

SOCIAL POLICY IN A 'FULLY EMPLOYED' ECONOMY

The 2007 Sambell Oration

**Address to a Brotherhood of St Laurence Conference
on**

**'The economic and social imperative: tapping the
potential of disadvantaged Australians'**

Saul Eslake
Chief Economist,
Australia & New Zealand Banking Group Ltd

Sofitel Hotel, Melbourne

Thursday 27th September 2007

Note: This address has benefited substantially from the research and drafting assistance of my colleague Mark Rodrigues. However all opinions expressed herein are mine, and should not be attributed to my employer or to any of its other employees.

It is an honour to be with you this morning to deliver the 2007 Sambell Oration. Bishop Geoffrey Sambell led the Brotherhood of St Laurence from 1954 to 1969, during which time he effectively modernised and professionalised the organization, increasing its capacity to promote social justice and reduce poverty. His legacy is evident in the ongoing work of the Brotherhood today, in its community-based programs, quality social policy research or influential networks with government and business alike.

His tenure coincided with what is conventionally seen as an economic golden age for Australia: growth was exceptionally strong; inflation was, for the most part, moderate; and measured unemployment was so low that rates any more than half of today's levels were regarded as sufficiently alarming to threaten the incumbent Government's security of tenure. That there was a need at all for the services of the Brotherhood during a period of such prosperity seems almost incomprehensible, and points to a level of disadvantage and poverty that could not simply be 'grown away'.

More perceptive observers have of course long since realized that in many ways this so-called 'golden age' was part of a much longer period during which the seeds of many of the problems which came to light during the 1970s and 1980s were actually sown. The low unemployment rates of the 1950s and 1960s were in part the result of precluding up to one-third of the potential workforce, namely married women, from obtaining or remaining in employment and, to a lesser extent, from conscripting young men into the defence forces (at an age which precluded from expressing their opinion about their fate at elections).

It was also a period in which the living standards of Australians began to decline relative to those of people in countries from which many of us, or our ancestors, originally came, and subsequently from countries to our north which we had historically regarded as in some way 'inferior' and/or threatening. Between 1950 and 1973, Australia's average per capita income slipped from 5th highest among the community of developed nations to 10th, and continued to fall until we ranked 18th in 1989, by which time we had been surpassed on this measure not only by many European nations, but also by Japan, Hong Kong and Singapore.¹

The rapid improvement in living standards in nations which had been ravaged by World War II was of course wholly desirable, as has been the more recent rapid improvements in living standards in Asia. More people have been lifted out of poverty in Asia over the last twenty years than at any other time in human history. We need to regard this as, *prima facie*, a positive development, not as a threat to our own standard of living.

But our *relative* decline both during the era which we have come to look back on as a 'golden age', and during the following two decades when we slowly began to recognize what was in fact happening, was also the result of our own poor national policy choices. In particular, Australia as a nation paid a price for consciously choosing to remain sheltered behind high trade barriers at a time when most other advanced nations were increasing their economic engagement with each other; for placing a lower value on the acquisition of higher levels of education than other nations; and for choosing to maintain forms of economic organization (such as high levels of state ownership of industry and centralized wage fixing) which may have been appropriate at earlier stages of Australia's development but which became increasingly less so as both Australia's and the global economy evolved.

¹ Data from the Groningen Growth and Development Centre Total Economy Database, available at www.ggdc.com.

The long process of unwinding those unfortunate policy choices had, and in some cases continues to have, painful consequences for many people – even though there is to my mind no question that Australia as a whole is significantly better off for having done so.

For example, while the dismantling of what used to be some of the highest barriers to imports of manufactured goods in the OECD has produced significant net gains to consumers, through lower prices and access to an expanded range of better-quality goods, it also produced 'losers', such as workers in previously 'protected' industries whose skills and experience were no longer required and who have either been unable subsequently to obtain employment or have only been able to do so at lower wages. Many of those losers have arguably not been compensated by the 'winners', through the taxation and social security systems. This is of course also true of those who are displaced from employment by technological change, which occurs irrespective of government policy.

Today, partly as a result of the series of economic reforms which have been implemented by governments of both major political persuasions over the past two decades, together with a much more favourable set of international economic conditions than we had to contend with in the 1970s and 1980s, Australia is enjoying what seems to be, at least as characterized by aggregate statistics, remarkable prosperity.

