Currently, the Australian economy is underperforming. Employment is growing relatively slowly, Commonwealth and state budgets are in deficit, and the great resources boom is starting to wind down. Internationally, recovery from the Global Financial Crisis (GFC) has been slow, frustrating the efforts of the industrialised world to close massive budget deficits. Against this backdrop, discussion at the ninth Economic and Social Outlook Conference centred on the reform options for returning the Australian economy to economic growth.

**Opening**

The conference was jointly opened by the University of Melbourne Vice-Chancellor, Glyn Davis, and Paul Kelly, Editor-at-Large for *The Australian*. Kelly began by noting that *The Australian* newspaper is proud of its long relationship with the Melbourne Institute and the University of Melbourne. He said that policy reform is more vital now than ever, arguing that there is a need to rekindle public support for reform. Unfortunately, the public has never been more disengaged.

Davis congratulated *The Australian* newspaper on its 50th anniversary, praising it for consistently writing about higher education and Indigenous disadvantage. He argued that it is very important that each side of an issue needs to be heard and debated, noting that the 2014 Outlook Conference provided an important opportunity for that to happen.

**Facing the headwinds**

Warwick McKibbin argued that the environment is uncertain and policy has to be flexible enough to respond. Short-term uncertainty is created by the end of quantitative easing in the US and structural adjustments in China. Interest rates are likely to rise and expectations need to be managed. Medium-term challenges are fiscal sustainability, with high debt-to-GDP ratios in developed countries. As to the longer-term challenge of demographic change, what matters is demographic change relative to everyone else. While the floating Australian dollar has worked brilliantly in previous crises, doing what it was supposed to do, this time it is not falling. We need to lower input costs and increase productivity, and take the high Australian dollar as a given.

Chris Richardson noted that during the last decade, Australia not only had a boom because of increased demand (and prices) for minerals, but also because of mining construction gearing up for the increased mineral production. The headwind for the next five to 10 years is the deterioration in the terms of trade for minerals, despite Australia having a competitive advantage in some industries: agribusiness, gas, tourism, (international) education and wealth management. Unfortunately, the temporary gains from the boom have coincided with permanent increases in expenditures, which have resulted in a budget that is not necessarily in crisis but needs much more repair than many realise.
Deborah Cobb-Clark said that in seeking to bring the budget back into line, we also need to maintain the social contract in the face of economic reform by improving labour market access and outcomes for disadvantaged groups. Labour market barriers for youth, such as high penalty rates, need to be reduced. Greater opportunities for apprenticeships, dedicated school-to-work programs, and work-experience programs are needed too – but need to be rigorously evaluated to ensure they provide a good use of taxpayers’ money. Moreover, an increasing proportion of the labour force suffers from poor mental health. We require much closer cooperation between mental health and employment services, making sure that work pays. Finally, through the reform process, we need to bear in mind that as we roll back the social safety net many disadvantaged individuals will not be in a position to rely on family support if they cannot find suitable employment.

**Sustainable budgeting: tailoring what we want to what we’ll pay for**

Shadow Treasurer, Chris Bowen MP, said that growth and social inclusion are mutually reinforcing, and the current budget does not satisfy the tests of fairness and equity. The budget is unsustainable because many proposed measures, such as the new Paid-Parental Leave and Direct Action schemes, are expensive. Other measures, such as the co-payment for GP visits, will save money in the short run but will be costly in the future. The next budget proposed by the Labor Party will be realistic and non-divisive, and foster entrepreneurship.

John Daley highlighted that correcting for the tailwind from the mining boom, there has been a structural deficit for seven years caused by tax cuts in 2007, a shrinking tax base due to the GFC, and increased spending on infrastructure and health services. Any improvements in the cash balance of the current budget are largely due to ‘bracket creep’, which is not a solution in the long run. Sustainable budgeting should save money while avoiding negative collateral impacts.

