Grattan Institute's report *Game-changers: economic reform priorities for Australia*

If Australian governments are serious about raising rates of economic growth, they must reform the tax mix and increase the workforce participation rates of women and older people. There's nothing else big enough to change the game over the next decade. Each of these reforms can increase economic growth substantially, and they should be the core economic reform priorities for Australian governments.

Editor-at-Large on *The Australian*, Paul Kelly, joined the report's author, Grattan's CEO, John Daley, in a discussion about the report and the importance of prioritising reform.

Speakers: **John Daley, CEO, Grattan Institute**
Paul Kelly, Editor-at-Large, *The Australian*

AUDIO: This is a podcast from Grattan Institute.

JOHN DALEY: I am Chief Executive of Grattan Institute and it's my very great pleasure to welcome you all here this evening. I'd like to begin with a couple of thank yous, particularly to the National Australia Bank whose premises we are in. As one of Grattan's affiliate partners, the National Australia Bank contributions help to make possible the work that we do.

This evening's proceedings are being recorded by ABC's Big Ideas for later broadcast, and they're also being recorded by Grattan Institute so this event will be available from our website both in video- and transcript form.

I would like to introduce Paul Kelly, who is one of Australia's most distinguished journalists and historians. As a journalist he won the Graham Perkin Journalist of the Year Award in 1990, Walkleys in 2001, was Editor-In-Chief of The Australian newspaper between 1991 and 1996 and is now Editor-at-Large for *The Australian* newspaper. Many of you will be familiar with his regular columns in *The Australian* which never fail, I would suggest, to both entertain, inform and cast some real insight on what is happening to our country and its policy. As an historian he's been a leading chronicler of Australia's recent political history. A series of books beginning with *The Unmasking of Gough*, and later retitled *The Dismissal*, *The Hawke Ascendency*, *The End of Certainty* about the Keating years, *Howard's Decade* and most recently *March of the Patriots*, which is a tremendous overview of how Australia's political history and its themes fit together.

As befits someone with that publication record, he's a Fellow of the Academy of Social Sciences of Australia and also has a Doctor of Letters from the University of Melbourne. So Paul, thank you for joining me.

PAUL KELLY: It's a great pleasure for me to be here at this event to talk to John about this most recent report from Grattan Institute, *Game-changers*, looking at economic priorities for Australia. In recent years Grattan Institute has emerged as one of the most important think-tanks in Australia. Its forte is evidence based work, a wide lens and a keen eye for priorities. One of the features of its work is that it does what I think universities do too rarely, and that is provide alternative policy advice to government.

This particular report is close to my own heart. It's looking at how we should conceptualise and identify what are the pressing economic priorities for the country. I think this is important given the quite turbulent period we've seen under both Kevin Rudd and Julia Gillard as Prime Minister – a degree of disintegration of the consensus for economic reform and confusion about what the policy priorities are. So I might start by asking John, in terms of this particular report, what was the central objective guiding this document?

JOHN DALEY: Thank you. The key idea was around priorities, and an insight that people who try and do too much at once by and large wind up doing very little at all. It was partly borne out of my experience when I was Head of Strategy for ANZ and I spent a lot of time talking to business unit leaders at the bank and encouraging them to do less, because it became very obvious that business unit leaders who do less wind up doing the things that are most important. And because they do the things that are most important, they make much more progress. The fundamental idea was to try and work out in a really disciplined way what we should worry about doing first.

PAUL KELLY: What were the criteria you used in terms of identifying which reforms are most necessary at the moment?

JOHN DALEY: There were two things that we looked at. First, what was the size of the reform? We looked at that in terms of the impact on gross domestic product in 2022. Then we looked at whether the reform would actually work. Why did we look at gross domestic product? The answer is GDP may not be perfect as a measure, but it's a great deal better than many other things. And it certainly correlates well with a whole series of things we care about, and it is effectively a marker of the resources available to the community that then enables us to do all the other things that we care about. We looked at 2022, because that's 10 years away. In a funny way is both a long and a short time. It's a long time in the sense there's not many governments that can count on a 10 year term. On the other hand, quite short in the sense that many of the things that really drive enormous change in a community take much longer than that to flow through. For example if you look at superannuation reforms, the size of the impact is just starting to be felt now on the Australian economy after decades of that reform being in place. So we looked at size. That's fairly straightforward in the sense of asking what's the dollar impact on GDP in 2022. One of the core criteria that we were using in terms of prioritisation was to think about that relative to the overall size of the economy. The Australian economy, according to the most recent numbers, and until the ABS revises them, is about 1.4 trillion dollars. So by definition, if your reform is not worth at least 14 billion, it's less than one per cent of the Australian economy and therefore probably not big enough to change the game.

PAUL KELLY: I think that's an important point. In other words, what you're talking about is bang for the buck: the impact on GDP and bringing a discipline to bear on that, and saying this has got to be fundamental in terms of the criteria.

