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.

Speakers: **John Daley, CEO, Grattan Institute**
Bob Gregory, Emeritus Professor, ANU

AUDIO: This is a podcast from Grattan Institute.

BOB: This evening's seminar is a joint production between Grattan Institute and The Crawford School and I would like to introduce our speaker, John Daley of Grattan Institute. We're going to run it as a conversation between John and myself. We'll cover the topics of the report and then open the floor to audience questions. So John, why don't you tell us about yourself and the report and then we can start.

JOHN: Thank you very, very much. And Bob, thank you very much for the introduction and the chance to be here. I'm the Chief Executive of Grattan Institute. In my past life I have been everything from a legal philosopher to a management consultant to a banker, to a stockbroker, which either shows a broad range of interests or a very short attention span. My money's on the latter. And for the last three and a half years it's been my privilege to be employee 01 of Grattan Institute and to see that Institute grow to what it is today. And it's obviously my very great pleasure to have Bob here today. Bob was too modest to introduce himself so I should introduce my partner as well as someone who's both worked in policy and in academia which, if I might venture to say, is an intersection we have not enough of, although obviously The Crawford School is doing its best to redress that balance. Bob's worked on a series of aged care reviews, he worked on the student income contingent loans which I think is one of the great Australian policy inventions. And he has been on the Reserve Bank of Australia. Thank you for coming.

And just by way of introduction, I should also thank the other people who have made today possible. Obviously those who support Grattan in terms of our founding members, the Commonwealth of Australia, the Victorian government, the University of Melbourne and BHP Billiton as well as a number of corporate affiliates who contribute to keeping the show on the road, particularly Google, National Australia Bank, Stocklands, Wesfarmers, the Scanlon Foundation, Lend Lease, Sinclair Knight Mertz, Arup, Urbis and the Origin Foundation. And of course I'd like to thank the people who deserve all the credit for this work, although I continue to take the wrap I hasten to add, Cassie McGannon and Leah Ginnivan did most of the hard work and are appropriately credited as co-authors, as well as the large number of people from Grattan Institute who contributed one way or another. Maybe I could just start, Bob, by talking about why we did this at all.

BOB: Before you do, I do think it's important, because I often go to sit on platforms with important people and they say what we need is reform, reform, reform and so on, and I say well that's good. What reform do we need? And they say well you know. It's quite remarkable how people like the idea of reform but go to water when they're asked to suggest what they're doing. So I think one of the good things about this report is that it does document all the sorts of things that people talk about, and it does provide the best intent as well as giving empirical evidence about how important they think each thing is.

JOHN: I was at the Melbourne Institute Social and Policy Outlook conference about 15 months ago, which as you know is one of the leading conferences, if not *the* leading conference in Australia for economic social policy: the Reserve Bank is there, the Productivity Commission is there and everybody else is there. I think it'd be fair to characterise that conference as everyone agreeing that productivity growth was going down and that was bad, and we agree that's bad, and everyone, with the exception of Tony Abbot who was there, agreed that a carbon price was the least of all possible evils. Then there was this deathly silence about what reforms we should have. I was surprised about that because here are a huge number of people who are working in this area and yet they were very unspecific about what we should do next. We started from a position that said if we are not clear, as a policy class, about what it is that government should do, we can hardly be surprised when our politicians don't have a clear and coherent policy agenda. Let's be blunt: they don't have an enormous amount of time to sit around and work out what a policy agenda should be. The business of politics and selling ideas is hard enough as it is. If they're not getting support from the policy community - 'this is what you should do' – chances are it's not going to happen. So that was actually the genesis of it and you're right, we're too often unclear about where we should start.

BOB: Tell us the main points.

JOHN: The way that we attacked this was to ask for economic policy reform, two questions: one, how big is it in terms of GDP in 2022? I'd be the first person to say that you can argue about the merits or otherwise of GDP as a measure but my argument would be it's close enough for most purposes. And why 2022? It's 10 years away. We could no doubt do a beautiful discounted cash flow over the next 15 years, but I'm not sure it's going to change the answer very much. We definitely change how complicated the analysis was. We definitely make it much harder to understand, but I don't think it's really going to change the answer. So that was our first criterion: how big is it? What's it worth to economic growth? Then our other criterion, coming from where we started, this issue around policy community and the importance of that was what's our confidence that this is a good idea? Ranging from pretty much everyone we talked to in the policy community, whether in academia, whether in the public sector, whether in think tanks, says "Yeah, look, more or less that's the right thing to do", all the way through to massive disagreement and indeed no-one actually being able to articulate what we should be able to do about it at all. As those of you who've seen the report will know, the key thing that comes up is a matrix that says there are three things that are big enough to care in terms of making a really big difference to GDP in 2022. They are female workforce participation, older age workforce participation and tax mix reform. I'll talk in a minute about what lies underneath the covers of each of those. Those three things are each worth in the order of about $25 billion a year. In an economy of one and a half trillion, $1.4 trillion depending on how you count it, that's big enough to make a difference. That's two per cent of GDP. If we increased GDP by two per cent more than otherwise, we might just notice that. One of the key points of the report is to say, there's lots of things we could do that would have an impact on GDP of two or three billion, but let's be honest, in an economy of $1.4 trillion, we're not really going to notice that, it's not going to make that big a difference. If we don't do it, it doesn't make that big a difference. So that's how we wanted to prioritise and I guess the thought that lay behind that prioritisation was one that said governments can't do everything at once, and indeed when they try to do everything at once usually they wind up getting very little done at all. If you're going to expend scarce political capital, you might as well spend it on a few things that'll make a big difference rather than a few things that frankly won't make much difference at all. So that was the idea that lay behind it and as I said, the three things that popped out, very much at the top of the chart, both in terms of being much bigger than anything else we could find, and in terms of being things where a level of confidence, given the literature, was pretty high, that yes these things would work. The policy reforms we're talking about would have the kind of desired impacts and that we might be out by two or three billion but the order of magnitude effect of the reform would be about $20-25 billion dollars a year effect.

