

The Policy Pitch

Big ideas for a small state: Grattan views on the policy priorities for the next Victorian government

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Victorians go to the polls on November 29. What are the big policy questions Victorians should consider before they vote? What issues should be the focus for the winner? Grattan CEO John Daley hosted this Policy Pitch panel discussion with four Grattan experts — Danielle Wood (tax and budgets), Pete Goss (school education), Peter Breadon (health) and Jim Minifie (productivity growth). They considered the big issues in their policy area and the choices that would really make a difference to Victoria's future.

Moderator: John Daley, Grattan Institute

Speakers: Danielle Wood

Dr Pete Goss

Peter Breadon

Dr Jim Minifie

PETER MCMAHON: Good evening and welcome to the State Library of Victoria. My name is Peter McMahon, I'm the Director of Digital Strategy here at the Library. Our event today is being held on the traditional lands of the Kulin Nation. I would like to acknowledge them as the traditional owners and pay my respects to their Elders and to the Elders of any other communities who may be here tonight.

It's my great pleasure to welcome you to *The Policy Pitch* presented by Grattan Institute and the State Library of Victoria. I would particularly like to welcome and acknowledge our speakers for this evening - John Daley, Danielle Wood, Dr Pete Goss, Peter Breadon and Dr Jim Minifie - members of the Library Board of Victoria and Grattan Institute members. I would also like to thank and acknowledge Friends of the Library who may be here this evening. Friends of the Library play a vital role in helping the Library acquire and conserve some of its most important collection items, as well as supporting our creative fellows and the Library's exhibition program.

We are delighted to be partnering with Grattan Institute to present this series. *The Policy Pitch*, which is held monthly, brings to the Library industry leaders who invite discussion about complex public policy issues that affect the lives of Australians. Clearly there is much interest in the big policy questions Victorians will need to consider before they vote at the polls on November 29. The title of our discussion this evening is *Big ideas for a small state: Grattan views on the policy priorities for the next Victorian government*.

I'm very pleased to introduce our participating chair, the CEO of Grattan Institute, John Daley. John is one of Australia's leading public policy thinkers with 20 years' experience in public, private and university sectors. He has worked for ANZ and McKinsey in a career that also includes expertise in law, finance, education and Workers' Compensation. John is joined by four Grattan Institute experts in the fields of tax and budgets, school education, health, and productivity growth. Please join me in welcoming John Daley, Danielle Wood, Dr Pete Goss, Peter Breadon and Dr Jim Minifie.

JOHN DALEY: Thank you very much and thanks again to the State Library for participating in this partnership, which I think has been a terrific way of bringing policy issues to public events in Victoria

and, of course, particularly for this venue. Amongst Grattan Institute this is actually our favourite venue in the entire state for running public events. There are not many places you get a stage with a properly raked audience and it's a terrific place for these kinds of discussions.

So, as mentioned, I'm joined today by a number of Grattan experts and let me just give you a quick, brief rundown on their background.

Starting on my left we have Dr Pete Goss who has relatively recently started with Grattan as the Program Director in our School Education Program. Before coming to Grattan, Pete was working with the Boston Consulting Group and before that, amongst other things, did a doctorate in biology at Harvard, so if there are any questions on that they'll be going to Pete.

On my left is Danielle Wood, she has also somewhat recently joined Grattan as the Fellow in what we call the Australian Perspectives Program, otherwise known as CEO's pet projects, which for the last couple of years has been focusing generally on prioritisation in government, but more specifically on Budget policy, so both on spending and on revenue. Prior to coming to Grattan Institute, Danielle was the chief economist at the ACCC (Australian Competition & Consumer Commission) and has a very distinguished record already in economics having graduated from the University of Adelaide.

To my right is Peter Breadon, he's a Fellow in our Health Program. Peter actually first worked at Grattan Institute five-and-a-half years ago when I first arrived and Grattan Institute first opened its doors. Peter at that stage was working for the Department of Premier & Cabinet. Subsequently he's done further study in Germany - so anyone who wants to understand what public policy courses there are in Germany talk to Peter - but for the last couple of years has been focusing in our health program and making an enormous contribution there.

And finally we have Dr Jim Minifie who is the Program Director for our Productivity Growth Program. Before coming to Grattan Institute, Jim was at the Boston Consulting Group for a long time as their chief economist and, continuing this idea of long-standing connections, 25 years ago – a bit more than that – was in the room two doors down from me at Trinity College. So it is a very small world. So we're still two doors down from each other. It's great to have you all here.

So we have an enormous range of expertise tonight. As you'll have noticed, there is a state election coming on the 29th of November and what we thought we'd do tonight, a little differently from our normal conversation perhaps in a lot of these *Policy Pitches* talking about a specific Grattan report, instead we thought it would be worthwhile talking about what are the big issues for the state election campaign, or at least what ought to be the big issues? We'll doubtless hear an awful lot of politics. I have a theory which is that in general the quality of policy varies inversely with the length of time 'til the actual election date. So, I'm guessing if this election is like any other, the quality of policy is basically all downhill from here, but we thought it would be worth talking about what should Victorian state political parties be talking about over the next two months as we think about where to take Victoria next?

Now, some of the key concerns in any election campaign, or at least some of the things that ought to be key, are essentially firstly, what can government do to intervene that would grow the pie, one way or another would leave us all more prosperous so that there are more resources to do the things that we would like? Secondly, how should government prioritise its budget to provide the services that all of us would like to have and how can they do that in a way that is sustainable so that we are essentially paying for today's services today, rather than hoping that somebody is going to pay for

today's consumption tomorrow? And then finally, in terms of growing that pie and also setting the budget, how are we going to look after those who are most in need?