JOHN DALEY: That's right, because one of the issues is that it is very easy to get caught up in reforms that sound important and that sound as though they're consistent with direction, but then you do the rough math and realise that's just not big enough to change anything. A lovely example would be parallel importation of books, which as you know consumed a huge amount

of time and energy. You actually do the math and see it's worth about four, five, six hundred million dollars a year in GDP.

PAUL KELLY: But we still made the wrong decision.

JOHN DALEY: We did, but the point is, if you're going to go through all that political pain, you might as well go through it for something that's going to make a difference.

PAUL KELLY: Sure. Can we move to your second criteria then?

JOHN DALEY: We looked at confidence, essentially as a policy community, that the reform would actually work. This was a slightly unusual criteria and it's one that we wrestled with internally before fastening on it. The insight that lay behind it was that really worthwhile reform seldom happens unless the policy community lines up and says we think that this is basically the right thing to do. If you look at the history of tariff reform, however unpopular it might have been with the general public, there were any number of economics professors and those working in public policy who said tariffs are actually a really silly idea and we should do away with them. Similarly you look at examples like the floating of the dollar. There was lots of people in the economics profession, and elsewhere in public policy, saying this is a really good idea and we should do it. Even on something like the goods and services tax, first recommended by the Asprey Review back in 1973, it took a long time but there were any number of people in the economics profession saying consumption taxes are fundamentally a better way of taxing than many of the alternatives.

PAUL KELLY: We might move on now to the substance. I wonder if you could just briefly sketch out the big three reforms that you have identified and then we can take each one in turn and elucidate each in more detail.

JOHN DALEY: The big three that we've identified are, first of all, female workforce participation: how many women in Australia work in the paid workforce. Secondly, older age workforce participation: how many people of older age participate in paid work rather than being retired. By older age, roughly speaking we mean over 55, with one of the key issues being those between 60 and 70. Finally, tax reform: the key tax reform that we focus on is reforms that would reduce levels of income tax and corporate tax, and increase levels of consumption taxes.

PAUL KELLY: Let's look at the first one that you talked about: female workforce participation. How do we rate on this test, and in particular compared to other OECD countries? I know that you've targeted Canada in particular in terms of our policy objectives. So first of all tell us how we rate and where you think we ought to be?

JOHN DALEY: We currently rate slightly better than the OECD average. It's worth remembering that that includes Greece and Italy. Therefore we normally hope that our economy does a little bit better than the OECD average. There are a large number of countries that are a long way in front of us: in the order of five, 10, percentage points of workforce participation. In the scheme of an economy, that's a big difference. By definition if your female workforce participation is 10% lower than somebody else's, your GDP is 5% smaller.

PAUL KELLY: In terms of the numbers, what's the actual gap?

JOHN DALEY: Roughly speaking the gap between us and Canada is about 10%, which is big enough to care. One of the reasons that we really focused on Canada is that it's a country very like us. You can look at Scandinavian countries and always get these complicated arguments about why they're different to us. But you look at Canada and, with the exception of Quebec, it's an English speaking country, it's a federation with a Westminster system, with a whole series of policies that look very like ours.

PAUL KELLY: If we reached Canada's level, what does that mean, in terms of your first criteria, for the add-on to GDP? How significant is this overall and over what time period are we looking at here?

JOHN DALEY: If we reached Canada's level that would imply about $25b worth of GDP. In an economy of 1.4 trillion, that is big enough to care. We think that we could obtain that in about a decade. In the report we talk about the history of Canadian reform. Canada had a period in the '90s where they were under a difficult fiscal situation. As they came out of that towards the end of the '90s there was a very conscious decision to try and improve rates of female workforce participation. Governments deliberately changed the tax and welfare mix so that women had much stronger incentives to go to work. They also consciously reduced the cost of childcare, most obviously in Quebec where they dropped the cost of childcare to $5 a day, which essentially meant that it was all but free. Quebec interestingly went from being one of the Canadian provinces with the lowest rates of female workforce participation to being one with the highest rates. We think that the levers that the Canadians used are also types that Australian governments could do as well.

PAUL KELLY: The main policy instruments presumably, as you've indicated, would be a new commitment to childcare policy and also addressing the taxation barriers.

JOHN DALEY: That's exactly right. Much of the discussion in the public debate over the last couple of years has been about what the demand side barriers to female workforce participation are. Why is it that employers are biased and why won't they hire women. Yet when you look at the evidence internationally about what drives some countries to have higher rates of female workforce participation than others, it's actually clear that really there's one game in town. That is what is the rate of take home pay for a woman who's thinking about going back to work?