Peter Boxall urged governments to run small surpluses of about one per cent of GDP, and proposed that government spending of 24 per cent of GDP is a good target. For specific budget measures, he proposed continuously increasing the pension age as life expectancy increases, slowing the growth of pension rates, and excluding high-income earners from Medicare coverage (who should take out private health insurance instead). There should be some transfer of income-taxing power from the Commonwealth to the states to tackle vertical fiscal-imbalance.

**Lunch address (day one): the budget challenge**

The Treasurer, Joe Hockey MP, noted that 50 years ago the government had an enormous influence on the economy and people took prosperity for granted. Australia now stands at the dawn of another grand age of prosperity, but we must accept the changing and reduced role of government in producing a deregulated and more competitive economy. He then gave an overview of the government’s initiatives in this direction, covering welfare, tax and health reforms as well as infrastructure policies.

**How to get early childhood education right**

The Assistant Minister for Education, Sussan Ley MP, welcomed early childhood education and child care as a discussion topic in a mainstream economics conference. While also an issue for social policy, the topic had implications for individual productivity, both in terms of the current workforce participation of parents, as well as the future productive capacity of children themselves. The government has commissioned a Productivity Commission inquiry into child care and early childhood education, and awaits its recommendations before attempting any major reforms in this area. However, any future reforms would need to support parental choice, workforce participation and child development. Some issues associated with the National Quality Framework, such as supervisor licensing, were being addressed in the interim by Commonwealth and state ministers, given their costs for providers with little associated benefits.

Julia Davison also welcomed the inclusion of early childhood care and development in the economic
The deteriorating performance on PISA tests by Australian students relative to some top-tier countries was linked to poorer early learning arrangements. Australia needs to start learning earlier, support the development of vulnerable children with additional resources, and make early learning affordable, especially for low-income families.

Stephen Zubrick presented research that indicated gaps associated with disadvantage opened up early in children’s lives and persisted over time. He identified the elements of the ‘toolkit’ people need to lead successful lives and the ways in which education might contribute to their development, even where the attributes were not measured well within education. Additional resources were required to help schools develop these important attributes, but these resources needed to be committed in ways that mean we learn something (via experimentation) about the impacts of particular interventions.

**Can the Commonwealth drive infrastructure?**

Malcolm Turnbull MP argued forcefully that the private sector is in a better position than the public sector to mitigate and price the risks associated with infrastructure investments. The public sector was often conflicted in both owning assets and attempting to regulate appropriate rates of return on those assets. However, privatisation is often politically unpopular because of perceived higher prices. Time-consistent policies were important with infrastructure because of the large-scale and often irreversible nature of these investments.

Paul Broad emphasised the importance of using prices to manage infrastructure use, citing traffic congestion – both rail and car – across Sydney Harbour Bridge as a major bottleneck in Sydney’s traffic that could be managed by using prices to smooth demand over a longer period. Such policies may mean that other large rail infrastructure investments were not required. However, there is still wide-scale objection to using prices to manage infrastructure usage.

Finally, Henry Ergas explained the rising costs of building road infrastructure by reference to competition for construction resources, the difficulty of developing infrastructure in increasingly populated areas, the costs of environmental/workplace regulation, the increased use of detailed input-driven specifications, and an increase in large-
scale (mega) projects. There has been some variation in construction costs across the Australian states, but this has largely been because some states (for example, Western Australia) did not engage in mega projects. One area for improvement in the future is better coordination between long-term transport and land-use planning.

Trade and investment: how to build regional relationships

Senator Penny Wong, Shadow Minister for Trade and Investment, noted that trade liberalisation has been one of the most important reforms of the modern era. The global economy’s centre of gravity is shifting to our region. For Australia to realise the potential gains (growth, living standards and employment), we need progressive economic reforms such as trade agreements which open markets, increase cross-border investment and foster deeper international integration. The largest benefits will come from freeing up trade multilaterally, through WTO agreements like Doha, although progress to date has been disappointing. Bilateral and regional trade agreements are second-best options so they need to be as ambitious as possible – in the scope of goods and services and in reducing deep trade barriers, especially with China. Further, ‘mega-regional’ trade agreements that are properly designed, such as the Trans-Pacific Partnership (TPP) and the Regional Comprehensive Economic Partnership (RCEP), are in everyone’s best interests.