Now, I'm sure you can cut up the issues in a state election campaign in any number of ways, but that struck us as a useful framework: how do you grow the pie; how do you prioritise the budget; and then how do you look after the people who need to be looked after the most?

So, why don't we start with the first of those and Jim, in particular, if we're looking at what state government, particularly a Victorian government, could do to improve rates of economic growth that'll ultimately increased the resources that are available to all of us, what should the priorities be?

JIM MINIFIE: John, let me start with I think the one area that state governments really have got huge influence over, and that is urban policy. Projections are for Melbourne's population to grow at about 90,000 a year, almost a million every decade for the next few decades, and finding a way to shape the city that gets the most for our current population of 4.5million, growing to over 7million over the next 30 years, can make a huge difference to how productive the city is and, by extension, the state as a whole. Time to quality jobs and time to services, including education, is just such a huge driver of how much we can deliver to one another and, ultimately, that'll get picked up in measured statistics like state income. And very specifically, it was disappointing to see in the current Plan Melbourne that the opportunity to progressively find ways in a selective way, but nevertheless a really focused way, to drive density in the sacrosanct middle ring of Melbourne suburbs was missing from that plan.

JOHN DALEY: We had something like 30 questions that came from people who signed up to this seminar today and one of those questions was essentially why is it that government is so unwilling to go there in terms of looking at increasing the density of, in particular, that middle ring?

JIM MINIFIE: So the glib answer would be politics, but the less glib answer is that there really are values that need to be carefully traded off and protected. So, you know, development willy-nilly is not the answer either, but clearly where there's a gain to be had by carefully protecting core values, but looking for opportunities where the incumbents and the entrants can both win, can over time significantly improve the efficiency of the economy and you end up with more people within reach of high quality jobs, of high quality education. And if you don't address that core issue you're going to end up with a ring of people who are far from services and far from jobs, the city will be less productive and those individuals in particular won't be able to access the benefits of the agglomeration economies that those of us who are lucky enough to be closer to town by virtue of our incumbency take as a right.

JOHN DALEY: Now that's a somewhat different take in terms of economic intervention, because normally when you talk about economic intervention and what governments can do the answer is or many people think that the answer is going to be around, "Well, how do we drive particular industries? How do we fill the gap left by the car industry? How do we take advantage of the scientific and medical research that's particularly around Parkville and around Caulfield and Clayton and so on? What do we do about emerging industries like micro-manufacturing? And, indeed, three of the 30 questions were all around that what you might loosely describe as industry policy. Is there something there, should it be a priority?

JIM MINIFIE: So, I would share your view that the, if you like, raw form of intervention to protect individual industries is the wrong way to go. That's been tried many times, including very recently with the car industry, and you're really throwing good money after bad in postponing what inevitably is

going to be a painful transition. But that doesn't mean that there aren't big opportunities to get the most out of our really significant investments in world class science and education. Australia, like many countries, struggles with translation of those research excellence fields into industry and there's much more that can be done there.

Essentially, it amounts to freeing up intellectual property and getting out of the way of individual academics from engaging with the private sector. But more broadly, there's so much government can do to permit new industries to come into being and to flourish that is more in the realm of deregulation. Victoria's been a great leader in recent years in partially deregulating the taxi industry which, while it may not be visible to any one of us, it's manifested very clearly in a reduction in the price of taxi medallions and, over time, that will make a small but material contribution to transport efficiency, as long as you get some of these other infrastructure and congestion pricing and what have you issues right.

So broadly the answer is yes, the industry composition matters; yes, there's a role for government in getting the most out of research; but there's also a strong deregulation agenda and there's a lot more to be done in occupations in other fields.

JOHN DALEY: So the one perhaps really big economic lever we haven't talked about so far is education, which I think a lot of the research would show in the long run essentially blows everything else away. And that of course takes us to your area Pete in terms of what is it that government should do from here, particularly around our school system, that'll make a difference in the long run to the quality of the education that our children receive?

PETE GOSS: Thanks John. So the challenge for Victorian education is broadly how to get better while getting bigger. And I'm going to pick up on the bigger point first, and it's related to Jim's point, that the latest Victoria in Future survey suggests that between 2011 and 2031 we're going to have an extra 380,000 school-age students, that's somewhere between 500 and 800 extra schools. New South Wales is just starting to grapple with this and some of the numbers suggest that they might need to invest an extra \$10billion, so that's a big amount of money. Victoria's increase is going to be even bigger in terms of absolute numbers. We're growing faster than New South Wales, but very uneven, so where do we need the schools? And we need to get that right.

The outer growth suburbs, seven of the local government areas are going to have to take half of that total increase in the number of students and there the challenge is going to be how do you build new schools and make them great schools in some areas that are a long way away from town and maybe explore some new models like integrating them with some of the early childhood and health services to make that much more seamless? 15% of those students are going to have to go in the four most densely crowded suburbs and local government areas in Victoria, not the inner ring but the very centre of the city, and land there is very expensive and we've got to plan that quite carefully to make sure that that expansion can be made available.

And the remaining third in the remaining 70-odd local government areas are going to have pretty low growth and there you've got an opportunity to trade off. Maybe do we need to allow in some cases class sizes to increase very slightly, one or two student increases would free up 5% to 10% of the Budget to do other things with. So that's how to get bigger in a smart way.

JOHN DALEY: Which leads to one of the questions that came through earlier from the audience which is so how do you weigh up this investment in school buildings - as you say, over the medium run that's quite a lot of money – against investment in support services?