BOB: Well, tell me more about the detail. Because one of the things that, if you do read the report quickly these three things really do stand out in your matrix. And the odd thing about those three things in a way is that if you click onto emails, or on the internet and try to follow *The Age* while you're away, or any of the newspapers, these things don't crop up much. I mean there's no monetary fiscal policy mix in here. There's no "The government debt in Australia (which you might say is one of the lowest in the world), is the source of all evil"; there's no "carbon tax" stuff. These things really do stand out in your analysis. And I think one of the things you should do towards the end, not now, is try and explain a little more clearly why you think they're so important. So do you want to go through one by one?

JOHN: Let me start with female workforce participation. This is essentially looking at how we get more women in Australia to participate in the workforce. Australian female workforce participation is above the OECD average. It's worth remembering that that includes Greece and Italy and a whole bunch of other places that I'm not sure we necessarily want to emulate economically. And we are a long way behind a bunch of countries that you would not expect us to be behind. In particular we're a long way behind Canada, which in so many ways is socially very similar to Australia. So there certainly appears to be opportunity. And then I guess we did a review of the literature which I think is unusually clear, if I might say so. I mean we're used to literature which, in economics and public policy, which says on the one hand there's this, on the one hand that, we need to do more research and more data and all the rest of it. I think you look at the stuff on female workforce participation, it's pretty clear that the thing that drives differences is essentially around how much does a mother get to take home out of her pay packet after she's foregone welfare benefits because she's now working, after she's paid tax and after she's paid for child care net of whatever childcare benefits the government provides. Now speaking to my friends, I don't think we should find it wildly surprising that mothers decisions to work or not is partly dependent on how much of their pay packet do they get to keep. So that's what the literature says, it fits our intuitions. And then when you actually go and look at Australia, number one, it's surprising, no-one in Australia has ever looked at, no-one has ever drawn the chart about what do marginal rates of tax look like when you add up tax and welfare, plenty of people have done that, and then add on the cost of child care net of benefits, which is surprising, because speaking as a parent that's exactly how we thought about it! And I suspect it's exactly how most parents think about it. That's your fundamental cost benefit equation. And the answer is essentially for a family where the father earns $70,000 a year and is working full time, the mother would earn $70,000 a year full time if she worked full time, and they're paying about $8 an hour for childcare. So we're talking a family that's not that different from a quite typical Australian family. She's only taking home, for the first three days that she works, 34 cents of every dollar that she earns. So that's not much of an incentive. That's the good news. The bad news is that if she works the next two days, so days four and five, she essentially takes home only about 10 cents of every dollar that she earns, and funnily enough that's unattractive. And every time we've presented this to an audience which included public servants, and I'll be intrigued to see whether tonight is the same, there is a mother up the back who says "That's right, I've got the spreadsheet and I work three days a week". So I'll be intrigued to know whether anyone else is in that position today, given that we're in Canberra. But it is very clear, if we look at our own numbers in Australia, that we have not got the tax, welfare benefits and child care benefits right in this country. If we are in a situation which very typical families are facing an effective rate where they only keep 10 cents in the dollar of what they earn, it's not surprising that our workforce participation is lower than it would be otherwise. And if you look at Canada, has had a very rapid increase in female workforce participation at exactly the time that they did the things we're talking about. So they essentially reduced the marginal rates of tax and welfare for women as they went back to work, they, particularly in Quebec reduced the cost of child care. And Quebec, which did that most aggressively, they made it I think $5 a day, it's gone up all the way to $7 a day. In other words it's almost free. They've seen their workforce participation, female workforce participation go from one of the lowest amongst the Canadian provinces to one of the highest within a 10 or 15 year period. So for that one, we think there's a pretty clear story.

BOB: Maybe we might talk about it a little bit one at a time? The first thing that I wanted to say was that, and this is slightly beside the point, but the analysis is all GDP focused, right?

JOHN: Mm-hm.

BOB: So, if a woman at home was producing, in her mind, $100 a week and she was going out and earning $100 a week and she might well be indifferent. But if she works in the labour market, $100 goes into the GDP. So you get the feeling that it's a bit GDP focused just now. But is that right? Or is it not right?

