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Staying the course of economic reform – increasing what we earn, Address to the Australia-Israel Chamber of Commerce, Melbourne

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Introduction

Last week, the June Quarter National Accounts confirmed one of our countries greatest national achievements, namely twenty five years of consecutive annual economic growth. 25 years of growth is the product of a generation of hard work by millions of Australians who got a job, created a job, started and ran a business, invented a new product, opened up a new market, took a risk and invested the reward.

These personal endeavors have been supported by policy changes by Governments that opened up our economy through competition, regulatory reform and trade deals. This brought new opportunities, greater productivity and higher levels of investment.

These private and public efforts were also supported by the flexibility of prices - interest rates, the exchange rate and wages – which all directed resources to where they were most needed and valued. The flexibility of these prices enabled our continuous growth – minimising the negative effects of the mining investment boom then and now as we transition to broader-based growth.

But there is no room for complacency.

While, at 3.3 per cent through the year, our economic growth is now above trend and at the top of the leader board of advanced economies around the world, to continue to take ground in increasingly uncertain and challenging economic times we must continue to fight for every inch of growth, as if it were our first.

Today's address is the second in a series, titled *'staying the course'*, which sets how the Turnbull Government is implementing our national economic plan for jobs and growth. In the first address at Bloomberg I spoke of how we are working to increase our resilience to external negative economic shocks by arresting our debt and further strengthening our banking and financial system. When the last crisis hit our shores, we had paid off our debt, we had ‘money in the bank’ with a net asset position, our budget was in surplus and our banks were in a strong position to withstand the storm.

Restoring the budget to balance by dealing with our spending problem and resisting cynical politics to focus on comprehensive financial systems reforms to make our banking and financial system stronger are all critical to this task.

Our success in the parliament this week, securing more than $11 billion in budget improvements and resolving issues like our superannuation package demonstrated that the Turnbull Government is getting on with governing.

In my third address in this series in a few weeks’ time I will be reinforcing, once again, why it is so important that we keep the doors of our economy open - to investment, trade and positive migration, which have all been foundational to our prosperity not just over the past 25 years, but for more than 200 years.

Today, I want to focus on the challenge of increasing what we earn as a nation in a world of low growth, low interest rates, low wages growth and low inflation.

The Australian economy is not immune from these global headwinds. While the mining investment boom helped Australia manage the challenges that advanced economies faced during the financial crisis we could not expect this to last forever. Now in addition to the global headwinds, Australia is managing a transition of its own.

Australia’s terms of trade is down more than one third off its peak – placing downward pressure on export earnings. Despite a modest improvement since this time last year, compensation of employees is well below trend levels, as are company profits. And wages growth has more than halved over the past ten years from over four percent to around two per cent.

Despite our growth, we are not feeling better off because growth in incomes has been weak, despite both interest rates and the costs of living as measured by inflation being low. This is what I refer to as our ‘earnings problem’. Real gross household disposable income, which looks at wages and transfer payments across the economy and how much money householders have available to spend on average, has been weak for some time and these trends are evident when you look at other, broader measures of living standards. In the decade leading up to the peak of the terms of trade in September 2011, real net national disposable income grew by 30%, compared to GDP per capita of around 17 per cent.

Today, the fall in commodity prices since their peak means that Australians are effectively unable to buy as many imports for a given quantity of exports. To put this in context, at the peak of the boom a shipment of iron ore bought over 50,000 iPads. A shipment today buys less than half that amount.

We want to see this change. We want Australians to earn more so they are in a stronger position to improve their living standards. More recently we are encouraged by the data on real net national disposable income per capita – which has moved back into positive territory in the past two quarters as commodity prices and the terms of trade retrace some of the previous falls. However, it is still early days and there is some way to go before they stabilise again.

Also encouraging was June quarter company profits data showing that while remaining flat over the year there was an increase over the quarter of 6.9 per cent, with manufacturing sector profits up by more than 10 per cent. Recent reporting data on ASX 50 earnings reported to date show 56 per cent reporting profits up, with more than a third meeting or exceeding expectations.

Still, our incomes are not growing as fast as they used to - our wages, our profits and the prices for what we sell. This will continue to undermine nominal growth and the revenue that is derived from these incomes that support the Budget.

This does not mean we have a 'revenue problem' as some have interpreted my recent remarks. Those talking about 'revenue problems' are typically just making arguments for higher taxes, which I do not share. A 'revenue problem' is about the numerator - the need to extract a greater proportion of national income from taxes than current settings are projected to provide. That is not our focus. As I said at Bloomberg, our focus, as a Government, is on dealing with our expenditure problem, in particular by flattening the growth curve on costs.

