

## Chapter 3: Preparing for the future

Projections in this report illustrate that Australia can continue to build prosperity and improve living standards over the next 40 years.

Real growth in GDP is projected to average 2.8 per cent a year going forward, compared to an average of 3.1 per cent a year over the past 40 years.

To achieve this growth, continued steps will be needed to boost productivity and encourage higher workforce participation. Further, the budget must be stabilised and debt levels reduced to ensure governments are well placed to respond to any future economic shocks.

### 3.1. Building jobs, growth and opportunity

The Government is responding to the twin challenges of the ageing population, and the changing international and domestic economic environment. A number of important structural reform processes have been initiated. These will help to achieve more efficient funding and delivery of government services, and contribute to the objectives of improving productivity and participation, as well as constraining expenditure growth.

#### 3.1.1. Review of the tax system

To enhance both productivity and participation, Australia will need a better tax system to deliver taxes that are lower, simpler and fairer.

While Australia collects taxes from a number of sources, taxes levied on personal and corporate income remain major sources of taxation revenue. This is despite the introduction of the GST and reductions in corporate and personal tax rates in recent decades.

Under current policy settings, Australia's reliance on income taxes will continue to increase. Bracket creep, for example, means that wage and salary earners will pay higher effective rates of tax on that income as their incomes grow over time. Studies, both in Australia and internationally, have also suggested that Australia's high reliance on company income tax imposes costs on the economy.

The rise of the digital economy, multinational corporations operating across international borders using global supply chains, and increasing mobility of capital are overwhelmingly positive economic developments. However, these developments are

posing substantial challenges for the tax system. Other countries are responding to these challenges by reducing company tax rates.

A well-structured tax system can assist in making Australia a more attractive place to invest, which will boost economic growth and create new jobs. The Government will undertake a review of the tax system to provide a longer-term considered approach to tax reform. The review will consider the competitiveness of Australia's tax system, consistent with the Government's aim for a better tax system that delivers taxes that are lower, simpler and fairer.

### **3.1.2. Reform of government service delivery**

To ensure government expenditure is sustainable and better targeted, particularly as we face major demographic change, governments need to focus their efforts on achieving the efficient provision of services. Important developments in this regard are the examination of the roles and responsibilities of the Australian Government and state governments, and moves to make better use of technology to improve the efficiency and responsiveness of government service delivery.

#### **Roles of the Commonwealth, and State and Territory Governments**

Over time, the Commonwealth Government has for various reasons become increasingly involved in matters that have traditionally been the responsibility of the States and Territories.

Rather than seeking ever greater centralisation of power in the national government as a way of dealing with increasing complexity, the Government is undertaking a review of the current arrangements, seeking to strengthen the way our federal system works by being clear about which level of government is responsible for what.

To this end, the Government is working with the States and Territories to produce a White Paper on the Reform of the Federation. Through the White Paper, the Government is seeking to clarify roles and responsibilities between levels of government to ensure that, as far as possible, the States and Territories are sovereign in their own sphere.

The objective is to reduce and end, as far as possible, the waste, duplication and second guessing between different levels of government. It is also an opportunity to address the lack of accountability between the levels of government.

Through the White Paper, the Government is seeking to:

- achieve a more efficient and effective federation and, in so doing, improve national productivity;

- make interacting with government simpler;
- ensure our federal system is better understood and valued by Australians (and the case for reform supported);
- deliver a clearer allocation of roles and responsibilities;
- enhance governments' autonomy, flexibility and political accountability; and
- support Australia's economic growth and international competitiveness.

Consideration will need to be given to where governments are best placed to provide services and where there should be greater space for private providers. As many government entities do not directly face the discipline of a competitive market, they are generally less efficient, so reducing or eliminating activity that can be better performed by the private sector can also increase productivity.

### **Better use of technology**

Importantly, governments will need to learn lessons from the private sector — which has harnessed new technology to achieve efficiencies in service delivery.

The establishment of a Digital Transformation Office (DTO) as an executive agency in the Communications portfolio is an important step in this direction. The DTO will focus on end-user needs in developing digital services, so that government services can be delivered digitally from start to finish and better serve the needs of citizens and businesses.

The establishment of the DTO is recognition that, like any other service provider, government should design its services in the most user-friendly way.

By designing digital services that are consistent and easy to use, fewer people will need to visit government shop-fronts or make phone calls. This will deliver efficiencies in operating costs, while making government services simpler, clearer and faster for Australian families and businesses.

Government policy development is heavily reliant on available data. There is huge potential to modernise and better manage Australia's national data infrastructure, with appropriate data sharing and access arrangements that take advantage of new technologies, and make the best use of existing data and scarce resources. Improved data quality and the ability to respond more quickly to emerging trends and issues will better inform policies for the benefit of all Australians.

## 3.2. Harnessing further gains in productivity and participation

### 3.2.1. Productivity

Australia's future productivity performance will be influenced by technological developments, both domestically and abroad, which create new possibilities for production. As a net importer of technology, the pace of global innovation and Australia's ability to absorb technological advances from abroad and convert them into new business opportunities will be particularly important.

