out an implementation pathway towards more mature domestic gas markets and addresses regulatory barriers to the reliable and competitively priced supply of gas to Australian consumers.

Action 8.7

Australian governments should ensure that our liquid fuels market can effectively respond to changes in international supply chains and our domestic market, such as a transition to greater import terminal capacity, by:

- undertaking two-yearly risk assessments of the vulnerability of Australia's liquid fuel supplies to short-term distributions
- ensuring policy settings support investment in import terminal capacity and fuel storage and distribution infrastructure
- phasing in neutral fuel excise arrangements for all transport fuels based on full energy content.

09

Creating the right environment and systems to drive innovation

Innovation outcomes will be strongly influenced by each of the other areas that the Business Council's action plan has identified as being required for growth and prosperity. This chapter builds on the actions already identified elsewhere in the plan.

What do we have to get right?

Innovation will flourish when people and organisations have the requisite skills and abilities and when they operate in an environment that provides them with an incentive to innovate.

We need to have the right innovation systems and environment in place to ensure that creative people and businesses in Australia are allowed to thrive and create value from new ways of doing things. A paradigm shift is necessary in the way we construct our approach to innovation. We need to shift away from an approach that is dominated by government programs toward a systematic and incentives-driven approach to innovation that utilises both supply and demand side measures.

A successful innovation system is one that is robust, adaptable and capable of evolving over time. Such a system should be capable of providing the connections and linkages that enable individuals and organisations to translate new knowledge into commercially viable innovations and enhanced productive capacity.

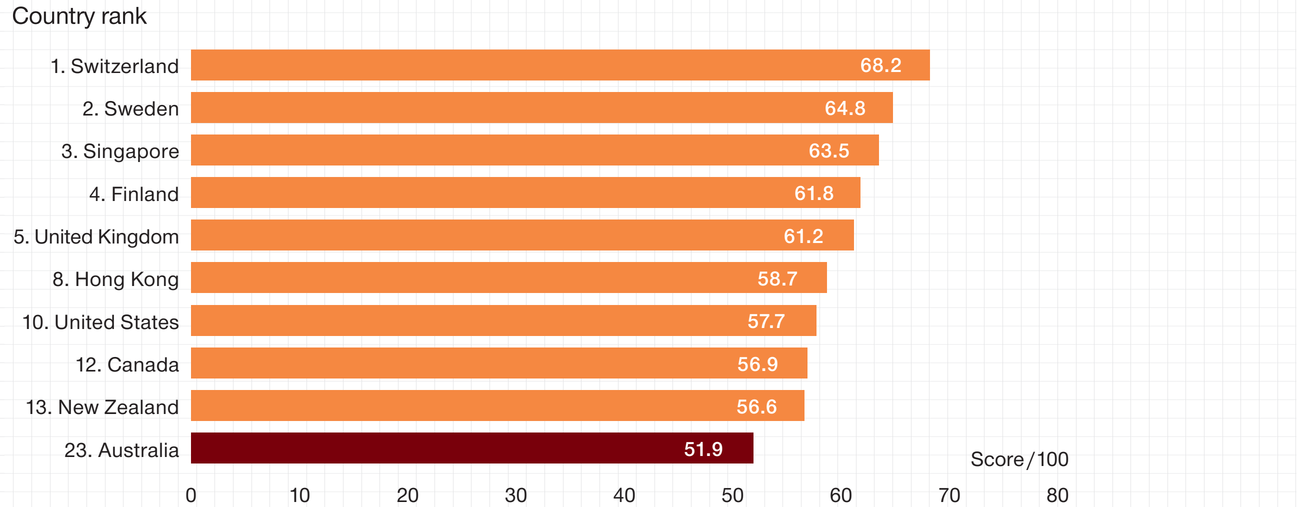
Key facts at a glance

Australia's performance on innovation currently falls well short of aspirations to have an innovation system with a top 10 ranking globally.

We need to improve innovation performance at a business level.

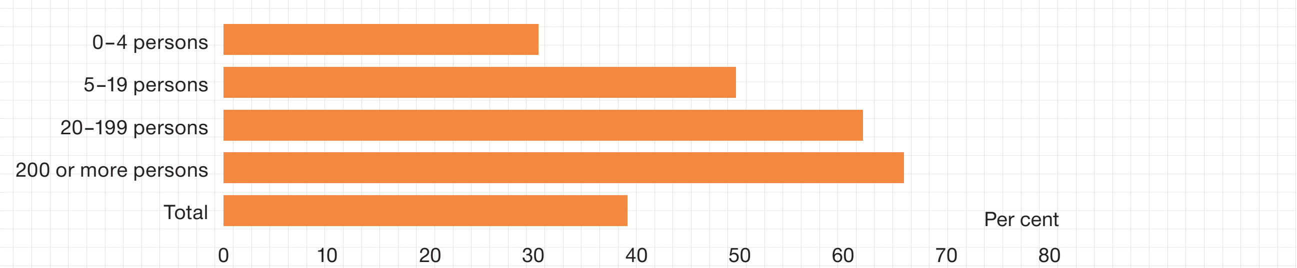
Innovation activity – as self-reported by firms – varies widely by business size and type in Australia.

Figure 57: INSEAD Global Innovation Index



Source: INSEAD & WIPO, 2012

Figure 58: Proportion of businesses with any innovation activity by employment size, 2010–11



Source: ABS, 2012e

Why do we need to create the right environment and systems to drive innovation?

Innovation drives prosperity and wellbeing

Innovation is fundamental to achieving productivity growth and to maintaining business competitiveness. Generally speaking, the better we are at innovation, the higher will be our productivity and therefore economic growth.

For business, innovation matters as it is central to the competitive process. This reflects the fact that the need for – and nature of – innovation is frequently driven by an imperative to respond to the demands of customers.

Australia is a small, open economy. We cannot compete on size or scale with other countries. We are also a relatively high-wage, high-cost country. What Australia, and Australian businesses, can compete on is our ability to innovate and to provide higher value add goods and services.

In addition to economic prosperity, innovation enables social wellbeing. Australia's healthcare costs are approximately 9 per cent of GDP and growing. This is unsustainable and we need more innovative and efficient methods of delivering health care. Innovation can create new and more environmentally friendly production methods. It can also improve government service delivery and reduce operating costs of government. In short, innovation is fundamental to the wellbeing and prosperity of our nation.

Innovation allows us to adapt and thrive in the face of change

Earlier chapters in the action plan outlined a number of 'big shifts' in the world we live and work in. These shifts of increasing digitisation, the growth balance shift towards Asia, the ageing population, the looming fiscal gap, and climate change are happening at a rapid pace. Innovation will be necessary to address these complex challenges and thrive in a changing environment.

Specific to businesses, the Deloitte Digital Disruption report found that one third of Australian businesses face major disruptions (not just digital but also in new business models) but few are responding effectively to this. More data suggests that across Australia businesses that do not innovate will not survive. In addition, the cycle of innovation has changed. Historically, innovation was primarily driven by individuals or from within organisations. It is now increasingly driven by consumers and their changing demands, requiring companies to respond agilely. In short, innovation is a survival imperative in the face of a changing environment.

Our current innovation system needs improvement

There is strong support for aspirations to have an innovation system in Australia that places us in a top 10 ranking globally.

However, Australia's performance in innovation, as measured by a range of different surveys, currently falls well short of this aspiration.

The INSEAD Global Innovation Index ranks Australia 23rd out of 141 countries, behind Switzerland, Sweden and Singapore. On the World Economic Forum Global Competitiveness Index we rank 22nd out of 142 countries. Of the 25 countries surveyed in the GE global innovation rankings Australia was assessed at 13th place.

How do we create the right environment and systems to drive innovation?

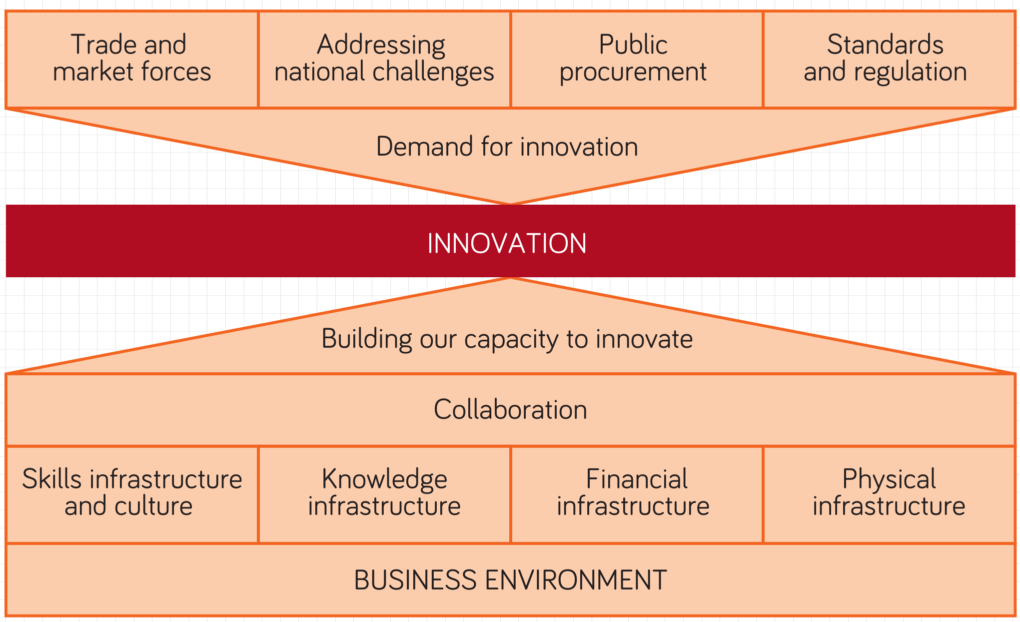
To create an economy and a society where innovation flourishes, we must create an environment and an innovation system that actively encourages and incentivises innovation.

Traditional innovation policy largely focuses on the development of innovation – the supply side, so to speak. Supply-driven policies seek to ensure that businesses have adequate resources to innovate. On the other hand, demand-driven innovation policies help create market conditions that incentivise the 'pull' of innovation. They focus on creating sustainable demand and creating better conditions for diffusion and uptake of innovation.

For example, new healthcare regulations, clean energy requirements, and labelling standards all stimulate public-sector-led demand for innovation from businesses. In contrast, R&D grants and incubator services are supply-side enablers of innovation.

An effective innovation system should combine both the supply and demand side components of the national innovation system to drive innovation.

Figure 59: Australia's innovation system



Source: BCA

Supply-side drivers of innovation

Business environment and institutions that support innovation

Innovation activity occurs within the context of the broader business environment. This includes the level of competition for a product or service, the openness of the economy, the taxation system, regulatory system, legal system, and the political and broader economic environment. All of these factors fundamentally impact the incentives faced by businesses and organisations to innovate.

We therefore need to create a business environment that encourages businesses to compete with each other, that enables businesses to profit from innovation, and allows them to be agile in the face of a changing market and to respond to changes in consumer demand.

Competition is one of the most effective means of providing an incentive for individuals and businesses to innovate. We need to continue to promote pro-competition reforms and to build on the implementation of the recommendations from the Hilmer report on National Competition Policy.

We need to create a tax system that provides incentives for businesses to innovate. We also need to put in place a workplace relations system that is flexible. Workplace arrangements should make full use of workers' skills and expertise, and should encourage the take-up of innovative practices.

Given the rapidly changing environment within which we are operating, our regulatory system must not inhibit the agility of businesses to respond to change. The regulatory system should support rather than inhibit our ability to innovate.

As an example, the regulations administered by the Therapeutic Goods Administration (TGA) resulted in it taking the medical device manufacturer Cochlear 14 months longer to get approval in Australia for a product than in Europe. Institutional infrastructure, such as the remit and resourcing of bodies like the TGA – but also the Australian Competition and Consumer Commission, the Australian Taxation Office and the Australian Securities and Investments Commission – therefore have a strong influence on the business environment.

Of all of the components of the national innovation system, the business environment is the most important to get right as it has the most wide-ranging and pervasive impact on individuals and businesses incentives to innovate.

Skills, infrastructure and culture

Ultimately, it is individuals who innovate, and they will innovate when they are equipped with the capabilities to innovate and operate in a culture that fosters innovation.

We must continue to invest in our people and equip them with technical skills in science, technology, engineering and mathematics (STEM) and ICT as well as soft skills like adaptability, design thinking and creative thinking. This needs to begin early in the education curriculum. We also need to ensure that our managers have the necessary management and leadership skills to drive innovation across work groups and organisations.

The education and training sector needs to reflect these priorities and, particularly when directed towards working professionals, should be targeted at addressing current skill gaps.

In addition to the training provided through the education and training sector, businesses are also responsible for developing innovation capabilities internally and in collaborative networks and clusters, so that knowledge may be deployed as a source of competitive advantage.

The flow of skilled international migration (both temporary and permanent) also contributes positively towards improving our collective human capital and our ability to innovate. It can also be used to address temporary skills shortages which may act as a barrier to innovation.

The ability and willingness of individuals to innovate is heavily influenced by organisational and societal culture. While it varies across businesses, Australia's performance in establishing a culture of innovation needs improvement. For example, an Australian Government adaptation of a Booz & Company study found that 44 per cent of businesses internationally had a 'highly aligned innovation strategy and innovation culture'. When this methodology was applied in Australia, it was found that only 18 per cent met this criterion.

Where innovation currently sits on the periphery of much businesses thinking and reporting, innovation needs to be systematically placed at the centre of business strategies and models. We must put in place organisational structures and workplaces that are agile and adaptable and where there is a culture of innovation. Stimulating creativity and imagination through our education system and in our workplaces is also essential in a fully functioning innovation system.

The system should provide appropriate reward for risk and there should be a culture that encourages responsible risk taking.

Knowledge infrastructure

Evidence demonstrates that investment and funding of basic research contributes positively to long-run innovation outcomes. We need to ensure that we continue to invest in growing our stock of knowledge. This knowledge can take time to develop. Therefore, we must provide our research and university sector with access to sufficient funding, and the availability of this funding must be matched with the lifecycle of the research.

Organisations such as the Commonwealth Scientific and Industrial Research Organisation (CSIRO), our universities, and research organisations such as National ICT Australia (NICTA) are critical components of our knowledge infrastructure. They contribute to generating, storing and distributing information and learning so that the knowledge can be put to practical application.

To be effective and efficient, research organisations should be well attuned to areas of comparative advantage for Australia. Given limited resources, and given that we operate in a global environment, our research and university sector should specialise in its expertise and prioritise where its investments of time and money are made.

Our investment in research also needs to align with the needs of industry. Engagement and collaboration between our research and university sector and industry need to become far more widespread. This means ensuring that the exchange of ideas and employees between the two is encouraged, and that barriers to this occurring are removed.

The handling of intellectual property rights is an important factor in individuals' and organisations' incentives and willingness to engage in research and development. The system must strike a balance between allowing individuals and organisations to benefit from their innovation and encouraging knowledge diffusion and access to this innovation on the other.

Availability of finance

Innovation requires an investment of money, time and other resources. Particularly for start-ups, improved access to different types of finance at different stages is necessary. Historically, there has been an over-reliance on either bank loans or government grants and the former is not necessarily a good judge of potential of innovation that doesn't exist.

An effective innovation system will be one where there is sufficient access to capital for innovative activities for firms of different sizes. Such access to capital can be provided by a range of institutions, including banks and other lending institutions, venture capital, angel investors, crowd sourcing and/or government grant programs.

Physical infrastructure

Physical infrastructure including information and communication technology infrastructure and traditional infrastructure such as roads, railways, ports and airports facilitates the flow of goods, services, people and ideas that underpin the operation of a national innovation system. If our infrastructure is effective, then our absorptive capacity – the ability to acquire, internalise and utilise knowledge developed elsewhere – will be enhanced.

In the digital age, ICT is a key driver for innovation and enterprises need to consider the opportunities for rapid adoption of new technologies like cloud, virtualisation and mobility solutions.