PETE GOSS: It was a great question. So school buildings are necessary of course, but they don't in themselves improve outcomes. So to get better I think the number one goal for Victoria is to get literacy, especially reading, right the first time and to do that for every student. So if you look at some of the NAPLAN results, that would suggest that by Year 3 95% or so of our students are at minimum levels, but actually those minimum levels are set pretty low and some of the international testing suggests that the number of students that are not at those levels are much higher. And if you don't learn to read early on then everything else in school is hard to catch up with, so that's the first way to get that up.

JOHN DALEY: I guess in terms of trying to do that, again, one of the questions that came in earlier is school leadership seems to make a big difference. What is it that government can do that will improve the quality of school leadership?

PETE GOSS: Yes, school leadership is critical and it's complex. Its effect on student outcomes is indirect, but when school leaders set high expectations and they manage their staff so that everyone in the school is then focused on how do we get every student moving forward as fast as possible, then school leaders can have a tremendous impact. The current Department of Education is very focused on school leaders. They've got a lot of stuff in there, the challenge is how to focus on doing only the right things and not the hundred other things that would be nice but don't necessarily add the most value.

So what they should do there, I'd suggest, is take some advice from the Victorian Competition & Efficiency Commission which said simplify the ten current accountabilities – I'm not even sure what all ten are – and focus on just three. Number one, principals should be held to account for improving the education gain of every student in their school; they should be accountable for improving the efficiency of resources so that we spend our dollars wisely; and then, once they've got that under control, supporting other schools locally.

JOHN DALEY: Thank you. So far we haven't talked about the far end of school education, so we've talked about early education and literacy, and one of the questions that came through is the Federal government is scaling back some of the programs that support transitions from education to employment. Is that something that a Victorian government should be worried about?

PETE GOSS: Yes, I love this question because it's so easy to talk about schools and not actually talk about students and that's what we're all there for. Pathways are really important. Three things to do: number one, high quality education in primary and early secondary is essential because that keeps as many people as possible on the pathway to a good academic outcome from Year 12 where that will maximise their choices. That's not going to be appropriate for everyone, so number two is to ensure that there are a range of alternative educational pathways for students who don't fit that academic Year 12 mould. And both of the these things, the quality of schooling and the range of pathways, are within the accountability of the state government.

Number three goes a bit beyond schooling and that's to ensure that there are jobs at the end of course and to encourage links between schools and industry, and there are some great pockets and some great examples of that and I think the state government could do more of those. I think the

slight challenge is that when we think about opportunities to go straight into work and not necessarily to take an academic pathway we have to make sure that that's the choice of the student and that we're not lowering expectations. We have high expectations, but allow diversity.

JOHN DALEY: And then finally, one of the things that we've heard a lot about in Victoria and, indeed, are hearing a lot of at the Commonwealth level at the moment is around school autonomy. Does it make a difference, should there be this kind of focus, and what kind of autonomy do we want?

PETE GOSS: Thanks, that's a big one. School autonomy can make a difference and can make a positive difference. It can, when done badly, make a negative difference which is unfortunate. We are hearing a lot about it. You won't hear a lot about it in New South Wales; there they talk about school authority. But Victoria has been on the autonomy path for many years and, frankly, and the government acknowledges this, without yet seeing the consistent gains that we need for all students. And, again, it's this issue that many things matter but the critical thing is to focus on those few things that matter the most and driving really effective implementation. And I think the things that matter most are can we see that every decision that is given to a school is going to be used in a way that identifies where each student is at in their learning and moves them as quickly forward as is possible?

JOHN DALEY: Thank you. So far we've been talking about how to make the pie a bit bigger. That of course, talking about education, which I think is 22% of Victorian government expenditure, leads us to actually think about the bigger picture of what are all the other things that governments spend money on? And, of course, ultimately we also need to worry about where the revenue comes from, but Danielle, where are Victorian government Budgets, are they sustainable, and what do we need to do from here?

DANIELLE WOOD: Well, before I answer that question, which is a big one, I thought maybe just giving people a guide as to where the money comes from and goes to would be a good idea, to give a bit of perspective. So on the expenditure side, the Victorian government this year will spend about \$50million, around half of that will be split between health, education and early childhood; another approximately 30% transport, infrastructure, justice, social services; and then a whole lot of rats and mice. On the revenue side, about a quarter of the revenue comes from Victorian government taxes, so payroll tax, land tax; almost half from Commonwealth government grants including GST distributions; and then the rest is sales of goods or fees for services. So that's the magnitudes that we're talking about.

In terms of whether the Budget's sustainable, I think if you look at the most recent, 2014/15 Budget, it does look reasonably healthy over the medium term. The government's been pretty successful in containing expenditure growth the last few years; we're forecast to have an operating surplus this year and every year over the forward estimates - and, to put that in a bit of context, we're actually the only state government that is forecast to have that - and net debt is forecast to decline from 6.3% of gross straight product to 4.5%. So there are a lot of positives in terms of the medium term I think.

JOHN DALEY: And the challenges? I'm hearing a "but"?

DANIELLE WOOD: There's always a "but". Look, I think there are a number of significant longer term challenges. First of all on the spending side, health is about a quarter of total spending. Historically that's been one of the fastest growing expenditure areas and I think with the aging population, with continued demand for more and better services, we have to expect that the pressures in terms of health spending are going to continue. They've been exacerbated by recent changes announced in

the Commonwealth government Budget which is effectively shifting back increases in spending to the state government from 2017 onwards. So we have to expect that if the state government wants to maintain the level of services it was expecting in those areas there's going to have to be some sort of revenue increase to make up that shortfall.