There is evidence to suggest that the pace of technological development globally has slowed. Many developed countries have experienced a slowdown in productivity growth over the past decade or so. Furthermore, some commentators suggest that future technological advances may not yield the productivity improvements seen in the past. If this were the case, developed countries may see a slowdown in income growth. In contrast, other commentators have noted that there may be significant growth potential from technological developments which are yet to be seen.<sup>11</sup>

It is not clear how much or how quickly future technological advancement will drive improvements in living standards globally. Despite this uncertainty, closer trade and broader relationships with emerging economies may provide Australia with greater scope for productivity growth, as these emerging economies represent new sources of global economic growth and innovation.

As previously noted, history also suggests that policy settings can have significant implications for growth in productivity and living standards. As a result of competition reforms in the 1980s and 1990s, for example, it has been estimated that productivity and price changes (in key infrastructure sectors such as energy and water) increased GDP by 2.5 per cent above what it would otherwise have been over the 1990s.<sup>12</sup> Continuing to encourage entrepreneurship and innovation, enhancing resource allocation, investing in and using infrastructure efficiently, facilitating trade with other countries and improving physical and human capital investment will all be critical to Australia's future productivity performance.

Efficient provision of infrastructure, including public infrastructure, is a hallmark of a well-functioning economy. Currently, deficiencies in certain aspects and usage of Australia's infrastructure — including roads, rail and ports — limit business expansion and growth and undermine productivity growth and living standards.

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11 For further discussion of these issues, please see Budget Paper No. 1: *Budget Strategy and Outlook 2014-15*, Statement 4: Sustaining strong growth in living standards.

12 Productivity Commission, 2005, *Review of National Competition Policy Reforms, Inquiry Report No. 33*, Canberra.

Effective transportation networks bring consumers closer to more businesses, and they bring workers in contact with more opportunities. They promote competition, greater specialisation by both firms and workers, and promote innovation and a more dynamic economy. Poor transportation can impede the competitiveness of businesses and reduce their ability to provide services efficiently to their customers and hurt our national productivity.

Investment in new infrastructure and making better use of Australia's existing infrastructure assets is important to generating economic activity in the near term as the economy transitions from resources-investment-led growth.

### **Box 3.1: The changing Australian business environment**

The way consumers and businesses interact is changing. This is driven by globalisation, the growth and proliferation of online services and disruptive technologies.

Over the past two decades, the continuing economic re-emergence of Asia has led to a shift in the world's economic activity. It is projected that by 2030, there could be around 3.2 billion middle class people in the Asia Pacific region.<sup>13</sup> Asia's continued rise will bring great economic opportunities closer to Australia's doorstep. Australia needs to be in a position to take full advantage of these opportunities.

Open markets give Australians access to overseas goods, finance and new business opportunities, and mean that domestic firms need to be more dynamic and competitive in order to prosper. Comprehensive free trade agreements, such as those concluded recently with Japan, South Korea and China, are important contributors to trade and investment liberalisation, helping Australian businesses compete on the global stage. The Government is also negotiating other free trade agreements, including negotiations with India and the Gulf States.

Mobile devices, social networking, cloud computing and other technologies are profoundly transforming the relationships between businesses and their customers. In this digital economy, consumers are becoming more powerful, and companies find themselves with new avenues for building competitive advantage.

As the Australian economy continues to move beyond the investment peak of the resources boom, it will be important that individuals and businesses in all sectors of the economy continue to innovate and adopt new technologies to work smarter and, by doing so, deliver higher quality, greater value or more output from a given set of inputs.

### **3.2.2. Supporting Australian businesses to thrive**

There are a range of other measures that governments can pursue to support productivity growth. These measures will help position Australian businesses to be flexible, competitive and robust in the face of dynamic global conditions.

The most recent review of competition policy in Australia, the Hilmer Review, was undertaken in 1993. The Productivity Commission has estimated the competition-enhancing reforms that followed the Hilmer Review delivered substantial

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13 Homi Kharas and Geoffrey Gertz, 'The New Global Middle Class: A Cross-Over from West to East', in Cheng Li (editor), *China's emerging middle class: beyond economic transformation*, Washington, DC: Brookings Institution Press, 2010, p 37.

benefits to the Australian economy during the following decade, with reforms in key infrastructure sectors leading to a 2.5 per cent increase in GDP.

In the 2000s, it was the surge in our terms of trade and the mining investment boom, rather than sustained microeconomic reforms, that underpinned growth in our living standards. In order to boost productivity and to recognise the considerable change in the business and global environment since 1993, the Government commissioned an independent review of competition policy in 2013. The Competition Policy Review released its Draft Report in September 2014, with draft recommendations to reform competition policy to position business to meet the challenges and opportunities of the global marketplace, digital disruption and the ageing population. Following consultation on the draft recommendations, the Final Report is due to be delivered to Government in March 2015.