Australia has now enjoyed sixteen years of sustained economic growth – the longest period without two or more consecutive quarters of negative economic growth (a common shorthand definition of recession) in at least 106 years; during which time we have enjoyed low and stable inflation, and by comparison with the previous sixteen years, low and stable interest rates. We are experiencing generational lows in measured unemployment; and a record proportion of the working-age population is in employment. Relative to other nations, our per capita income has recovered from its low point of 18th in 1989 and 1990 to 8th in 2006, restoring our relative ranking to where it was in the late 1950s and early 1960s; the only OECD countries now ahead of us on this measure are the United States and six relatively small northern European nations.

Moreover, and notwithstanding the widespread impression to the contrary, this improvement in average standards of living have *not* been accompanied by an increase in income inequality, at least at an aggregate level. According to ABS figures published at the beginning of last month², between 1994-95 and 2005-06, average household disposable income rose by 33.9%. The equivalized (for differences in the number of people per household) disposable income of households in the lowest income quintile rose by 33.5% over this period; while that of households in the second-lowest income rose by 34.0%.

The share of households in the lowest quintile in total household disposable income was unchanged over this interval at 7.9% (although it varied between 7.7% and 8.3% during this period); while that of households in the second lowest quintile rose marginally from 12.8% to 12.9%. At the other end of the spectrum, the average equivalized disposable income of households in the top quintile rose by 36.1% over the years 1994-95 to 2005-05, and their share of total household disposable income increased from 37.8% to 38.5%. However rather than this being at the 'expense' of those at the bottom of the income scale, relatively speaking, it was households in the second-highest income quintile who fared relatively worst, with their average incomes rising by 30.8% over this period, and their share of the total declining from 23.7% to 23.2%.

² ABS 2007, *Household Income and Income Distribution, Australia, 2005-06* (catalogue no. 6523.0).

Thus it can be said that Australia's taxation and social security systems have been quite effective in containing the tendency for 'market forces' to produce greater dispersion in the distribution of income – and certainly more so than in the United States, where the share of household disposable income accruing to the top income quintile has increased from 48.7% to 50.4% over the past decade while that of the lowest income quintile has fallen from 3.7% to 3.4%.³

On the other hand, *wealth* is much less equally distributed in Australia than income. According to the ABS' 2003-04 *Household Expenditure Survey*⁴, whereas the share of total household income accruing to the poorest quintile in 2003-04 was 12.5%⁵, their share of total household net worth was just 1.0%. Conversely, the richest quintile owned 59% of total household net worth, a considerably higher proportion than their 29.5% share of total household income. Or, to represent the same figures in a different way, whereas the richest one-fifth of households had, on average, incomes some 2.4 times greater than those of the poorest one-fifth, their net worth was on average almost 60 times greater than that of the poorest one-fifth.

Those who have been unable to enter home ownership, who do not directly own shares, or who (because of their lack of employment) have not had access to superannuation, have obviously not shared in any of the substantial capital gains enjoyed by those who have owned real estate or shares during the 'bull markets' in these assets since the early 1990s. And since capital gains, if they are taxed at all, are now taxed at half the rate applicable to other income – a distinction which, incidentally, I can see absolutely no economic rationale or justification – it is much less likely that increases in wealth will have been as equally distributed as increases in income.

Indeed, since wealth has grown much more rapidly than income over the past fifteen years or so, and since wealth is much less heavily taxed than income (and has become even less so during this period), it is highly probable that the distribution of wealth has become much more unequal over the last fifteen years or so, even if the distribution of income has not.

Moreover, since, as a result of the changes to the tax treatment of income derived from superannuation funds which took effect on 1 July, it has effectively become optional for people over the age of 60 to pay either income or capital gains tax, it seems likely that in the absence of further policy changes in this area the distribution of both income *and* wealth could become more unequal over time.

Researchers have also found evidence that inequality has risen between regions and suburbs within Australia's largest cities. Perhaps the most dramatic illustration of this is provided by Bob Gregory and Boyd Hunter at the Australian National University, who found that between 1976 and 1991, household income in the lowest 1% of neighbourhoods based on 1986 socio-economic status (SES) ranking fell 23%, while incomes in the highest SES areas increased by 31%⁶.

³ DeNavas-Wait C, Proctor B and Hill Lee C 2006, *Income, Poverty and Health Insurance Coverage in the United States: 2005*, US Census Bureau, Washington DC, August.

⁴ ABS 2005, *Household Expenditure Survey, Summary of Results* (catalogue no. 6530.0), Table 8.