Other pressures, I think capital works is likely to be a big one. We've had a number of significant transport infrastructure projects that have started to be funded in the current Budget, so we're looking at north of \$15billion for the total East West Link project, another \$11billion for the Melbourne Rail Link, and those sort of expenditures obviously have pretty significant implications for the recurrent Budget position going forward. You've got depreciation, you've got maintenance, operating expenses, and then you've got interest expenses on any debt that's taken out to finance those projects, so potentially quite significant implications over the longer term.

JOHN DALEY: Yes and, indeed, we've seen quite a lot of commentary in the media about the way that transport may well be a really big issue in this election. Indeed, intriguingly, of those 30 questions that we had in advance, five of them were about transport which certainly suggests it's a big deal. Interestingly, there wasn't a single question about health, even though it's the largest single area of expenditure, indeed, about 28% of all Victorian state government expenditure goes on health. Peter, given that it is so large, even if it's not necessarily always at the top of peoples' lists of interests, what should be the priorities for an incoming state government in health?

PETER BREADON: Well, I'm personally hurt that no-one in the audience seems to have questions about health, but you can make that up to me at the end. What's the context? Danielle's spoken a little bit about this. The Commonwealth government is taking about \$2billion out of health funding to states, that's in the short term. In the longer term, the Commonwealth has also said it's not going to share the growth in hospital costs as they previously were going to do and they've changed indexation as well, so there are some pretty serious long term cost pressures in health as well. The good news in a way for Victoria is that, firstly, the Australian system is not one of the highest costs in the world and within Australia Victoria has got the lowest hospital costs. And hospital cost is the most important for the state government; that makes up about 70% of all their health spending. So in a sense that's great because the costs are relatively under control, but it also means it's harder to make up for that shortfall without cutting access or cutting quality, so that's going to be a challenge that they're going to have to deal with in the short term.

Now, we've looked at public hospital costs around Australia within each state and we found that after you control for all the legitimate causes of cost differences between different hospitals, even within Victoria which has a very tight distribution, low-average costs, even here the difference between the highest cost hospital and the lowest cost hospital per patient is still \$1,000. So if you close that gap, even part of it, you can save a couple of hundred million dollars a year. So we've talked about that before, that's one route they can take to deal with those immediate term cost pressures.

The other is that this cost pressure could be a prompt to take on some of the tricky and challenging controversial reforms in hospital cost control and efficiency. We've looked at workforce roles and updating those, so the opportunity to bring in nurse assistants to help take on some of the work that nurses are doing and having specialised nurses do some of the things the doctors do in special cases or in low risk cases, things like endoscopies and sedation and so on. So it's another reform the government could pursue. But that's kind of the immediate term issue of dealing with these cost pressures due to some of this pressure from the Commonwealth, but there are also longer term issues.

There's limited time this evening, but two that I would think about focusing on, one of the big challenges for the health system overall is how do you join up the parts of the system run by different governments, the primary care setting where you have your GPs and clinics in the community, and your acute care setting? That's a really big structural challenge for the health system and I would urge a new Victorian government to look at these new Primary Health Networks that are replacing Medicare Locals and say, "How can we actively try and drive their mission and shift them and make sure that they partly focus on reducing avoidable admissions to hospital?" So why couldn't the Victorian government provide a financial incentive and say, "For this area that you look after as a Network, if you can reduce the avoidable admissions to hospital we'll pay you for that. We're saving money, we can provide that incentive", the state government's no worse off and you start to integrate the incentives between the hospital and the primary care setting. That's just one example in the area of integration.

The other thing I think the government should really look at is how to build up the focus on the impact on patients of treatments. So Victoria's got a proud history of reform in hospital funding, that's one of the reasons that costs are low. They can start to use some of those same mechanisms in pricing to look at paying for quality, paying for outcomes, instead of just cost. So there are various models for that around the world and I can talk about that more later, but I think the first thing is to build up the information, start recording what are the outcomes for patients in a systematic way so that we can measure who's getting what kinds of benefits, and then factor that in to the way the whole system is run.

So that's just a few of the big themes that it would be good for Victoria to look at.

JOHN DALEY: It is, on the other hand Peter, a very large challenge. If we look at change in government spending over the last decade or so, remembering that today the Victorian government spends about \$50 billion a year, of that they've increased health spending in real terms by about \$5 billion in the last decade. So something like 10% of Victorian government spending is essentially just the increase and that appears to be primarily because we're providing more services for a person of a given age.

PETER BREADON: That's true. So the question is, people look at the rapid growth in healthcare spending and hospital spending and they project it out and freak out and think, "What can we do about it? Is the system sustainable? What major structural change do we need to make?" This is part of the debate that underlies, at the Commonwealth level, the co-payment proposals and the response to that. Our argument is that while this cost growth is rapid and big, it's gradual, we can plan for it, and as societies become wealthier they choose to spend a greater proportion of their GDP on health. So I think it's something, particularly given the drivers like aging and so on are slow and predictable, I think we can plan for it. I don't think we need to make radical quick fixes, but the work we've done has pointed to things like how do you control variation in costs in the system and how do you look at a granular level and see where the problems are and give the information and the tools to fix those problems? We're currently doing some work on patterns of care and how they vary as well.

So I think rather than a huge broad structural withdrawal of funding, you need to look at just managing the system better and gradually improving that over time.