JOHN: I think it's fair, although I don't know it makes a difference, if I can put it like that. So firstly, the way that we think about it in terms of answering the question about who pays for the child care, if it were true that the value of the work that was being done at home was substantially greater than the value of the work that would be done if that woman went to work, then that would be a real problem. And yes, we'll be measuring GDP and saying GDP is going up, but actually the real value of what's been done in the country is falling. Now it depends on exactly what you think the mother is doing at home and how you value it. To the extent that it's about child care, there's two questions. One is what is the cost of simply looking after a child? We know that the cost of the full cost - because we essentially privatised child care in Australia - including all the bells and whistles, at the moment is about $8 an hour. It depends on exactly where you go, depends on if you're paying per day rate or for an hourly rate, but that's about where it is. Now if you think about it, even someone on a basic wage in Australia is earning well more than double that. So in terms of the efficiency of child care, from a genuine GDP perspective, we are better off if child care is done in child care centres where by definition you're getting economies of scale rather than essentially mothers by and large looking after children one and two at a time. And that's why we would argue this is a genuine GDP benefit, at least as far as we're talking about child care. Then there's an issue about the quality of child care, and I guess the literature basically says it makes quite a substantial difference in terms of the quality of child care and the outcomes for children while the child is between zero and one. The literature kind of cuts both ways between one and three or four, but I think it would be fair to summarise it as saying there's not that much in it. And the differences in outcomes that you get when a child goes to school at five, depending on whether they have or have not been in child care, is not enormous. So that's the child care thing. And then of course there's anything else that a mother does at home which is of value and which doesn't happen if they start to work. Now it may be that some women are being incredibly productive at home and doing enormous amounts of things, and that's really valued by their family. But then we would argue that's absolutely a decision they can make. The problem is that at the moment, when we've got effective marginal rates of 70, 80 cents, they're not making a fair decision between those things, they're making a decision between the value of whatever they do at home to them versus 20% or 30% of whatever it is that they produce for the workforce. And so they're not making, if you like, optimal decisions, at least on an individual level and therefore at an aggregated level. And that's why we're reasonably confident that this is not just an increase in GDP as measured formally, but it's also a substantial increase as a matter of reality.

The only other one that does come in is a question mark about volunteering. That's one of those things where the numbers are sitting there on the ABS for anyone who cares to go and look at them, and it's just not that big.

BOB: No, no. See, both these things have been on the agenda for a long time. And in both cases we've moved on both, right? We do more on child care as a country than we used to, and the marginal rates, which are very high, have been cut. But don't seem to be getting very far because, at the end of the day, as the lady was saying, the governments and the politicians add the sums and then they say this is too much. And it is a lot of money. So what exactly are you proposing the government should do in a way which may enable the politicians to, in a low tax world, accept the extra cost for?

JOHN: Yeah. I mean I think that this is something where some of the pain is going to have to go both ways. One of the issues is that we've set up family tax benefit in a way that is quite generous to what you might describe as middle income parents. And in particular we've set up family tax benefit so that the means testing of it is on a family income, and all the literature is quite…

BOB: And that's why the marginal rate's so high.

JOHN: And that's why the marginal rate's so high and all the literature's really clear on this. If you want female workforce participation to go up, the one thing you do not do is have a welfare benefit which is means tested on family income as opposed to the income of the primary income earner, whoever that might be. So I think that that's, if you like, a relatively easy kill. And how much of that is effectively a withdrawal of benefits from families who are getting it at the moment, and how much of that is effectively an additional benefit because, or at least withdrawn more slowly, kind of depends on how much political pain you're prepared to wear. But our argument would be either way you get the same impact on GDP and on genuine economic productivity, really all you're then arguing about is how much of that is a fiscal cost which we're either going to have to find other programs to cut or find other taxes to raise. I think there are also some very peculiar factors about the way that we've designed the child care benefits. The marginal rates are really, really high for a couple of reasons. One is we means test child care benefit, and one of the consequences of that is that as you start to work more like three or four days, you're both paying for child care and paying more tax and losing other welfare benefits and you're losing child care benefit. And then at the same time what happens particularly as you get towards four or five days if you've got two kids is that you run out of child care rebate. And so the consequence is that you're paying absolutely 100% of the cost of child care. Every hour you work you're essentially losing child care benefit and consequently you literally start going backwards very, very fast. So I think it's about restructuring the interaction between child care benefit and child care rebate. And I think we were quite explicit in the report. This is maybe the place where we are less clear on the solution than we are for the other two because there is work to be done on exactly how you would go about restructuring those benefits. As you would know better than most, the Australian system is sufficiently complicated that you can get an awful lot of unintended consequences as you start to mess around with Australian benefits. And there's work to be done to work out how do we re-jig this in such a way that we wind up with much flatter looking marginal tax rates and welfare rates for women as they go back to work.

BOB: Just have one more question before I ask the audience whether they want to say something, and that is that when you look at Australia's female participation rate against, say, OECD countries, the thing that always strikes me is not that it's so low, but that it's so heavily concentrated on part time work. Us and the Brits, for example. You look at the US and there's much more full time work. So do you think the big adjustment's going to be on the full time, part time mix? Or do you think the big adjustment's going to be bringing women into the labour market who are not there now?

JOHN: I suspect we'll get both because our argument would be we are well under on both measures in terms of percentage of women who participate at all, and percentage of women who are there part time. I suspect that the kind of marginal welfare and tax rates we've got are the precise explanation for why there is so much part time work. And as I said, if you're earning $70,000 that's not atypical for a mother, if you're working full time. You're essentially going backwards for the last two days you work. I mean why would you do it? You're earning 10 cents in the dollar and at that point you haven't paid for transport, you haven't paid for a whole bunch of things that probably are real, real costs. And so I suspect there are a large number of women who are making a purely economic decision that says if I work five days I take home maybe an extra $40 or 50 dollars compared to working three days, why would I bother doing it?

BOB: One of the things you'll notice when you look at the labour force stats recently is that the growth rate more or less of the labour force participation for women between say 25 and 45 with children is more or less stopped. And the big growth rate now is for women essentially over 45. And you can think of that in a number of different ways. I mean you can think "Now the children have got out of the way", or you can think of it as some sort of cohort effect: shifting from a generation of women who didn't used to work to ones who do. So, before we move onto another topic, can I ask whether people would like to say something about this part? I thought that policy stuff was a bit vague.