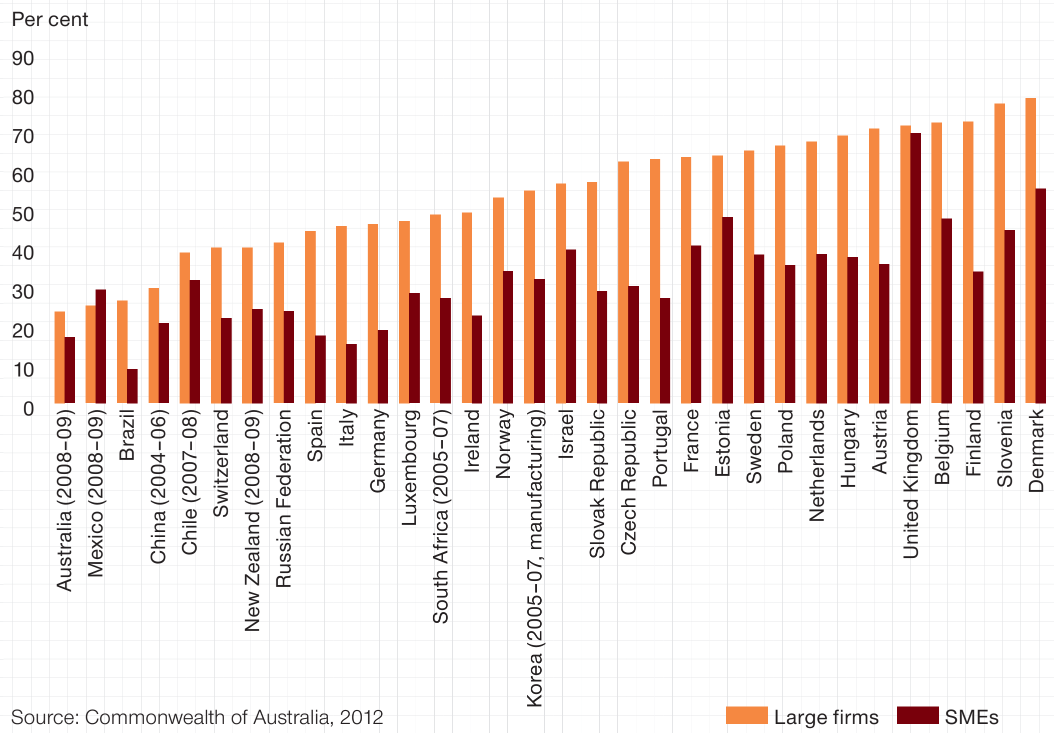
We must ensure that our investment in physical infrastructure enhances our ability to innovate and builds our productive capacity. We need to effectively prioritise our investment in physical infrastructure to ensure that we maximise the return on our investment.

Collaboration

An effective innovation system should also foster collaboration between individuals, universities, research institutes, think tanks, industry, public agencies, private organisations with shared interests and complementary skills. Collaboration allows the involved parties to not only share knowledge and resources but also the inherent risk in innovation. ABS data shows that innovation-active businesses are more than three times more likely to collaborate than those that are not active.

This figure shows Australian firms' low level of collaboration when compared internationally.

Figure 60: Share of innovative firms collaborating by size, 2006–08



Source: Commonwealth of Australia, 2012

Encouraging engagement and interaction, and staff mobility, between the various actors within the innovation system should be actively encouraged.

Business-led clusters can place complementary organisations and associated institutions in physical proximity with shared infrastructure and resources. Government policy designed to promote clusters of industries should play to Australia's national strengths, and investments should be made with a long-term view as collaborative efforts require trust and time to develop and therefore require continuity.

We also need to improve our international collaboration. Approximately 98 per cent of innovations originate from abroad. Access to this innovation is therefore critical. This requires strong linkages with global institutions and organisations, being an active participant in international research, and fostering and maintaining productive relationships with overseas organisations, industries and research bodies.

Demand-side drivers of innovation

Trade and market forces

Trade brings innovation through the diffusion of technology, processes and technical assistance from foreign buyers and sellers. One enabler of innovation is access to larger regional or global markets.

Innovation is a requirement of succeeding in domestic, but particularly in international, markets. Government should therefore focus its efforts on areas that can deliver innovation and that will lead to globally tradeable goods and services.

Market forces, such as consumer demand and competition, are also critical in creating a demand pull for innovation. Changing consumer demand creates market conditions to create new products and/or services and competition creates the imperative to reduce costs through innovation and to add additional value as a source of competitive advantage.

Addressing national challenges

Aligning our national innovation system to address key national challenges can create a sustainable pull for innovation.

The Chief Scientist has outlined a number of key national challenges and CSIRO's research efforts are geared towards solving nine national challenges of climate, energy, water, health, food, ocean, light metals, minerals and nanotechnology.

Creating demand in these areas could involve government creating new markets in these critical areas for private enterprise to tackle grand societal issues. For example, the implementation of a carbon price in Australia has not only increased demand for innovation on carbon-reducing technology, but also created new business models. Providing incentives to businesses that innovate in these markets, encouraging consolidation and competition will enable sustainable markets for innovation.

Addressing these national challenges has implications beyond domestic markets. This can potentially position Australia as a leader for addressing complex societal challenges related to climate, energy, water, food and the ocean and pave the way for increased market demand for Australian innovation.

Public procurement of innovative goods and services

One of the most important players in creating demand for innovation is the government as a customer. Government can play the 'lead customer' in the case of first of a kind service or a trial product. As a lead customer, government undertakes the organisational risk of untried innovations and at the same time signals endorsement to subsequent customers or investors in the innovation space. This confidence stimulates market demand for the innovation.

For example the United States Small Business Innovation Research Programme (SBIR) requires federal agencies to allocate a portion of the contracts from their research and development budget to SMEs.

Government can also procure innovation in its endeavour to transform the way it delivers services. This could include a transition to ePortals and online services and the development of mobile applications. To drive this, we need to set targets for government agencies like those laid out in the *Advancing Australia as a Digital Economy* report and rigorously track their achievement.

Standards and regulation

Excessive regulation represents a burden to individuals and businesses, and inhibits innovation. However, sensible standards and regulation can stimulate, rather than inhibit, innovation.

Appropriate standards and regulation can create lead markets for innovation. For example, mandatory label requirements for household goods such as refrigerators in Australia incentivise manufacturers to innovate to meet energy consumption standards demanded by consumers and help consumers make more informed choices.

Markets for new innovations are often fragmented and prospective buyers may be unable to coordinate or standardise their demand because they lack knowledge of future innovation. Appropriate standards and regulation can assist in promoting confidence in new markets.

The digital economy, including the issue of digital identity, represents an emerging market where considerable innovation is taking place. The approach to regulating this market needs to depart from the usual approach to regulation. It is essential that regulation focuses on enabling, rather than restricting, both innovation and participation in the digital economy. The rapid rate of technological and behavioural change means that regulation must be capable of adapting to a constantly changing environment.

Recommended actions

Action 9.1

The national approach to innovation should shift away from a focus on government subsidies and expenditure, toward a systematic approach to innovation. The most innovative countries have adopted national innovation strategies, and we should reaffirm areas of existing or potential comparative advantage for Australia, such as the mining equipment, technology and services (METS) sector, and use these to determine and foster national innovation priorities. Government policies should be directed towards these priorities.

» Establish a National Innovation Council. This should replace all other relevant bodies and be reviewed every two years. The first task of the council should be to identify these areas of comparative advantage and national priorities. Development of future, and review of existing, innovation policies should be referenced to these.

» The BCA is undertaking work to identify the drivers of competitiveness for all sectors of the Australian economy, including the capacity for businesses to be more responsive to customer demands and provide greater value add.

Action 9.2

Implement the National Science, Technology, Engineering and Mathematics (STEM) Strategy called for by the Chief Scientist of Australia. This will enable a whole-of-government approach to coordinating STEM policies, prioritising public investment and adopting an incentive structure that encourages growth in business investment.

Action 9.3

The Commonwealth should require that state governments introduce primary-level specialist teachers, particularly in mathematics and science.

Action 9.4

Refinements to the Australian education curriculum should include design thinking as a core competency from primary school onwards.

Action 9.5

We should harmonise intellectual property frameworks across the publicly funded research sector. This can be achieved by establishing consistent principles and templates for contracts and managing intellectual property across the public research sector.

Action 9.6

The government should realise the benefits of the digital economy by:

- articulating the benefits from the application of broadband technologies so that it can harness the benefits from the investment being made
- driving reform in the delivery of public services such as health care, Centrelink benefits, Medicare and the Australian Taxation Office. This should include adopting a 'digital first' policy aimed at increasing the government's use and application of innovative ICT in the public sector
- regularly reporting on progress towards achieving its target of having 80 per cent of Australians' engagement with government through the internet or other online services by 2020.

Action 9.7

Collaboration between public research bodies, education institutions and businesses needs to be strengthened.

- Competitive grant schemes such as the Australian Research Council and the National Health and Medical Research Council should place greater weight on collaboration and engagement with industry as part of the criteria for their assessment.
- Government should examine extending the funding timeframes of the public research sector to better match funding with the timeframes necessary to develop collaborative relationships.
- We need to aim to double the number of formal engagements between CSIRO and business.

Action 9.8

The government needs to put in place settings that facilitate digital commerce and promote confidence in engagement in the digital economy. This should include:

- developing regulations and systems covering evidence of identity that support e-commerce and that allow for the growth in the market of trusted third-party credentials, the services that rely on this evidence, and that allow government to unleash innovation in its service delivery
- given the emerging nature of the market, developing principle-based regulation that provides protection to consumers and service providers.

Prioritisation and timeline for implementation

The previous section outlined 93 recommended actions across nine policy areas that we believe will help to set Australia on the right course.

The point of this action plan is to square up to Australia's economic reform task in a coherent way with a particular focus to drive productivity and competitiveness. It is about identifying and articulating how we can actually progress reform.

While these recommendations are intended to be actionable, it would not be possible to complete them all simultaneously. Rather, we propose that they be prioritised and implemented in a staged way. Our recommendations fall into three categories:

Phase one: those that should be pursued immediately, reflecting their capacity to build trust and confidence over the next one to two years

Phase two: those whose implementation will help consolidate our economic position over three to six years

Phase three: those which will see the benefits of reform bear fruit and help to achieve an optimal economic performance over a six to 10-year timeframe.

A suggested approach to phasing the 93 recommendations as set out in each of the nine categories is outlined below.

Of the recommendations, some will be easier to implement and progress than others. Equally, some will have greater significance in terms of their potential influence on Australia's growth prospects. As with much of public policy, a balance will need to be struck in terms of reform effort and payoff.

An assessment of ease of implementation versus overall importance has been made for all recommendations across the nine areas. This assessment is detailed in Appendix 2.

TAX, FISCAL POLICY AND THE FEDERATION		PHASE ONE				PHASE TWO			PHASE THREE			
		0	1	2	3	4	5	6	7	8	9	10
1.1	Prepare Intergenerational Report	●	●									
1.2	Undertake whole-of-government audit	●										
1.3	New fiscal rules – Commonwealth		●									
1.4	New fiscal rules – states and territories		●									
1.5	Overhaul of Australian tax system				●	●	●	●	●	●	●	●
1.6	Lower company tax rate			●	●	●						
1.7	Contribute to global tax negotiations on base erosion and profit shifting			●	●	●	●	●	●			
1.8	Progress administrative simplification of the tax system			●	●	●						
1.9	Review and clarify roles and responsibilities within the federation, COAG and federal fiscal relations			●	●	●						
1.10	Improve GST revenue-sharing arrangements among states and territories				●	●			●	●	●	●
1.11	Introduce National Productivity Payments			●	●	●	●	●	●			

PLANNING FOR POPULATION AND CITIES		PHASE ONE				PHASE TWO			PHASE THREE			
		0	1	2	3	4	5	6	7	8	9	10
2.1	COAG to commit to well-managed population growth as a strategic imperative for Australia		●									
2.2	Prepare a new National Population Strategy			●	●	●						
2.3	Maintain current migration policy settings		●									
2.4	Federation review to consider governance arrangements and accountabilities for major cities				●	●	●	●	●			
2.5	State governments to improve strategic planning for growth				●	●	●	●	●			
2.6	Refocus cities planning on liveable and efficient cities				●	●	●	●	●			
2.7	State governments to prepare regional development plans alongside major resource projects				●	●	●	●	●			
2.8	Collaborate on an economic development strategy for northern Australia				●	●	●	●	●			
2.9	Reform development assessment systems		●	●	●							
2.10	Prioritise projects using rigorous and transparent evaluation methods for development projects		●									
2.11	Planning agencies to better promote sustainable economic development				●	●						

PROVIDING INFRASTRUCTURE		PHASE ONE				PHASE TWO			PHASE THREE			
		0	1	2	3	4	5	6	7	8	9	10
3.1	Federal government to produce a national infrastructure policy			●	●	●	●	●	●	●	●	●
3.2	Preparation of a pipeline of approved infrastructure projects		●									
3.3	Update infrastructure competition regulations			●	●							
3.4	Implement COAG heavy vehicle scheme				●	●	●	●				
3.5	States to provide Infrastructure Australia with high-quality investment proposals			●	●	●						
3.6	Infrastructure Australia to form own view on projects		●	●	●							
3.7	New Commonwealth–state infrastructure funding agreement				●	●	●	●	●			
3.8	States to produce regular 15-year infrastructure plans				●	●	●	●	●	●	●	●
3.9	States to introduce new processes for considering unsolicited projects			●	●							
3.10	Building Australia Fund to become centrepiece of infrastructure funding policy by federal government			●	●	●	●	●	●	●	●	●
3.11	Broaden infrastructure funding sources			●	●	●	●	●	●	●	●	●
3.12	Adoption of infrastructure ownership guidelines by governments			●	●							
3.13	Governments to develop specialist infrastructure expertise			●	●							
3.14	Restore the Australian Building and Construction Commission	●										
3.15	Productivity Commission strategic assessment of national infrastructure policies				●					●		

REALISING THE POTENTIAL OF PEOPLE AND WORKPLACES		PHASE ONE				PHASE TWO			PHASE THREE			
		0	1	2	3	4	5	6	7	8	9	10
4.1	Address literacy and numeracy deficiencies			⬢	⬢	⬢	⬢	⬢	⬢	⬢		
4.2	Deepen capacity of Australian educational engagement with Asia			⬢								
4.3	Encourage excellence in teaching			⬢	⬢	⬢	⬢	⬢	⬢	⬢		
4.4	Improvement of educational pathways			⬢	⬢	⬢	⬢	⬢	⬢	⬢		
4.5	Reform school funding arrangements				⬢	⬢	⬢					
4.6	Create environment for world-class, differentiated university courses					⬢	⬢	⬢	⬢	⬢		
4.7	Improve focus of vocational education and training arrangements					⬢	⬢	⬢	⬢	⬢		
4.8	Improve youth transition into labour force				⬢	⬢	⬢					
4.9	Increase participation rate of older workers through better financial incentives						⬢	⬢	⬢	⬢	⬢	
4.10	Encourage older Australians to keep working or re-enter workforce						⬢	⬢	⬢	⬢	⬢	
4.11	Increase participation rate of mothers and primary carers						⬢	⬢	⬢	⬢	⬢	
4.12	Encourage flexible work arrangements for working parents			⬢	⬢	⬢						
4.13	Improve assistance for disadvantaged jobseekers				⬢	⬢	⬢	⬢				
4.14	Increase rate of Newstart Allowance					⬢	⬢	⬢	⬢	⬢	⬢	
4.15	Support geographic labour mobility				⬢	⬢	⬢	⬢	⬢	⬢		
4.16	Productivity Commission inquiry into best practice workplace relations system			⬢	⬢	⬢	⬢					
4.17	Change Fair Work Act to increase flexibility, innovation and reduce costs		⬢									

RETHINKING OUR APPROACH TO REGULATION AND GOVERNANCE		PHASE ONE				PHASE TWO			PHASE THREE			
		0	1	2	3	4	5	6	7	8	9	10
5.1	Maintain market-based approach to critical institutions	●										
5.2	Strengthen transparency of Australian Government decision-making processes	●										
5.3	Make preparation of Regulation Impact Statements a legislated requirement		●	●	●	●	●	●	●	●	●	●
5.4	Make greater use of ASX Corporate Governance Council		●									
5.5	Establish new framework of accountability for major regulators			●	●	●	●					
5.6	Undertake a stocktake of National Competition Policy			●	●							
5.7	Establish new framework for regular review and updating of regulation		●	●	●	●			●			
5.8	Identify regulatory reforms for first tranche of new productivity payments to the states			●	●	●	●	●				
5.9	Broaden government and public sector understanding of business			●	●	●						
5.10	Develop framework for productivity measurement of public sector				●	●	●	●				