Our focus on revenue in the budget is about protecting the integrity of the tax base, making the system growth friendly and ensuring it is sustainable and fit for purpose – as demonstrated by our initiatives on multinational tax avoidance, our enterprise tax plan and our changes to superannuation tax concessions. An 'earnings problem' is about the denominator - it's about trying to grow the size of the pie from which everyone is sharing, including the Government to provide necessary services and support that are relied upon by the community. We must support and implement policies that help us to increase what we can earn as a nation, as businesses and as individuals in a low growth, low interest rate, low inflation, low wages growth, volatile world.

Translating growth in national incomes into higher earnings for families and households is also a good result for the economy. Greater growth in household incomes means more fuel in the tank for household consumption. Over the past twenty five years household consumption has been the most significant contributor to our national economic growth - not exports, not dwelling investment, not public expenditure nor inventories.

Coinciding with the fall in incomes in recent times has been a softening in household consumption. This has been mitigated to some extent by a decline in the household savings ratio as Australians have saved less to maintain their living standards. This cannot be expected to continue indefinitely and unless we can encourage growth in household incomes it will be more challenging to maintain the growth in household consumption that is essential in assisting the transition in the economy away from relying on the resources sector.

Further softening in household consumption can only further undermine overall growth prospects in the domestic economy and the jobs that depend on it. But there are positive signs. Consumer confidence has improved significantly over the past year – reflecting the strength of our labour market. The number of optimists outweighs the number of pessimists and that is what we need. We need more optimists going out having faith in our economy's ability to transition and supporting it through consumption.

The impact of slower income growth can also be seen when we look at the comparison between real and nominal growth in GDP. Despite our strong growth performance in what we are producing as measured by real GDP, we are not earning as much from it as we were before as measured by nominal GDP. That's why fighting for every inch of growth matters more now than ever before - we need more of it, given we are getting less from it.

On only a few occasions in the last fifty years has nominal growth been lower than real growth. In last week's national accounts through the year nominal growth tipped slightly above real growth for the first time in two years, off the back of a slight uptick in the terms of trade. Year-average nominal growth though remained below the real growth outcome. It is nominal GDP that has the greater impact on government revenues than real GDP.

When Australians and Australia earn less for what we produce, so does the Government. This is where addressing what we earn can really support the job of budget repair as it has done on previous
occasions.

This is not a substitute for dealing with expenditure. However, nor can the need to focus on expenditure be a reason to ignore or diminish the importance and urgency of economic policy changes necessary to support more earnings rich growth.

Each cycle is unique and our economy in transition requires different policy responses. Nominal GDP growth has played a significant role in previous periods of fiscal consolidation. Under the Keating and Costello consolidations, nominal GDP grew at 11 per cent and 6 per cent respectively. Nominal growth during the most recent consolidation since 2013-14 has been on average just 4 per cent. In the past three years nominal growth has been just 2.7 per cent. Low rates of nominal GDP growth are a very strong headwind when you are trying to bring a budget back to balance.

Treasury Secretary John Fraser demonstrated this a different way in his recent speech in London, plotting budget years against real GDP and the GDP deflator, noting that the current period of consolidation will be more difficult than previous periods. The impact of nominal growth on budget repair can be seen when look at the fiscal impact of policy decisions versus parameter variations on individual budgets over the last twenty years.

We can see going back to Peter Costello's first budget that after strong policy decisions to restore the budget to surplus and as time went on and nominal GDP grew, it was higher revenues and reduced outlays on automatic stabilisers (represented by the red bars - parameter variations) such as welfare payments, rather than budget policy decisions, that took over the job of improving the budget and paying down the debt.

As revenues grew and the pressure on outlays was reduced, the balance of policy decisions shifted to increased outlays and tax cuts, paid for not by policy decisions to reduce expenditure or raise taxes, but higher revenues and lower outlays generated by higher nominal growth in the economy.

The high tax club did not have to make an argument during this time, because incomes and government revenues were rising and expenditures were not under threat from declining revenues. You see, the argument from the high tax club is actually not about wanting higher taxes for their own sake, but rather not having lower expenditures.

Ironically, the critics of the Howard Costello Government at the time sought to use the growing surplus against them - they saw it as a political liability for the Government. Everyone had an idea about how to get money out the door.

In this context, to have kept the focus on reducing the debt and returning taxpayers money to them in tax cuts - as evidenced by the net impact of policy decisions on revenue during this period being negative - was a significant achievement. As was the establishment of the Future Fund that now stands at $120 billion. However, what could be afforded then, in a period of strong nominal growth, on payments and revenue, does not mean it can be afforded now.