⁵ Note, the figures quoted in this and the next paragraph differ from those derived from the ABS survey quoted earlier because the quintiles referred to here are net worth rather than income quintiles, and because they are not 'equalized' for differences in household size and composition.

⁶ Gregory, R and Hunter, B 1995, *The Macro Economy and the Growth of Income and Employment Inequality in Australian Cities*, Canadian International Labour Network, McMaster University.

More recent studies confirm the existence of different poverty rates for different areas, although it remains unclear if this has deteriorated any further since the early 1990s⁷. A more casual observer might point to the disparity in house price growth between affluent suburbs and outer suburban areas in Sydney and Melbourne in recent years as evidence of the same proposition⁸.

Not surprisingly, these income and wealth trends are closely associated with the distribution of labour market outcomes. Gregory and Hunter found that employment fell by 45% in the lowest 1% of neighbourhoods between 1976 and 1991, compared with only a marginal decline in the highest socio-economic status areas. More recent analysis of unemployment by federal electorates shows that in some areas, particularly in NSW, unemployment rates remain stubbornly high between 8 and 9½%, more than twice the national average and five times that of the best performing electorate⁹.

As regards the linkages between economic growth and the labour market, there is one clear difference between the economic conditions of the 1950s and 60s and those of today. Back then growth in the labour force was exceptionally strong, boosted by the post war baby boom, and high levels of international migration. So while there was a job for virtually everyone who wanted one, there was also a steady stream of new workers to meet increases in labour demand.

Today, the labour supply tap flows somewhat less freely, largely reflecting lower rates of population growth since the 1970s. While we have been able to meet rising demand for labour by increasing workforce participation, particularly of females, there are increasing signs that after 16 years of continuous economic growth, this may not be enough. Businesses are increasingly reporting that the inability to obtain suitable labour is the single biggest constraint on expanding output. Higher rates of wage and non-wage benefits, and increasing use of non-conventional hiring mechanisms such as Section 457 visas, are testimony to the increasing scarcity of labour. This scarcity will only intensify in coming decades as the 'baby boom' generation leaves the labour force.

The combination of strong demand for labour and a drying-up of traditional channels of new supply presents a unique opportunity in our history to pursue the claims of those on the margins of society. For these people, the benefits of employment extend beyond the financial (as important as this is). Employment also instils confidence and a sense of self worth, intangible benefits that will only be indirectly apparent in social indicators such as reduced rates of drug and alcohol dependency, depression and crime. And employment breaks the nexus that can bind generations in unemployment. Gainful employment is the key to breaking the cycle of disadvantage and poverty.

Now, more than ever, the objectives of economic and social policy are inextricably intertwined.

Before exploring this issue in more detail, I want to say something about what might be called the 'economics of full employment', not least because it has been so long since we've been in such a position.

⁷ Tanton, R, McNamara, J, Harding, A, and Morrison, T 2006, *Rich suburbs, poor suburbs? Small area poverty estimates for Australia's eastern seaboard in 2006*, Paper for the 1st General Conference of the International Microsimulation Association 20-21 August 2007, NATSEM, Canberra.

⁸ Here in Melbourne, for example, the median house price in Toorak has increased 23% over the year to the June quarter 2007, while in Melton South it has fallen almost 6% (REIV data).

⁹ Lunn, S 2007, State Shamed by Jobless Data, *The Weekend Australian*, 22-23 September 2007, p 5.

Second, I want to look at some of the distinguishing characteristics of people who are not currently in the labour force, and at the policies which might aid them in securing employment. Finally, I will make some observations about Australia's education system, and how I believe it can play a greater role in preventing disadvantage before it becomes entrenched.

The economics of full employment

By almost any measure, the Australian economy is pretty much as close to 'full employment' as it has been in a long time, and on some, closer than it has ever been. Consider the following:

- the unemployment rate now sits at 4.3%, the lowest since 1974;
- a broader measure of labour utilisation - the ratio of employment to population – is now 62.3%, a record high;
- business is increasingly reporting difficulty sourcing labour, and;
- measures of industrial capacity utilisation are around historic highs.

