PRIME MINISTER

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TOWARDS A PRODUCTIVITY REVOLUTION

A NEW AGENDA OF MICRO-ECONOMIC REFORM FOR AUSTRALIA

ADDRESS TO THE
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The Australian Government is committed to implementing a new reform agenda for the nation to build a modern, competitive Australia capable of meeting the challenges of the 21st century.

For the economy, that means developing policy frameworks to maximise Australia's global economic

competitiveness in an increasingly competitive and, now increasingly unpredictable, world.

That is why in large part I travel today to the United States, Europe and China – respectively the world's largest economy, the world's largest investor in Australia and Australia's largest merchandise trading partner.

My objective is simple: to argue Australia's economic case in a number of the principal economic capitals of the world and to prepare Australia for the global economic uncertainties that lie ahead.

The Government is acutely conscious of the complex and in part conflicting economic challenges we have inherited:

- inflation rates running at 16 year highs at home that have fuelled 12 interest rate increases in a row, and

- at the same time, substantial instability in global financial markets, resulting in downward revisions in global growth and prompting the US Federal Reserve to cut interest rates by 300 basis points in just six months.

That is why in its first three months in office, there has been considerable and necessary emphasis on macro-economic stability.

In January, following the Government's first Cabinet meeting of the year, the Government released a five point strategy to tackle inflation.

Throughout this time, the Government has also maintained close contact with Treasury, the RBA, ASIC and APRA on the fallout from the US sub-prime crisis in global financial markets and its implications for Australia.

What for parts of the Northern Hemisphere has been a winter of economic discontent has also presented considerable challenges for economic policy makers here during the Southern Hemisphere's summer.

But beyond this important and immediate challenge of continuing macro-economic management, the purpose of my remarks today is to outline the Government's broader economic reform agenda for the decade ahead (notwithstanding the fact that of course our political fate rests entirely in the hands of the Australian people).

Australia has suffered for too long from short-termism. What the nation needs is a long-term economic reform program around which we can build a broad, long-term political consensus.

That in part is why the Government next month is convening the Australia 2020 Summit.

The economic stream of the Summit aims to harness new proposals on how to enhance Australia's global competitiveness - and to add these proposals, where appropriate, to the Government's overall policy reform agenda.

My remarks today therefore fall into three parts.

- First, the state of global financial markets and their unfolding impact on the global economy as well as outlining the Government's response to these developments.

- Second, an overview of the current state of the Australian domestic economy – highlighting the fundamental challenge of low productivity growth and rising inflation.

- Third, an outline of the Government's long-term micro-economic reform agenda for the years ahead around the central organising principle of Australia's fundamental need for a comprehensive, long-term productivity agenda.

Global Financial Markets

Today we face a global financial crisis that poses very significant challenges for the global economy as well as our own.

The crisis began in the US housing and mortgage market, but has spread rapidly through broader credit markets, equity markets, and is now impacting the real economy.

The whole world has been affected.

In part, the current financial crisis represents a repricing of risk following the extraordinary global credit growth of the last several years.

This credit growth was characterised by a period of strong economic growth, low interest rates and rapid increases in asset prices (especially the housing and share markets).

These conditions created a financial boom in which credit became widely available and relatively cheap by historical standards. Many investors began to accept higher risks and lower returns – as reflected in the decline in corporate investment yields.

In the United States the flow of cheap credit helped spur a burgeoning sub-prime mortgage market.

At the same time, advances in financial engineering allowed the development of sophisticated new financial instruments, including loans bundled into Collateralised Debt Obligations. It seems that some market participants did not understand the risks associated with many of these new products.

This became apparent when some sub-prime loans began to default. In mid 2007 there was a sudden loss of confidence in the value of mortgage-backed securities. Financial institutions with heavy exposure to the sub prime market such as Bear Stearns in the US, and institutions

with large reliance on securitisation such as Northern Rock in the UK, were dramatically affected.

As liquidity dried up, the credit crunch in the sub prime market evolved into a general tightening of credit across markets and across financial products. Because the extent or distribution of these risks is not fully known, there has been a reduced willingness to lend – the previous market complacency with risk has been replaced by excessive risk aversion.

It is important to note that Australia's financial conditions are different to many other countries.

The Australian economy has so far proven to be resilient, despite 12 interest rate rises and the fallout from the global financial crisis.