It's not surprising. If you have young children there's a real opportunity cost to going back to work. The way that many women think about it is for every dollar earned, how much do I keep? In particular they think about it after tax, after foregoing a series of welfare benefits because they're now earning money, and after paying for childcare net of benefits and rebates. We were the first people in Australia who've actually drawn that picture for a couple of sample families in terms of adding in the impact of childcare costs and childcare rebates and benefits. It's a very stark picture that for a significant number of women, ironically those earning less money, so those on 40, 50, 60, 70 thousand dollars a year, facing essentially taking home very little of what they earn. If you take a family with two children in childcare, where he earns $70 thousand, and she would earn $70 thousand if she worked full time, she essentially works for about $50 for the last two days. So she's taking home 10 cents of every dollar that she earns. She hasn't paid for transport at this point. That's not wildly attractive. That's what we have identified as the key lever. There's good international evidence that that's the main driver and then when you look at where Australia is, particularly for those not earning high incomes, there are some really substantial welfare traps that we've built and need to change.

PAUL KELLY: Let's move on to the second area which is the participation of the older cohort of the workforce, where our participation rates were very bad, but we've started to improve. What's your judgement about where we are in terms of older participation in the workforce, what are your objectives over a period of time, and again what boost to GDP could we see?

JOHN DALEY: Around 55% of Australians in the 55 to 64 year olds age group are in the paid workforce. Compare that to New Zealand, again a country that's not that too different to Australia, where around 72% of people in that age group are participating in the paid workforce. That has a big impact on GDP and one of the things that we've focused on in Australia over the last couple of years is productivity. We spent relatively little time talking about participation, but it does fall to the bottom line in much the same way. Ken Henry's lovely framework looks at how basically gross domestic product is ultimately a combination: a multiplication of participation (how many people are working, times their productivity) which is how much do they produce per hour, times the population (how many people live in the country).

So we think that there's an opportunity. We modelled the impact of a couple of reforms that we could identify and where I think there's some reasonably nice work that's been done using the HILDA dataset to show what the impact of those reforms might be.

PAUL KELLY: How extensive are the reforms that you're talking about, and in particular, the policy instruments here go to pension entitlement and superannuation entitlement. There's been a little bit of modest movement in this area. I guess one of the questions is to what extent governments can be more aggressive in terms of implementing these reforms as opposed to the extreme sense of caution that they've displayed so far. But I wonder if you could just talk about these two policy instruments and what your agenda is in this area.

JOHN DALEY: Again, the starting point for this was what's going to make the biggest difference. With female workforce participation we said the biggest lever is tax welfare and childcare rates. With older people, again we looked at the evidence and asked why are most people retired? If you took a casual reading of public debate over the last two years you'd say the big obstacles to older age participation are that they can't find a job, employers are prejudiced against them, older workers are too ill or infirm to work. And yet when you actually go and look at Australian Bureau of Statistic surveys around why it is that people are retired, the answer is, although there are some who can't work physically, and although there are some who can't find a job, for the overwhelming majority the answer is because I reached retirement age. In other words, I got to the point that it was financially okay for me to retire, so I did. I think in a society where there's ever fewer blue collar jobs, where the reality is that there are a vast number of 65 year olds who are in very good physical health and mental health, it's not unreasonable to think that those people might work a little bit longer and indeed many of them already do. But in terms of the policy levers that we spoke about, the dominant factor is *I reached retirement age*. So how do you change that? Firstly, you can change the actual incentives. At the moment you qualify for the age pension aged 65, that's going up to 67 over about the next decade or so. Our suggestion is to move that to 70.

Similarly, at the moment you can access your superannuation aged 55, that's being moved to 60, and again our suggestion is that that be moved to 70. We actually think that the alignment of superannuation age and pension age is important. One of the little gems that was buried down the bottom of the Henry report, and also in other reports that have been floating around recently on older age workforces, around a third of all superannuation balances are drawn down – that's

balances, not accounts, balances, dollars in the bank and superannuation funds and so on – before people hit retirement age. There are a large number of people who are retiring, essentially living off their superannuation for a number of years, and inevitably some of them then either at age 65 or sometime later wind up drawing down the age pension. The catch from a government budgets perspective is that we've given very big tax concessions to superannuation, but a dollar of superannuation that's spent before you hit the pension age is of no use to the Commonwealth budget at all. Superannuation only helps the Commonwealth budget if people use it after they've reached the pension age. We think those two issues are the big drivers. Based on some work that was done using the HILDA dataset, we think that both of those things have a really big impact on the age at which people decide to retire.

PAUL KELLY: Let's move to the third major reform. This is tax reform. What you want to do is raise more revenue through the GST and then cut personal income and corporate taxes. Can you give us the quantums and the structure involved in this and also explain why this is such an important reform?