EMBRACING GLOBAL ENGAGEMENT		PHASE ONE				PHASE TWO			PHASE THREE			
		0	1	2	3	4	5	6	7	8	9	10
6.1	Place free trade and investment at the centre of G20 and B20 deliberations			●	●	●	●	●	●	●	●	
6.2	Intensify efforts to conclude free trade agreements				●	●	●	●	●	●	●	
6.3	Raise the general threshold for foreign investment screening					●	●					
6.4	Review of Australia's foreign investment policy as it applies to state-owned enterprises			●	●	●	●					
6.5	Reduce regulatory impediments in key services industries			●	●							
6.6	Reduce regulatory burden in trade-exposed sectors			●	●							
6.7	Maintain a more internationally open labour market			●	●							
6.8	Establish high-level CEO dialogues with other emerging economic partners in the region				●	●	●					

A STRONG, STABLE AND COMPETITIVE FINANCIAL SYSTEM		PHASE ONE				PHASE TWO			PHASE THREE			
		0	1	2	3	4	5	6	7	8	9	10
7.1	Maintain Australia's AAA sovereign credit rating	●										
7.2	Broaden and deepen Australia's domestic debt markets			●	●	●	●					
7.3	Address tax biases between different savings and investment options						●	●	●	●	●	
7.4	Maintain high standards of regulatory consistency in financial markets		●	●	●	●						
7.5	Facilitate movement of capital and minimise market distortions				●	●						
7.6	Commission a review of the financial services sector		●									

A COHERENT AND COMPREHENSIVE ENERGY POLICY		PHASE ONE				PHASE TWO			PHASE THREE			
		0	1	2	3	4	5	6	7	8	9	10
8.1	Integrate energy and climate change policy			●	●	●	●	●	●			
8.2	Reset policy settings to lower costs associated with carbon abatement requirements	●	●	●	●	●	●					
8.3	Energy Market Commission to stress-test and review resilience of Australia's electricity markets		●	●	●							
8.4	State governments to complete outstanding energy market reforms		●	●	●	●	●	●	●	●	●	●
8.5	Streamline project planning and environmental approvals for energy resource projects	●	●	●								
8.6	Develop a National Gas Strategy				●	●	●	●	●			
8.7	Develop strategic approach to liquid fuels market			●	●	●	●	●	●			

CREATING THE RIGHT ENVIRONMENT AND SYSTEMS FOR INNOVATION		PHASE ONE				PHASE TWO			PHASE THREE			
		0	1	2	3	4	5	6	7	8	9	10
9.1	Adopt a new systematic approach to innovation and establish a National Innovation Council		●	●								
9.2	Implement national science, technology, engineering and mathematics strategy			●	●	●	●	●	●	●	●	●
9.3	Introduce primary-level specialist teachers				●							
9.4	Incorporate design thinking and problem solving into national school curriculum				●	●	●	●				
9.5	Harmonise intellectual property frameworks across the publicly funded research sector				●	●	●	●	●			
9.6	Government to realise benefits of the digital economy				●	●	●					
9.7	Strengthen collaboration between industry and research bodies, including CSIRO				●	●	●	●	●			
9.8	Light-touch regulation to facilitate digital commerce				●	●	●					

Part Five: Measuring success

This action plan has highlighted how well-managed growth is fundamental to achieving a prosperous society. It has proposed a series of actionable recommendations with a view to strengthening the economy and supporting wealth and job creation.

Future growth in incomes and the number of new jobs created will provide some sense of the success of our policy prescriptions and whether we are prospering as a society. However, progress is typically judged across the many domains of life beyond material wellbeing – including social cohesion and how we preserve the natural environment.

In this action plan the Business Council has not attempted to identify a single measure of prosperity. Rather, we have followed the approach of the ABS and others of gauging progress across a range of performance indicators within three categories:

» **economic and material prosperity**

» **social progress and liveability**

» **sustainability.**

A small number of metrics have been chosen on the basis that they should pick up success in the features identified earlier as characterising the hallmarks of a prosperous society.

The indicators were selected because of their potential to provide an indication of long-term progress, their relevance to Australia's stage of development and unique endowments, and because they can be obtained reliably and consistently from reputable sources.

Figure 61: Enduring prosperity: Measures of success

	Economic and material prosperity	Social progress and liveability	Sustainability
Headline indicator	Real GDP per capita	Gini coefficient	Environmental Performance Index – Ecosystem Vitality
Other indicators	Global Competitiveness Index	Healthy life expectancy at birth	Household water consumption per capita
	Ease of Doing Business Index	Year 9 students meeting minimum educational standard	Industry water productivity
	Multifactor productivity	High school or equivalent attainment rate	Energy intensity
	Employment-to-population ratio	Tertiary education attainment rate	
		Housing affordability	

Source: BCA

Economic and material prosperity

Headline indicator: Real GDP per capita

Real GDP per capita is a useful proxy for the progress of a society. If real GDP per capita is increasing, there is a strong likelihood that more goods and services are becoming available to consumers, and that consumers are in a better position to buy them. It provides a sense of a nation's capacity to accommodate the material needs of its residents.

Though a useful indicator, it is not perfect in as much as it does not acknowledge the value of housework, in-home child care, in-home care for the elderly, volunteer work, and community service. Real GDP per capita also does not fully account for all factors such as clean air, clean water, leisure time, and increased life expectancy; nor does it fully account for the cost of such undesirable changes as increased traffic congestion or loss of open space.

In seeking an indicator of the capacity of Australians to purchase and consume goods and services – that is, a true measure of income – real GDP per capita requires adjustment. These adjustments take account of income flows between Australia and overseas, changes in our terms of trade, and depreciation of fixed capital used in the production process. Real net national disposable income adjusts GDP for these factors.

While real net national disposable income is a more technically accurate measure of incomes, real GDP per capita is better understood within the community and it is the most widely used metric of economic growth. It also correlates reasonably well with other aspects of prosperity including improved health and education outcomes and social cohesion. For these reasons we have chosen real GDP per capita as one of our key headline indicators.

In terms of what we might reasonably expect for growth in real GDP per capita, the projections contained in the 2010 Intergenerational Report provide some useful benchmarks.

Exhibit 10: Another doubling of real incomes?

The Intergenerational Report outlined prospects for average real GDP growth per capita over the next 40 years of 1.5 per cent per annum.

The figure was derived on the basis that Australia succeeds in growing the economy by around 2¾ per cent per year and that the population grows at 1¼ per cent per year.

As outlined above, maintaining strong growth is going to require increased labour force participation, higher levels of capital per worker and a supportive environment for entrepreneurial creativity and skills formation.

Achieving average economic growth of 2¾ per cent is a reasonable target and can be delivered if we keep growing the labour force (by around 1.1 per cent per year for the next 40 years) and if we succeed in restoring labour productivity growth to 1½ per cent per year.

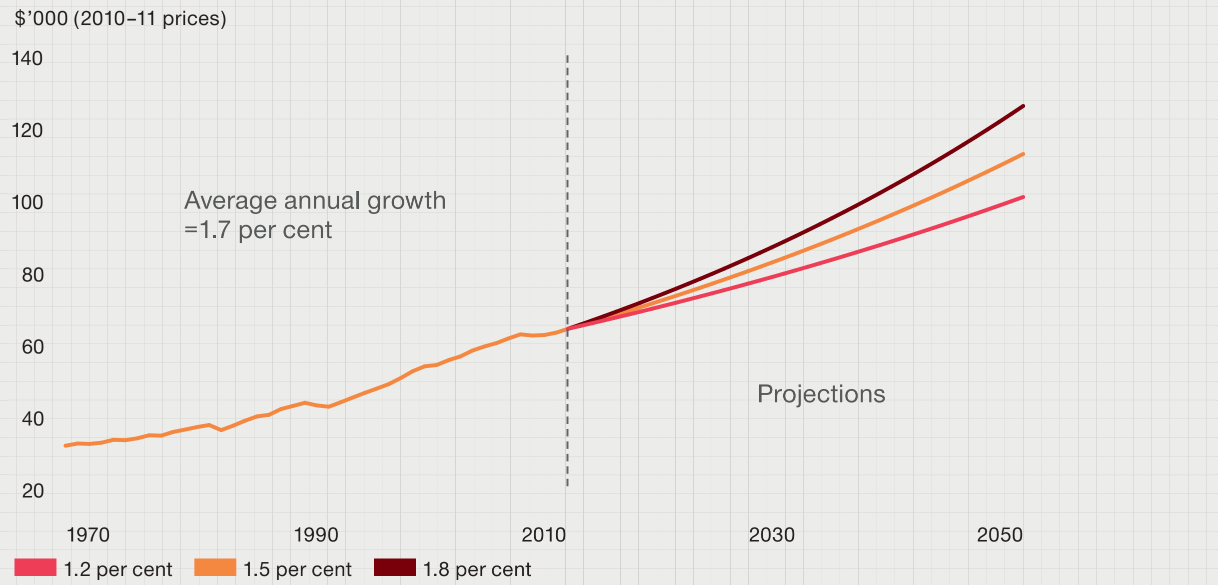
Australia should aspire to meet these benchmark measures. Achieving an annual labour productivity outcome of around 1½ per cent is obtainable if we can:

» keep investment flowing into the economy (to ensure that rising capital per worker can contribute around 0.6 percentage points to annual labour productivity growth)

» get the innovation framework and systems right such that we can restore multifactor productivity growth to its historical average (of just under 1 per cent per annum).

Achieving real GDP per capita growth consistently of 1.5 per cent per year would see real per capita incomes double over the next 48 years. (If we succeeded in achieving labour productivity growth of closer to 2 per cent per year then the doubling of incomes would occur around 12 years earlier.)

Figure 62: Real GDP per capita growth scenarios



Source: ABS, 2013b; BCA

Note: years refer to financial years. Projections begin from 2013.

Other indicators: Ease of doing business

As outlined in this report, a key aspect of prosperity and economic growth is the role played by business. If we are to continue to grow the economy and benefit from the wealth created by enterprises then we must foster a supportive business environment.

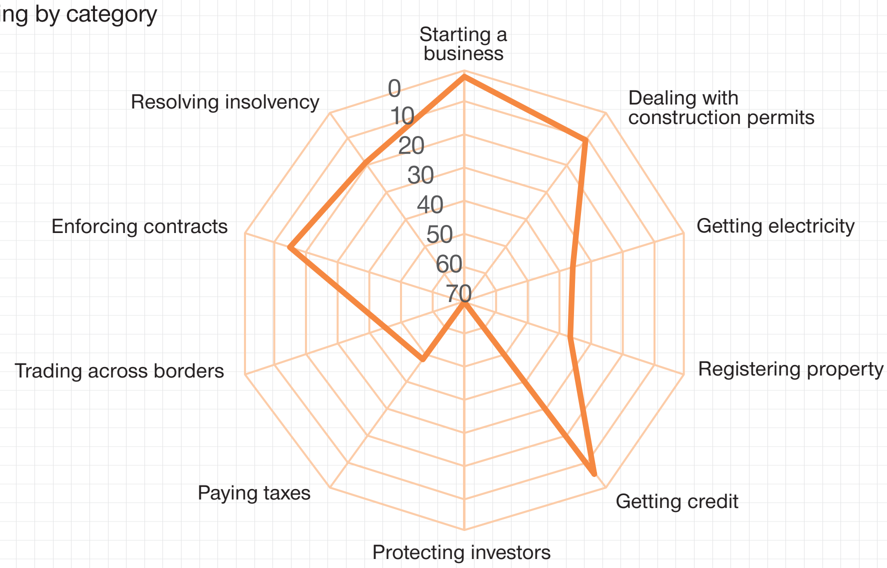
A successful vibrant economy is one in which it is easy for enterprising Australians to set up and run businesses as they seek to create value propositions that meet the needs and expectations of consumers.

Progress in this respect can be gauged by the annual World Bank Ease of Doing Business Index. This composite index assesses the efficiency of the business environment. It examines the cost and time taken in 10 categories: starting a business; dealing with construction permits; obtaining electricity; registering a property; obtaining credit; protecting investors; paying taxes; trading across borders; enforcing contracts; and resolving insolvency.

In 2013, of 188 countries assessed, Australia ranked 10th, which represented an improvement from 11th in 2012.

Figure 63: Ease of Doing Business Index, 2013

Ranking by category



Source: World Bank, 2013

Other indicators: Global Competitiveness Index

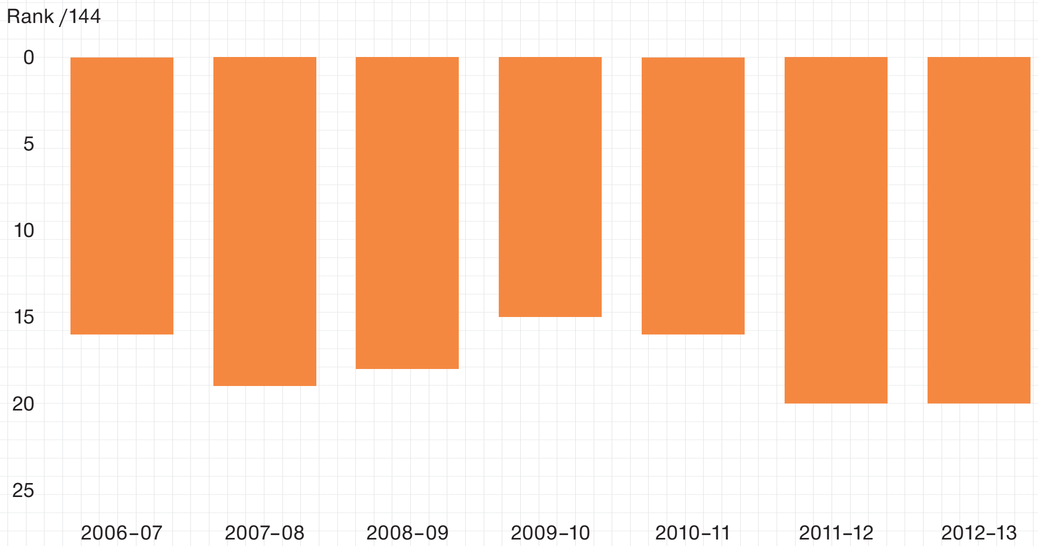
The Global Competitiveness Index compiled by the World Economic Forum assesses the international competitiveness of countries utilising more than 100 metrics across 12 key pillars of competitiveness.

The World Economic Forum pillars of competitiveness that are included in the index cover: the institutional environment; extensive and efficient infrastructure; the stability of the macroeconomic environment; a healthy workforce with a high-quality basic education; quality higher education and training; efficient goods markets; an efficient and flexible labour market; a sound and well-functioning financial sector; technological readiness; market size and trade openness; the quality of overall business networks and business sophistication; and technological innovation.

These pillars of competitiveness extend across the drivers of growth we have examined in this document as well as many of the nine areas where we are recommending action.

In 2011–12 Australia ranked 20 out of 144 countries assessed, dropping from 14th place in 2004.

Figure 64: Global Competitiveness Index ranking



Source: Global Competitiveness Index 2012–13 data platform

Other indicators: Growth in productivity

Improved productivity performance at the firm level helps a company lower its production costs, sell more products at a lower price, and enhance its relative ability to compete. At the aggregate level, increased productivity is the key to boosting real GDP per capita and over time will be among the most important determinants of living standards.

To this end, developments in productivity will be vital to whether we can achieve our goal of enduring prosperity.