Nonetheless, Australia is not immune from events abroad. As spreads increase, they push up the cost of finance, and lead to higher interest rates for home mortgages everywhere including for Australian working families.

The crisis in financial markets is also leading to downward revisions in growth projections for the global economy.

The US economy is expected to slow markedly this year, which will see global growth slow from the strong rates of growth recorded in recent years.

Slower world growth will inevitably affect Australia, although the economic strength of North Asia has a capacity to shield Australia from the sharper downturn amongst the G3 economies.

But we can take nothing for granted.

That is why the Government will continue to pursue a policy of responsible economic management aimed at placing the economy on a stable, long-term growth trajectory.

And that is why I will take every opportunity to argue the distinct features of the Australian economic case during my visit abroad.

- That Australia has a central bank with robust and enhanced independence.

- That we have a strong regulatory framework for Australia's financial market.

- That Australia has very low domestic exposure to sub-prime mortgage defaults.

- That the balance sheets of our principal corporates are strong.

- That resources demand (from China and India) is holding up strongly and well into the future.

- That the Government continues to be committed to a conservative approach to budget policy.

- That the Government has zero net public sector debt.

- And that the Government is not complacent about the need to push ahead with further, long-term economic reform.

And I will do this because I remain an unapologetic optimist about Australia's long-term economic future despite the challenges that lie ahead.

Government’s response to the global financial crisis

Governments usually face two choices in response to global financial crises.

They can either react to crisis by turning inwards:

- by blaming globalisation for exposing them to economic threats that are not of their own making;
- by trying to erect new barriers to openness; or
- by trying to opt out of global financial markets by re-regulating their domestic financial markets.

Alternatively, governments can choose to hold firm, keep their nerve, and stay the course on policies that will promote stability for the present and continue to reform the economy for the future.

It may seem to some that these two goals are in conflict with each other.

It may seem to some that we would achieve more domestic economic stability if we were less open to global market volatility.

That is not the view of the Government.

Openness and full engagement with the global economy has given Australia much more economic growth than before.

Protectionism, by contrast, would limit Australia's opportunities, delivering a sclerotic economy and declining living standards.

Australia's engagement with the global economy certainly presents us with challenges, but it also presents us with the responsibility to respond intelligently to those challenges.

By working with our regional and global economic partners we can work towards the restabilisation of the global financial system and address any long-term reforms the system may require.

Global economic problems require global solutions.

Australia's response must also involve coordinated action with our economic partners.

The Government's approach involves several elements including the following:

- We will continue to monitor liquidity needs internationally and, through the RBA, participate where appropriate in coordinated central bank action.

- Through the RBA, we will also continue to monitor and maintain appropriate support for liquidity requirements domestically.

- We will continue to monitor the Australian financial system in light of the current turbulence to ensure that it remains efficient, flexible and competitive – including maintaining competition and choice in the Australian domestic loans market for the benefit of consumers.

- We will work with other economies and international financial institutions to improve global standards of transparency and disclosure by financial institutions.

As financial markets become more global and assets are traded more quickly between nations, so too must regulation and supervision become more global.

The current crisis has highlighted the importance of disclosure and transparency. Loss of confidence in the risk management practices of financial institutions and ratings methodologies as well as weaknesses in disclosure, valuations and financial reporting has been at the core of the crisis.

Internationally, we need better rules on the transparency of risk exposures, valuation practices and nature of leverage.

- We will work with other economies to improve international risk management systems. This must include:

    - Options for stronger international financial supervision;

- Developing improved global standards that will underpin national regimes for transparency, crisis management and stability;

- Strengthening the co-ordinating mechanisms for providing international surveillance of all countries' financial systems and for identifying systemic risks to the global financial markets; and

- Ensuring that national authorities respond effectively when specific risks are identified.

This will require efforts by us and others to work closely with the key international co-ordinating agencies, the IMF, the Basel Committee and others, to identify key risks and vulnerabilities and programs of reform.

The Treasury, the RBA and the regulators have been discussing these matters with their global counterparts.

Pursuing these matters will be a core priority in my engagements abroad over the coming weeks.

- Finally, we will redouble efforts to bring the Doha Round of trade negotiations to a conclusion.

  The successful conclusion of the Doha Trade Round would give the global economy a much needed psychological boost at a time when there is a heightened risk of protectionism.