JOHN DALEY: As with the first two reforms, and I can assure you that this is purely a modelling coincidence, it's worth about $25b. The essential reform, as you mentioned, is to essentially increase how much is collected via the GST and reduce income and corporate taxes. We're fundamentally doing this not because increasing how much is collected through the GST is a good thing, but because reducing corporate and income taxes is a good thing. The way we thought about it was all taxes are distortionary one way or another. The issue, however, is that we do want to collect some tax because that's the price we pay, as Oliver Wendell Holmes put it, for living in a civilised society. The reason that corporate and income taxes tend to be so distortionary is that they affect how much people wind up investing either in terms of their business or in terms of their own time. Whereas consumption taxes, relatively speaking, have less of an impact on peoples' decisions about how much they essentially wind up contributing to the economy.

I was actually somewhat surprised that something like 40% of spending in Australia currently falls outside the GST. Although we spent a lot of time focused on fresh food in particular, the big things that are missing are actually around education and health. One of the things that's good is that spending on them is relatively inelastic. People will wind up spending more or less the same amount no matter how much it costs, and consequently taxing it doesn't distort their decisions. Whereas income and corporate taxes do distort their decisions. We can see, again from looking at the international evidence, that the impact is quite substantial. That's why we want to broaden the GST, and reduce the income and corporate tax rates. The impact on corporate tax is surprisingly large.

PAUL KELLY: How much would you cut corporate tax?

JOHN DALEY: Well if you broadened GST, to cover 100% of spending – and there's also a little bit of a kicker that you get because you've simplified the administration of the whole thing because you don't get argy-bargy over what's education and what's something else, or what's fresh food and what's not quite fresh food – you raise about $34b. You need to give a bit more than $3b of that back in welfare because there's a series of people who don't earn income, and we shouldn't make them substantially worse off as a result of this type of tax reform. That leaves you about $30b, on the assumption that you split that half and half between income tax and corporate tax. It enables you to bring the current corporate income tax rates down from about 34

cents down to about 23 cents. So it's a very big shift in terms of corporate thinking. And then in terms of income tax, it's harder to say what that does because it depends on exactly how you decide to distribute the reduction between different tax rates. But again, it would be material and most families would notice it.

PAUL KELLY: I know this is a revenue neutral proposal. I guess what it also highlights is the degree of political difficulty. I think the first two proposals which go to workforce participation are much more politically feasible than the third one. And of course going back to your initial criteria, it didn't relate to broad political acceptability but to policy consensus inside the policy community. So how realistic do you think this sort of tax reform proposal is in terms of getting it up?

JOHN DALEY: I don't think it's impossible. We'll be the first people to say it's unlikely this is going to happen in the next six months. And indeed given the somewhat unequivocal statements from both Julia Gillard and Tony Abbot in the last couple of days, it's almost certainly not going to happen in the next six months. But it's worth remembering that tax reform has happened in Australia. Hopefully this one won't take quite as long as the GST. But it's also worth remembering that governments that have essentially put major tax reform in place actually got themselves re-elected. The Keating reforms around fringe benefits tax and so on, they wound up getting re-elected. Howard introduced a goods and services tax, and that government was re-elected. There are certainly plenty of precedents in Australia for governments tackling difficult, inevitably unpopular tax reform, and getting themselves re-elected. I think one of the reasons is we have a tendency to say this is going to cause the sky to fall in the day before it happens. The day after it's happened everybody just moves on with their lives. By the time they get to the election, the taxes are what the taxes are and life goes on. If that's generated a whole bunch of economic growth, everybody's happy.

PAUL KELLY: Just an observation in passing: I think if you look at the recent political experience it is that for reform like this, you need to give something back to the community. It might need not to be revenue neutral but you might need to actually go beyond that. I'd like to highlight another important aspect of this report and that is that one of the consequences of identifying three mega reforms is that there are a lot of other reforms that didn't get into that basket. You talk about innovation, industry policy, industrial relations, infrastructure, schooling, higher education, health, the broader debate about a productivity agenda. That is a very long list, and you've left them out for different reasons. What I'd like to do is to tease you out a little on some of the reasons why those other reforms didn't make it.

JOHN DALEY: As you say, one of the most interesting things about this is we actually set out to prove a negative, which is hard, but usually worthwhile because the key to prioritisation is talking about what do you choose not to do. In terms of industry policy, maybe there's a bit more of a consensus that there is scant evidence that governments intervening to try and promote particular industries has much of an impact. In fact there's quite good evidence that by and large, when governments try and do that, they essentially blow their dough. So we actually go backwards.

In terms of innovation policy, again, when you start digging through the international work on this, there is not much evidence that any of those innovation policies actually work. Certainly there's little evidence that the benefit of the innovation generated is higher than the cost of the innovation policy it took. For example, there is good evidence to show that Australia's flagship

policy around research and development tax incentives of various kinds may well increase the amount of material that gets called research and development, because that means that people wind up paying less tax. Saying that people will pay less tax if they label something research and development is a good way of getting to label it research and development. But it doesn't seem to have much of an impact on economic growth. And that's not very surprising because most of the innovation that generates productivity improvement is not new to the world, you don't get a patent for it, you basically notice someone somewhere else in the world doing something cleverer than we're doing, you do it here, and we reap a productivity improvement. So that's innovation.

