Future proofing

John Daley
CEO, Grattan Institute
Customer Owned Banking Convention, Darwin
21 September 2015
Future proofing

**Australia has had a great decade, with the benefits well spread**
- The mining boom was very large and drove a big lift in incomes
- The benefits were well-spread across States, income levels, and ages
- Older age groups became much wealthier as interest rates fell
- Health improved, crime fell, and well-being indicators are generally high

**However, harder times are ahead**
- Per capita incomes are likely to growth much more slowly
- The long run of prosperity has led to complacency
- Budgets are unsustainable

**Younger age-groups are more vulnerable**
- Home ownership is falling, particularly for those with low incomes
- In the UK and US, a younger generation is less well off than its parents

**Increasing growth and balancing budgets requires tougher calls**
- The most important growth opportunities require tax and welfare reform
- Budget reform should rethink pensions, superannuation and asset taxation
- Most of the sensible choices imply lower property prices
- Meanwhile, older households will have an increasing share of consumption
The Australian mining boom was the largest in the world

Mining investment 2005-2012
(US$b, nominal)

Source: Grattan Institute, *The Mining Boom*
It was also the largest mining boom in Australia’s history

Mining investment in Australia as percentage of GDP

Source: Treasury analysis (unpublished) based on RBA, March Quarter 2010 Bulletin, “Mining Booms and the Australian Economy”, citing Butlin and Withers; mining investment in the annual national accounts (current prices, original); 2015-16 Budget forecasts
Real incomes rose 60%

Index year: 2000=100

Source: ABS 5206.0 table 30
All groups benefited from substantial income growth

Growth in household post-tax real income, 2000 – 2010
Percent increase, mean of quintile

Grattan Institute, Budget Pressures on Australian governments
Personal incomes grew strongly even in the non-mining states

Annual growth, per cent

### Average weekly earnings

#### Mining states
- 1995/6 – 2002/3: 1
- 2002/3 – 2011/2: 4

#### Non-mining states
- 1995/6 – 2002/3: 1
- 2002/3 – 2011/2: 3

### Household income per person

#### Mining states
- 1995/6 – 2002/3: 1
- 2002/3 – 2011/2: 4

#### Non-mining states
- 1995/6 – 2002/3: 1
- 2002/3 – 2011/2: 3

Note: Wage = AWE deflated using CPI cap cities deflators, where wage data includes FT and PT. Household income = Gross disposable income per capita (Household) deflated using CPI deflators.

Source: Grattan Institute, *The Mining Boom*
Incomes increased for everyone aged over 25 over the long term

Median annual income, $2013

Source: Grattan Institute, *The Wealth of Generations*
The average 55-74 year old is now a millionaire

Mean wealth by age of head of household

$ thousands ($2013-14)

Source: Grattan Institute, *The Wealth of Generations*
Over half of this wealth is in property

Mean wealth by age of head of household
$ thousands ($2013-14)

Source: Grattan Institute, *The Wealth of Generations*, updated based on ABS 6523.0
House prices increased much faster than incomes

House prices and full-time weekly earnings
Index: 1970 = 100

Source: Grattan Institute, Fiscal challenges for Australia
Residential land accounts for a growing share of national assets

Share of national assets
1989 to 2014, per cent

Source: Grattan analysis of ABS National Accounts 2013-14
Health improved

Amenable mortality
depaths per 100,000 population

Self-reported health status
Percentage of population in lowest two categories ("fair" or "poor")

Source: AIHW
Source: ABS
Future proofing

Australia has had a great decade, with the benefits well spread
• The mining boom was very large and drove a big lift in incomes
• The benefits were well-spread across States, income levels, and ages
• Older age groups became much wealthier as interest rates fell
• Health improved, crime fell, and well-being indicators are generally high

However, harder times are ahead
• Per capita incomes are likely to growth much more slowly
• The long run of prosperity has led to complacency
• Budgets are unsustainable

Younger age-groups are more vulnerable
• Home ownership is falling, particularly for those with low incomes
• In the UK and US, a younger generation is less well off than its parents

Increasing growth and balancing budgets requires tougher calls
• The most important growth opportunities require tax and welfare reform
• Budget reform should rethink pensions, superannuation and asset taxation
• Most of the sensible choices imply lower property prices
• Meanwhile, older households will have an increasing share of consumption
Economic growth is likely to be slower