Full employment is a kind of utopia for economists and policy makers. It is one objective, after all, of macroeconomic policy. However, it also poses challenges for government looking to sustain economic prosperity. No longer can it blindly allocate resources to programs safe in the knowledge that any spending will boost demand and soak up spare capacity in the economy. As Treasury Secretary Ken Henry pointed out earlier this year:

'As a rather crude, but nevertheless instructive generalisation, there is no policy intervention available to government, in these circumstances [of full employment], that can generate higher national income without first expanding the nation's supply capacity. Policy actions that expand the nation's supply capacity target at least one of the 3Ps — population, participation or productivity – that we have been talking so much about in recent years'¹⁰.

And the policy environment is about to get a whole lot more challenging, as the first of the 'baby-boom' generation enter retirement. Treasury estimates that the growth rate of the working age population will fall by around three-quarters, from an average rate of 1.7% pa over the past 40 years to just 0.5% per annum over the next 40. If you think the labour market is tight now, you ain't seen nothing yet...

Fortunately, social policies aimed at transitioning disadvantaged people into the labour force satisfy Ken Henry's 'test' of expanding the economy's supply capacity. Perhaps now, with an economic imperative as well as out of a sense of moral and social obligation, we may finally begin to make inroads into entrenched disadvantage and poverty.

On the margins of society

Before we can talk about how we use the opportunity before us to tackle issues of entrenched disadvantage and poverty, we must first understand who we're talking about.

¹⁰ Henry, K 2007, *Treasury's Effectiveness in the Current Environment: Address to Staff*, 14 March, Canberra.

- As at August 2007, there were some 447,700 people unemployed. Of these, 15% were long-term unemployed – that is, they have been unemployed for more than a year.
- The young are grossly over-represented among the unemployed. As at August 2007, there were 120,900 15-19 year olds who are unemployed at a rate of 14.2%, over three times the national average rate. At the same time, there were almost 53,000 15-19 year olds neither attending full-time education nor in the labour force.
- As at September 2006, there were 544,600 'underemployed' workers - those who are employed but would like (and are available) to work more than they currently do (predominantly part-time workers) – and a further 93,400 people marginally attached to the labour force (including discouraged job seekers).¹¹ Adding these people to the unemployed gives a total labour 'underutilisation rate' of around 10½% - more than double the official unemployment rate for that month. Significantly, while the unemployment rate has fallen precipitously over the past decade, the 'underemployment rate' has remained broadly steady at around, or a little above 5% for most of this period.¹²
- In addition, as at September 2006, there were almost 700,000 people who wanted to work and were available to start work within four weeks, but were not actively looking for work for various reasons including, 'own ill health or physical disability (reported by 20% of men) and 'caring for children' (reported by 28% of women).

As confronting as these figures are, they seem almost benign when compared with the labour market experience of Australia's Indigenous population. According to the Productivity Commission's latest biannual report on Indigenous disadvantage, the proportion of Indigenous Australians aged 15 to 64 years in the labour force was just 58.5% in 2004-05, compared with 78.1% for non-Indigenous Australians¹³. Those in the labour force also have much reduced employment prospects: in 2004-05 Indigenous Australians had an unemployment rate of 12.9%, which was around three times the rate of non-Indigenous Australians (4.4%). The unemployment rate for Indigenous youths (aged 15-25) was 27.8%, three times that for non-Indigenous people (9.2%). Note that these figures count Community Development Employment Projects (CDEP) participants as employed, implying that labour force participation and unemployment figures would be even worse in the absence of CDEP.

Worryingly, these trends are not improving as might be expected. Bob Gregory from the Australian National University has found that excluding CDEP employment and improved outcomes for the few Indigenous people whose incomes place them in the top 30% of the Australia-wide employment income distribution – what he terms the Indigenous elite – the employment to population ratio of the remaining 80% of Indigenous people fell from 28.4% in 1991 to 19.6% in 2001¹⁴. That is, fewer than one in five Indigenous Australians are employed in the mainstream economy.

¹¹ Data on 'underemployment' are only collected annually, for the month of September: see ABS 2007, *Underemployed Workers, Australia, September 2006* (catalogue no. 6265.0), February.

¹² ABS 2007, *Persons not in the Labour Force, Australia, September 2006* (catalogue no. 6220.0), March.

¹³ SCRGSP (Steering Committee for the Review of Government Service Provision) 2007, *Overcoming Indigenous Disadvantage: Key Indicators 2007*, Productivity Commission, Canberra.

¹⁴ Gregory, R 2006, *Indigenous Employment and the Hard Policy Choices*, Australian Journal of Labour Economics, March.