In terms of industrial relations, that was maybe slightly different in the sense that we struggled to identify very clearly what reforms would make a substantial difference. Although there's been a huge amount of talk in public about this, that and the other industrial relations reform would have an enormous impact on productivity. When you actually go through and look at it, firstly, often people are very unspecific about what they would actually change about the industrial relations regime. Secondly, when you ask what the evidence is that shows that you would make a big difference, what we have is what my former colleague, Saul Eslake, described as an accumulation of anecdote. There's lots of things that people can point to a specific thing and say industrial relations regime means that we have to do X, Y, Z, that cannot possibly be helping, therefore industrial relations is a big impact on productivity. But of course the gap that's missing, the jump that's made is how big is that problem in the scheme of things? How many employers have that problem?

If you look, for example, at the BCA report that was issued late last week looking at the impact of industrial relations, amongst other things, on infrastructure projects, buried down in the fine print is something that says actually, there's a bunch of infrastructure projects in Australia that are best in class, best in the world. So it is certainly possible to do things in Australia in a way that is best in the world, despite whatever our IR regime might be. Then when you look at the history of IR in Australia, and indeed overseas, the correlation between various industrial relations regimes and productivity, either labour productivity or multifactor productivity, is very weak indeed. You just can't draw any link between the two.

There's a very elegant study that's been completed recently and published from La Trobe University where they looked at firms, some of which were highly unionised, and some of which were not unionised, but in the same industry. They looked at the impact of the Workplace Relations Act under Howard, because the theory was that that basically reduced the power of unions substantially. In theory, therefore, you would expect to see the productivity of unionised firms go up faster than the productivity of non-unionised firms. To summarise the study, basically the evidence was all over the shop and there wasn't a particularly clean link. It is very possible that our industrial relations regime could be reformed to substantially improve productivity, but there is very little evidence about how big that would be.

PAUL KELLY: One of the critical issues here, not just for Australia but for the West, for Europe and for the United States, given the economic tribulations that they now face, is the capacity of political leaders and government institutions and Parliaments to legislate reforms in the teeth of the negative campaign. I think that's a timely break point at which we might now turn to the audience and see if they'd like to ask John questions in terms of the agenda he's put forward, his big three items, why he put those in and why he didn't include other reforms, as he explained at the end.

AUDIENCE: Thank you, that's very interesting. I'm particularly interested in the interactions between the three major policy agendas you've articulated, and I'm wondering in costing them and looking at the impacts of them, if you've looked at the interrelationships. Particularly around the distributional impacts of tax reform and to what extent that can be ameliorated by productivity changes. It would be interesting if you could expand on that.

JOHN DALEY: We didn't spend much time thinking about the interaction between them. If you're looking at 22 or 25 different reforms, then figuring out the interactions between all of those obviously becomes an exponentially larger exercise. There are obviously some links between them because it so happens that all of the reforms we have identified essentially involved tinkering with the tax and welfare system one way or another. In many ways I suspect they actually help each other. If you increase consumption taxes and reduce income taxes, then by definition you increase the incentives to stay in the workforce for both older people and for women. In terms of the interaction between them, if you have more women, particularly between the ages of 30 and 40, who participate in paid work when they've got small children that then means that there's far more people who've retained connection with the workforce through those critical years and are, therefore, more likely to continue to be attached to the workforce in later life. So it has an impact on an older age workforce participation in the long run. In terms of the impacts on welfare, it varies. In terms of older age workforce participation to the extent that it encourages older people on lower incomes to stay in the workforce, it's probably helping. But I suspect it's relatively neutral, as it applies equally irrespective of their incomes. Obviously as you did that you'd want to have some kind of safety net that said if you're 60 and you've been in an occupation that means that you can't work anymore, then obviously you should be able to still get access to the age pension, which is not that radically different to how things work at the moment.

In terms of female workforce participation, the reforms we are talking about would actually be strongly progressive. The reason for that, as I said earlier, is for somebody who would earn $100,000 if she was working full time, the current situation in a funny way doesn't look too bad. She gets to keep the better part of 40 cents in every dollar of what she earns and so the incentives to go back to work are quite strong. Where the incentives fall apart is for people on 40, 50, 60 thousand dollars, on much lower incomes, they are the people who at the moment are not encouraged to go back to the workforce. They wind up worse off as a result in the immediate term, they also wind up a lot worse off in the longer term because they've spent five, six, seven or 10 years out of the workforce and then it's really hard to get a good job as they go back.