JOHN: Yeah, and fair cop.

AUDIENCE: I thought you made a very interesting point there about transport as well. Did you attempt to actually put transport into the equation?

JOHN: No, is the short answer. The numbers were sufficiently horrific on child care we thought we made the point. And of course it's very difficult to model because the differences in transport costs between different families will be quite substantial. And the beauty of this kind of analysis is that the differences in child care costs are probably much less substantial. The variation in child care costs is not that high, and consequently we could say this is probably pretty typical of most families in this particular situation.

BOB: Of course on the child care, the other reason why the full time, part time is important is that so many of the women who work part time can cover a lot of the child care without actually paying. You can cover it with your mother or maybe the partner or so on, to some extent. All of that becomes more or less impossible when it's full time, so this clear jump.

AUDIENCE: Hi, my name's Simon Brown. Thank you very much for your presentation so far. When you're segmenting the workforce participation for women into part time, full time, do you say women as well by industry or types of roles they look at? Because obviously there are concerns about inequality of women in the boardroom, things like that, and whether that has an impact on your analysis.

JOHN: The short answer is no, we didn't. We are looking at an aggregate level. What I would say though is the cross country literature is pretty clear that the major problem here is around how much do I get to take home? And of course that is constant across industries because it's completely driven by tax and welfare and so on. So we haven't, but I'd be surprised if it's outrageously different for a given level of income. And one of the things that's quite interesting about this is not only is this an economic issue, and not only is it obviously a gender issue in terms of there's a whole bunch of women who are not doing much work because they're discouraged from doing it and consequently they find it difficult to get back into the workforce. There's also a very substantial social equity issue in terms of economic equity, because the take home rates of pay for a woman who would be earning $100,000 aren't too bad because her hourly rate of work, pay for work, versus her cost of child care, she's doing quite well. She's taken home quite a lot of what she earns as a proportion. The problem is that if you're only earning 50, 60, 70 thousand dollars a year and therefore relatively little per hour, then the cost of child care becomes a material proportion of what you would take home, certainly after you've taken into account the benefits and so on. And so the take home rates of pay as a percentage of your earnings are particularly low for women earning $50, 60 thousand dollars a year. They're the people who are most discouraged from participating in the workforce. If you're a woman who's a high flying part of a high earning family, life has got plenty of incentives to go to work. So we're actually discouraging people from working who are lower down in terms of earnings.

BOB: I'm sorry to do this to you, but you spent a large amount of your time working on this very topic in government, right? You were head of …

AUDIENCE: Yeah, the issues have been fairly sort of, for a long time, I think this marginal tax rate thing, one of the points you raised before about complexity, that you try to adjust some of these problems and you just create so many others in other groups has always been a headache. But I'm not sure what the Henry Review with Jeff Harman's done in the interim. I've been out of government since that time, they were just trying to simplify all those relationships with tax. Are there any lessons from that?

JOHN: Well it's interesting because the Henry Review actually contained what I think has been subsequently called the Manhattan diagram, which has the marginal tax rates with tax and welfare, they didn't add on the child care point. Although interestingly not on this issue was kind of like a side blow almost. It didn't look at it in detail, and I guess one of the whole points that we're trying to make is yes, this is a hard problem, but given it's one of only three things that are worth $25b a year, maybe that's where we should be putting our policy effort and to the extent it costs the budget something, maybe it's a good place to spend our money.

BOB: I make two more points: one is that you haven't mentioned sole parents. And there's a lot of pressure to get them back to work. I mean, their benefits are cut once the kids get older, a lot of pressure. And it is interesting that there's been no focus on the married women to that extent. And the politics of that is sort of interesting. And the other thing is that when you look at what both parties are doing about women and children, they're into paid parental leave. You know, they prioritised that and they decide they're going to fight about whether they'll import nannies, you know, but mainly on the women, they're focused mainly on the women who are in work and that period of time in the first year or so. They haven't sort of got into this business about child care for all the women at the moment. And is that just money or is it what the women want, or the politics? What do you think that's about?

JOHN: I suspect it's about politics. There's significant ambivalence in the community about whether women should be working, and particularly in some parts of politics there's real ambivalence about it. And so anything that genuinely encourages lots of women to go back to work is something that at least some people are politically pretty sceptical about. Whereas, of course, the beauty of maternity leave is you're paying women, mothers to stay at home. So there's no problem in doing that politically. I mean one of the pieces, studies we cite in this, you know, has done a lovely piece of regression analysis essentially arguing that for every government dollar put into maternity leave, you get double the bang if you put that dollar into essentially supporting child care, which is hardly surprising. The way to have a big influence on female workforce participation is to pay women for when they're working, not paying women when you know they're staying at home anyhow. So I think that that's the politics that lies behind it. And I guess one of the points that we're trying to make with this report is focus on the thing, you know, this is a big economic payoff as well as all the equity issues I've talked about: focus your attention where it's going to make a difference, even if that's not politically quite so attractive.

AUDIENCE: With the increased participation rate in females, are you making allowance for the decrease in male participation?

JOHN: We didn't, to be fair, and I haven't looked at how closely those things are linked in the OC data. It's a good question.

AUIDENCE: Is that an aggressive political question?