Growth in Real National Income per person
Average percentage growth per year over period

- Labour productivity
- Foreign income
- Labour utilisation
- Terms of trade
- Income per person

Treasury, Rethink, 2015
Trend economic growth has slowed across the developed world

Potential output growth of developed economies
% per year

Source: Grattan Institute, Fiscal challenges for Australia
Historically there have been long periods of little income growth in Australia

Source: Grattan Institute, *The Wealth of Generations*
Australia made more tough economic choices when times were tougher

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Trade and currency</strong></td>
<td></td>
<td></td>
<td>FTAs?</td>
</tr>
<tr>
<td>Float A$</td>
<td>Tariff reductions</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Macro policy</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>RBA inflation targets</td>
<td>Bal. budget</td>
<td>Work-choices</td>
<td></td>
</tr>
<tr>
<td><strong>Labour markets</strong></td>
<td></td>
<td>Fair Work?</td>
<td></td>
</tr>
<tr>
<td>Accord</td>
<td>Enterprise</td>
<td>Workplace Relations Act</td>
<td></td>
</tr>
<tr>
<td>Bargaining</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Competition policy</strong></td>
<td>Hilmer review</td>
<td>National Competition Policy</td>
<td>Demand driven higher ed</td>
</tr>
<tr>
<td>GBE review</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Privatisation</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GBE reform</td>
<td>CBA sale</td>
<td>Airline IPO</td>
<td>Telstra sale (1)</td>
</tr>
<tr>
<td>Telco dereg.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Regulation</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign bank entry</td>
<td>Dividend</td>
<td>Bank capital reform</td>
<td></td>
</tr>
<tr>
<td></td>
<td>imputation</td>
<td></td>
<td>NRA</td>
</tr>
<tr>
<td><strong>Tax</strong></td>
<td>Capital Gains tax</td>
<td>Federal State</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Dividend</td>
<td>financial reform</td>
<td></td>
</tr>
<tr>
<td></td>
<td>imputation</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Federalism</strong></td>
<td>Super-annuation</td>
<td>Federal state</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Health reform</td>
<td></td>
</tr>
</tbody>
</table>

Note: The NRA is a broad set of microeconomic reforms largely focused on public sector efficiencies

The Commonwealth’s budget problems were masked by GFC and mining boom

Cash balance is equal to receipts minus payments, minus Future Fund income, (under 0.25 per cent of GDP)

Source: Grattan Institute, *Fiscal challenges for Australia*
Older households are taking much more from government

Average net benefits per household (government payments, less tax)
2010$

$35,000
$30,000
$25,000
$20,000
$15,000
$10,000
$5,000
$0
-$5,000
-$10,000
-$15,000

15-24 25-34 35-44 45-54 55-64 65+

Source: Grattan Institute, The Wealth of Generations

$20b/yr cost to budget
Policy choices, not population ageing, drove health and pension spending increases

Real increase in expenditure 2003-2013
($2012 billion)

Health

More, improved, and new services per person

Age Pension

Rate & eligibility change

Indexation >CPI

Population growth and ageing

Source: Grattan Institute, Budget Pressures 2014
Budget repair strategies have been dominated by hope rather than tough calls.

Actual and forecast Commonwealth underlying cash balance per cent of GDP

Forecast made in:
- 2011
- 2012
- 2013
- 2014
- 2015
- 2016

Source: Grattan Institute, *Fiscal challenges for Australia*
Future proofing

Australia has had a great decade, with the benefits well spread
• The mining boom was very large and drove a big lift in incomes
• The benefits were well-spread across States, income levels, and ages
• Older age groups became much wealthier as interest rates fell
• Health improved, crime fell, and well-being indicators are generally high

However, harder times are ahead
• Per capita incomes are likely to grow much more slowly
• The long run of prosperity has led to complacency
• Budgets are unsustainable

Younger age-groups are more vulnerable
• Home ownership is falling, particularly for those with low incomes
• In the UK and US, a younger generation is less well off than its parents

Increasing growth and balancing budgets requires tougher calls
• The most important growth opportunities require tax and welfare reform
• Budget reform should rethink pensions, superannuation and asset taxation
• Most of the sensible choices imply lower property prices
• Meanwhile, older households will have an increasing share of consumption
All households are saving more