In terms of the tax reform, it depends how you do it. One of the things that Ken Henry articulated really clearly, and very well in his address to the tax forum last year, was to say do not try and engineer regressiveness or progressiveness through the tax system. The purpose of the tax system is to collect tax. The purpose of the welfare system is to deal with regressiveness. Now that said, if you are going to increase GST, by definition selectively on health, education and food, you are always going to be able to find a family that spends 80% of its income, for some reason, on education, health and food. But they are going to be very non-average family. I think one of the things that you do have to do in tax reform and welfare reform is to say either we make this so expensive it's completely unaffordable, or we accept that there will be winners and losers, albeit substantially more winners than there are losers, because the whole reason we're doing this for economic growth.

The tax reform we're talking about will have a couple of losers. As I said, we have deliberately talked about welfare give backs in a way that should mean that on average most people are a little bit better off. Inevitably there will be a couple of losers because with any tax or welfare reform, there is someone who's on the wrong side of legislative change. I accept that those losers always make a lot more noise than the winners, that's in the nature of our politics, but that's what you have to do if you're in the business of tax reform because in the end, it's a huge economic lever for good.

AUDIENCE: In relation to older workers, did you look at frameworks or possibilities for helping people to participate in the workforce without necessarily completely stepping away from their superannuation or pension incomes?

JOHN DALEY: We did look at the possibility and it's talked about at some stages in the literature about deliberately creating a transition to retirement, so allowing people to essentially access some or all of their pension early but continue to work. There's a nice piece out of the European Union where these kinds of arrangements have been in place. It seems to suggest that the gains you make because a couple of people decide to continue to work a bit, who might otherwise have retired completely, are essentially outweighed by the number of people who instead of continuing to work full time, wind up working part time. So in pure economic contribution, it's a bit of a wash. As I said, in terms of an Australian context where the real issue is essentially about access to superannuation, I think we need to get a bit clearer about why we've given people superannuation in the first place. The whole purpose of superannuation was to essentially give people a very substantial tax break as well as a structure that then essentially meant that government pension liabilities were a lot lower than they would be otherwise. That was the fundamental idea of the Keating reform. You only have to look at Europe at the moment, and the looming, enormous issues that they've got with pension liabilities, to realise that was a very good idea.

The problem we are seeing in Australia at the moment, is if you allow people to use their superannuation before they hit pension age, many of them will. The problem is that that does, as I said, nothing for your government pension liabilities, because very few people have so much superannuation that essentially they can live off it until they die. Today, if someone retires at 65, on average they will live to 85. So they've got 20 years' worth of living on whatever money they have and unless they have an enormous amount of superannuation, chances are by the time they get towards the end of life, they will actually be applying for the age pension. That's why we thought about it and came to a view that we will be much better off simply aligning the pension age and the retirement age. If people have saved up during their lives, outside of superannuation, and they choose to retire at 60 and they've got enough money to retire at 60, good luck to them. But you and I are not paying for it with our taxes.

AUDIENCE: Thanks very much. John, I've really enjoyed the report and the first couple about women and old age, but I wanted to quiz you a little on the tax reform one, partly because it is so difficult to do. I note that you had to be revenue neutral on tax reform because the governments are spending a lot. In particular I want to draw your attention to the money that governments are spending on transport. In the report, you talk about how the competition policy reform of energy shifted that spending out from the public sector into private sector, and it seems to me there would be an opportunity to propose the same thing, shifting transport spending from the public sector into the private sector thereby reducing the size of the public sector. And the amounts that the New South Wales government announced in today's budget,

for example, on spending on transport matters would pretty quickly add up to a game-changer of an equal size to the three that you've nominated.

JOHN DALEY: The way that we thought about transport is to actually try and pull it apart because it's a difficult issue with lots of moving pieces. The first was to think about congestion and there are costs of congestion that are borne by the community, and as we thought about it, we came to the conclusion that around the world building more roads doesn't help congestion, it just expands the size of the problem as you wind up with more people on the roads. You certainly don't wind up with massive reductions in journey times. The only thing that really seems to make a big difference is imposing congestion charging. We looked at that. It's definitely worth doing but it's not a game-changer. It's worth a couple of billion dollars a year, we should probably have a go at it, but it's not a big deal.

Then there is the question of how much do we spend on the roads in total. How much are we pouring into infrastructure for roads and rail in particular? There's some evidence out of Infrastructure Australia that many of the projects that Australian governments are committing to, at least on paper at the moment, the benefits outweigh the costs and quite substantially. Roughly speaking, for $10b of spending you get about $15b of benefits, if you look at the average cost benefit ratio for Infrastructure Australia projects.

On the other hand, the rate of spending at the moment is about as high as it's ever been. If you read the average report about infrastructure at the moment you'd come to the conclusion that Australian governments have stopped spending money on infrastructure. The New South Wales government may be doing its best, but over the last couple of years Australian governments have spent substantially more on road and rail infrastructure as a percentage of GDP than they have at any stage since 1987 when the Bureau of Statistics started to collect numbers on the subject.