JOHN: No, it's a good question to actually ask: to what extent are they, in fact, linked? My guess is that you would expect male participation to go down a bit. I suspect actually what you'd see is more part time as opposed to full time. I would guess that'd be the big impact would be more around that rather than seeing a substantial drop in participation at all. But I don't know whether you've ever looked at it, Bob?

BOB: Yeah. I don't think there's much connection. Unless they're near retirement, then what the men and the women do is fairly closely linked. I think let's go to the second point which is, you make a big deal about the older group as well. So two of the three are labour force recommendations aren't they?

JOHN: Yeah, they are. They're both participation I guess, one of the things that we've had an awful lot of emphasis on two of our Ps over the last decade in terms of population, in terms of productivity. We've had relatively little emphasis on participation and you know, it still multiplies up just the same. So yes, the second participation one is around older workforce participation. And again, the literature seems pretty clear that where you set your pension age and where you set your access to superannuation age makes quite a big difference to people's decisions about when they retire. Again we shouldn't be wildly surprised that those kinds of financial incentives make a big difference to people's decisions. And again you look at Australia and again we're quite a long way behind a lot of places in the OECD. Again we're ahead of the OECD average. Again that's not a great benchmark. And it certainly looks like the big issue here is around where we set the pension age and the access to super age. And then I guess we added onto that some work pulled out of the Bureau of Stats again. I will confess the longer I spend at Grattan the more I am amazed how much stuff is in there that nobody looks at.

BOB: That's right. No, no, that's right.

JOHN: And it's not hard. I mean I think the ABS has done a great job making all that stuff ridiculously accessible to anyone who goes looking. And it's very clear that the majority of Australians who retire choose to retire. Their dominant reason for retiring is because I reached retirement age. And yes, there are people who can't work and I think this is an interesting issue, when this is getting discussed in public and whenever I present this in public, what often gets brought back is yes, but what about the metal worker who's 55 and can't work and all the rest of it? To which I would say, that's right, you want to have a system that says that if you are 60 and you genuinely can't work, that you can nevertheless get access to your super and access to your pension. But bear in mind that that's a minority of the population, a small minority, and probably getting smaller given both changes in community health and given changes in the make-up of our workforce. We just have a lot less in the way of heavy duty blue collar workers than we did 50 years ago. And consequently this is a big opportunity in terms of the policy levers; there's some nice work that's been done using the Hilda data set that suggests how big the impact would be, and we've of course already seen a government move it from 65 to 67 over the next decade. We would say that was a terrific idea and it just wasn't anything like big enough. And I think one of the things here is, and I'm not sure that governments have done a great job of communicating this, they've talked about the way that life expectancy is going up. But I think what they haven't done a great job of communicating is, if you like, some of the detail around that, which is for the first 70 years of this century most of the increase in life expectancy was essentially in people not dying young. It was about people not dying in childbirth, was people not dying as children from various childhood diseases, it was people not getting killed in accidents, all of those kinds of things. Whereas since 1980 or so, most of the increase in life expectancy has been as a result of people over the age of 65 living a lot longer. And indeed life expectancy age 65. So in 1880 you would have lived to about 76, and in 1980 you would have lived to about 77. So it really didn't change for over a century. And then in the last 35 years it's taken off like a rocket! And we've seen it move from 76, 77 through to 84 and the slope of the graph is a dead straight line and heading upwards. And one way that we've been thinking about this and talking about this is to say that's actually a fantastic success of Australian policy. Our health care, all of those kinds of things mean that people are living much longer. That's good. They're actually by and large living much healthier lives, so at age 70 they're no longer kind of tottering around. By and large they're well and vigorous and all the rest of it. That's great, that's huge benefits to people. The catch is that all of the cost of that has fallen to the budget bottom line in terms of pensions, and none of the benefit has fallen to the bottom line. We still have the same pension age that we had back in 1909. Yes, we're moving it up by two years over the next 10, but that's nothing like as big a shift as we've already seen in life expectancy and we are almost certainly going to see a lot more.

BOB: Can I put in a free plug? This is my latest babe, as it were. But your proposal, though, is quite clear, right? You have two of them. One is you want to move the retirement age to 70.

JOHN: Mm-hm.

BOB: Quickly. And by retirement age I mean access to a government pension. And then you also want to make access to your private pension to be tied in as well.

JOHN: Yes.

BOB: So, if you think about that, that's a really big shift. One of the reasons why it's a big shift is that, and you actually haven't got this in the report but there's no reason why you should have, is that hardly anybody retires actually at 65. Hardly anybody now, right. The number of men who cease work at 65…

JOHN: At exactly 65, yeah.

BOB: …is about 12%. A lot of people go onto the pension at 65, right. That's very rare. But they're not coming off full time work. They're coming off de facto retirement policies like disability pensions. Or they're coming off their own private super and then going onto the government pension part time. So the main conclusion of my paper really is that the retirement age more or less is not what it's about. So many people are going early one way or another. And the two ways they go early is either disability, and you get tougher on that, or you get tougher on the private stuff. That's going to be a hard ask, I think, except, unlike the women's issue, the government's clearly moving in the way you're suggesting, without the heat. I mean the squeaks about moving retirement age from 65 to 67, maybe because it's a long way away, the squeaks were really mild. And the squeaks on moving the private access from 55, go up to 60 has been mild.

JOHN: Yeah.

BOB: So it's a bit easier to do this, I suspect, apart from the 70 notion which sounds …

JOHN: Yeah, maybe it should be 69, you're right.