JOHN DALEY: But it does sound as though a lot of that will ultimately be about saying, "We may well continue to spend more and more on health as we become wealthier" and I guess the flipside of that is saying that some of this demand we may effectively just spend more, but then we've got to find a

way of paying for it. And Danielle, I guess that takes us to the other side of the Budget in terms of the taxation side. What are our best options on the revenue side for the Victorian Budget from here?

DANIELLE WOOD: Well, I think if you think about the most efficient ways to make up a revenue shortfall economists would probably come back with two answers. One is increasing the GST and by that I mean either increasing the rate of preferably, for an economist, broadening the base so you're putting in health, education and fresh food. It may not be terribly realistic in the short term. The other more efficient tax that state governments have available is land tax and economists really like land tax.

JOHN DALEY: As did one of our audience members who asked what about a Henry George approach to land tax?

DANIELLE WOOD: A Henry George approach, so essentially that is taxing the rents on land. The reason it's so efficient is if you put a tax on land you don't get the same behavioural change that you get with taxes on income or corporate taxes or stamp duties, for example. It's also really hard to avoid for obvious reasons and it's also a pretty progressive tax because wealthy people own more land and higher value land, they'll pay a higher proportion of their total income in land tax than those at the bottom end of the income distribution.

Then comes the question of the mechanism for collecting that land tax. Grattan in the past has advocated that we should do that via council rates, rather than utilising the existing land tax base and it's essentially for pragmatic reasons. There are a lot of exceptions built into the land tax base as it currently stands, not least of which is the owner-occupied home exception, and essentially those concessions and exemptions mean that what otherwise would be quite an efficient tax base is otherwise pretty distortionary. So doing it via council rates, probably a levy in the mould of the fire services levy. So we could think of it as a state services levy, a way of collecting additional revenues to fund more health spending, more education spending.

JOHN DALEY: Thank you. So far we've talked about growing the size of the pie and also how we then distribute that pie, we haven't talked much about disadvantage. Jim, are we doing enough as a state government and what should the priorities for an incoming state government be?

JIM MINIFIE: So there are different flavours of disadvantage and if any of you have read the Productivity Commission report on deep and persistent disadvantage it is very heart-rending to see the position of people in a wealthy society who, for various reasons, have had very difficult circumstances, often transmitted intergenerationally. And I think thinking long and hard about how we can reach out to those groups, often with a very, very long time horizon to improve circumstances, should be at the heart of government policy, but that doesn't make the problem easy to solve. It's also not just a state government responsibility, so much of the household tax transfer arrangements obviously occur at the Commonwealth level. And really I think it can't be overstated the important role of just the core competencies around economic management, keeping the economy on an even keel so that labour demand is strong, ensuring that the education provision really does reach out to every child and, over time, you'll begin to see that pay off, and the same goes for health.

I'm not close enough to the specifics of whether there are issues that are falling between the cracks, for example, between local governments and state governments with respect to housing. I suspect there are and I suspect that with the emerging group of people on the fringes of the city, which is perhaps a little bit more evident around some disadvantaged areas of Sydney than it is in Melbourne,

you're seeing a new form of urban-mediated poverty with lack of access to services being reinforced by some of these urban trends I spoke about before, and that's another reason to ensure that we really continue to make sure that the vast bulk of the population is within range of those core services.

JOHN DALEY: Thank you. Well, we've covered a lot of territory and I guess it's now over to you, the audience. What questions do you have? What do you think we should be prioritising as a matter of policy change over the life of the next Victorian government, whoever it should be? What do you see as being the big shifts that we should be looking at introducing? And obviously, if you've got any questions in particular for anyone on the panel please fire away. So who would like to go first?

AUDIENCE: I'm not sure who will be best to answer this, but recent polling by the Climate Institute found that 71% of Victorians support state government policies to encourage renewable energy. What policies do you think they should be?

JOHN DALEY: Jim, do you want to talk about energy?

JIM MINIFIE: There's no question that we're in a national interregnum, if you like, with respect to appropriate climate change policy and the last time we had one of those a number of states did begin to build really a sub-national but a supra-state focus on how to decarbonise the economy. I expect that is going to be a priority to the extent that that national gap persists. Now, getting policy that dovetails into whatever's left of national climate change policy is difficult to do when you don't know how much is going to be left.

To my mind, a sensible approach would be to try to look for a technology-neutral approach that carves out the trade exposed sectors and looks as much as you can like a broad-based carbon tax or emissions trading arrangement that covers multiple states. And you could do that fairly sensibly potentially from a base in the electricity generation sector, but the way that interacts with the renewable energy tariff and the rest of the national scheme means that it's very difficult to act at a state level until there's a little bit more clarity at that national level.

PETE GOSS: Can I add to that, I think in the longer term this is a good point to talk about the importance of science, technology, engineering and mathematics in education because we need a population that both is able to judge and make up their own minds about these types of issues and to the extent that we need change in the economy to be able to contribute to that.

AUDIENCE: My question is for you Pete about education. The Federal government is really interested in driving up teaching quality and their lever is around universities and initial teacher education. What could the state government do to improve teaching quality and what are some of the levers that you would recommend they should look at for the election?

PETE GOSS: Great question, thanks. The quality of the teaching, what teachers do in the classroom is what really matters in terms of driving up the outcomes for students ranging from engaging the students to identifying where they are and what they should be taught next. That happens in a number of different ways. The first part of this is who chooses to go into teaching? And who chooses to go into teaching is a function of how well the profession is viewed and also what the career prospects are. So Victoria has previously spoken about making teaching in Victoria more attractive than it is in any other state. I think that that would be an important way of attracting high quality candidates into teaching, and by high quality, one part of it is people who can understand what they're

going to teach and also the assessment, but it's also having the right personal characteristics to engage with students.