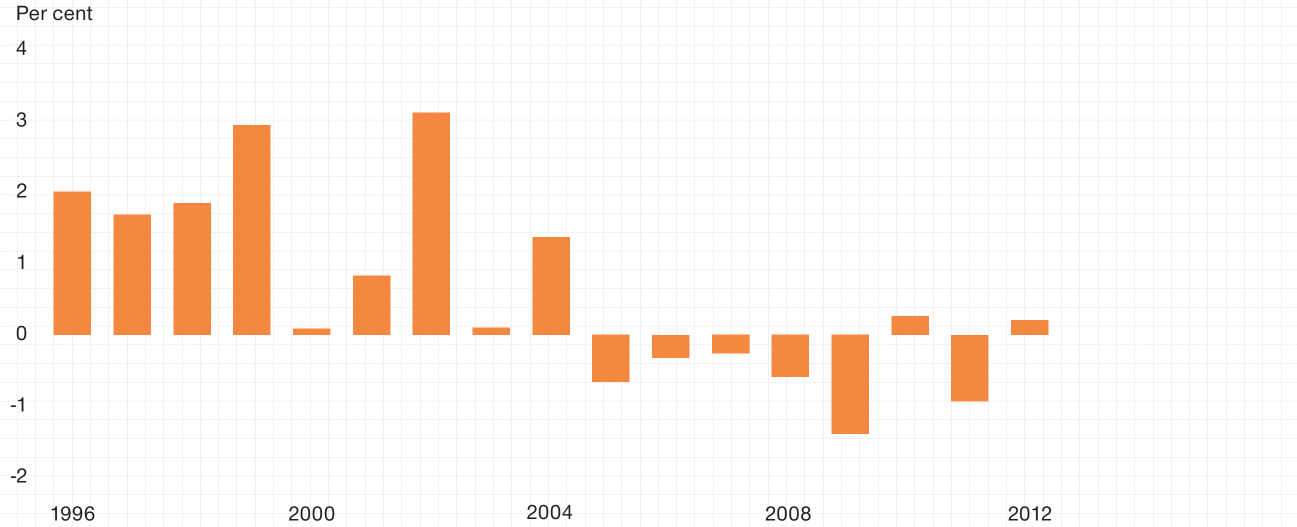
Multifactor productivity, which measures the efficiency with which labour effort, capital, resources and ideas are combined in the economy, is the key metric.

Measures of multifactor productivity are released annually by the ABS. Caution needs to be exercised in interpreting multifactor productivity measures, as they are derived as a 'residual' – the difference between measured outputs and measured inputs into the production process. They are also focused on market sector activities.

Productivity estimates will typically exhibit significant variation from year to year due to a combination of measurement error, real economic shocks, and the cyclical nature of productivity. In the short to medium term, therefore, multifactor productivity estimates are most useful when viewed as average growth rates between growth-cycle peaks.

Over the past 40 years or so annual multifactor productivity growth in the market sector of Australia's economy has averaged around 1 per cent. However, since 2003–04, the ABS has reported that multifactor productivity growth in Australia has been negative in six out of eight years.

Figure 65: Multifactor productivity growth



Source: ABS, 2012d

Note: years refer to financial years.

Other indicators: Employment-to-population ratio

A growing workforce is vital to economic growth in conjunction with increasing productivity. Likewise, the availability of good well-paying jobs is more likely to underpin a prosperous society recognising that many people gain a sense of worth and social engagement from their work.

An appropriate measure of success will be the extent to which Australia can keep growing its labour force by holding up workforce participation rates. The employment rate (i.e. the proportion of the total Australian population that is employed either full time or part time) will become increasingly important as our population ages and the dependency ratio increases.

The employment rate of Australians aged 15 and over has increased by around 6 percentage points over the past two decades to 62 per cent, reflecting strong economic growth and an increasing participation of women and those aged 55 and over.

Figure 66: Employment-to-population ratio

Source: ABS, 2013k

Social progress and liveability

Headline indicator: Income inequality

Well-managed growth needs to take into account issues of fairness when it comes to the distribution of the wealth and income that is generated by our enterprises. Past experience around the world has shown that gross inequalities in levels of income and wealth are invariably associated with social conflict and political instability.

There are various ways to consider aspects of the distribution of income and to measure the extent of income inequality including the difference between mean and median incomes, frequency distributions, various percentile ratios, and income shares. The Gini coefficient is a single statistic that summarises the distribution of income across the population.

The Gini coefficient ranges between zero when all incomes across society are equal and one when one person or household receives the entire national income. The lower the Gini coefficient the more even the distribution of income. The Gini coefficient is particularly useful for examining changes in income inequality over time.

Estimates of the Gini coefficient for Australia are produced by the ABS every two years or so for inclusion in the *Household Income and Income Distribution* publication.

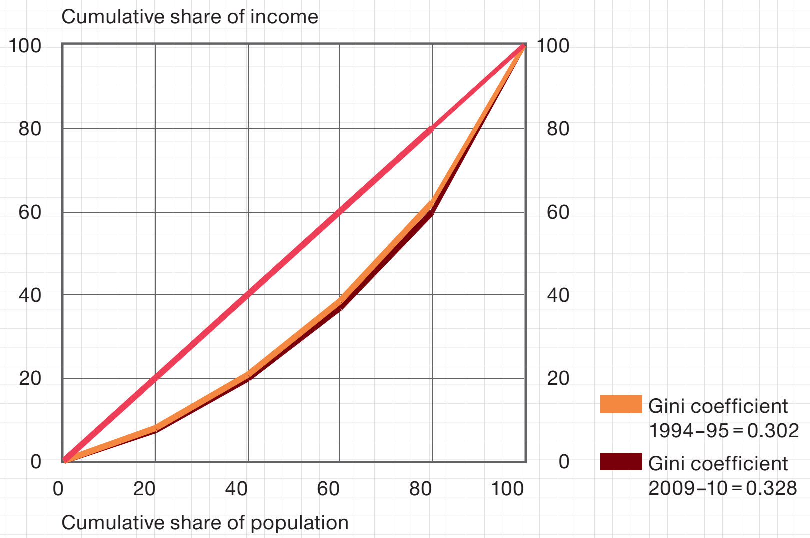
Such updates are of considerable interest to governments, welfare organisations and the community as a whole. Developments with the Gini coefficient provide some gauge of the effectiveness of the tax and transfer system, which is the primary mechanism by which income obtained by individuals from their market activities (labour earnings and investment income) are redistributed.

According to the OECD, the effects of Australia's tax and transfer system reduced inequality by around 23 per cent, which is in line with the OECD average. In the late 2000s Australia's estimated Gini coefficient on market income (before tax and transfers) was around 0.42. The Gini coefficient on disposable income (i.e. income after taking account of social security transfers and taxes) was 0.33.

The most recent estimate released by the ABS suggests that in terms of equivalised household disposable income (i.e. household incomes adjusted to take account of family size), the level of income inequality was little changed between 2007–08 (where the Gini coefficient was 0.336) and 2009–10 (Gini coefficient 0.328).

The overall trend over the past 15 years from 1994–95 to 2009–10 suggests that income inequality has increased slightly (with the Gini coefficient increasing from 0.302 to 0.328).

Figure 67: Gini coefficient, Australia



Source: ABS, 2011b

Other indicators: Healthy life expectancy at birth

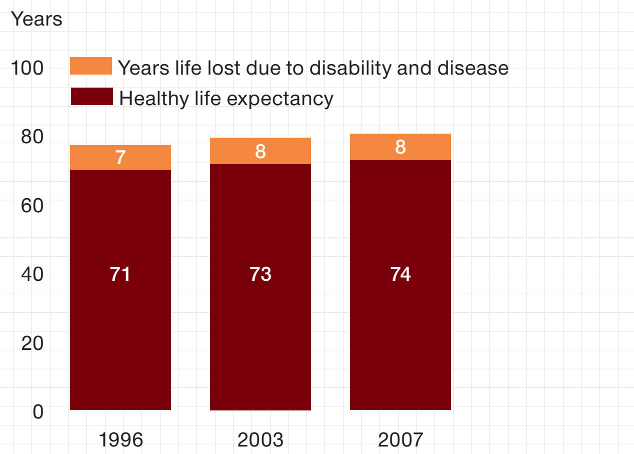
Good health benefits individuals both directly and by assisting them to succeed in other areas of their life. Conversely their personal, working and social lives may be compromised or disrupted through ill health or disability. At an aggregate level, a healthy workforce is vital to a country's competitiveness and productivity.

There are various indicators of a country's performance when it comes to health issues including infant mortality rates, life expectancy and potential years of life lost as a result of accidents or preventable disease. These indicators tend to be strongly correlated with GDP per capita meaning that on average countries with higher incomes enjoy better health.

The number of 'healthy life years' a person can expect to live free from disability or disease can provide an indication of the ability for Australians to live longer lives in better health. This measure also captures the increasing impact of chronic disease and should reflect the quality and accessibility of health care.

It is measured every four years by the World Health Organization. In Australia in 2007, healthy life expectancy was 74 years, comprising total life expectancy of 82 years and an average of eight years spent in a less healthy state (dealing with disabling medical problems). Between 1996 and 2003, the increase in healthy life expectancy was less than the increase in overall life expectancy although this trend has since reversed.

Figure 68: Healthy life years



Source: AIHW, 1999 & 2007; WHO, 2012; BCA

Note: years refer to expected years at birth.

Other indicators: Year 9 students meeting minimum education standards

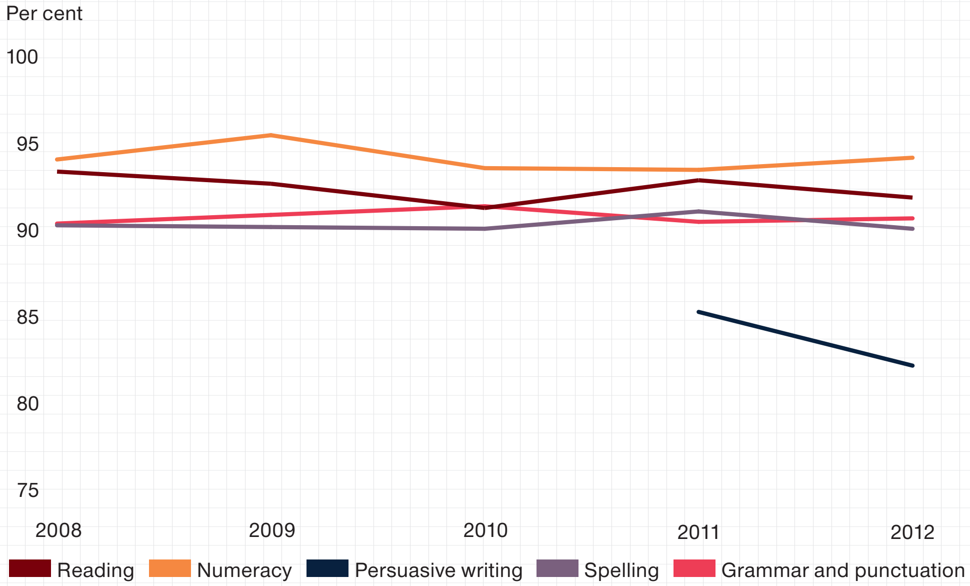
The quantity and quality of the basic education received by individuals in society has always been of fundamental importance to the success of societies. Having the right basic education and training is necessary so that individuals can meet their full potential and fully participate in social, cultural and economic life.

Evidence exists that demonstrates the important role of basic education in enhancing intergenerational mobility. There is a strong relationship between the proportion of children meeting minimum educational standards and intergenerational mobility as children are able to access good-quality education regardless of their socio-economic status.

The proportion of Year 9 students meeting minimum education standards has been selected as an important indicator of success. It allows measurement of absolute outcomes and includes a broader sample of students than associated international assessments. It also considers the quality of educational outcomes – something that is not reflected in attainment or enrolment rates.

The proportion of Year 9 students meeting minimum education standards is measured annually by the Australian Curriculum, Assessment and Reporting Authority across five domains: numeracy, reading, grammar and punctuation, spelling and persuasive writing.

Figure 69: Year 9 students meeting minimum education standards



Source: ACARA, 2008 to 2012

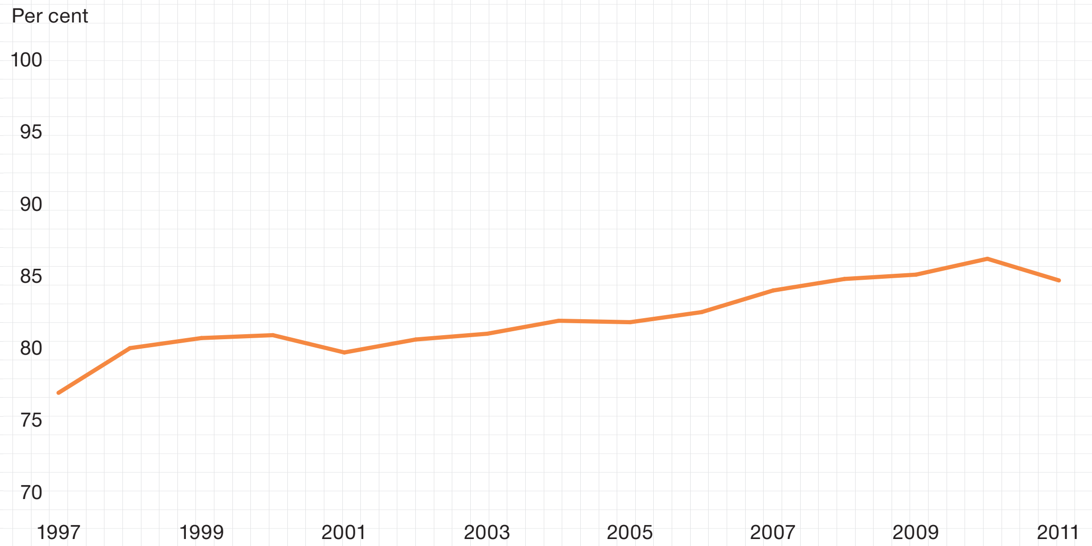
Other indicators: High school or equivalent attainment rate

As well as obtaining a basic education, completing a formal education to a high school or equivalent attainment is fundamental to an individual's future income and employment prospects. The average lifetime earnings of those leaving school before Year 12 is 20 per cent less than those who completed Year 12 or equivalent, and 32 per cent less than the national average. Some 49 per cent of long-term unemployed and 42 per cent of all unemployed people did not achieve a Year 12 or equivalent qualification.

COAG has identified a target for the proportion of young adults (aged 20 to 24) completing Year 12 and or an equivalent registered training certificate. The target is 90 per cent by 2015.

The proportion of young Australians who have completed Year 12 or equivalent training increased from 76 per cent in 1997 to 84 per cent by 2011.

Figure 70: High school or equivalent attainment rate



Source: ABS, 2012b

Other indicators: Tertiary education attainment rate of 25 to 64-year-olds

To be successful in an increasingly globalising world, countries need to nurture well-educated and adaptable workers. This is particularly the case as we strive to become a high-value, high-productivity country.

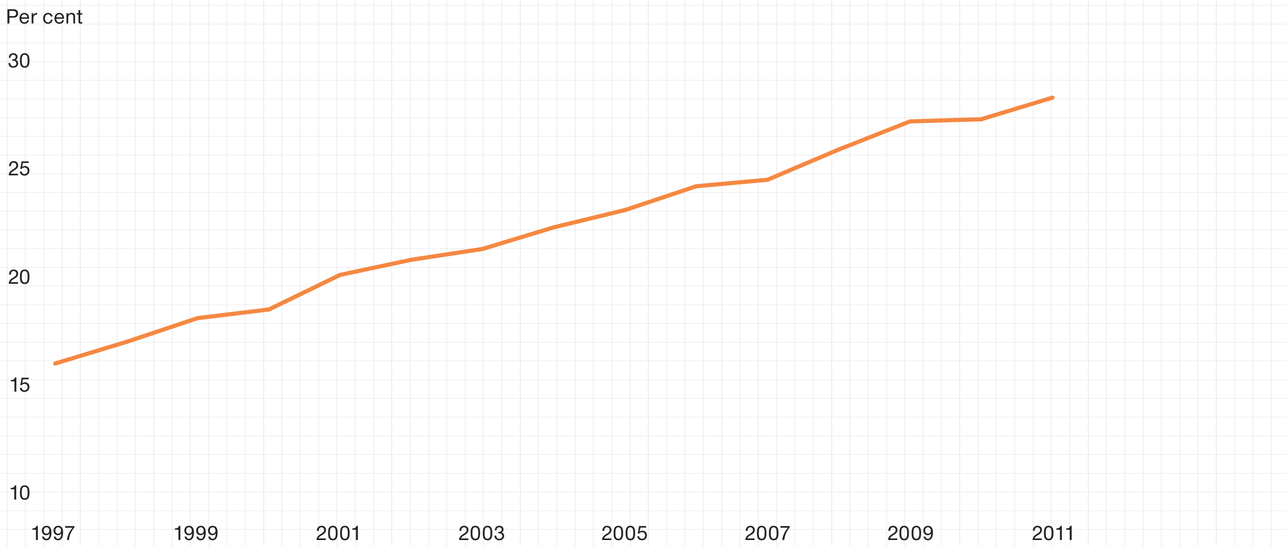
Tertiary qualifications further enable individuals to increase their lifetime earnings and employment opportunities. Graduates earn significantly more over their lifetime than those without tertiary qualifications and over the past five years more than half of the new jobs created have been in occupations requiring a bachelor's degree or higher.