BOB: Well some people have decided to do a trick on this. And that is to, you know how you index wages and pensions to CPIs, they've talked about indexing these things on life expectancy, which is a bit of a trick. I'm not quite sure how you do this but that way you sort of creep it up. But one of the things that's always puzzled me (I'm over 70, by the way)… Every time I see somebody that's 70 I look at them to figure out how lucky I am to be where I am and where I'm going to go. The reality is because everybody's retiring much earlier, because the disability payments are so big, one really does wonder about working 'til 70. And I don't think it's really about lifting weights. I mean just life out there is pretty hard in work nowadays, you know what I mean. People work longer hours on average. There's been a growth of part time work, and maybe part time is what you have in mind. But if it is part time, it won't be anywhere near as big as you think.

JOHN: Yeah. And look, we made some assumptions about how much will be full time and part time. If you look at the numbers, we are seeing a greater number …

BOB: Yeah, we are.

JOHN: …of 60 to 64 year olds participating and that is growing.

BOB: We are. It's starting to grow now. For men and women both, yeah.

JOHN: But you're right, there are two things going on here and the super one is I suspect one of the bigger ones, because that's effectively what's allowing people to retire early is they've got the super. I guess I'd focus on two things there: one is - and again it was one of those little sentences that was buried in Henry - a third of all superannuation balances are being drawn down before 65.

BOB: Yeah, I picked that up. I think that's an important. When you look ahead, everybody's going to have more private super because of the guarantee level. But you only have more private super if you've still got it when you're 65, as it were, when you retire. And what Henry points out is about a third of the people spend it.

JOHN: No, no, a third of the balances. It's not a third of the people.

BOB: Oh, a third of the balances …

JOHN: Which is much worse!

BOB: And when you think about it, I think that's … I mean that's obviously choice, right. So what are they doing? They're partly they're increasing their access to the age pension.

JOHN: Yeah.

BOB: You can see that in the data. But also it may well be that they all think they've got a little bit too much super. So when you've got a little bit too much super, what you do is you borrow against the house, eh? So when you retire, instead of owning your house the day you retire, you own your house less $50,000 or $30,000. And the $30,000 you put in from your super. So, one of the things you're doing (which is different from the women, by the way), is you're not offering incentives in this age group. What you're offering is laws.

JOHN: Oh, and sticks, in effect.

BOB: You're offering sticks. And that's sort of interesting point: you're saying "Thou shalt not retire until 70". Whereas for the women you're saying "It's all about money", you're going to offer sticks and cash. And that's one of the reasons why I think governments are finding it easier to move on one front than the other, because they get hung up about the cost for the women.

JOHN: Yeah. Whereas this doesn't cost them as much.

BOB: And no sticks equivalent for the women.

JOHN: Not that I found.

BOB: Only for sole parents basically.

JOHN: Yeah. But I think, Bob, the point about the superannuation and, again, the Henry Review makes this point very well, is we have given people enormous tax breaks around their superannuation.

BOB: Yes, we have.

JOHN: The justification for those tax breaks is essentially that we are reducing future government liabilities in terms of age pension. But of course the problem is that every dollar you spend on your super before you hit pension age does nothing for future government liabilities around age pension. And of course the reality is even if you have been paying super for the entirety of your life, unless you take a really big income cut when you retire, if you live to 85, and chances are you will, you will run out of superannuation. And therefore you will be putting your hand up for a pension whenever it is that it runs out. And consequently super balances that are drawn down before the age of 65 are effectively super balances that are going to make a difference to future government pension liabilities. One thing I would add, and we did flag this in the report, the nice clean policy solution is one that says you just can't get access to super 'til 70. I can see why that's going to get portrayed as being too hard and "It's my super so you can't take it away from me". So our suggestion is that's fine, it is your super. But on the other hand you've got a lot of tax breaks on that. What we should say to people is "Yes, absolutely it's your super, and you can take it out before you hit the pension age of 70. However if you take it out early you have to give the tax back."

BOB: So maybe a question or two on this before we move onto the final topic. Yes?

AUDIENCE: You have mentioned employers' tendency to want young people.

JOHN: Yes. Fascinating question because when this issue was being played out in the media today, you would think that that was far and away the major problem here. When you look at the numbers, that is not why most people are retiring. Very few people are retiring because they cannot get a job. Most people are retiring because they have a job and they choose to retire. Now I'm sure that we can do some things to change employer attitudes around the hiring older people. And I suspect actually having more older people on the workforce would be the biggest thing we could do that would make a difference. But I suspect also that the vast majority of employers who have a 65 year old would be delighted if that person worked an extra five years. This is someone who's been in your business a while, isn't going to move around that much, knows their stuff, is an eminent professor who is probably …

BOB: Who got sacked at 65, but let's not go into that!

JOHN: …who is very productive. Now maybe universities are less enlightened.

BOB: Yes?

AUDIENCE: Are they retiring just because they want to retire or are they retiring because it seems to be a better alternative than staying in the job you've got? In terms of age profile, you know?

JOHN: I'm sure they're retiring because it looks like a great option. That's not the point. The point is what can we do, as a country, so that we will be more economically productive than we are at the moment? And the issue with retiring early… You know, I'd like to retire tomorrow too! It'd be terrific, but that has a cost to the country. And when we say to 65 year olds "You can retire at 65", that has a cost to the country. And then there is a question of fairness. And what we argue is, it is absolutely fair to ask people to work longer than they used to because their life expectancy at age 65 is now a great deal higher than it was 30 years ago.