The second part of that is the initial teacher training. That's mainly the responsibility of the Commonwealth in terms of the courses that are done through the universities, but the state government employs a large number of those teachers and so it could be using effectively its muscle to say, "We would like to employ teachers with a certain set of characteristics", whether that be all of them with a Master's degree or maybe more primary school teachers who have specialisation in some of these science technology areas. The third big thing they can do is they can ensure that teacher training doesn't stop when you get your Diploma but it continues during the first few years, and there it's a matter of having mentors in the schools and ensuring that that training is part of the ongoing learning and development.

JOHN DALEY: Pete, the South Korean government has instituted a system in which it essentially tests teaching graduates and says if you want to teach in a South Korean school then you have to do well on the kind of tests that they administer. And they don't have to be simply a sit down multiple choice exercise; obviously they can be a, "Come and teach a couple of sample lessons so we can see what you look like". Is that an approach that a Victorian government should think about?

PETE GOSS: I think they should. I think that one of the leading teacher education places in the country is at Melbourne University. There are other very good ones, but one of the things that they are doing is to give their graduates a test that's not just a test of "Is your reading really good? Is your literacy really good and is your numeracy?" that's a test of "Can you teach students?" And the way they do that is they give a student with a challenge and they say, "Diagnose what the issue is, what are you going to do about it, show me how you're going to do it" and you have to pass that clinical sort of test to show that your teaching is up to scratch.

JOHN DALEY: One could add, the full South Korean experience is that they then, because they don't have the same Federal issues that we do, if there's a university with relatively poor outcomes on that test they cut their intake by 50% the following year, which is one of those solutions that may be a little radical for Australia although I suspect it would work.

AUDIENCE: My question goes to infrastructure policy, it's a two-parter. First part is how do we create an infrastructure policy decision making system in this state that can endure the four-year electoral cycle? And the second part is, given we have an infrastructure lag and given we have a rapidly growing population, how do we convince our policy makers that funding infrastructure or containing infrastructure funding to within the Budget or from the operating surplus is just not a rational way forward?

JOHN DALEY: Maybe if I can talk briefly to that? First of all, Grattan has announced that we're going to essentially open up a transport program starting next year, and if there's anyone who deeply wants to be the Program Director for that program they should put up their hand very, very quickly because we've started the selection process for it. The second thing I guess to remember around infrastructure funding is that first best policy is for state governments to invest a lot of money in genuinely productive infrastructure; third best policy is for state governments to invest a lot of money in not very productive infrastructure; and second best policy is to invest a reasonable amount in okay infrastructure, but don't spend too much of it.

Now, I think it would be fair to say around Australia we have seen state governments doing an awful lot of third best policy over the last few years. Australian state governments have been spending on infrastructure like there is no tomorrow for the last seven or eight years. Just on road and rail infrastructure we've gone from spending about 0.8% of GDP to about 1.3% of GDP and it's not obvious that we've seen a big jump in productivity as a result. And, indeed, many of those pieces of infrastructure manifestly the benefits did not exceed the costs and how do we know that? Essentially because the projects went broke, things like the cross-city tunnel in Sydney, Clem7 and so on, demonstrably we didn't pick great projects and, of course, we have a national monument called the Alistair Darwin Railroad to prove that not all infrastructure spending will in fact result in benefits commensurate with the spending.

So I think that's the real challenge and I think one of the reasons that perhaps the Victorian government has decided that it's going to require that infrastructure spending come out of recurrent surpluses is precisely that it imposes some kind of discipline on infrastructure spending. So that's one half of your question and in a sense that, I think, is the easy half. The tough part is how do we create a system which structurally results in much more disciplined infrastructure decisions? And of course we had a thing called Infrastructure Australia, and in the last Federal Budget the Federal government committed of the new projects that got money for the first time; not a single dollar went to a project that was high priority on the Infrastructure Australia list. So it's not a very encouraging story. We're kind of definitely in category three a lot of the time at the moment.

I think that the solution is to look at setting up some kind of Infrastructure Victoria body that is genuinely a statutory body set up at, relatively speaking, arm's length from government, full-blown governor and council appointments and a statutory remit to really look at the benefits and costs of projects and a statutory remit to make that stuff public. I think this is an area like so many where sunlight is a better disinfectant than anything else I can think of and so I suspect that that would be a good first step. Now, that leaves a lot of design questions about exactly what would that body look like, to what extent does it second-guess what the Department of Transport does, to what extent does it do its own analysis and so on. But I suspect that that's the kind of thing we need to build the public consensus that will then drive the political consensus so we don't continue to have what we have at the moment, which is one party preferring one project, not least because it's the precise project that the other party didn't back. That's clearly the worst of all possible worlds.

We need to be in a world in which we wind up over the medium run with real political consensus around what are the thing that'll make the most difference in terms of spending and hopefully a consensus that's as evidence-driven as possible so that scarce infrastructure spending does indeed go to things where the benefits will genuinely substantially exceed the cost. So that's two questions on transport.

AUDIENCE: I wanted to follow-up on some of the comments that Danielle made earlier, in particular these new revenue streams that she noted that governments have available to them. So this was the land tax and expanding the GST and, as Danielle noted, these aren't new ideas and they're supported by conventional economics and I have a suspicion that in the bowels of Federal Treasury and State Treasury there are probably policy papers that talk about implementing them, and yet they aren't implemented. So I'm just curious as to what you guys see as the barriers to tax reform?