  Particularly at a time when the psychology of protectionism may become acute.

  It would also demonstrate to developing nations that the advanced economies are serious about honouring undertakings concerning trade liberalisation that were made back in 2001.

The Government's intention is to engage actively with our global economic partners on these important matters in the period ahead.

There is no point simply describing the unfolding global economic reality.

The Government instead believes we must become an active part of the global economic solution as well: arguing both our own economic case to global investors; as well as arguing the case for appropriate global financial market reform.

Australia's long term productivity challenge

Beyond the uncertainties of the global economy, the Government has inherited a domestic economy from its predecessors that is replete with its own challenges.

In the year leading up to the election, we argued that Australia has in recent years been through a period of extraordinary opportunities as a result of the mining boom.

We highlighted the fact that the Government had squandered many of those opportunities that could have led to faster growth, by failing to make long term investments in Australia's future productive capacity.

I believe history will see the 12 years of the Howard Government as an era of opportunities lost.

The Government had breathtakingly favourable fiscal and economic conditions, like no other Australian government has had.

Yet it failed to seize those opportunities.

Or even, it seems, to grasp them.

The result of inadequate and poorly targeted investment in skills formation, in innovative capacity, in infrastructure, and in budget management now manifests itself in the skills shortages, infrastructure bottlenecks, and inflation challenge that Australian workers and businesses now well understand.

Productivity is, in the long term, the key to building a more internationally competitive economy – one that can produce more output from its existing resource base; one that can grow faster without fuelling inflation and consequently, driving up interest rates.

The need for action on the productivity agenda is clearly underscored by the long downward slide in productivity growth since the late 1990s:

- Labour productivity growth in the market sector averaged 3.3 per cent per annum in the five years to 1998-99.

- It fell to 2.1 per cent in the five years to 2003-04.

- It has fallen further to just 1.1 per cent in the first three years of the current cycle up to 2006-07.

- Productivity growth in the market sector fell to zero in the year to December 2007.

The same trend is evident when we measure Australia's performance against other economies.

Australia was ranked behind 14 other OECD nations in the OECD comparison of whole economy productivity levels in 2006.

Benchmarked against the United States, the global productivity leader, Australian productivity rose from 77 per cent in 1990 to 85 per cent in 1999, but by 2006 it had fallen back to 79 per cent.

In comparative terms, Australia has now almost completely lost the relative productivity gains of 1990s.

Low productivity growth has contributed to the rising inflationary pressures inherited by the Government last year, with underlying inflation at 3.6 per cent, its highest level in 16 years.

Low productivity growth has also made Australian exporters less competitive, contributing to export volumes growing at an average annual rate of just 1.9 per cent in the seven years since 2000, in contrast to the average 6.9 per cent growth over the preceding seven years.

Australia's rising inflation, rising interest rates and the particular challenges on the external account point to significant long term problems that have not been systematically addressed.

We cannot sustain strong economic growth unless we lift our productive growth.

We cannot sustain improvements in living standards unless our productivity growth improves.

We cannot meet the challenges of international economic competititiveness if we do not lift our productivity growth; if we do not have a highly skilled workforce; if our workforce is not sufficiently innovative to solve business problems; or if our infrastructure is not modernised to serve our businesses as platforms for growth.

And so Australia must now begin to implement a policy of long-term reform to boost productivity growth through a productivity revolution.

A new agenda of microeconomic reform – towards a productivity revolution

The Government's economic reform agenda is based on the 3 Ps that drive long term economic growth: productivity, workforce participation and population growth.

Investing in a reform program focussed on higher productivity, and higher levels of workforce participation and which deal with the population policy challenges of the future will lift the economy's supply capacity, delivering stronger, non-inflationary growth over the long term.

Australia's productivity challenge has been highlighted on at least two significant occasions by the Commonwealth Treasury in its Intergenerational Reports in 2002 and 2007.

Last year's report warned that if nothing changes, average living standards of Australian households over the next four decades will grow at a rate well below previous decades.

Treasury has also warned that because our population is ageing, living standards in the next forty years are projected to increase by an average of only 1.6 per cent per year – compared to an average of 2.1 per cent over the past four decades.

The difference may sound small, but a 25 per cent reduction in growth in average living standards means a lot to ordinary households.