Currently some 37 per cent of young adults aged 25 to 35 have a higher degree and the government has set a target of 40 per cent by 2025.

Given the need to keep growing our labour force with well-educated and well-trained workers and a need to continually retrain and keep our skills relevant, we should aspire to having a high proportion of the available workforce – that is, those aged 25 to 64 years – with tertiary-level educational attainment.

The proportion of 25 to 64-year-old Australians with a bachelor's degree or higher has increased from 16 per cent in 1997 to an estimated 28 per cent in 2011.

Figure 71: Proportion of 25 to 64-year-olds with a bachelor's degree or higher



Source: ABS, 2012b

Other indicators: Housing affordability for homebuyers

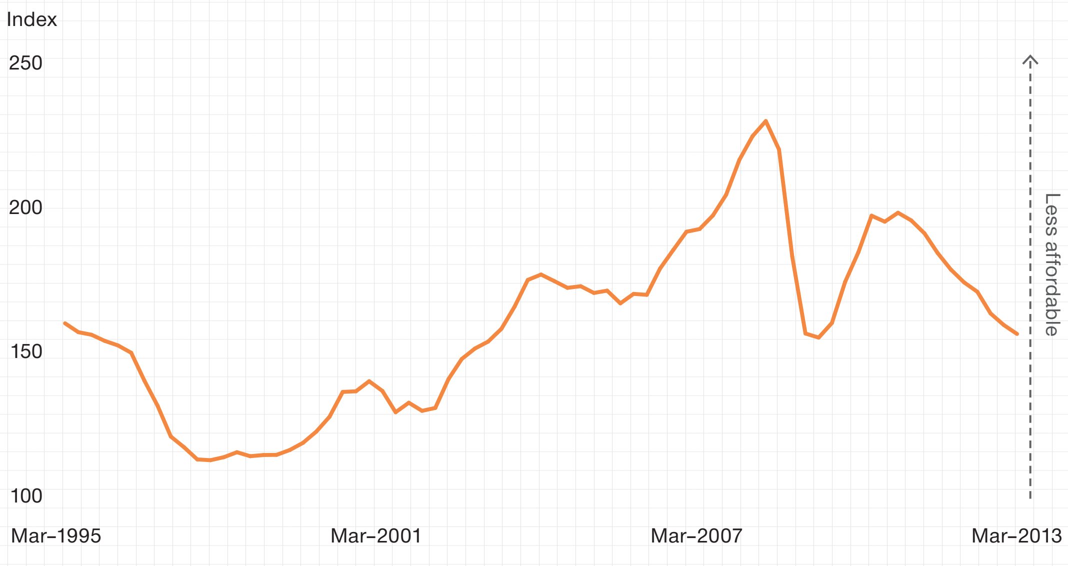
Access to housing is a fundamental feature of a person's wellbeing – providing shelter, security and privacy – and the quality of housing within a neighbourhood along with successful urban planning can contribute to the quality of the social environment.

While not all Australians choose to own their own homes, the majority do and home ownership contributes significantly to many people's sense of financial independence. Over $2.7 trillion in household wealth is accounted for by residential housing.

The affordability of housing is, however, a major issue. Mortgage payments comprise a large component of monthly living expenses and the extent of housing commitments influences the financial resources left over to satisfy other wants and needs.

There are various ways to measure housing affordability, of which we have chosen a methodology based on the HIA–CBA Affordability Index that takes into account house prices, interest rates, monthly payments and wages. Over the past 10 years there has been a pronounced rise in this index as house prices have risen strongly, while recent improvements in affordability reflect falling interest rates.

Figure 72: Housing affordability



Source: ABS, 2013c; ABS, 2013h; ABS, 2013n; RBA Interest Rates, Indicator Lending Rates; BCA

Sustainability

Headline indicator: Environmental Performance Index – Ecosystem Vitality

The efficient and sustainable use of scarce resources (including natural resources) is vital if we are to grow in a way that the community will support. Higher GDP will tend to put greater stress on the natural environment, albeit that the higher incomes that come with a growing economy increase our capacity (including the resources we have at our disposal) to address this concern.

Many natural assets are not only essential for basic life support (such as air that is safe to breathe and high-quality and plentiful supplies of water) but also play an important role in the process of economic development.

Successful, well-managed growth requires us to manage the nation's natural capital efficiently and responsibly. This holds to the view that a goal of sustainable development is to ensure both the wellbeing of those currently living and the potential for the wellbeing of future generations.

Natural capital comprises natural resource stocks, land and our existing ecosystems. These natural resources include those that are non-renewable (such as land, coal, oil and gas) as well as conditionally renewable resources including forests, fish stocks and water.

Sound management of natural resources, climate change and energy and sustainable consumption and production are the most common sustainable development indicator themes.

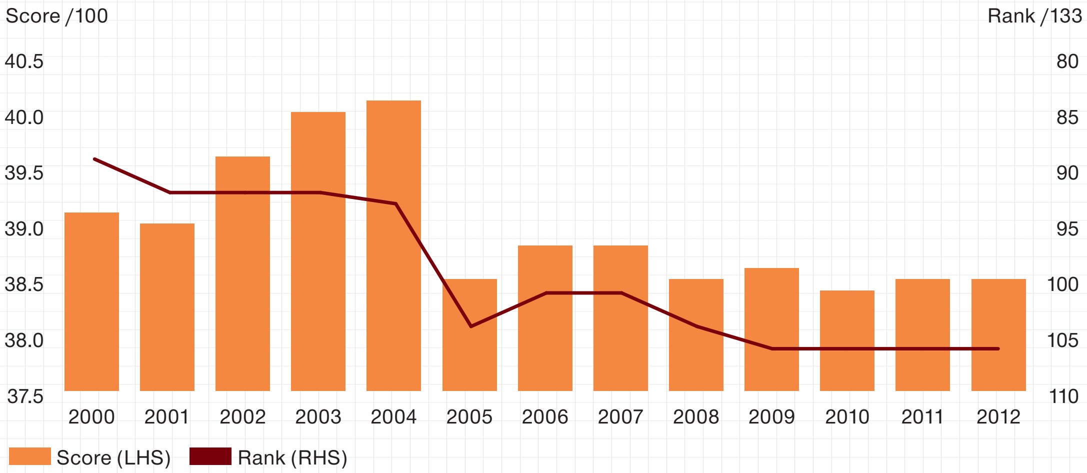
Yale and Columbia universities, together with the World Economic Forum, have compiled an Environmental Performance Index that is useful in assessing aspects of countries' sustainable growth performance in terms of how ecosystem vitality is maintained. It is categorised into two components: Environmental Health and Ecosystem Vitality. We have focused on the latter.

This measure provides a single rating to assess impacts on the natural environment through a robust methodology across several dimensions of sustainable development performance.

The index is compiled using 17 indicators that fall within seven related categories: air quality; water resources; biodiversity and habitat; agriculture; forests; fisheries; and climate change and energy.

The index allows for a country's performance to be tracked over time and also allows international comparisons. Australia's performance against this index has declined in absolute terms since 2000 and our relative ranking against 132 other countries has fallen from 89th in 2000 to 106 in 2012.

Figure 73: Environmental Performance Index – Ecosystem Vitality



Source: Yale Center for Environmental Law and Policy, 2012

Other indicators: Household water use per capita

Australia is the driest inhabited continent in the world, yet our per capita water usage is one of the highest globally. The sustainable use of water and a need to minimise the impacts on the environment of its extraction is essential to preserving our productive land and biodiversity.

Total water consumption per capita by households from all sources will provide an indication of how efficiently we are managing this important natural resource.

In Australia household water consumption (measured in terms of kilolitres per person) has declined by some 38 per cent over the past decade from 120 kL per person to 75 kL per person. This in part reflects the imposition of drought-related water restrictions and campaigns to promote water efficiency among households.

Figure 74: Household water consumption

Source: ABS, 2000; ABS 2004; ABS 2006; ABS 2012f; BCA

Note: years refer to financial years. Data are interpolated where unavailable.

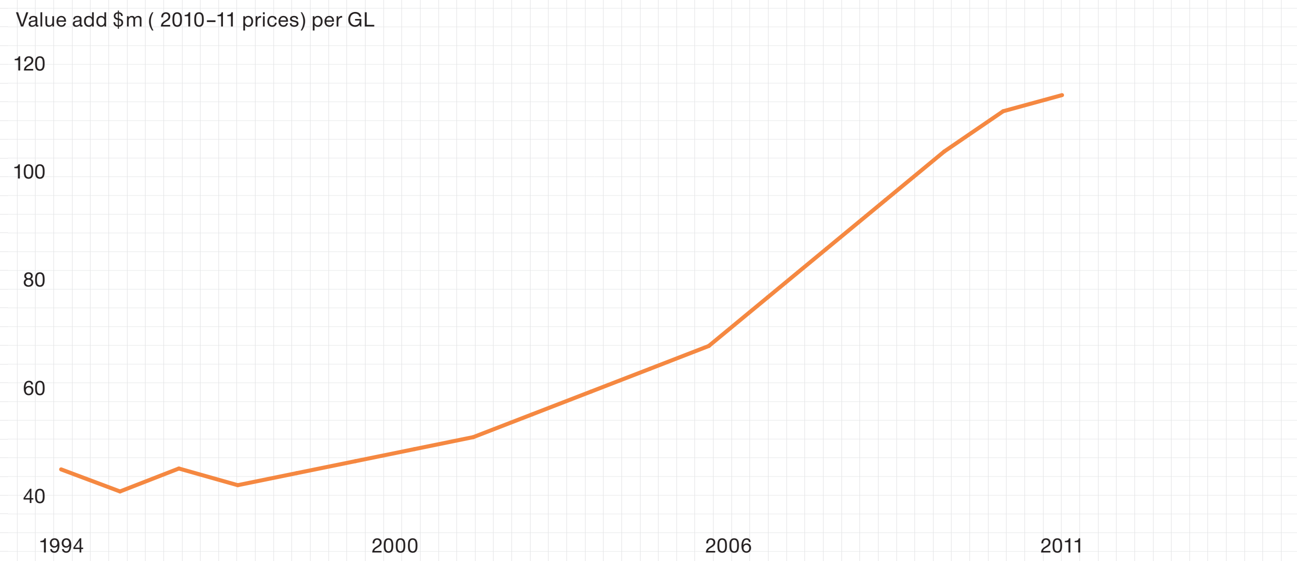
Other indicators: Efficient use of water by industry

Some 87 per cent of all water use in Australia emanates from business and more than half by the agriculture sector. One indicator of the sustainability of this use is to consider the amount of value added (or wealth created) by industry for each gigalitre of water used.

The ABS provides information every two years on trends in this area in its *Water Account* publication. Over the past decade the gross value add per gigalitre of water used increased from $49 million to $98 million (2010–11 prices).

In using this indicator as a measure of successful sustainable development it will be necessary to be aware of sectoral developments as any structural shift in the composition of economic activity (e.g. away from agriculture) will show in improved water use efficiency at an aggregate level.

Figure 75: Industry use of water



Source: ABS, 2000; ABS 2004; ABS 2006; ABS 2010; ABS 2012f; ABS, 2013b; BCA

Note: years refer to financial years. Data are interpolated where unavailable.

Other indicators: Energy efficiency

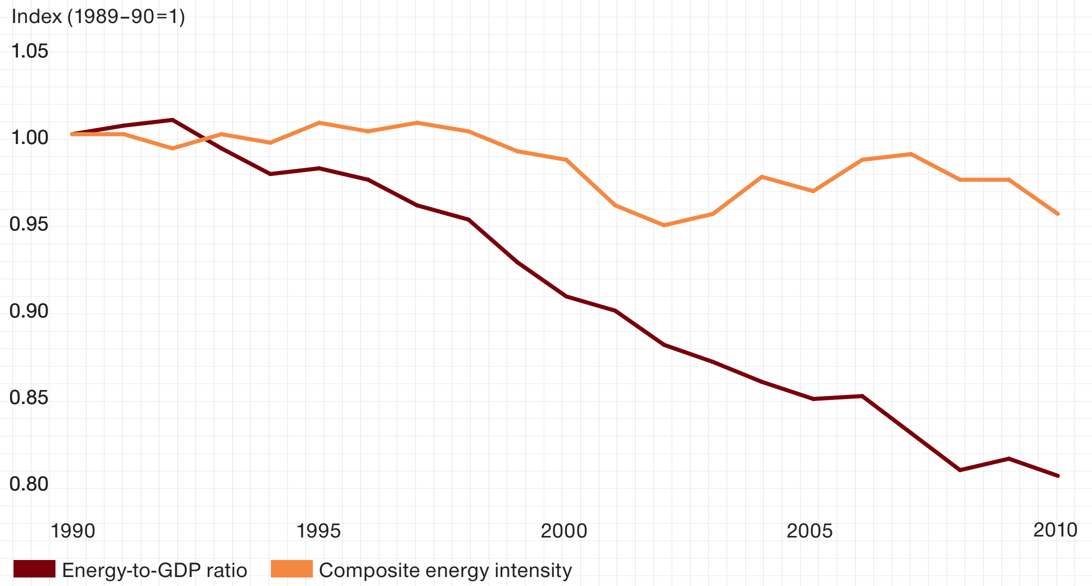
Energy use is a key driver of natural resource depletion and Australia's greenhouse gas emissions. The efficient use of energy will become increasingly important to both Australia's economic and environmental sustainability.

As outlined above, if we put in place the right strategic energy policy and ensure that we foster the right climate for innovation then Australia's prosperity should not be constrained by the availability of energy and we should be able to grow without harming the environment.

One useful measure is the energy intensity required to produce a unit of GDP. Decreased energy intensity reflects increased efficiency of energy use. A composite energy intensity index can be used to aggregate changes in energy intensity in each sector weighted for the share of production. This will provide a sense of change in energy intensity independent of structural changes occurring in the economy.

Over the 20 years from 1989–90 to 2009–10, composite energy intensity declined at an average rate of 0.2 per cent per year.

Figure 76: Composite energy intensity and energy-to-GDP ratio



Source: BREE, 2012b

Note: years refer to financial years.

Appendixes

Appendix 1: The fundamental principles of well-managed growth

Open markets and an open economy

Markets are powerful drivers of economic prosperity and higher living standards. They help with the allocation of resources and facilitate what is produced, how it is produced and to whom it is distributed. Open and transparent markets go hand-in-hand with openness to international trade and investment. But it is necessary to take a pragmatic approach to markets and recognise that regulation sometimes has a part to play in making markets work better.

Workforce participation

Workforce participation is an important driver of economic growth and has benefits for broader social inclusion. The right incentive structure is needed to reward workers for successful and productive activities and to attract people into the workforce. This includes tax settings, the welfare framework and linking wage rises to productivity improvements. The industrial relations system is fundamental to workforce participation, job creation and worker mobility. A good-quality basic education is also needed to underpin employability, and ongoing education and training are necessary to maintain a talent pool of well-educated workers.

Productive capacity

The quality and capacity of infrastructure – including investment in freight, transport, water, electricity and communications – plays an important role in determining the structure, strength and capacity of the economy. The main scope for improving productive capacity lies in continuing to attract investment to further build underlying physical capital, along with new investment in the skills and training of the workforce.

Efficient regulation

There is a rightful role for regulation in the economy, and effective regulatory institutions are a cornerstone of an effective market-based economy. Good regulation should help to clarify the rules of the game, enforce property rights, increase certainty and reduce barriers to investment and expansion for business. This should include competition laws that protect the competitive process and not particular competitors. Good regulation gets the balance right recognising the roles played by the formal device of the law and the informal device of reputation as enhanced by competitive markets.