DANIELLE WOOD: Look, I think the barriers always come down to the fact that there are winners and there are losers from any reform. So if you talk about state government tax reform, one of the most common proposals you see put forward is this higher land taxes but lower inefficient taxes, such as

stamp duty. The winners from that are clearly people that would move around a lot so they'd pay a lot of stamp duty. The losers are people that have a high value house that they want to stay in forever. I think there's a salience issue, so you're getting your annual tax bill, you know it's there, so there's a lot of resistance to that, whereas the people that might not pay the stamp duty are probably not going to remember to send their thank you card to the state government for abolishing it.

Potentially there's also an interesting state/federal issue playing out there as well which I heard John Freebairn raise at a recent lecture which I thought was quite interesting, and he said, "The trouble is the state government bears the cost of this type of reform. There's a broader economic benefit, you increase economic growth, that increases collections of income tax and corporate tax and they go to the Federal government". So what he was proposing was a 1990s National Competition Policy-style payment system whereby the Commonwealth government would actually compensate the state government for undertaking tax reform and effectively share some of those benefits.

AUDIENCE: There's been a lot of good discussion and debate about population growth in Melbourne and development of Melbourne. I'm interested in your views about regional development and, in particular, attracting investment, development and population growth in regional Victoria?

JOHN DALEY: Jim, would you like to take that?

JIM MINIFIE: So the regions are diverse in Victoria and the industry base is diverse. Some of them are going to thrive when agriculture and aquaculture, mining, forestry thrive; others are going to thrive when tourism thrives; and so there's no one size fits all answer. It does seem to be difficult to use, if you like, seed government funding to result in sustained independent self-sustaining industries where they otherwise wouldn't have been viable, and so that puts some limits on, I guess, the power of government to re-shape the regional economy. And so it does come down to looking for opportunities to get out of the way of opportunities that individual regions might have in front of them and then to look at where there could be public goods that could drive the industries that are going to support activity in those regions.

So, in particular, Australia and Victoria's had a long and proud history of agricultural R&D. You can't expect individual farmers to do that kind of work but it leads to a very, very strong, if it's done well, very strong positive result in the industries that are going to drive those regions. And there can be some similar analogous types of investments across other sectors.

JOHN DALEY: And if I can just add to that, it's worth remembering that governments in Australia have been trying to drive regional growth for the last 120 years and it hasn't worked yet, and that's essentially because it is very hard for government intervention to move jobs to people. It is far easier for people to move to jobs and one of the clear features of contemporary economic patterns, not only in Australia but around the world, is essentially economic activity is drifting towards services and it's drifting towards services in big cities or places reasonably close to big cities.

So, indeed, in Victoria we see Bendigo, Ballarat and Geelong as being kind of medium-sized centres within spitting distance of Melbourne and they're doing quite well. We see small towns that are also within spitting distance of Melbourne, places like Gisborne, Missenden, also doing quite well, and then we see areas further away continuing to grow some of them, so particularly the larger centres, places like Swan Hill, but smaller regional centres essentially shrinking in population terms, essentially because agricultural productivity is going up and that's a good thing. So I think that that is where we are and there are two things we can do here, we can either try and push all of that economic water

uphill or we can accept that that is the pattern we are likely to see for a long time given the way that a modern society and a modern economy works.

Now that's a very difficult thing to say politically that many of these more remote areas are unlikely to grow particularly quickly, but that's the most likely outcome and really it's a question of how much money are we going to throw at the problem? As I said, we've got 120 years in which most of those programs haven't been evaluated very well; certainly the long run outcomes are that they haven't done much in terms of shifting their long run pattern which is for economic activity and populations to essentially move towards very large population centres.

AUDIENCE: We've spoken a lot about revenue and what government can do to intervene, what about reducing cost? In particular I'm referring to the public service, not including the emergency services, frontline services, all of that, but the cost of doing business due to bureaucratic red tape is a significant deterrent to the revenue base, so you're not attracting particular sectors or global businesses to the state because of that. How do you see us getting over that hump?

JOHN DALEY: Well, maybe we can divide that question into two. Firstly, Danielle, to what extent is this a big budgetary opportunity? And then secondly, Jim, to what extent is this a big productivity growth opportunity in terms of looking at that red tape?

DANIELLE WOOD: In terms of the budgetary opportunity, I think there have been some fairly substantial cuts in the Victorian public service already so I'm not sure to what extent it's possible to go further without impacting on service delivery. In terms of cutting red tape, well, that tends to be off-Budget benefits, so more to the productivity side I would say.

JOHN DALEY: Yes. It's worth remembering that the big money doesn't go to public servants; the big money goes paying nurses and teachers and police, those are where the big numbers are. And so you can cut an awful lot of public servants, what sounds like big numbers, and yet it's just not a big deal in terms of the Budget. But Jim is there a big red tape opportunity do you think?

JIM MINIFIE: It's hard to estimate the size of it, but it's been a long time since it was heavily a core government priority. If you look back to the, if you like, high water mark of national competition policy which included regulatory impact evaluations, that era has come back to some degree as part of the COAG process over the last four or five years, but there's a lot more to be done. Specifically in Victoria, I know there are people in this room who've done work on this topic, there are as I recall well over 50 regulators of one type and another in the Victorian apparatus and there would be a significant opportunity to prune that. The dollar value of that I don't know, but people who run small businesses do say that they run into constraints of different types and it would almost certainly be a positive to reduce some of that thicket.

JOHN DALEY: It's probably worth also remembering there's a local government agenda there too, is that right?