The story is equally bleak for refugees. In November 2004, migrants who arrived under the Humanitarian Program had a labour force participation rate of 58.3%, compared with 70.2% for migrants more broadly and 63.7% for the population at large.¹⁵ They are also less likely to find a job with an unemployment rate of 11.6% compared with 5.6% for all migrants and 5.2% for the overall population. These figures, as bad as they are, obscure the full labour market challenge confronting newly arrived migrants. Rupert Myer quoted some figures in his address to the Brotherhood's Business for Refugees Week Breakfast last year that I found astounding: 68% of refugees remain unemployed 18 months after arrival and 43% are still unemployed after 4 years¹⁶.

It seems clear from recent experience that, in this area at least, a rising tide does not necessarily lift all boats. Lack of confidence, experience and skills, lack of access to transport or affordable child care, and in some cases prejudice and discrimination, prevent too many people from participating in the current period of economic prosperity.

To this end, I commend the Brotherhood on its work with community enterprises, which combines close supervision with practical experience in the labour market. I also note that the afternoon session of this conference will showcase employment partnerships that are already producing results for job seekers.

Business is also beginning to engage on this issue. By way of example, ANZ has set ambitious targets in the area of Indigenous employment. Our Reconciliation Action Plan includes a program that provides trainees with practical banking and workplace experience, nurturing the capabilities and confidence that provide broader future employment or academic opportunities. Since the joint program began in May 2003 we have recruited over 50 Year 11 and 12 students as trainees in regional ANZ branches. ANZ has committed to recruit at least 100 participants each year until 2009 and, together with the Aboriginal Employment Strategy, extend the program to further regional and metropolitan areas across Australia. The Action Plan also commits ANZ to promoting at least 20 Indigenous employees on merit to management positions by 2014; and to lifting the proportion of employees from Indigenous backgrounds in our Regional and Rural business to 3% by 2011.

There is obviously more than business can and should do in this area, but programs such as this not only demonstrate the possibilities available by leveraging the economic might of corporate Australia, but also the willingness of the big end of town to invest in well-conceived programs that provide real outcomes.

Education: the silver bullet

It should be clear from our history of dealing with issues of disadvantage and poverty that it is extremely difficult to unwind once it becomes entrenched. While the work of organisations such as the Brotherhood are important in assisting those on the margins of society, policy must begin to take a more strategic view about how we can prevent disadvantage and poverty in the first place. Prevention is, after all, better than cure.

¹⁵ ABS 2005, *Labour Force Status and Other Characteristics of Migrants, Australia, November 2004* (catalogue no. 6250.0), June.

¹⁶ Myer, R 2006, *Address to the Brotherhood of St Laurence Business Breakfast for Refugee Week 2006*, 27 October.

For me, education comes close to being a 'silver bullet' for addressing many of these issues.

There is now overwhelming evidence, both in Australia and globally, of the inverse relationship between educational attainment and various measures of disadvantage. Consider the following:

- Employment prospects improve with increasing levels of educational attainment. In May 2006, the latest period for which we have data, the unemployment rate of those that haven't completed Year 12 was 8.3%, over 3 percentage points above the national average at the time and around 3½ times the rate of those with a university degree.
- Incomes are also positively correlated with educational attainment: early school leavers earn around 20% less than those completing high school, who in turn earn 20% less than those completing vocational education, who earn about 40% less than university graduates.
- Perhaps most disturbingly, we know that labour market outcomes tend to perpetuate across generations. A recent Productivity Commission report found that children whose parents' income falls within the bottom 40% of the income distribution, or whose mothers have a relatively low level of education, are over-represented among the lowest 15% in terms of physical, social/emotional, learning and overall development¹⁷.

As if these trends aren't enough to spur action, we also know that the macroeconomic benefits are significant. Analysis by the OECD suggests that an extra year of schooling lifts per capita GDP by about 6%¹⁸. This is broadly consistent with Australian research suggesting that a one-year increase in the average level of schooling would increase annual GDP growth by 0.5ppts per annum and would ultimately increase the level of GDP by 8%¹⁹.

The linkages between education, labour force participation, productivity and living standards are readily apparent from comparisons within Australia. People living in my home State of Tasmania have, by a wide margin, the lowest average household disposable incomes in Australia, nearly 15% below the national average. This reflects the fact that only 57% of working-age Tasmanians are employed, a smaller proportion than for any other State and some 5 percentage points below the national average; and the fact that the productivity (defined as output of goods and services per hour worked) of those Tasmanians who are employed is the lowest of any State, and about 15% below the national average.