AUDIENCE: And it that across industry categories? Because I'm not sure I want a 65 or a 70 year old man who's been working in the building sector for 40 years climbing on my roof! Because he could hurt himself.

JOHN: Yeah. Whether we want 69 year old builders, you know, is that a safe thing? Obviously there will be differences between different backgrounds. But that's why we said don't set the general policy by reference to the relatively small minority of exceptions. Certainly manufacturing is shrinking, and it certainly is a percentage of the population. Construction's probably flat. It's worth remembering that Bunnings has actually made an entire business model out of deliberately employing people who used to be in the construction sector, climbing on rooves, who are now actually, by and large, pretty good doing their thing in Bunnings stores. So this goes to the earlier question, what else do you have to do from a policy perspective? There probably is an issue here around training, although again I think that the literature suggests that if you're training people aged 60, you've kind of missed the boat. Because if you want someone working at 65 or 70 who wouldn't otherwise be working, really the training has to happen back when they're 45 or 50.

BOB: I'm going to do, in these days of instant polls, something unusual. Now the third recommendation is the tax mix: basically to up the GST or extend its coverage to pick up the food and education, and then you use the revenue to cut income tax and company tax. That's the basic idea. So we can go onto that, or we can continue on the labour force start. So those who want to go onto the tax mix, can you give me a sign? Okay, it's the tax mix.

JOHN: I think we're talking about tax. Our proposal is essentially that we would broaden GST to cover health and education and food. Particularly health and education are big ones. The GST currently only covers about 60% of what people spend money on. So 40% is missing. A good chunk of that is health and education, and are, as a percentage of what people spend money on, in fact growing. So we're not broadening it because broadening it, per se, is a good thing. It's because it's a less distortionary tax than plenty of other things we can think of. And in particular it's a less distortionary tax than corporate tax and income tax.

BOB: By distortion, you have in mind work?

JOHN: Yeah. It's distortionary in the sense of discourages things which would otherwise be economically productive. And we're very explicit about this: is all tax is distortionary. The right question is which tax is less distortionary than the others? And I guess we're relying on the literature that says relatively speaking, consumption taxes tend to be much less distortionary of economic activity than corporate taxes and income taxes. And the fundamental reason for that is that, basically, people like spending money a lot more than they like working, and consequently if you tax the thing that they like, that will tend to be less distortionary.

BOB: This is a bit general, but the thing that strikes me about tax is that, and it's fairly obvious that, given our expenditure patterns and given where you're likely to go, we basically don't have enough tax revenue. The Secretary Treasurer gave a nice paper about four or five weeks ago, about the tax shortfall. So it seems to me we don't have enough. And my personal view is we should up the tax a bit, as well as cuts and expenditure. But the political debate seems to be all about tax cuts, and certainly not about increasing and widening the GST. The political debate seems to be that tax cuts are free, we can all have them. Whereas you look at the data, and not only do we need more tax revenue but if the Australian economy slows up a bit, as I suspect it probably will, the tax shortfall is going to get bigger. So I think we might just finish the discussion around the politics of all this, because you know, you did begin by saying the whole point of doing this exercise is to get the priorities right, to get the changes made. I can see, as is already happening, the age stuff not going as far as you want, but I can see it sort of going on that way. And maybe that doesn't cost government anything, basically.

JOHN: They're winners.

BOB: The women's thing I can see going on at the margin, but at the end of the day, governments always argue it costs too much, which gets you into the tax debate, right? And the last one, the GST, is really hard. So, the question I want to ask you is do you think the political process has become less reform-orientated? You see it in the paper, *Oh the golden years of Hawke and Keating, reform*, blah, blah, blah. And now they don't want it and if they try and do it, like the Labor Party has done, they're in trouble everywhere. The Opposition clearly says there's only one way to reform: that is everything's got to be cut, tax has got to be cut, expenditure. So has the situation changed? And if it has changed, why? I mean the other thing I could have thrown in is that if you start getting minority governments, then it's going to get harder, as we've seen under Gillard, who I think's done pretty well at getting things done, given the environment she's in - but getting no political credit for it!

JOHN: Yeah.

BOB: So, is the age of reform over, do you think?

JOHN: Yeah. Look, I don't think so, and obviously getting reform through in a minority situation is harder. And like you, I'm surprised how much has in fact happened. But I would argue that minority government is more a kind of fluke of electoral numerics rather than a likely outcome on a continuous basis.

BOB: When you've taken account both houses?

JOHN: No, I think we're likely to see a split Upper House for a long time, but then the Upper House hasn't actually been a long term blocker for reform for a long time.

BOB: No, that's true.

JOHN: I would say that it looks like over the last 15 years the pace of … if we had a sort of lovely graph of political reform in the same way that we can measure productivity, we'd probably see it kind of going down more or less over the same time period. But I'm not sure that our politics is actually exclusively to blame. This is where I started. If you look at what we have, either as academics or think tanks or public services, told governments were the big economic reforms they should do next, I would argue …

BOB: Like the Henry report?

JOHN: Well the Henry report's a good place to start, but …

BOB: Here's the list.

JOHN: Here's the list. But I think it would be fair to say that compared to the sort of consensus that was built in the '80s and '90s, that isn't there today in the way that maybe it was back then. I don't know, you were closer to the action…

BOB: Oh, the past is always golden.

JOHN: Oh no, when you were running the show, Bob, it was a lot better.