JIM MINIFIE: Yes, I think that's fair. Now, that's even more difficult to evaluate quantitatively, but you've got a significant tier of government that doesn't receive a lot of attention and the performance of which is difficult to evaluate. And so there's probably an opportunity there, it's a longer term agenda though.

AUDIENCE: If a lot of modern economic growth is going to come from service industries and technology, what can state governments do to encourage innovative firms to locate and thrive in Victoria, rather than going overseas?

JIM MINIFIE: It seems that the magic ingredients are that combination of innovative local firms, so you need the skill base and the entrepreneurial culture and the settings for entrepreneurship locally, and global firms that can provide international best practice and can market those innovations to a global market. And on some dimensions Victoria already does very well on that front, so I don't think there's a silver bullet that is going to make a step-change in that area. You can see areas where, for example, in the peer-to-peer economy there's more that can be done to permit that to foster: co-working spaces are a great idea; there are some new models that go far beyond venture capital based around the universities for incubating new business.

But it is important to recognise that the scale of those activities is typically not large and it's very difficult to build a Silicon Valley. That started back in the 1950s and so it's a bit late if we think we're going to get one any time soon through government policy.

JOHN DALEY: But a bit more generally Jim, that is about the growth of service industries and is that where this agglomeration into cities in terms of having a large CBD and the area around it and a lot of people who can get access to it, that becomes extremely important?

JIM MINIFIE: Yes, that's right and I should have mentioned that clearly one of the drivers of this importance around having a high-functioning dense inner city is that the payoff to proximity is just that much higher in these new classes of roles. That's quite right.

AUDIENCE: With the Commonwealth changing the way they're going to grow pensions by indexing them to average weekly earnings instead of male weekly earnings and by indexing them to the CPI instead of wages in the future, we're concerned that there's going to be an increasing gap between people on the age/disability pension and the community, and particularly for those in private rental that is becoming an increasing issue of housing stress and deepen disadvantage. State government has seemed to come to a grinding halt in terms of commitment to social housing and I gather that of the planning applications for the CBD at the moment, none of them are affordable housing. The Commonwealth's cutting out NRAS. Is there a responsibility looking forward to this for state governments to be more proactive in this space of affordable housing/community housing?

JIM MINIFIE: So you do see around the world in cities that are experiencing rapid urban development that many of them do prioritise social forms of housing as a part of the mix. Traditionally that hasn't been a big focus in Australia and there's no question that people consume different bundles of goods and services and the price of those can vary strongly, and so there's no guarantee that just because you get the average person's CPI that you're getting your cost of living handled. So yes, potentially state governments will have to pick up the slack if real incomes are falling behind for a group at this time.

JOHN DALEY: Well, that's a piece around social housing and I guess there's a more general question, Danielle, about whether state governments at the moment do in fact provide a number of concessions for pensioners of various kinds. Should we be increasing those concessions?

DANIELLE WOOD: That's a very vexed question. I mean, from an economist's perspective, the transfer system actually works more efficiently if you leave that to the Commonwealth government to

do so they handle those inequality-type issues and state governance levy across the board, taxes or service charges. When the Commonwealth's not doing their job well then perhaps state governments do feel the need to step into the fray and offer those sorts of concessions.

JOHN DALEY: And then do so inefficiently, which I guess is one of the vices of federalism?

DANIELLE WOOD: That's right.

JOHN DALEY: And that's the difficulty.

AUDIENCE: I'd like to link the question of affordable housing with all of you effectively on the panel. Do you know the evidence between providing affordable housing and its contribution to productivity, health benefits and education benefits?

JIM MINIFIE: Well, my way of answering that question is that to have a society in which all members can participate fully ought to be a widely accepted goal of government and, in a huge city, part of that is about your location and the quality of the housing that you're able to access. Now, whether that's obtained through a specific housing-style intervention or whether it's through income support that permits people to realise that goal through having the purchasing power to buy housing that suits them. I'm not an expert in that area, but I'll do some more homework on it. It's clearly something that for a growing city it's going to remain front and centre of ensuring that we retain social cohesion and fairness.

PETE GOSS: I think it's a great question on the education site. The best teaching in the world is going to struggle if a child is coming to school with a background that is making it hard for them to concentrate and learn, and housing is one component of that. We know that the best time to get people on the path towards learning and success in later life is as early as possible and if we don't do that then the costs come back to bite us. So to the extent that that is having an impact on children, it's not the only group, but that is a very inefficient way of thinking about budgeting in addition to just the fairness aspects.

JOHN DALEY: Thank you. Well, we've covered a huge amount of territory this evening, as always I'm sure there is a large amount of territory we could still cover from here and unfortunately time has run out on us. Can I thank a few people for making tonight possible? Obviously first and foremost State Library of Victoria; secondly the staff from the State Library who, as always, have been a complete pleasure to work with; a number of people from Grattan Institute, particularly Alex and Andrew who work tirelessly behind the scenes to make these events at least appear seamless and it's only because they work very hard at zipping up the seams that they look that way. I'll obviously thank those on the panel from Grattan Institute tonight.

I hope it's been an interesting way of thinking about the breadth of issues in a state election campaign. Clearly there's a lot on the table, clearly there are many things that a state government really needs to think about as we move into the election campaign as to how we can make Victoria a better place to be. So thank you to all of my panellists here: Pete, Danielle, Peter and Jim. And finally, thank you to all of you in the audience here, it wouldn't be an event without you, it's great to have you hear and we look forward to seeing you in a months' time at the next *Policy Pitch* here at the State Library. Thank you very much.

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