The real achievement of the Howard Costello Government, amongst so many, was they delivered a growing economy with strong real wages growth that enabled Australians to get ahead, that supported their Budget, provided a reliable social welfare safety net and repaid the debt.

The Turnbull Government has the same challenge today. We can see that after the GFC, the Rudd Government combined record levels of policy expenditure locked in against false revenue promises that were never delivered. This quickly turned surplus into deficit and money in the bank into a spiraling debt. This debt curse of Labor is what we must now contend with and, at this stage, without the support of a strong nominal growth tail wind.

This is why lower earnings is a problem that we must address by boosting investment and unlocking productivity and value in our economy to set Australia up for another generation of growth. In others countries, and indeed within this country under the previous Labor Government, the prescription being followed in the post GFC world has been to put Government at the centre.

The focus has been on both monetary and fiscal policy stimulus that at best can only ever bring forward investment rather than create it, as it eventually has to be paid for. This is not a sustainable solution. With monetary policy having exhausted itself globally and expansionary fiscal policies leaving us with higher taxes and bigger debts, we believe economic policy must take a different path by particularly focusing on lifting the level of private investment in our economy.

At the G20 the Prime Minister and I have been consistently advocating the need for structural reforms to take priority over the focus on monetary and fiscal stimulus. Our focus must be to boost trade and investment and smooth the return of private capital to our economies. And we are practicing what we preach here at home - this is what our national plan for jobs and growth and this year's Budget is all about.

In the past year the Turnbull Government has been working to deliver the structural reforms our economy needs to strengthen growth and promote investment, and in that short time we have achieved a great deal. Everything we have done has been part of a plan to ensure we foster investment and promote the creation of jobs and stronger growth. As the economy transitions from the mining boom, we want to see jobs and growth not just in resource-rich states or larger states — we want growth that is broad-based and felt across the entire economy by all Australians.

The importance of incentivising investment through good policy settings is not always as obvious as it seems, and the costs of failure can be felt in all sectors of the economy. One area where the Government, led by my colleague Josh Frydenberg, has been working with the states and territories through COAG in recent months is in the area of gas market reform. COAG Energy Ministers have agreed the most significant reforms to our gas markets in two decades. The Commonwealth and state and territory governments have agreed to the creation of trading hubs in the north and south through law and rule changes which simplify the way gas is traded, easier access to transport infrastructure, and to cooperate on regulatory and scientific issues on how to increase onshore gas supply. These reforms target the operation of the market, and are designed to increase competition and make the supply of gas more secure and affordable.

Once the beneficiary of an enormous investment boom, the gas market now faces numerous challenges as investment has dried up. While the causes are varied – market design, the global investment climate and state government policies to name a few – the consequences are real for industrial users now facing higher gas prices and less flexible contracts. In some instances, these gas users are being faced with little choice but to reduce or defer investment or even consider shutting down. While good work has been done with the states and territories to improve the operation of the gas market, it is unfortunately a clear example of reduced private investment leading to real costs for the economy and Australians employed in related industries.

Our drive to avoid such outcomes has seen the Government seek to remove barriers to investment wherever possible. Nothing demonstrates our commitment to this more than the Budget I delivered earlier this year. This was no ordinary Budget — it was a comprehensive economic plan for jobs and growth.

Better Tax System

At the centre of this year's Budget was the enterprise tax plan. Our plan backs small to medium sized businesses, in particular, to become larger businesses by backing them to invest more of what they earn by reducing the tax they pay. We'd rather see a dollar back in their pocket because we know that they are more likely to turn it into two dollar, while the Government is more likely to turn it into fifty cents.

It might come as a surprise that this wasn't the most popular policy to take to an election — but we stood right behind it and continue to do so because we know it's the right policy to support growth and investment, particularly in the non-mining sector which is so critical to our transition.

Our plan also keeps average full-time wage earners on a lower rate for longer, keeping them from reaching the second highest tax bracket. The legislation to enable this has been introduced to Parliament and I expect it to become law in the coming weeks.

Infrastructure

In order to support the private investment we want to see as a result of all these initiatives, the Government is also investing heavily in infrastructure. We are investing a record $50 billion in national infrastructure to improve our productive capacity and freight links and back the digital economy. We are backing key projects such as Western Sydney Airport, Westconnex and the nbn.