There's a very interesting question around private ownership. Where do we spend the money, exactly? And how do we make the capital allocation decisions? If you think about the analogy to utilities, the big game in utilities came as we privatised them, not because we wound up substantially changing the amount of electricity we delivered. More or less the same amount has been delivered. What really changed was that we became much more efficient in delivering it. I suspect that's true to some extent in terms of transport. Except I would argue a lot of the time we have already privatised at least the building of our major roads. There are many roads in Australia already that are toll roads which are where we outsource the whole box and dice. There are another number of non-toll roads where, although government retains ownership of it, construction is essentially outsourced. I'm not so sure that there are enormous gains there.

There might be gains in terms of tying the pricing of roads and particularly freight, because that's what causes a lot of the damage to roads, back to who looks after them. If you could build a really tight link between which roads are being driven on, and then who gets the money to maintain and upgrade those roads, you might get a substantial efficiency dividend. I think it would be fair to say that thinking in Australia about that link and how you might make it work is in its infancy. I'm not aware of anything you can pull off the shelf to see how that might actually work. Consequently we certainly have it on the chart – on the side of not really quite sure how we do this, but it's definitely worth having a long, hard think about.

AUDIENCE: Thanks for the report. I think it's a great long-needed contribution to the debate. Which of the three reforms do you think is the most politically saleable? Secondly, how would the three reforms impact Australia's ability to be resilient against external shocks? For example, the current potential impacts of external economic shocks from Europe.

JOHN DALEY: To take the second question first, I'm not sure that any of them make the Australian economy particularly more resilient. I think that the reality is most of that resilience is what we've done over the last couple of decades in terms of opening up the Australian economy, floating the dollar. It's the free float of the Australian dollar which makes the Reserve Bank truly independent, and moves the governments out of the business of industry policy. We still have 13 or 14 billion dollars' worth of industry policy but in the scheme of things, that's a lot better than where we were. And consequently one of the things that explains the economic statistics over the last couple of days, which have surprised people a lot, is this is now a very open economy. As it gets a major shock like rapid expansion in mining investment, for example, it's an economy that relatively speaking adapts to that pretty quickly. If you want to make an economy resilient, that's what you have to do. I'm not sure that any of these three things is going to make us a lot more resilient. Possibly shifting the tax mix around couldn't hurt and it pushes us in the right direction, but I wouldn't be claiming that it's going to be a major impact.

Regarding your first question on which of the three reforms are the most politically saleable, I would say on the evidence given in the last couple of days with both the Prime Minister and the Opposition Leader unequivocally ruled out a change to the GST, we'd have to put that one at the bottom of the list. Given that the Prime Minister said we've already done 65 to 67 and we're not doing any more, and the Opposition Leader said well, we'll think about older age participation but we'd need a proper debate first, that's certainly not wildly encouraging. So you put that second. As neither of them said anything about female workforce participation, you put that on the top. I suspect there's also a reason for that which is we've been less specific about exactly how you have to fill all the tax and welfare rates for women. It's frankly unfinished business that needs to be worked through, and I suspect until that gets spelt out and you can see the winners and losers, it'll seem more palatable. In the medium term, the one that will become easiest is around older age workforce participation. That's because it's the one that doesn't cost you anything on the budget. We have Australian governments both at a federal and a state level that are under very substantial fiscal pressure, and if they can do a piece of economic reform that also gets them a better fiscal position, I think that they'll be that much more willing to swallow the pain.

I'm reasonably hopeful that any of these three things, indeed all of them might get up over the next 10 years and, if you look at the history of Australia, – and I guess Paul's books have helped on this more than many other things – this is a country that has succeeded in pulling off a whole series of very difficult economic reforms that were deeply unpopular at the time, and the country has done very well as a result. Although we're somewhat despondent about our political leaders day to day, I'd suggest year to year there's a reasonable chance that they'll make the tough decisions. That's been their track record.

AUDIENCE: Thanks John. I think that your suggestions on improving participation are really interesting. I wanted to ask you about the older workers and particularly about increasing the superannuation access age from 55 to 70. There's probably a very good argument for equalising the access age with the age pension. If I recall correctly, increasing the female

access age to the age pension from 60 to 65 took about 15 to 20 years. In your modelling, did you increase the superannuation age instantaneously? Or does it happen gradually?

JOHN DALEY: With both of these things we believe that as with the structure of previous reforms, is exactly the right answer to do it over a period of years. Back in 2009 the federal government moved the pension age for men from 65 to 67 essentially over the next decade. We would say this was a great reform, structured exactly the right way, but it just didn't go far enough, because they could equally have moved the pension age from 65 to 70 over a decade. It effectively went up by half a year every year, and we would get to where we are. Now one of the lovely things about what we're modelling is that we're simply looking at GDP in 2022, and so we think it would have the full impact by 2022, just because by 2022 that would be the new retirement age and therefore most of the benefit of the reform flows through by then. If you model these reforms a more accurately so you're asking what has the greatest net present value between now and 2022, then implicitly old age would be like that and tax would cut in a bit earlier. One of the things that we tried to do in this piece was keep it simple and think about it in 2022, and if it's big enough to care in 2022, it's probably big enough to care now.