Role and size of government

For a market economy to be successful there will be a significant role for government. Governments should help deal with business cycles and financial market crises through appropriate macroeconomic and macro-prudential policies. They have a role in redressing market failures including externalities and to provide basic public goods. Government policies, as a whole, need to be predictable and stable recognising that they do affect investment and production decisions of the private sector involving time horizons extending out many years. The tax system should raise and redistribute revenue at the least possible cost to economic efficiency and with minimal administration and compliance costs.

Role of the financial system

A sound and well-functioning financial sector plays a central role in underpinning a market-based economy. An efficient financial sector allocates the resources saved by a nation's citizens, as well as the capital that enters the economy from abroad, to their most productive uses. The system needs to be transparent and trustworthy, with appropriate regulation to protect investors and others in the community, and should be underpinned by mechanisms that support a thorough and proper assessment of risk.

Sustainability

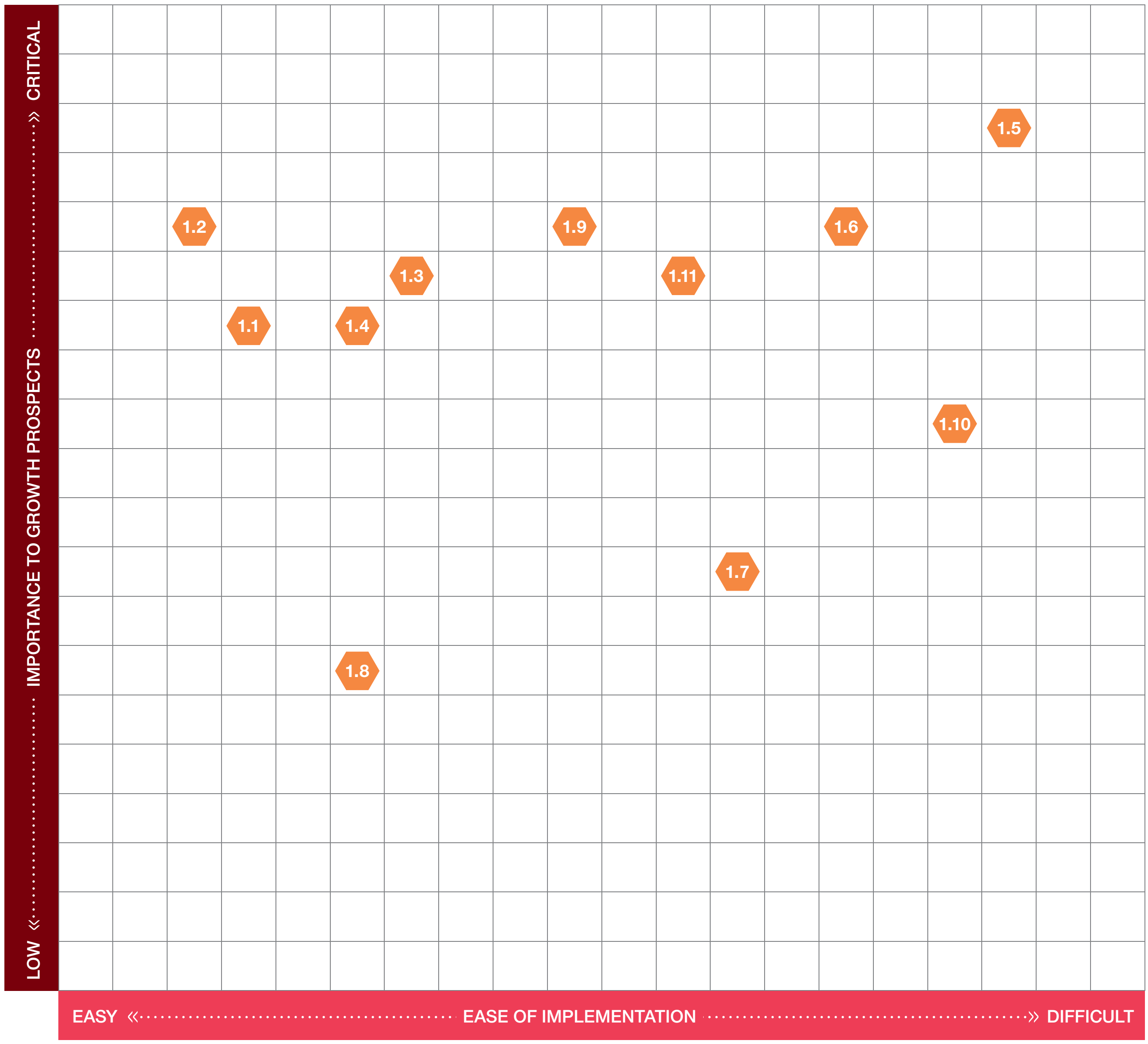
A sustainability agenda is vital for economic growth, population growth and to wealth creation. It is an inevitability of population and economic growth – the competition for resources simply means that we must use resources more efficiently. The sustainability agenda is the natural home of business.

Appendix 2: Action matrix: Ease of implementation and contribution to growth prospects

Of the recommendations outlined in this action plan, some will be easier to implement and progress than others. Equally, some will have greater significance in terms of their potential influence on Australia's growth prospects. As with much of public policy, a balance will need to be struck in terms of reform effort and payoff.

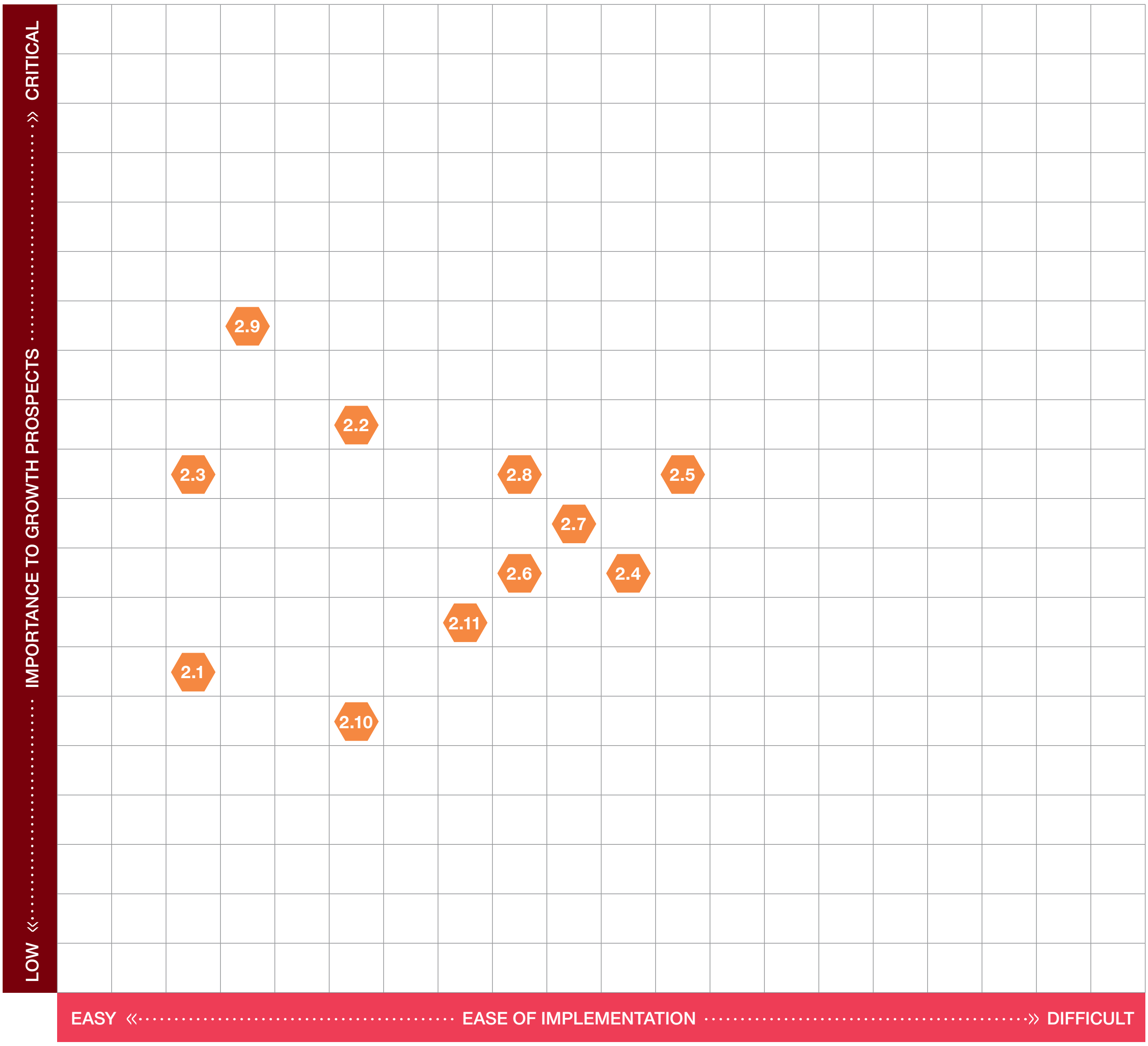
This is an assessment of the ease of implementation versus the overall importance for all recommendations across the nine areas.

Tax, fiscal policy and the federation



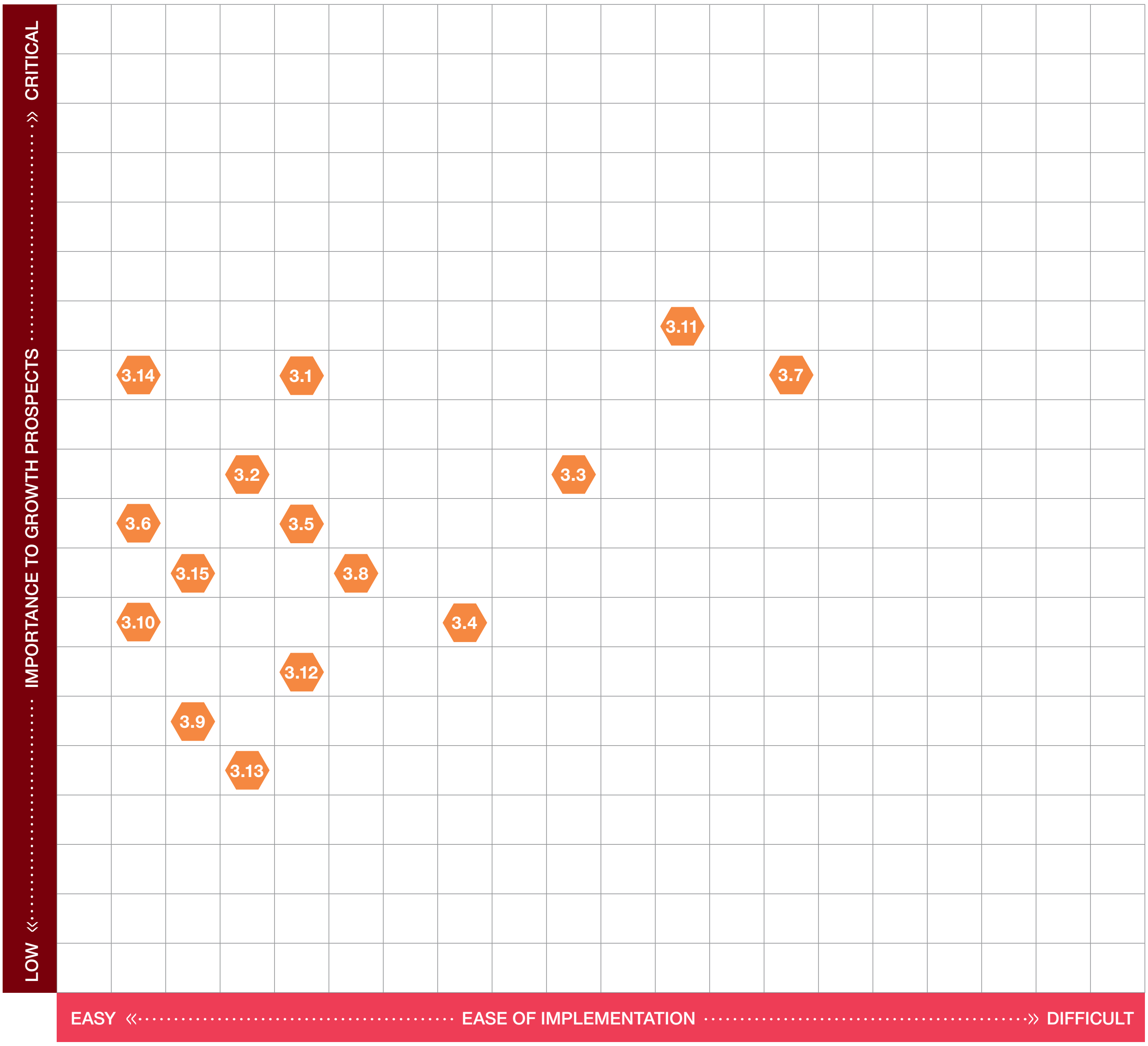
1.1 Prepare Intergenerational Report
1.2 Undertake whole-of-government audit
1.3 New fiscal rules – Commonwealth
1.4 New fiscal rules – states and territories
1.5 Overhaul of Australian tax system
1.6 Lower company tax rate
1.7 Contribute to global tax negotiations on base erosion and profit shifting
1.8 Progress administrative simplification of the tax system
1.9 Review and clarify roles and responsibilities within the federation, COAG and federal fiscal relations
1.10 Improve GST revenue-sharing arrangements among states and territories
1.11 Introduce National Productivity Payments

Planning for population and cities



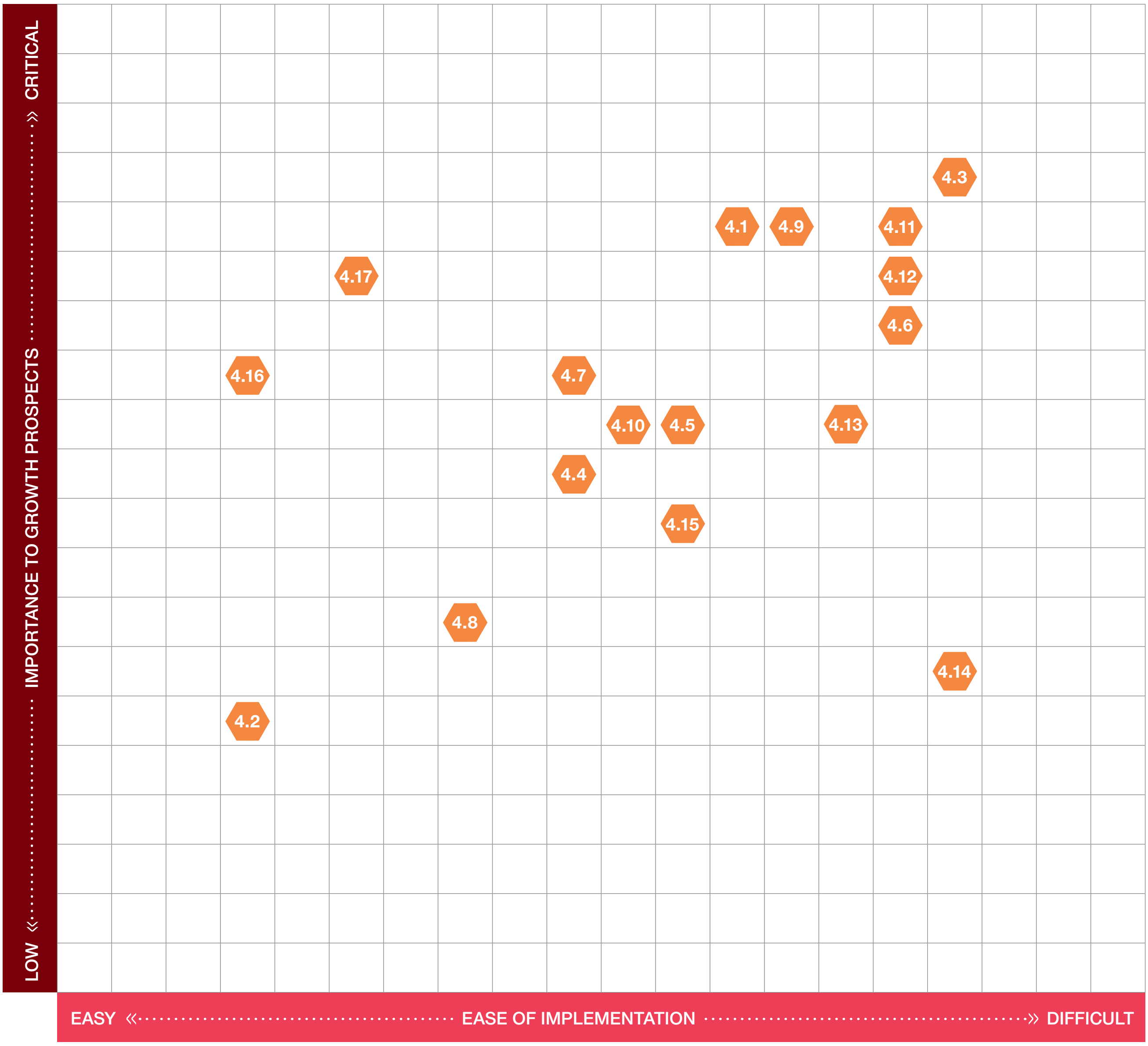
2.1 COAG to commit to well-managed population growth as a strategic imperative for Australia
2.2 Prepare a new National Population Strategy
2.3 Maintain current migration policy settings
2.4 Federation review to consider governance arrangements and accountabilities for major cities
2.5 State governments to improve strategic planning for growth
2.6 Refocus cities planning on liveable and efficient cities
2.7 State governments to prepare regional development plans alongside major resource projects
2.8 Collaborate on an economic development strategy for northern Australia
2.9 Reform development assessment systems
2.10 Prioritise projects using rigorous and transparent evaluation methods for development projects
2.11 Planning agencies to better promote sustainable economic development