The relatively low productivity of Tasmanians in employment is hardly surprising given that the proportion of Tasmanians working in the highest-skill occupations is 3 percentage points below the national average, while the proportion of those working in the lowest-skill occupations is above the national average by a similar margin. And these results are understandable given that fewer Tasmanians of working age have any form of post-secondary qualification than people in any other part of Australia (5.3 percentage points above the national average), while a much larger proportion of Tasmanians than of people in any other part of the country have not completed year 12 (more than 10 percentage points above the national average).

¹⁷ Productivity Commission 2006, *Potential Benefits of the National Reform Agenda, Report to the Council of Australian Governments*, Canberra.

¹⁸ OECD 2005, *Education at a Glance 2005*, OECD, Paris.

¹⁹ Dowrick S 2002, *The Contribution of Innovation and Education to Economic Growth*, Paper presented at Melbourne Institute Economic and Social Outlook Conference, Towards Opportunity and Prosperity, 4-5 April.

And the consequences of the below-average quantity of education received by Tasmanians are compounded by the fact that, insofar as it can be measured, the quality of education received by Tasmanians is below that of other Australians in several important respects²⁰.

Similar comparisons can be made between Australia and other nations. There are a number of ways you can measure a nation's education performance, but across the range, at best Australia is place around or a little above the OECD average, and at worst, is towards the lower end in some important respects.

Let me point out some of the lowlights. Just 65% of Australian 25 to 64 year olds have at least an upper secondary education. This compares with an OECD average of 68% and rates of 88% in the United States, 85% in Canada and 79% in Canada.²¹ Of course, education levels amongst younger cohorts are somewhat better than for the working age population at large, implying that the future population will be more highly educated as these cohorts move through the age structure. However, this process is occurring in all OECD countries, and at a faster rate in many. For example, the proportion of 25 to 34 year olds with a tertiary education is 38%, slightly above the OECD average of 32% but well below leading nations such as Canada (54%) and Japan (53%). Worryingly, in recent years, enrolments of domestic students in Australian universities and vocational education and training providers have begun to plateau. Meanwhile 16.9% of Australian 20 to 24 year olds are not in education and without at least upper secondary education²².

Australia's comparative performance in early childhood development is even less impressive. The OECD estimates that just 42% of Australian 3-4 year olds are enrolled in some form of early learning (as distinct from child care). This compares with an OECD average of 69%. Simon Marginson notes that "the legacy of early neglect is weak literacy in the bottom layer of school students and a higher than average school drop-out rate"²³.

It seems that, notwithstanding improved education levels amongst younger generation, Australia is still destined to slide down international rankings of these indicators if current trends persist.

Australia doesn't fare all that well (or at least as well as we should) on measures of the quality of education either. The Productivity Commission reports that in 2003, 30% of Australian 15 year olds did not achieve at least a PISA Level 3 score for reading literacy – the level designated by the Government as indicating proficiency – and 33% did not achieve at least a Level 3 score for mathematical literacy²⁴.

This isn't the place to enter into what has for some time now been a vigorous discussion about how we might go about improving our performance on some of these metrics.

²⁰ For a more complete discussion of these observations, and for references, see Eslake S 2006, *Tasmania's Economy: Lots of Progress but Lots Still to Do*, Presentation to the Economics Society of Australia (Tasmanian Branch), 8 December; and Eslake S 2007, *Productivity, Prosperity and Tasmanian Living Standards*, Address to a lunch hosted by the Tasmanian Liberal Party, 26 February (both available at <http://www.anz.com/aus/corporate/EcoComm/StateFocus.asp>).

²¹ OECD 2007, *Education at a Glance 2007*, OECD, Paris.

²² OECD 2005, *Education at a Glance 2005*, OECD, Paris.

²³ Marginson, S 2007, *OECD Exposes Knowledge Gap*, Australian Financial Review, 24 September, p. 40.

²⁴ Productivity Commission 2006, *Potential Benefits of the National Reform Agenda*, Report to the Council of Australian Governments, Canberra.

I will however venture a somewhat unconventional metric by which we can judge the success of any policy interventions: the day the likes of Terrence Tao, Barry Marshall and Robin Warren are lauded in our schools and in the media to the same extent as the likes of James Hird, Ricky Ponting or 'Joey' Johns, then we know we are making progress²⁵.