BOB: So, you said we'd finish at 6:30, I'd like to crib just a little few minutes, if I can, and ask the audience for some general comments. What did you think about the balance of what he's talking about? Is he in the ball park? Is he wasting his time? You know, general points..

AUDIENCE: Well you mentioned any period, and the thing is we're subject to international pressures as well. For example, in five years' time, our government will be in a position whereby it's able to sort of call itself, you know, by any number of stimulus and that, that Australia was sort of prevented from getting into a crisis. And the other thing is also general policy. Funding has to be done for all sorts of things within house. You're saying that things are taken care of pretty well in the health side of things, education side of things, etc. There's always some areas going to sort of have to suffer, albeit the margins minimally, with the reforms.

JOHN: Well I guess the point about these reforms is we started off by looking very specifically at things that were going to make the pie bigger. And so inherently those things tend to make budgets, in the long run, easier to frame rather than harder to frame because, by definition there's more money to go around, and that's the way we framed it. There's lots of things we would like to be spending money on over the next two decades. Some of it may just be basically filling holes that are coming to the points that have been made earlier. The question we were asking was where do you start filling those holes? Where are the things that'll make a big difference? And I guess the point we were trying to make is we could only find three. And we're hoping that that will actually be something that really focuses government minds in terms of saying "look, if you're not working on one of these three, it's really not going to make that much of a difference".

BOB: It's a pretty strong remark, that. Yes, Ben?

AUDIENCE: I think that the exercise is a great one because I think the structural problems in these lists as it will be coming public lists for debate. Lobby groups for instance have no incentive to say "I want $100m, take it from there because they're going to use it less efficiently than me". All that does is produce a fight between lobby groups. Public servants do it secretly, in a cupboard somewhere. Only the PC sort of has a list, and even the PC knows it gets its money from government, it doesn't really produce a list. Every now and again a Henry Review produces a list because it's an invented enquiry and so on. But the full list is not produced very much. The exercise is great, but I think there's more work needed, dare I say it, because it was building on the focus of what have been the studies in the past. And also as a classification sort of issue. That is, I can think of two game changers which in some ways overlap with what you've got, and indeed influence them significantly, but are not sort of given a heading in what you've produced. And that is the top two, and Henry's a lot lower in impact than the top two you've got. The top two you've got are participation, which is putting more bodies into the paid workforce, and that naturally increases GDP and gives you the $20m that you need to start the ball in those two cases. There's two other policies that can do that quite readily as well: one is immigration. You want more bodies in the workforce, immigration's your baby, and especially in the short term. In the medium term, if you want more bodies in the workforce, tertiary education is the way to do it. Not primary and secondary which is much harder to generate these outcomes, because everyone's locked in, they're compulsory. But tertiary, like the demand driven system now, can generate a lot more bodies and higher quality bodies in the sense of they're all higher paid, on average, and a high participation. So migrants similarly are high participation, female and age, and tertiary educated, more female participation and more age participation. And I think from the studies I've seen, the $20b plus is easily met by those in the short term by immigration, in the medium term which begins as quick as four years, by tertiary education. And your interpretations don't say migration, education. They say age and women. But it seems to me there are the game changers that can be really stated a little differently and in some ways arguably might be easier policies than some areas you've covered.

JOHN: We did actually look very explicitly at both of them, and the reasoning on each was as follows. On immigration, it's a bit of a trick. In terms of how to express this, we obviously expressed it in terms of GDP, in terms of absolute dollars, because it's easier to think about, and easier for people to grasp. But what we're in fact *really* talking about is GDP per capita, because none of the other things really change the per capita numbers. Of course the catch with immigration is that it changes the per capita thing. And although you get a big increase in GDP, you don't get much in terms of GDP per capita.

BOB: That's right. Sure.

JOHN: So the way that we valued immigration was what's the lift in GDP for existing residents? And the answer is not much. There's some, but not much. And the PC's done a lovely piece of work that basically tries to demonstrate why that's the case. And the kind of intuitive answer to that is, the problem with increasing immigration materially is that you essentially have to pay for a huge bunch of infrastructure at the margins, and the cost of the infrastructure basically doesn't quite outweigh the additional revenue but it comes a long way to it. So that was on immigration. On higher education, the story's a bit more complicated. Two things: firstly, when we talk about increasing Australian higher education participation, by definition today, you are increasing it at the bottom end. So participation rates amongst people basically with high ATARs are extremely high. Participation rates amongst people with lower ATARs are much lower. And our experience over the last couple of years as we have substantially increased the number of places, are that most of the marginal places have in fact been to students with low ATARs. Now there's some work that Grattan has underway essentially looking at what are the lifetime returns to higher education, and the bottom line is for people with low ATARs, the lifetime returns are not great. And some of them may well not even be going forwards. They're certainly not going forwards by very much. So our argument would be that the marginal returns from here of increasing higher education participation are not as high as the current average returns. And then there's the second issue which is that even if you kind of open the floodgates to Australian higher education participation tomorrow, as a proportion of the total working population within the next decade, it wouldn't be that high. So it might well pay off over 20 years but it won't pay off over 10. And I guess we were focused on what will make a difference over 10, because it's hard enough to get governments to focus on the next 10 years, get them to focus on 20 is even harder.

BOB: But I really think we could talk about it with John for a long time. So thank you for coming. I hope you enjoyed it. Let's thank John. Not next week but the week after, there's a whole week of policy events [unclear] and ANU. You can probably pick up what's on on the internet or the newspapers and I'm sure you'll be interested in those sessions too. Thank you very much for coming.

End of recording

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