Kerry Brown highlighted the intimate links between China’s and Australia’s economies, noting that we either sink or swim together. The current trade/economic relationship is unsustainable due to China’s growth model and Australia’s reliance on resource exports. A key objective for China is the development of its domestic market which holds great potential for Australian growth, but which will involve strong competition. Australia can no longer rely on ‘luck’ and physical assets; instead we must focus on developing and exporting services to China and thinking very hard about tactical entrances to the Chinese markets.

Finally, Andrew Michelmore offered the perspective of someone closely engaged in building relationships with China. He highlighted three key stages in relationship development:

- Establishing a trade/investment relationship with China, which Australia and many businesses have already done;
- Deepening those relationships through time and understanding cultural differences; and
- Getting value from synergies.

With the real value lying in the third stage – which very few Australian businesses have reached – Australia needs to get back to the reform agenda and show Asia that Australia is ahead of the competition. Meanwhile, businesses need to seek out partners and develop relationships over time.

End of the age of entitlement

Kevin Andrews MP, Minister for Social Services, argued that work is a social good and the foundation for an expression of human dignity. National policy should focus on finding work for everyone who wants to work. The resources sector’s shift from construction to production, large Commonwealth deficits and debts, and the ageing of the population are challenges that Australia currently faces. Welfare reform should be aimed at enabling all people to contribute to economic life according to their abilities. Quoting British banker Stephen King, he said that ‘consuming tomorrow’s income today’ would jeopardise Australia’s ability to provide for the vulnerable and needy. Long-term recipients of welfare have higher risks of poor health, lower self-esteem and social isolation, and are more likely to stay on welfare. A welfare system with adequate payments to encourage people to work where it is reasonable to do so is required.

Jenny Macklin MP, Shadow Minister for Families and Payments and Disability Reform, argued that investing in the Australian people – including in the safety net – is the key to economic prosperity. Poverty, inequality and social exclusion are not just bad for the individual but also for the economy. She criticised the current proposed budget and said that the Treasurer’s talk about the ‘end of the age of entitlement’ short-sells Australia’s potential by downgrading its human capital investment.
The government’s proposal to prevent those aged under 30 years who are unemployed and not in education from receiving any unemployment benefits for at least six months would push these young people into extreme poverty, not build their skills or make them ready for work. In Europe, austerity had caused lower wages and skills, rising unemployment and inequality, and social fragmentation.

Mr Andrews responded that a reform of minimum wages would be difficult and would need public support. Ms Macklin replied that cutting minimum wages would not put young people back into work. Both speakers favoured income management, which especially helps Aboriginal communities, and agreed that mutual obligation (of the government and the individual) is important.

**Dinner address: seizing the opportunity**

Prime Minister Tony Abbott MP began his address by asking whether a reforming prime minister can succeed any more in this country given the decisive shift in the system and culture against reform. His answer was a resounding ‘yes’. He emphasised the successful reforms the government has implemented since the election, such as stopping the boats, repealing the carbon tax, creating an infrastructure boom unmatched in the last century, and getting the budget back under control.

Although Australia has had strong economic growth over the past 23 years, growth is not a given; it is earned by the continual decision to stay competitive. The past six years have been lost years of economic drift; and the new government has inherited a debt and deficit disaster, as well as an unsustainable budget with undeliverable spending promises. Australia needs long-term structural reform to face these challenges and stay competitive which is why the current budget shifts spending from short-term consumption to long-term investment. This $50 billion investment addresses the end of the resources-boom investment, improves long-term competitiveness and productivity, and builds confidence in Australia’s future. He stressed that the global infrastructure gap, the difference between needs and spending, is growing and that financing infrastructure projects must come not only from the government but from the private sector and foreign investment. The Prime Minister concluded by saying that this government has embarked on a great and necessary task, and as a government and a nation, we will not fail.