Providing infrastructure



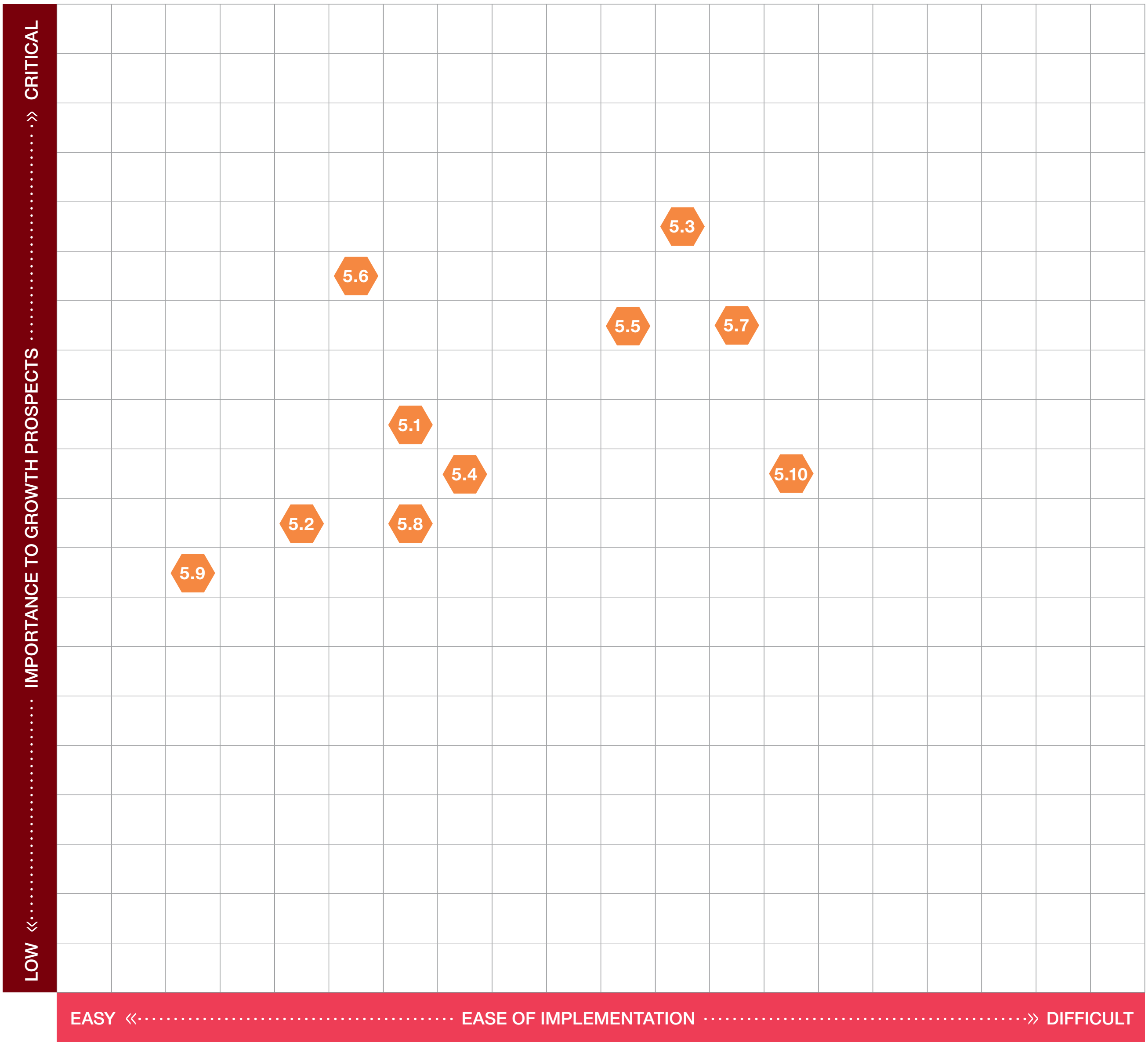
3.1 Federal government to produce a national infrastructure policy
3.2 Preparation of a pipeline of approved infrastructure projects
3.3 Update infrastructure competition regulations
3.4 Implement COAG heavy vehicle scheme
3.5 States to provide Infrastructure Australia with high-quality investment proposals
3.6 Infrastructure Australia to form own view on projects
3.7 New Commonwealth–state infrastructure funding agreement
3.8 States to produce regular 15-year infrastructure plans
3.9 States to introduce new processes for considering unsolicited projects
3.10 Building Australia Fund to become centrepiece of infrastructure funding policy by federal government
3.11 Broaden infrastructure funding sources
3.12 Adoption of infrastructure ownership guidelines by governments
3.13 Governments to develop specialist infrastructure expertise
3.14 Restore the Australian Building and Construction Commission
3.15 Productivity Commission strategic assessment of national infrastructure policies

Realising the potential of people and workplaces



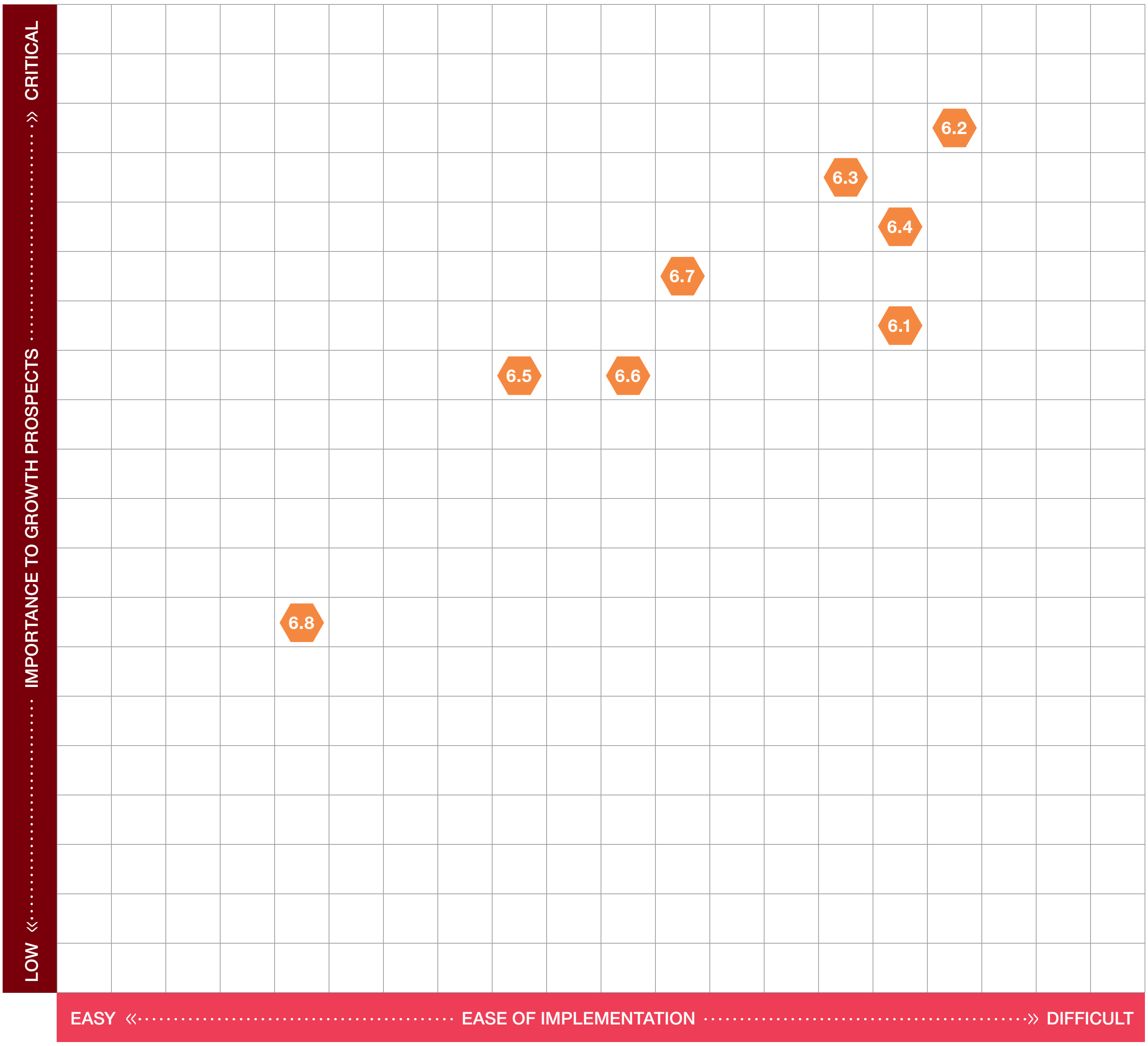
4.1 Address literacy and numeracy deficiencies
4.2 Deepen capacity of Australian educational engagement with Asia
4.3 Encourage excellence in teaching
4.4 Improvement of educational pathways
4.5 Reform school funding arrangements
4.6 Create environment for world-class, differentiated university courses
4.7 Improve focus of vocational education and training arrangements
4.8 Improve youth transition into labour force
4.9 Increase participation rate of older workers through better financial incentives
4.10 Encourage older Australians to keep working or re-enter workforce
4.11 Increase participation rate of mothers and primary carers
4.12 Encourage flexible work arrangements for working parents
4.13 Improve assistance for disadvantaged jobseekers
4.14 Increase rate of Newstart Allowance
4.15 Support geographic labour mobility
4.16 Productivity Commission inquiry into best practice workplace relations system
4.17 Change Fair Work Act to increase flexibility, innovation and reduce costs

Rethinking our approach to regulation and governance



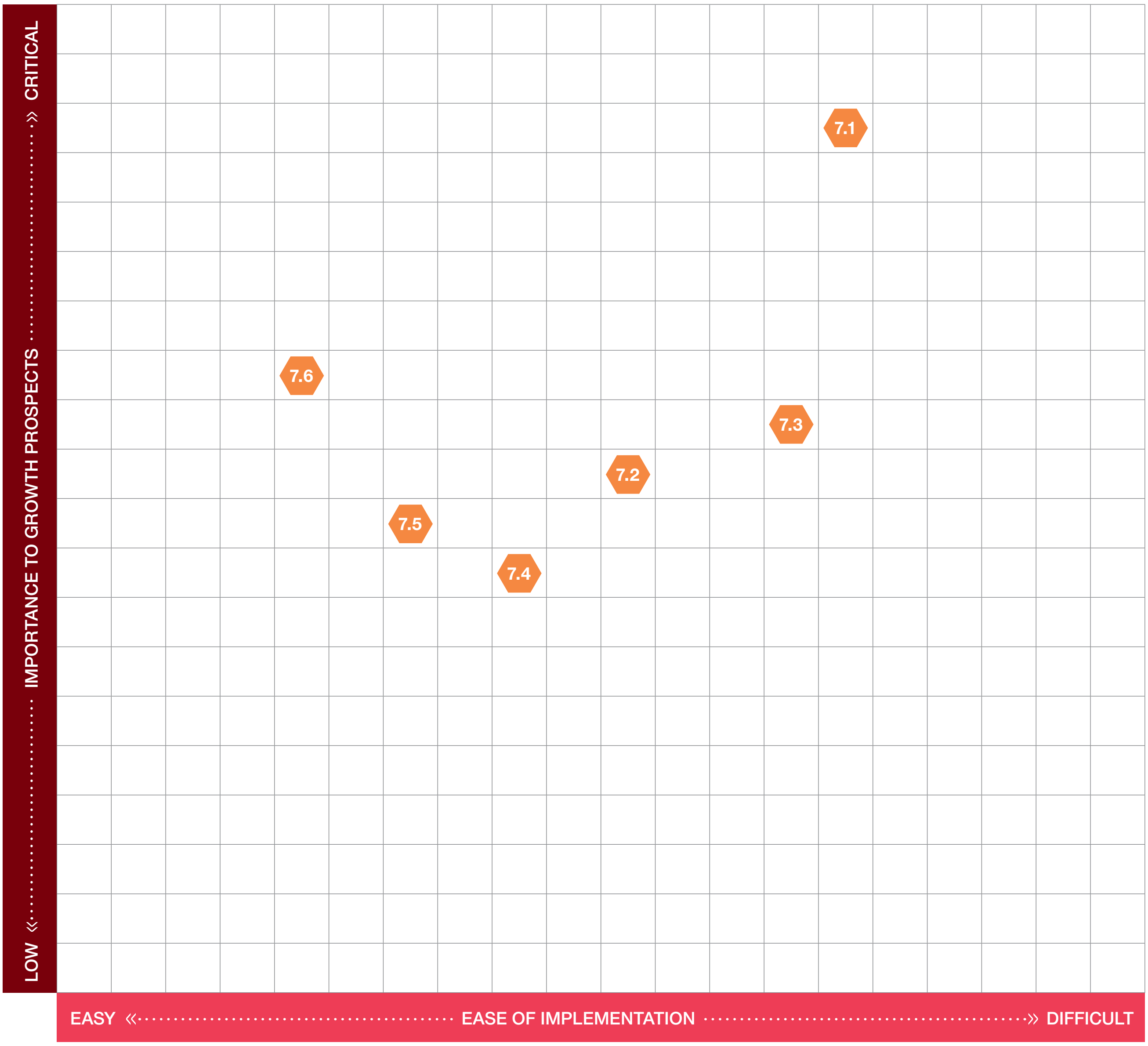
5.1 Maintain market-based approach to critical institutions
5.2 Strengthen transparency of Australian Government decision-making processes
5.3 Make preparation of Regulation Impact Statements a legislated requirement
5.4 Make greater use of ASX Corporate Governance Council
5.5 Establish new framework of accountability for major regulators
5.6 Undertake a stocktake of National Competition Policy
5.7 Establish new framework for regular review and updating of regulation
5.8 Identify regulatory reforms for first tranche of new productivity payments to the states
5.9 Broaden government and public sector understanding of business
5.10 Develop framework for productivity measurement of public sector