Savings as a proportion of disposable income, per cent

Source: Grattan Institute, *Wealth of Generations*
Home ownership is falling for younger ages, particularly low incomes

Home ownership rate by age
Per cent

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>25-34</td>
<td>90</td>
<td>80</td>
<td>70</td>
<td>60</td>
</tr>
<tr>
<td>35-44</td>
<td>80</td>
<td>70</td>
<td>60</td>
<td>50</td>
</tr>
<tr>
<td>45-54</td>
<td>70</td>
<td>60</td>
<td>50</td>
<td>40</td>
</tr>
<tr>
<td>55-64</td>
<td>60</td>
<td>50</td>
<td>40</td>
<td>30</td>
</tr>
<tr>
<td>65+</td>
<td>50</td>
<td>40</td>
<td>30</td>
<td>20</td>
</tr>
</tbody>
</table>

Percentage point change in home ownership rates, 1981 to 2011

Source: Grattan Institute, Wealth of Generations
Homes are relatively affordable – unless interest rates rise …

Initial repayments on new mortgages as percentage of household disposable income

Note: Assumes 10% deposit, 25-year repayment of principal and interest on median priced house; assumes household disposable income is 1.5 times average pre-tax individual earnings

Source: Macrobusiness, based on RBA, APM Abelson & Chung
... which seems a distinct possibility

Global interest rates

“Lowest interest rates at least since Ancient Babylon”

Andy Haldane
Chief Economist, Bank of England

Source: Andrew Haldane, speech to Open University Milton Keynes 30 June 2015,
Younger cohorts in the UK now earn less than their predecessors at the same age.

Median gross annual wages in UK
2013£

Source: Grattan Institute, *The wealth of generations*
The incomes of 24-34 year olds in the US have declined relative to older workers

Median incomes in US
2013USD

Source: Grattan Institute, *The wealth of generations*
Future proofing

Australia has had a great decade, with the benefits well spread
• The mining boom was very large and drove a big lift in incomes
• The benefits were well-spread across States, income levels, and ages
• Older age groups became much wealthier as interest rates fell
• Health improved, crime fell, and well-being indicators are generally high

However, harder times are ahead
• Per capita incomes are likely to growth much more slowly
• The long run of prosperity has led to complacency
• Budgets are unsustainable

Younger age-groups are more vulnerable
• Home ownership is falling, particularly for those with low incomes
• In the UK and US, a younger generation is less well off than its parents

Increasing growth and balancing budgets requires tougher calls
• The most important growth opportunities require tax and welfare reform
• Budget reform should rethink pensions, superannuation and asset taxation
• Most of the sensible choices imply lower property prices
• Meanwhile, older households will have an increasing share of consumption
### Economic growth opportunities are difficult and limited

<table>
<thead>
<tr>
<th>Extra GDP in 2022 (in $2010)</th>
<th>Female part’n</th>
<th>Tax mix</th>
<th>Older part’n</th>
</tr>
</thead>
<tbody>
<tr>
<td>$20bn</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$10 bn</td>
<td>Health system</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Health system</td>
<td>VET</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Electricity grid</td>
<td>Bus dereg</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Higher ed</td>
<td></td>
<td>Industry policy</td>
<td>Rd congestion</td>
</tr>
<tr>
<td>LVET</td>
<td></td>
<td>Security</td>
<td></td>
</tr>
<tr>
<td>Youth part’n</td>
<td>Land freight</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Aged health</td>
<td>Disease prevent</td>
<td>Foreign invest.</td>
<td>School perf’c</td>
</tr>
<tr>
<td>Aged health</td>
<td>Urban water</td>
<td></td>
<td>Transport i’st</td>
</tr>
<tr>
<td>Aged health</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Evidence poor**
- Oligopoly regs
- Industrial relations
- Innovation
- Federal financial

**Low confidence in solutions** → **High confidence in solutions**

Note: Initiatives in red likely to have much larger impact over longer term.

Source: Grattan Institute, *Game-Changers*
Lifting eligibility for Age Pension and tax-free super would increase retirement ages

Cumulative per cent of male labour force retiring by age

Source: Grattan Institute, Balancing Budgets
Superannuation-funded early retirement only really benefits those in the top half

Proportion of age cohort receiving some superannuation payment

Source: Grattan Institute, *Balancing Budgets*
There are few options for budget repair that are both large and socially responsible.