Concluding remarks

The Vice-Chancellor of Melbourne University, Professor Glynn Davis, said last week that 'a time of prosperity is the ideal moment to pursue what George Bush senior memorably called "the vision thing"',²⁶.

And Australia is better positioned now to pursue 'the vision thing' than it has been at any time in more than three decades. As I have already noted, Australia's per capita national income is now exceeded only by the United States and five relatively small European countries. The Federal Government, in particular, has been reaping substantial revenue gains from the continuing strength in the Australian economy and, in particular, from its 30% share of the increase in company profits resulting from the commodities boom.

I estimate that favourable 'parameter variations' – the term used in the Budget Papers to describe the impact on the Budget bottom line of changes in economic and other parameters used to estimate revenues and expenditures – have boosted the total amount of resources available to the Government in the past five Budgets (that is, over the years 2002-03 to 2010-11) by a minimum of \$398 billion²⁷. 88% of these 'parameter variations' are the result of upward revisions to estimates of revenues.

Of these initially unforeseen resources available to the Government over the past five Budgets, I estimate that \$388bn – that is, all but \$10bn – has been, or will be, spent or 'given away' in the form of tax cuts (that is, what the Budget Papers call 'policy decisions').

Some of these 'policy decisions' have been intended to address long-term policy problems, such as lifting participation rates among segments of the population where these have traditionally been well below the average. And more recently, the Government has elected (as I for one have long urged) to invest part of its Budget surpluses into funds whose investment income will in turn be used to finance worthy capital expenditures in higher education and in the health system.

But I can not honestly say that the majority of the 'policy decisions' which have been made in recent Budgets pass what has come to be known as the 'Ken Henry test' that I referred to earlier. That is, in my view, especially true of what I estimate to be the \$336bn which has been, or will be, handed over to households in the form of cash, either through income tax cuts, or increases in a range of personal benefit payments.

²⁵ Professor Tao is the winner of 2006 Field Medal, while Professors Marshall and Warren won the 2005 Nobel Prize for medicine. I presume the latter set of names need no explanation.

²⁶ Glyn Davis 2007, 'Unis must win votes too', *The Age*, 20 September, p. 17.

²⁷ These are conservative estimates because in arriving at them I assume, where necessary, that the bottom-line impact of 'parameter variations' and 'policy decisions' for years beyond the fourth year published in the Forward Estimates in each set of Budget Papers remain unchanged at their fourth year value, rather than escalating from year to year as they typically do in the published estimates for the first through fourth years.

Let me stress that I am not opposed, in principle, to tax cuts – and I am emphatically in favour of tax reform (though that is not necessarily the same thing as tax cuts).

However I have three profound reservations about the wisdom of the personal income tax cuts which have been the central feature of recent Federal Budgets.

First, I believe that handing over such large sums of cash to households at a time when the economy is operating at closer to full capacity than at any time in the past three decades, and when it is already gaining a stimulus equivalent to more than 1 pc point of GDP from the commodities boom, is serving to boost domestic spending and thus to put additional upward pressure on interest rates – notwithstanding that the Budget remains in surplus.

Second, I am particularly concerned that the changes to the tax treatment of superannuation savings and to the eligibility criteria for the age pension will have the effect of making it optional for people over the age of 60 to pay income tax, and to make it easier for relatively affluent senior citizens to access taxpayer funded concessions and benefits – thereby exacerbating what the Government has spent the past five years telling us is the greatest fiscal challenge facing Australia over the medium-to-longer term, namely the costs associated with the ageing of the population.

Third, I cannot convince myself that cuts in personal income tax represent the most economically and socially desirable means of disbursing the fruits of the commodities boom which we happen to be enjoying at the present time.

Obviously neither I nor others who think that these massive windfalls could have been used in more economically or socially useful ways – including addressing the problems that I have been describing today - have been spectacularly unsuccessful in converting the Government to that view. Nor have I, or they, been much more successful in converting the alternative Government to that view, since the Opposition has indicated has endorsed the two most recent rounds of tax cuts (although they were opposed to those in the 2005-06 Budget); and they have also endorsed the Government's policy of maintaining the Budget surplus at around 1% of GDP.

Hence I hope that this conference, the practical successes demonstrated by the Brotherhood of St Laurence in this area and its advocacy work around employment opportunities for disadvantaged Australians, will help to concentrate more resources in furthering this important objective, which now more than ever has an economic imperative as well as a social justice dimension.