**Changing climate on climate change**

Regarding climate change, the panel described current international efforts and compared different mechanisms used globally to reduce emissions, agreeing that Australia should commit and actively contribute to the global effort. However, there was disagreement about the optimal mechanism Australia should adopt.

Greg Hunt MP, Minister for the Environment, described how internationally there are three approaches to reduce emissions: one regulatory and two market-based approaches, being production tax and incentives for abatement. He foreshadowed that the Australian government would repeal the carbon tax, which is one form of production tax, and move to the Emissions Reduction Fund (ERF) scheme, which provides incentives to reduce emissions on a competitive basis. The government believes the ERF scheme will achieve the maximum emissions reduction in the shortest possible time.

Ross Garnaut argued that Australia should do more than marginally reduce emissions. Carbon pricing is a relatively efficient indirect tax and therefore a good solution for the government when facing revenue problems. He suggested retaining the infrastructure of the Emissions Trading Scheme (ETS) in order to move straight to ETS when we are ready for flexible prices; and removing the Clean Development Mechanism (CDM) credit limit, then restoring it when other countries are making an effort comparable to that of Australia.

Matthew Warren said that one common challenge in the substantial transformation of the energy sector in recent years is the constant trade-off between sustainability, reliability and affordability.
Four challenges in making future climate policy were how to:

– Use tariff reform to support the network with a diminishing number of consumers on the network;
– Design a market structure to correctly signal investment and exit in the electricity market;
– Ensure overall sustainable falling emissions; and
– Frame policy to reflect that the growth of energy and GDP are no longer linked in the future.

The productive workplace

The overwhelming consensus of the panel was that new changes to industrial relations law would not generate many productivity gains for Australia. Peter Gahan argued that although good institutions were necessary for workplace productivity, governments cannot regulate for a high-performance workplace culture. Australia needs workplace policies that support profit-sharing, gain-sharing and share-ownership schemes. He also extolled the virtues of flexible employment and labour-market transitions, active labour-market policies and income security during periods of transition. Three areas for improvement in Australia were:

– Improved workforce capabilities through modern employee job skills and business literacy;
– Cultivation of capable management and strategic business leadership with attention to innovation; and
– Regulatory reform that appropriately balanced the trade-off between flexibility and security.

Judith Sloan argued that although multi-factor productivity has fallen we are not in an era in which low productivity is the new norm. Gains from human-capital investment have been marginal. Australia should instead focus on being cost-competitive because labour productivity on its own is not a useful measure. More research was needed into cost competitiveness in Australia. Future enterprise agreements are unlikely to generate productivity gains and the future role of the government should be to ‘get out of the way’.
Tim Lyons argued that, were history any guide, additional changes to industrial relations law would not change the path of productivity growth in Australia. He addressed myths about the Fair Work Act by using statistics collected from various sources. He outlined an approach to Australian industrial relations that emphasised (i) a rights purpose to correct for the disproportionate bargaining power held by employers; and (ii) a mechanism to improve the distribution of economic outcomes delivered to the poor and middle class.

**Putting incentive back into federation**

Stephen Duckett believes that the reason we have a federalism debate about health service delivery is that the two models (Commonwealth unitary and federation) have strengths and weaknesses. The constitution is also unclear about which level of government is responsible for hospitals. He highlighted the current issues: a significant vertical fiscal imbalance; Commonwealth and state policies concentrating on the health services they themselves fund; the overlapping roles leading to cost and blame-shifting; poor coordination of program design leading to program discontinuities; and reciprocal interdependence. He outlined three reform options: privatisation (to create a social insurance model); clarification and division of responsibilities; and coordination. However, he was pessimistic about these reform options being applied.