Budgetary impact of tough budget choices
2013$ per year

<table>
<thead>
<tr>
<th>Choice</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age Pension assets test</td>
<td>$11b</td>
</tr>
<tr>
<td>Negative gearing</td>
<td></td>
</tr>
<tr>
<td>Pharmaceutical spend</td>
<td></td>
</tr>
<tr>
<td>Pension and super access</td>
<td>$24b</td>
</tr>
<tr>
<td>CGT discount</td>
<td></td>
</tr>
<tr>
<td>Higher ed subsidies</td>
<td></td>
</tr>
<tr>
<td>Defence spending</td>
<td></td>
</tr>
<tr>
<td>Cost effective medicine</td>
<td></td>
</tr>
<tr>
<td>Super contr concessions</td>
<td>$12b</td>
</tr>
<tr>
<td>Super earn concessions</td>
<td></td>
</tr>
<tr>
<td>Fuel tax indexation</td>
<td></td>
</tr>
<tr>
<td>Transport infra costs</td>
<td>$14b</td>
</tr>
<tr>
<td>Industry support</td>
<td></td>
</tr>
<tr>
<td>School class sizes</td>
<td></td>
</tr>
<tr>
<td>GST broaden</td>
<td>$19b</td>
</tr>
<tr>
<td>Health rebate</td>
<td></td>
</tr>
<tr>
<td>Mining royalty</td>
<td></td>
</tr>
<tr>
<td>CGT owner occ</td>
<td></td>
</tr>
<tr>
<td>Payroll threshold</td>
<td>$40+b</td>
</tr>
<tr>
<td>Fuel tax credit</td>
<td></td>
</tr>
<tr>
<td>Bracket creep</td>
<td></td>
</tr>
</tbody>
</table>

Source: Grattan Institute, Balancing Budgets
Better targeting of age pensions, super, and asset taxation dominate the attractive options

Budgetary impact of tough budget choices
2013$b per year

<table>
<thead>
<tr>
<th>Category</th>
<th>Pensions &amp; super</th>
<th>Assets taxation</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age Pension assets test</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Negative gearing</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pharmaceutical spend</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pension and super access</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CGT discount</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Higher ed subsidies</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Defence spending</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost effective medicine</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Super contr concessions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Super earn concessions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fuel tax indexation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transport infra costs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industry support</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>School class sizes</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GST broaden</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Health rebate</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mining royalty</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CGT owner occ</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payroll threshold</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fuel tax credit</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bracket creep</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Grattan Institute, Balancing Budgets
The most wealthy retirees earn more from superannuation – and even more elsewhere

Annual income, people aged >65
2010$
160,000
120,000
80,000
40,000
0

Wealth decile

Wealth
2010$ m
4
3
2
1
0

Other income
Wages
Investment & business earnings
Superannuation
Pensions

Source: HILDA survey 2009-10; Grattan Institute analysis.
More landlords are negatively gearing and average losses are growing

Number of people negatively gearing residential property (LHS)

Average loss (RHS)

Financial year ending

Collective losses on rental property jumped when the CGT discount was introduced.

Total net rent $ 2013-14 ($bn)

Most capital gains are made by the top 10 per cent of income earners

Percentage of net capital gains for each income decile (2012-13)

Australia has lower property tax revenues than some comparable countries

Taxes on property and transactions, per cent of GDP

Source: OECD (2014), Revenue statistics, updating Grattan Institute, Property taxes
Future proofing

Australia has had a great decade, with the benefits well spread
• The mining boom was very large and drove a big lift in incomes
• The benefits were well-spread across States, income levels, and ages
• Older age groups became much wealthier as interest rates fell
• Health improved, crime fell, and well-being indicators are generally high

However, harder times are ahead
• Per capita incomes are likely to growth much more slowly
• The long run of prosperity has led to complacency
• Budgets are unsustainable

Younger age-groups are more vulnerable
• Home ownership is falling, particularly for those with low incomes
• In the UK and US, a younger generation is less well off than its parents

Increasing growth and balancing budgets requires tougher calls
• The most important growth opportunities require tax and welfare reform
• Budget reform should rethink pensions, superannuation and asset taxation
• Most of the sensible choices imply lower property prices
• Meanwhile, older households will have an increasing share of consumption