It's often overlooked that the nbn is the biggest infrastructure project in our history. It was a complete mess when we came to Government, but is now on track and hitting its rollout targets for completion in 2020 after a heroic effort by our now Prime Minister when he was

Communications Minister. Today more than 3.1 million homes and businesses can order and nbn service, while just 51,000 premises were connected to the nbn in six years under Labor. At current rollout speeds, we can connect that many premises in just 11 days at half the price of Labor's nbn. Once complete, the nbn's impact will be transformative for our economy.

Here in Melbourne, while we would like to see the East West Link built, we continue to work with the State Government on the detail of investments we have committed to the Monash Freeway, M80 Ring Road and Murray Basin Rail to name a few. We also want to ensure our wider building and construction industry is given the best possible environment in which to drive economic growth by ensuring it is operating in an efficient, safe and law-abiding way.

This is why the Government is committed to re-establishing the Australian Building and Construction Commission (ABCC). The ABCC will fix the toxic culture of industrial unlawfulness plaguing the industry. We have just experienced the highest quarterly number of working days lost in the construction industry since September 2012 – which was the first quarter after the ABCC's abolition.

We cannot afford this vital industry and the economic growth it delivers to be held hostage to militant unions.

The Building and Construction Industry (Improving Productivity) Bill introduced into the Parliament by the Prime Minister will introduce higher penalties for breaches of industrial law; stronger protection against discrimination, coercion and undue pressure; broaden the circumstances under which industrial action attracts penalties and prohibit industrially motivated picketing action.

Innovation and Science

The Government has of course also been taking action through our National Innovation and Science Agenda to support new and innovative businesses by ensuring tax and other incentives are in place to foster investment, innovation and enterprise. In the first phase, our changes to tax breaks, depreciation rules, bankruptcy provisions and other regulatory settings are all designed to help our innovators seize new opportunities and flourish without Government getting in the way.

The Government is also backing the FinTech industry so Australian companies can seize new opportunities and export markets for our financial services. In March this year, we released our FinTech Statement, setting out a plan for a strong and vibrant FinTech industry in Australia. I have also established a FinTech Advisory Group to advise me directly on matters of importance to the industry. We are supporting the FinTech sector through a number of initiatives, including supporting ASIC's consideration of a 'regulatory sandbox' licensing exemption, considering how to address the 'double taxation' of digital currencies when it comes to the GST, committing to establishing a crowd sourced equity funding framework and initiating a review of blockchain technology to consider how it can be applied across the economy. I was very pleased to see the International Organization on Standardization yesterday back Australia to lead the international effort to develop international standards on blockchain.

Included in our recent initiatives are our 'landing pads' in international innovation hotspots, including one in Tel Aviv which has just begun operation. This landing pad will help our Australian innovators learn from the best in the business, collaborate with local Israeli and international firms; and assist in sharing technologies and best practices.

I can also announce today that the Government has now formally commenced negotiations with Israel on a tax treaty that will improve trade and investment by removing tax barriers for business, which I remain hopeful could be concluded in the first half of next year. We have had productive discussions with visiting Israeli officials on eliminating double taxation in order to reduce cross-border barriers to flows of people, investment and technology.

Defence Industry

Our defence industry plan is another critical part of our plan for jobs and growth, backed by a much needed investment of $89 billion in ships and submarines for the Navy over the next 20 years. Our plan will transform not only our defence forces but also our national defence industry. Because while our naval shipbuilding is being completed in Adelaide and Perth, our investment will support thousands of high-tech manufacturing jobs right across the supply chain.

Here in Melbourne the week after the Budget, I visited APT Advanced Manufacturing in Berwick with Minister O'Dwyer and Member for La Trobe Jason Woods. This is one of the many companies in the defence industry supply chain which we are supporting with our investment in defence and naval shipbuilding, and they have a great story. Once their bread and butter was auto-parts, but now they manufacture parts for our Collins Class subs and they will be part of the supply chain for our new naval shipbuilding programme. And, as a company with a turnover between $2 million and $10 million, they will be immediate beneficiaries of our enterprise tax plan, helping them reinvest in and grow their business and hire new workers.

No doubt there will be countless stories just like APT's that will be replicated across Australia as our investment in defence ramps up in the coming years.

FSI and Harper

Essential to supporting these initiatives is a strong economy, supported by a strong financial sector and competition policy that promotes innovation and more choice and lower prices for consumers. That is why two of the first things I did as Treasurer this time last year were to respond to the Financial System Inquiry and the Harper Competition Policy Review.