Vince FitzGerald believed that vertical fiscal imbalance led to centralisation of power in Canberra. However, micro-management resulted in tensions between the levels of government, bloating of bureaucracies, and a lack of incentives to pursue efficiency and blurred accountability. The main lessons from past successes are that (i) the states must be treated as sovereign with clearly defined areas of jurisdiction; and (ii) we need a commitment to national evidence-based policy, good leadership, demonstrations of trust, and open communication about the sharing of resources. The Commonwealth should provide leadership on policy directions, minimum national standards and achieving national consistency, as well as provide funding; while states should tailor services to local needs, coordinate delivery and play a major role in policy and delivery innovation.

Focusing on education, Richard Bolt said that the problem is not the lack of incentives but the lack of coherence between state and Commonwealth policies and programs. Success comes through strategic collaboration; failure comes through disjointed and competing policies and programs. The federation has produced two competing school-funding streams which are not harmonised: the states fund government schools and the Commonwealth funds non-government schools. Increased school funding is necessary but not sufficient: schools should use their core funding to achieve better learning. But unilateral federal grant programs undermine this goal. States should continue to fund school and vocational education; and the Commonwealth should continue to fund early childhood and higher education. But planned collaboration is necessary for the whole education system to work well, with the Commonwealth taking a less directive role.

**Wrong tax system for the digital age**

Rob Heferen focused on the implications of globalisation and digitisation for the Australian tax system. The increased importance of trade in intangibles renders the localisation of profits, and hence its taxation, ever more difficult. The effectiveness, and hence the perceived fairness of the tax system, has important implications in terms of compliance.

To Chris Evans, the architecture of the Australian tax system is outdated. The current tax mix, with its high reliance on personal and corporate income tax, has to change. The most desirable reform path requires multilateral action to treat multinational corporations as single entities and tax them accordingly. But this shift in paradigm is made difficult by inertia, multinational corporations’ power and the ambivalence of governments.

Alf Capito also noted the over-reliance on corporate and personal income tax. The problem is the size of government and we should try to limit government excesses. There is healthy competition among tax jurisdictions and there will always be competition. Overall, the problem does not lie with the Australian tax system; the problem is the
global system. In particular, base erosion and profit-shifting is a deliberate policy in the US.

**Lunch address (day two): the Labor alternative**

Bill Shorten MP, the Leader of the Opposition, detailed his party’s commitment to informed debate and reform across a range of critical areas such as education, health, labour, retirement and superannuation. He emphasised the importance of common sense, egalitarianism, and open dialogue in policy-setting, and noted Labor’s introduction of significant historical reforms relating to income tax, Medicare and universal superannuation.

He criticised the government’s proposed budget, particularly in terms of fairness and social inclusion. The Paid Parental Leave scheme was extravagant; while proposed restrictions on access to Newstart Allowances and the Disability Support Pensions, and the introduction of the co-payment for medical services, would negatively impact on people in need of assistance.

**Financing the future**

Luci Ellis argued that the Basel III regulatory framework is more protective and allows financial risks to be measured more properly compared to the pre-crisis regulatory framework. The Basel III regulations will not hinder the Australian economy as the rules can be tailored to meet country-specific nuances. The new regulatory framework will not distort or change the relativities of the funding of households to businesses.

Carsten Murawski wanted to ensure that individuals have adequate savings to fund their retirements. Australians are not saving enough for their retirements and many lack the financial understanding to do so. In order to solve this problem, the focus needs to shift from institutions to individuals. More research is needed to understand individuals’ saving behaviour, using test programs aimed at improving financial literacy to produce evidence-based policy.

Barry Sterland saw the two big agendas for the G20 as growth and resilience in the global economy. Growth will need to be driven by structural reform – that is, trade, labour market and fiscal policy rather than just monetary policy. In addition, the new regulatory framework will aim to underpin activity in the real economy and ensure the financial system is able to support investment and real growth.