Embracing global engagement



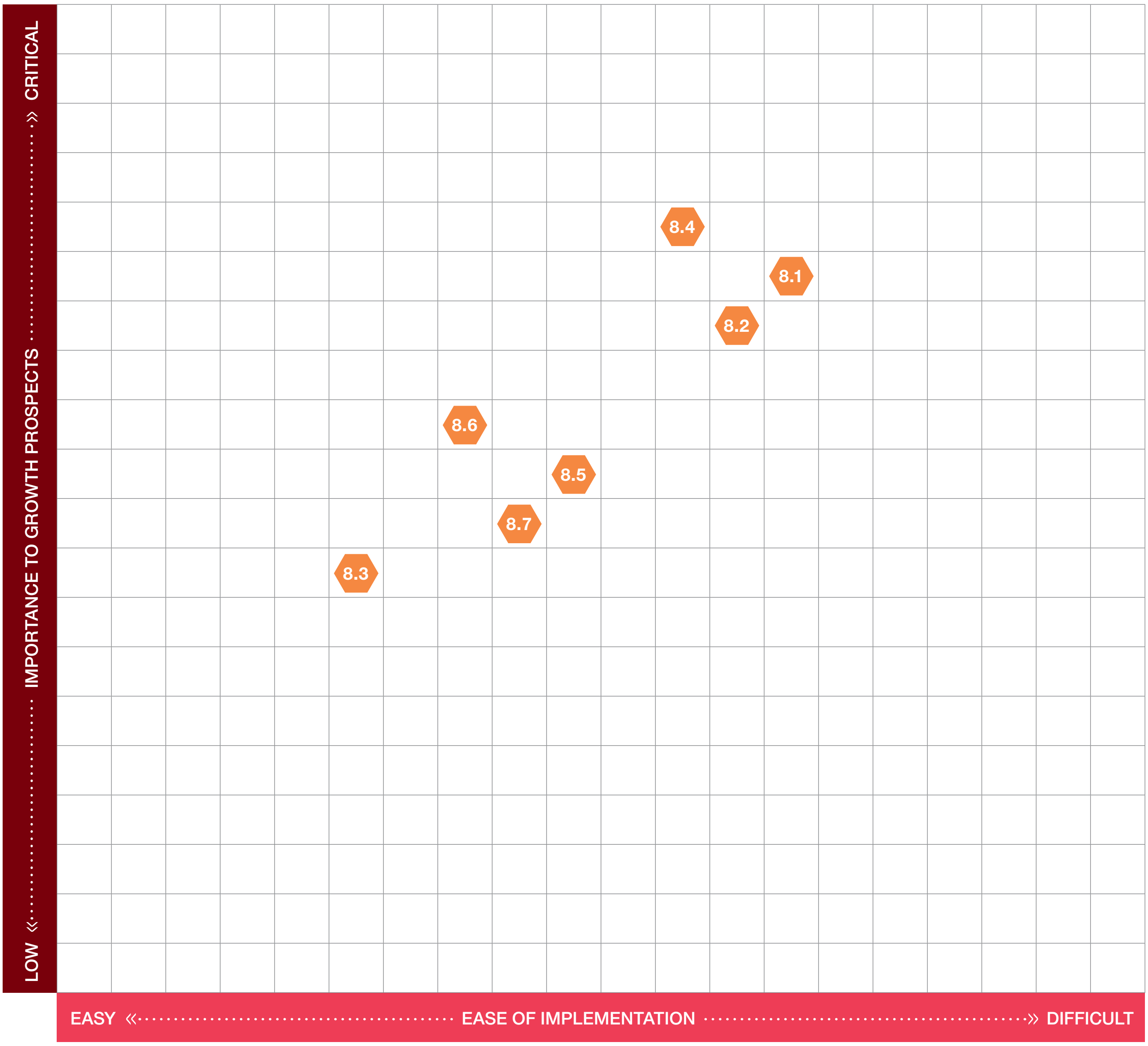
6.1 Place free trade and investment at the centre of G20 and B20 deliberations
6.2 Intensify efforts to conclude free trade agreements
6.3 Raise the general threshold for foreign investment screening
6.4 Review of Australia's foreign investment policy as it applies to state-owned enterprises
6.5 Reduce regulatory impediments in key services industries
6.6 Reduce regulatory burden in trade-exposed sectors
6.7 Maintain a more internationally open labour market
6.8 Establish high-level CEO dialogues with other emerging economic partners in the region

A strong, stable and competitive financial system



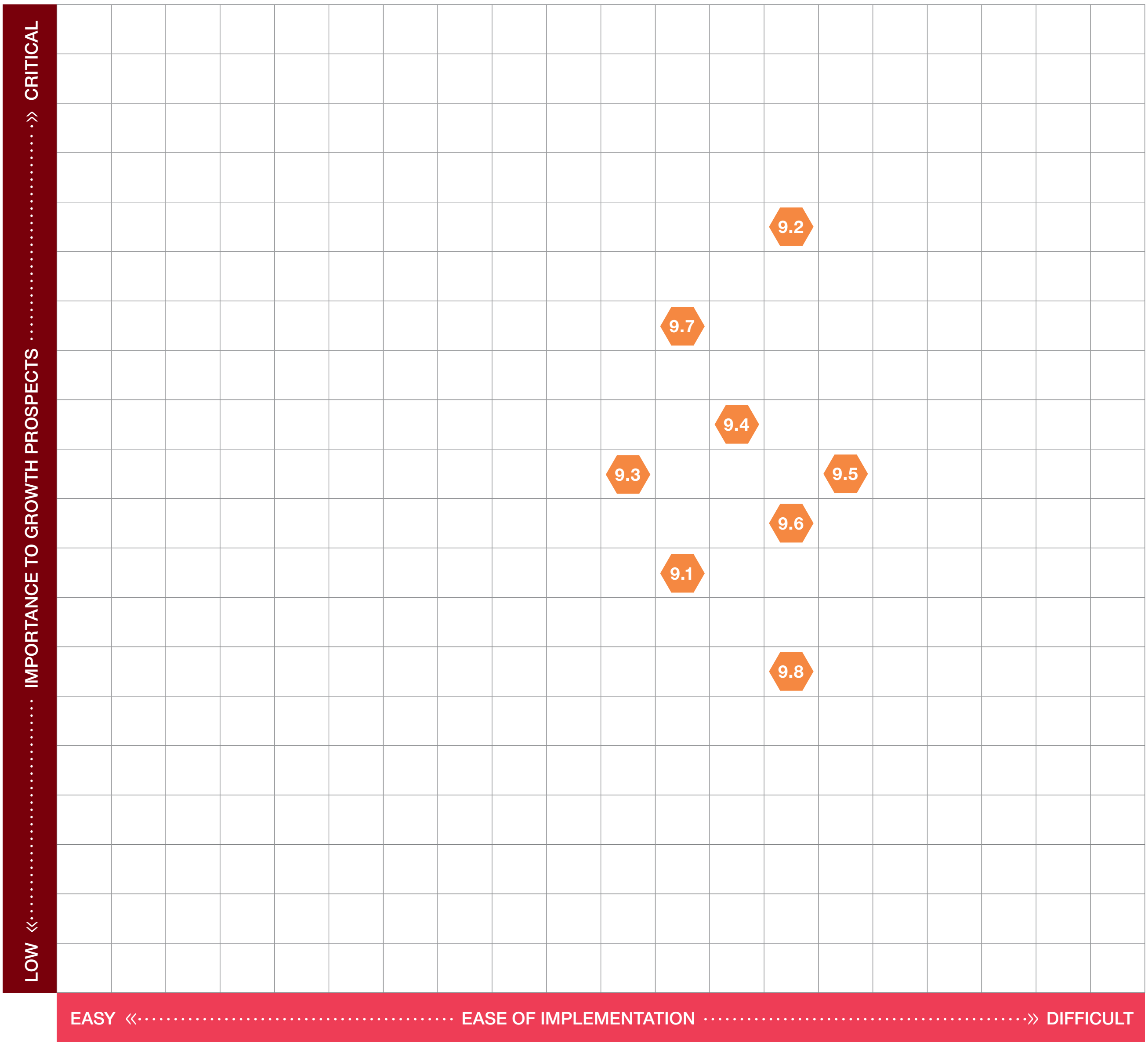
7.1 Maintain Australia's AAA sovereign credit rating
7.2 Broaden and deepen Australia's domestic debt markets
7.3 Address tax biases between different savings and investment options
7.4 Maintain high standards of regulatory consistency in financial markets
7.5 Facilitate movement of capital and minimise market distortions
7.6 Commission a review of the financial services sector

A coherent and comprehensive energy policy



8.1 Integrate energy and climate change policy
8.2 Reset policy settings to lower costs associated with carbon abatement requirements
8.3 Energy Market Commission to stress-test and review resilience of Australia's electricity markets
8.4 State governments to complete outstanding energy market reforms
8.5 Streamline project planning and environmental approvals for energy resource projects
8.6 Develop a National Gas Strategy
8.7 Develop strategic approach to liquid fuels market

Creating the right environment and systems for innovation



9.1 Adopt a new systematic approach to innovation and establish a National Innovation Council
9.2 Implement national science, technology, engineering and mathematics strategy
9.3 Introduce primary-level specialist teachers
9.4 Incorporate design thinking and problem solving into national school curriculum
9.5 Harmonise intellectual property frameworks across the publicly funded research sector
9.6 Government to realise benefits of the digital economy
9.7 Strengthen collaboration between industry and research bodies, including CSIRO
9.8 Light-touch regulation to facilitate digital commerce

Appendix 3: Draft terms of reference for an audit on the size, scope and efficiency of government

Objectives and scope

The review should examine in detail and report on the size and scope of the Commonwealth Government, in order to advise the government on how best to manage expenditure and fiscal risks in the future with a view to improving fiscal sustainability.

The review should address the following matters.

Stocktake of expenditure and health of government finances

Undertake a stocktake of current government programs in order to identify the composition and distribution of expenditure according to program, portfolio, function and size of outlay.

Identify the fastest-growing areas of expenditure and the underlying drivers of that growth.

Identify the quantum of committed expenditure beyond the forward estimates period.

Critically analyse the current position of the government balance sheet, including any emerging risks or contingent liabilities that are not reflected in the current position.

Expenditure responsibilities in the federation

Analyse the current split of roles and responsibilities between the Commonwealth Government and state and territory governments, including areas of duplication, overlap and inefficient administration.

Efficiency and effectiveness

Assess the current efficiency and effectiveness of government in fulfilling its policymaking, administration and program delivery functions with reference to comparable public service benchmarks.

Identify opportunities for the implementation of alternative service delivery models employing latest technologies and emerging innovations.

Identify current activities undertaken by government where there is not a strong case for continued direct involvement of government in service delivery and the activity could be undertaken more efficiently by the private sector.

Adequacy of budgetary institutions

Assess the adequacy of current institutions and budgetary practices in promoting efficient and effective government, disciplined expenditure, long-term fiscal sustainability and budget transparency.

This should include the role of mechanisms such as the Parliamentary Budget Office, Expenditure Review Committee, Australian National Audit Office, Intergenerational Reports and the efficiency dividend.

Recommended actions

The review should outline recommendations with an associated implementation plan under three key strands of reform:

» Near-term actions: steps that the government can readily take in the near term to reduce expenditure or increase efficiency.

» Medium-term actions: develop a program of rolling detailed audits to be undertaken, with priority placed on the largest and fastest-growing areas of expenditure along with those that are the most inefficient.

» Institutional reforms: actions that will improve the range and effectiveness of permanent mechanisms, which promote the transparency of expenditure and incentives for expenditure discipline and efficient service delivery. This should include a set of fundamental principles for upholding and assessing the efficiency and effectiveness of government in the future.

Composition and consultation

The review should consult widely with ministers, the public service and the community in developing its report. Its interim and final reports should be publicly released, with comment invited on its interim report.

The review should be overseen by a suitably qualified chair and panel, supported by a small secretariat. Those engaged in the review should bring a mix of different backgrounds and experience, including:

» senior-level public sector experience in both the Commonwealth and the states and territories

» experience leading a high-performing private sector or not-for-profit organisation

» experience in overseas jurisdictions

» change management and other experience involved in the implementation of major reform programs

» appropriate accounting and economics expertise.

Timing

The review should provide its interim report, focusing on near-term actions that can be undertaken in the 2014–15 Budget by the end of 2013.

Its final report should be delivered by no later than the end of March 2014.

Glossary

AAA	AAA sovereign credit rating
ABCC	Australian Building and Construction Commission
ABS	Australian Bureau of Statistics
ACARA	Australian Curriculum, Assessment and Reporting Authority
ACCC	Australian Competition and Consumer Commission
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AIDC	Australian Industry Development Corporation
AIHW	Australian Institute of Health and Welfare
APEC	Asia–Pacific Economic Cooperation
APRA	Australian Prudential Regulation Authority
ARC	Australian Research Council
ASEAN	Association of Southeast Asian Nations
ASIC	Australian Securities and Investments Commission
ASX	Australian Securities Exchange
ATO	Australian Taxation Office
AUD	Australian dollar
B20	Business Twenty
BAF	Building Australia Fund
BBB+	BBB+ credit rating
BCA	Business Council of Australia
BREE	Bureau of Resources and Energy Economics
CBA	Commonwealth Bank of Australia
CER	Clean Energy Regulator
COAG	Council of Australian Governments
CPI	Consumer Price Index
CSIRO	Commonwealth Scientific and Industrial Research Organisation
EMTR	Effective marginal tax rate
EPBC Act	Environment Protection and Biodiversity Conservation Act
EPortal	Enterprise information portal
FDI	Foreign direct investment
FIRB	Foreign Investment Review Board
FTA	Free trade agreement
G20	Group of Twenty
GBP	Great British pound
GDP	Gross domestic product
GE	General Electric
Gini coefficient	A measure of inequality
GL	Gigalitre
GST	Goods and services tax
HIA	Housing Industry Association
IA	Infrastructure Australia
ICT	Information and communications technology
IEAC	International Education Advisory Council
IGA	Intergovernmental Agreement
IGR	Intergenerational Report
IMF	International Monetary Fund
INSEAD	Institut Européen d'Administration des Affaires (European Institute of Business Administration)
JSA	Job Services Australia
kL	Kilolitre

LLN ...... Language, literacy and numeracy
LNG ...... Liquefied natural gas
METS ...... Mining equipment, technology and services
NAB ...... National Australia Bank
NAPLAN ...... National Assessment Program – Literacy and Numeracy
NBER ...... National Bureau of Economic Research
NBN ...... National Broadband Network
NCC ...... National Competition Council
NCP ...... National Competition Policy
NEM ...... National Electricity Market
NGL ...... Natural gas liquids
NHMRC ...... National Health and Medical Research Council
NICTA ...... National ICT Australia
NPA ...... National Partnership Agreement
OECD ...... Organisation for Economic Co-operation and Development
PIBA ...... Primary Industry Bank of Australia
PJ ...... Petajoules
PPP ...... Public–private partnership
QBTU ...... Quadrillion British Thermal Units
R&D ...... Research and development
RBA ...... Reserve Bank of Australia
RCEP ...... Regional Comprehensive Economic Partnership
RET ...... Renewable Energy Target
RIA ...... Regulatory Impact Assessment
RIS ...... Regulation Impact Statement
RMB ...... Renminbi
SBIR ...... Small Business Innovation Research
SME ...... Small and medium enterprise
SPP ...... Special Purpose Payment
STEM ...... Science, technology, engineering and mathematics
TGA ...... Therapeutic Goods Administration
TPP ...... Trans-Pacific Partnership
UNECE ...... United Nations Economic Commission for Europe
USD ...... United States dollar
VET ...... Vocational educational and training
WEF ...... World Economic Forum
WELL ...... Workplace English Language and Literacy
WHO ...... World Health Organization
WIPO ...... World Intellectual Property Organization
WTO ...... World Trade Organization

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VISION

Enduring prosperity for all Australians

GOALS AND ASPIRATIONS

A strong economy and full employment

A strong society and improving standard of living

Growing sustainably and using our resources efficiently

RESPONDING TO A CHANGING WORLD: THE CASE FOR CHANGE

Rise of emerging economies

Technology and digitisation

Natural resource consumption

Restructuring of the Australian economy

Growth and ageing of population

THE NINE THINGS WE MUST GET RIGHT

- Tax, fiscal policy and the federation
- Planning for population and cities
- Providing infrastructure
- Realising the potential of people and workplaces
- Rethinking our approach to regulation and governance
- Embracing global engagement
- A strong, stable and competitive financial system
- A coherent and comprehensive energy policy
- Creating the right environment and systems for innovation

PHASES FOR POLICY ACTION

- **Phase One (1–3 years):** Building trust and confidence
- **Phase Two (3–6 years):** Consolidating and growing the economy
- **Phase Three (6–10 years):** Realising our full economic potential and reaping the benefits

MEASURES OF SUCCESS

A strong economy and full employment
Australia to be ranked in the top five in the world for real GDP per capita

A strong society and improving standard of living
Maintain a reasonable distribution of wealth and income

Growing sustainably
Continue to reduce the resource intensity of our overall economic activity

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