The Government's response to these reviews recognises the importance of both a resilient financial system and strong competition policy to our economic growth going forward. The Government accepted all but one of the recommendations in the FSI and our response will guarantee a strong and resilient banking sector that ensures Australia can respond to the challenges and opportunities that the future brings. The Government's response also included measures to protect consumers such as banning excessive card surcharging, which has now come into force as of this month.

Previous National Competition Policy reforms in the 1990s following the Hilmer Review had substantial benefits for Australia, boosting our GDP by 2.5 per cent. These reforms are an example of the benefits we can all receive when Governments work together to pursue and deliver the reforms that our economy needs. The Government's response to the Harper Review will promote stronger growth and more and better choices for consumers. We have set out an agenda that will boost innovation, open up new markets and drive real improvements in how we run our services that will see Australia prosper in the years ahead.

The Government's response to the Harper Review goes well beyond our well-publicised decision to amend section 46. In addition to other substantial changes we are making to the competition law, we have also begun work with the states and territories on a new national agreement to promote innovation in government service delivery and regulation across the economy, particularly in human services which has such an important impact on our living standards. At the Commonwealth level, we have made a commitment to open data by default and have provided the Treasury with additional funding to undertake a series of rolling reviews under the Government's Regulatory Reform Agenda, with an initial focus on issues identified by Harper and the FSI.

While these reforms are a good start, the Government is committed to continuing to seek out new ideas and policies that support our productivity and innovation. Good policy settings support productivity by ensuring our economy and governments are flexible and able to adapt as our economy transitions. Today I can announce that the Government will be asking the Productivity Commission to undertake an inquiry into Australia's productivity performance and provide recommendations on productivity-enhancing reform; to be the first in a regular series of reviews undertaken at five-yearly intervals.

This review will provide an overarching analysis of where we stand in terms of our productivity performance and provide us with more ways to ensure we continue to facilitate structural change in our economy that supports productivity growth. The review will complement the Intergenerational Report (IGR) that the Government releases every five years. The IGR assesses the long-term sustainability of Government policies and how changes to Australia's population size and demographics may impact economic growth and public finances over the next 40 years. The PC's findings will assist the Government in continuing to identify priority areas of reform to address potential future challenges as we work with the states on implementing the reforms recommended by the Harper Review.

Participation

A key challenge for any government is to ensure that as many people as possible are engaged in the economy, to be participating in work and feel that they are part of the process. We need to ensure that as many members of the community as possible have to feel that the system is working for them and their financial future.

Fuller participation results in paying commensurate and not higher taxes, from earning a wage, from taking risk in the pursuit of reward through enterprise by setting up a business, not drawing welfare support and contributing to the national productive effort. Providing the right conditions for investment will lead to more jobs. To support these jobs, we are also implementing major initiatives to support participation in the labour market, particularly by helping young Australians and women into the workforce.

One of our key initiatives in this year's Budget was the Youth Jobs PaTH – Prepare Trial, Hire — a programme that will help up to 120,000 young people get a job and stay in a job. The Youth Jobs PaTH — opposed, shamefully, by the Union movement — will help young job seekers get the skills employers want and incentivise businesses to take a chance on young people to help them get a foothold in the workforce. We redirected funding from less successful job programmes to fund the Youth PaTH, because we know that the best form of welfare is a job and, if we can get this right, the payoff of our investment for these young people, the businesses that employ them and the wider economy will be worth it.

The Government is also continuing to work to secure the savings we need to implement our childcare package, based on the recommendations of the Productivity Commission. This package helps families with children get into work by creating a simpler, more affordable and accessible childcare system that responds to longstanding community frustration with the current system that is complex and difficult to navigate.

Conclusion

We must support and implement policies that help us to increase what we can earn as a nation, as businesses and as individuals in a low growth, low interest rate, low inflation, low wages growth, volatile world.

We must ensure that all our policies, especially state and federal taxes are not just economic growth friendly, but also income growth friendly for all citizens.

We must continue to remove impediments and create the right conditions for Australian employers, especially small businesses, to grow and create more jobs.

A growing economy requires individuals generating new products and services to create value. These new and potentially improved offerings, products or technologies create new markets and thereby new wealth is created.

This is the type of the economy that can coax private capital out of its cave. That is our task.

Our national economic plan for jobs and growth will promote investment, drive innovation, transform our defence manufacturing industries right across the supply chain, reduce the tax burden on investment and enterprise, open up our enterprises to new markets through more new export trade deals, develop infrastructure that underpins investment and remove the impediments to investment in critical sectors such as construction by restoring the Australian Building and Construction Commission.

This is the course we must stay.

Australian Government

The Treasury