At present, the Government is also working towards reducing the complexity and compliance burden of doing business in Australia by continuing its focus on red tape and green tape reduction. Since 2013, the Government has announced more than \$2.1 billion in net red and green tape savings for individuals, businesses and the not-for-profit sector. This is more than double the Government's commitment to remove \$1 billion in red and green tape from the economy each year, and includes the removal of around 10,000 pieces of redundant legislation.

It is important to continue to energise enterprise and to make it easier for business to start up in new and emerging markets. A review is underway by the Productivity Commission on the barriers to entry and exit for business.

Workplace regulation has been progressively and substantially reformed in recent decades. Many of the fundamental reforms were undertaken in the 1980s and 1990s, in particular the shift from centralised wage-fixing to enterprise bargaining. These reforms have delivered substantial benefits, for example a more flexible labour market that is better placed to adjust to macroeconomic shocks, such as economic downturns.

The Government has asked the Productivity Commission to undertake an inquiry into Australia's workplace relations framework.

Reforms to Australia's financial system in the 1980s and 1990s underpinned Australia's economic stability and growth over the past 25 years. These reforms are amongst the main reasons that Australia weathered the global financial crisis well in comparison to international peers. Additionally, deregulation of the financial sector has meant the volume and quality of financial services in Australia has dramatically improved.

To sustain high performance in the financial system, the Government commissioned in 2013 an independent inquiry into the performance of Australia's financial system. The Murray Inquiry was tasked with examining how the financial system can be positioned to meet Australia's evolving needs and support Australia's economic growth.

The Murray Inquiry found that, overall, the Australian financial system had performed well over the past two decades and has many strong characteristics. Nevertheless, it found room for improvement and made 44 recommendations designed to foster an efficient, competitive and flexible financial system that is capable of meeting future challenges. The Government is currently considering its response to the report.

### **3.2.3. Encouraging higher participation**

Continued efforts to encourage higher participation across the community would have widespread benefits for Australia's economy and society.

In general, Australians are living longer and healthier lives than in years past, and are more active in their older years. Over the next 40 years, Australia will need to embrace the potential of this talented older population group, particularly by valuing their increased and ongoing engagement in the workplace and community. The Government has introduced the Restart Programme, which provides a clear and long-term financial incentive for employers to employ and retain older Australians.

The Government will also continue to support prospective parents and parents (particularly women) in the workplace through accessible, flexible and affordable child care and early learning. The Productivity Commission's report on Childcare and Early Childhood Learning notes that although Australian Government funding for childcare facilities, services and fee assistance rebates has escalated to around \$7 billion a year, many parents report difficulties in finding early childhood education and care at a location, price, quality and hours they want. By addressing barriers such as the availability of appropriate child care, governments can support increased workplace participation. The Government is committed to child care becoming more flexible and accessible for Australian families. The Government is carefully and methodically considering the Productivity Commission's recent report on Childcare and Early Childhood Learning and will shortly announce its response as part of a comprehensive families' package.

Higher workforce participation can reduce the fiscal pressures associated with providing welfare support and serve social inclusion and equity goals. The Government believes that assistance to the unemployed should help them move into employment rather than encouraging them to remain on welfare. A number of programs are being introduced, including a new employment services system and a reinvigorated Work for the Dole, to meet the needs of job seekers, employers and service providers. Programs such as the Job Commitment Bonus and Relocation Assistance to Take Up a Job have also been introduced to assist young, long-term unemployed jobseekers to move off welfare and into paid work.

As discussed in previous chapters, attracting skilled migrants can provide both economic and social benefits to Australia. In an increasingly competitive global labour market, skilled migration that is well targeted and appropriately adjusted to our

economic circumstances will support Australian employers and businesses, and provide benefits through a younger and more skilled population in which there are more workers supporting the rest of the community.

### **3.3. Continuing budget repair**

The fiscal projections in this report show that significant progress has been made to repair the budget, but this task is incomplete. Without the Government's proposed policies, or alternative measures with an equivalent fiscal impact, the budget will not return to surplus at any point over the next 40 years and net debt would rise to 57.2 per cent of GDP by 2054-55, or \$2,609 billion in today's dollars.

As explained in Part 1, the projections in this report are sensitive to the underlying assumptions, and reflect just one possible outcome based on a set of well-informed assumptions.

The economic growth projections also need to be understood as an average growth projection through to 2054-55, and not as a forecast of uninterrupted growth. In reality, it is almost certain that any economy will experience business cycles or external shocks over a 40 year time horizon.

The uncertainty around projections highlights the importance of placing the budget in the strongest possible position to meet whatever challenges the future may bring. To prepare for the future, taking early action to address budget challenges is imperative to avoid the need for a sharper adjustment in the future and to afford quality government services in the years to come.

The 2015 Intergenerational Report shows that we can have a positive and more prosperous future if we plan for tomorrow, today.