**Bringing the outsiders in**

Chairing this session, Tony Nicholson noted that as well as 700,000 officially unemployed there is an equal number of underemployed. It does not make economic sense for so many people to be excluded. Warren Mundine expressed disappointment at the negative response to the proposition of moving people from welfare to employment and stated that accusations of unfairness targeting welfare recipients were misguided and partisan. If the word ‘welfare’ was replaced by ‘poverty’ there would be a very different response. The enduring poverty of some Indigenous and non-Indigenous communities can be attributed to a reliance on welfare payments. His personal history was of coming from a large, poor family where work provided dignity, a sense of purpose and a stronger sense of community, as well as financial security. Policies should aim at getting people off welfare to participate in the real economy and avoid marginalisation. The most effective means of escaping poverty is work, not more and more training courses or making welfare participants continually apply for jobs.

Patrick McClure believes that Australia’s welfare system is overly complex and is not financially sustainable. The four pillars of welfare reform were:

- Creating a simpler and more sustainable system;
- Strengthening individual and family support;
- Engaging with employers; and
- Building community capacity.

He proposed a simple architecture of four payment types: tiered payments with rates differing according to circumstances; disability support for those with no capacity to work; child payments that bring together Family Tax Benefits, Youth Allowances, Abstudy and other payments; and the aged pension.

Cassandra Goldie emphasised that welfare reform should focus on real rather than imagined problems,
saying that the debates have become overly politicised. Reforms encouraging the transition to work are futile if there are no jobs available. The success of income management policies was not due to income management per se but to individual case management. She advocated greater access to existing data, collaborative leadership and a decent social security system.

Sources of comparative advantage

Brian Fisher gave an overview of the terms of trade boom and its macroeconomic consequences. Many Australian mines (for example, iron ore) have relatively low costs and may remain profitable as prices decline due to increased supply. Australia’s lack of value-adding in resources was not problematic as margins tend to be greatest in mineral extraction. Further microeconomic reform to enhance productivity and labour market flexibility is needed as expanding capacity in Australia is relatively expensive.

Mick Keogh emphasised that Australia’s comparative advantage in agriculture lay in low-rainfall farming. The growth in demand from the Asian middle class was an opportunity for some Australian producers, such as of meat and wool, given their cost competitiveness and reputation for quality. Many food processors had closed, partly due to the high concentration in Australia’s retail markets. Greater investment in agricultural research and development and in regional infrastructure will be needed.

Martin Ferguson focused on the liquefied natural gas industry. He highlighted the imminent rapid increase in exports and discussed what was needed to encourage further investment, given likely continued strong demand from Asia. Several new competitors have lower costs and hence both industry and policy-makers need to focus on increasing the sector’s competitiveness. Possible measures include industrial relations reform, reducing green and red tape, allowing market signals to operate and having a culture of innovation.

The political economy of achieving reform

This panel, chaired by Paul Kelly, discussed the impact of political institutions on Australia’s ability to deliver the policies that are needed. Putting good policies in place is much more difficult than it used to be. What aspects of the political process contribute to this situation and what changes in the political process do we need to solve this?

Terry Moran argued that Australia went through a very successful reform process in the 1980s because good policy proposals were brought forward and discussed in-depth by the community, and as a result found powerful advocates as well as bipartisan support. They were implemented carefully. Trusted leaders were able to explain the policies to the public. Measures to strengthen accountability, a focus of government departments on policy rather than administration, and a greater involvement of external experts are needed to achieve those reforms again.

Senator Nick Xenophon examined the challenges of making policy with the incoming Senate, in which neither major party has a majority. He foreshadowed that this will lead to a gridlock and possibly a double-dissolution. The government has alienated broad parts of the population with some of its policy proposals, and will thus continue to struggle. But as a struggle with a hostile upper house will force the government to readjust its policies, a difficult situation in the Senate might eventually save a government from itself.

Michael Woods stressed that problems need to be articulated clearly before the public can accept policy solutions. It was important to involve the community in the process of policy formation to ensure that a policy is understood to be fair and beneficial to the community as a whole. The discussion between the stakeholders also allows politicians to assess the true benefits and costs of a policy for different groups. Vested interest groups and ideologues often get in the way of establishing a transparent process that involves the whole community.

The authors are all members of the Melbourne Institute.