AUDIENCE: One of the biggest criticisms you'll get against expanding the reach of the GST is its regressive nature. I was wondering if you considered a progressive consumption tax which might blunt some of those criticisms?

JOHN DALEY: As I said earlier, I think using your tax system to deliver socially progressive outcomes is essentially using the wrong instrument. In particular if you think about a GST, the whole reason that it is simple and relatively cheap to collect is that if I sell you something, I know that I have to take 10% of what I've sold you and send it off to the government. That's how it works. I don't have to ask any silly questions about how much you earn, all of those kinds of things. You as a consumer don't have to keep a whole bunch of records. I as a retailer am the only person who's got to keep records, and heaven knows that's complicated enough. So that's why I would suggest no, you don't want to make your GST progressive. What you want to do is make your welfare system progressive. So you say, as we do already, those who have relatively low incomes, or indeed no income at all, are those people to whom we provide welfare. Exactly how much welfare is something that you work out. If you want to make this reform slightly progressive, then if low income earners or those on pensions at the moment account for about 10% of Australian spending, that's our best guess. If you essentially gave 12% of the extra revenue back in welfare, then by definition it is, on average, progressive. So you don't have to move the amount that you give back in welfare very much to make it, at least on average, a progressive reform.

AUDIENCE: John, you've excluded social and environmental reforms from your analysis, and you've also written that economic reforms provide resources for other types of reforms. When then should we be pursuing the social and environmental reforms and what do you see as the game changers there?

JOHN DALEY: I think we should be pursuing social and environmental reforms in parallel. Obviously government has a number of objectives and social wellbeing and environmental wellbeing are part of those objectives. There are only so many things that a Grattan Institute can have a go at in one report and we thought that we'd bitten off more than we could chew just doing economic reforms. So those are things that I would love to have a go at.

With economic reforms, there's a reasonably good metric of size, and impact in terms of looking at GDP. We lack those metrics in terms of social welfare. If I take two reforms which are unambiguously about social welfare; a national disability insurance scheme on the one hand, and giving more resources to our poorest schools on the belief that that will improve their performance. I would ask you which of those is a more important reform in terms of its social welfare impact? I'd suggest we're struggling to find metrics that will put those two things on a common scale. I don't think that that's an insoluble problem, but I will confess it's one on which I'm really interested in anyone's bright ideas on the answer because it's very hard. There isn't anything much in the literature we've been able to find so far that tells you how to do that. It's surprising when you think about it that no-one's really had a go at thinking about what is the metric for judging those things next to each other.

Similarly with environmental reforms, if it's simply about counting up the number of species, then yes, you can count one against the other. But I suspect many people, when they look at environmental reforms, want to do something a little bit more complex than that. So again we lack a metric to measure is it more important to effectively consume the community's resources putting more water in the Murray, or locking up chunks of our offshore environmental resources in marine parks? Which of those is more important? And I think again the answer is I don't know. Coming up with sensible metrics to judge those kind of reforms against each other is essential if you're going to do sensible prioritisation. Those problems are not insoluble, they're just really hard and not things that as a community we've nailed to date.

PAUL KELLY: I'd like to thank everybody very much for coming along, and to thank John in particular for the quality of the exposition he's given us.

JOHN DALEY: Thank you very much. Can I thank you Paul, first of all, very much for your thoughts this evening? I'd like to thank a couple of the people who make Grattan Institute possible, particularly our founding members: the University of Melbourne, the Commonwealth Government, the Victorian Government and BHP Billiton, all of whom essentially contributed to the Grattan Institute endowment in a way that genuinely guarantees our independence. Thanks too to our affiliates who contribute every year: National Australia Bank, Wesfarmers, Stockland, Google, Arup, Urbis, the Scanlon Foundation, Lend Lease and Origin Foundation. Their support makes a difference to the work that we can do

I'd like to thank the Grattan staff who worked on this report. They're talked about in the report, particularly Cassie McGannon, Leah Ginnivan and Jim Savage who worked very hard to make this report what it is. But also all of Grattan staff, and this is, I think more than any other report that we've produced, something which every single person at Grattan Institute has touched one way or another and it's been a better report for it. And finally just to say that this is available from the Grattan Institute website and I encourage you to all download your copy and as always we'd be very grateful for any comments.

And finally to say thank you all very much for coming, thank you to NAB, our hosts, and we look forward to seeing you again at a Grattan Institute event in Sydney in the not-too-distant future.

AUDIO: This has been a podcast from Grattan Institute. Want to hear more? Check out our website.

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