The conclusion is that productivity growth is going to be more important than ever before if we are to sustain higher living standards with an ageing population.

Let me be absolutely statistically stark in highlighting the difference between the high and low productivity road to Australia's future.

Productivity growth across the whole of our economy has averaged just 1.5 per cent per year so far this decade.

In comparison, productivity growth was more than one third higher during the 1990s.

The second Intergenerational Report makes the challenge of reversing this trend clear: if future generations are to realise the same growth in average living standards as we have been able to achieve in the past, our productivity growth will have to rise to around 2¼ per cent and be maintained for the next 40 years.

That's a major task for the nation.

That's a major task for the national government.

Australia has not experienced these kinds of productivity gains since the mid to late 1990s, when productivity growth surged off the back off the hard fought reforms of the 1980s and early 1990s.

And of course our task is made that much tougher when you consider our starting point. Three years into the current productivity cycle as measures of the ABS, whole economy productivity growth has averaged just 0.8 per cent a year.

I believe we must now embrace a new national objective of getting our productivity growth rate back on track.

That is why the Government intends to adopt a number of ambitious targets for the future – targets aimed at achieving faster rates of productivity growth for the nation.

Since the beginning of the decade, Australia's annual productivity growth has averaged 1.5 per cent, behind the US (2.0 per cent), the UK (2.3 per cent) and Japan (1.9 per cent).

In a decade’s time, Australia should aim at realising productivity growth rates that not only keep pace with but exceed those of our principal competitors in the OECD.

This means implementing a national program of action on productivity growth.

That is why the Government will be directing the central agencies – Prime Minister and Cabinet, Treasury and the Department of Finance and Deregulation - to begin developing specific targets in each of the areas of government policy which directly contribute to increasing productivity growth.

These productivity targets will be progressively released in the months ahead in each of the key drivers of long-term productivity growth.

These productivity-building targets will include, but not be limited to, key indicators for skills, education, innovation, infrastructure, as well as rolling back the regulatory overhang on business.

The Government will begin deploying specific indicators to focus our public investment and over time to track our performance.

For example, we already have a target to lift school retention from 74 to 90 per cent.

Furthermore, in vocational education the Commonwealth and States have reached agreement on the need for targeting a halving of the proportion of Australians aged 20 to 64 without qualifications at Certificate III and above, and a doubling of the number of higher qualification completions (diploma and advanced diploma).

But we will be going further.

We will set these targets because we are committed to ensuring that government does its part to address the productivity challenge this nation faces.

Of course, the Government's productivity agenda starts with an education revolution.

Australia needs a substantial and sustained increase in the quantity of our investment, and the quality of our outcomes across the education, skills and training system.

The links between productivity growth and investment in human capital, through education, skills and training, are well established.

That is why we have unveiled substantial initiatives including:

- the provision of up to 15 hours per week of early childhood education for all 4 year olds.

- providing high speed broadband to schools, computers at school for all students from years 9 to 12, and funding of up to $1.5 million for trades training centres at every Australian secondary school;

- a strategic focus on vocational training through the Skills Australia expert group and an investment in an additional 450,000 training places over the next five years.

- HECS incentives for students who study maths and science as well as those teaching those subjects, and a comprehensive examination of the future of higher education.

- 1,000 new mid-career research scholarships to help retain and attract the most talented researchers.

- A new national curriculum in maths, science, English and history.

We are also reviewing Australia's whole national innovation system, with the goal of making the changes necessary to foster greater investment in research and development and build a stronger culture of innovation in businesses.

The Government will also be implementing a new workplace relations system from the beginning of 2010 – for the first time in the nation's history a uniform set of industrial relations laws for the entire private economy of the nation.

The new system will encourage flexible enterprise agreements and create new flexibilities for common law agreements and modernised awards – all designed to support productivity growth.

Economic analysis highlights the positive correlation between enterprise bargaining and productivity growth, as research last year from the National Institute of Labour Studies most recently observed.

Second, in addition to the changes in human capital investment that will drive productivity growth, the Government is committed to building advanced infrastructure for the economy of the 21st century.

Our national infrastructure is, quite simply, the physical platform for business growth.

Infrastructure Australia will advise on ways in which barriers or disincentives to investing in nationally significant infrastructure can be removed.

Infrastructure Australia has been tasked with developing a nationally consistent regulatory environment for PPPs to encourage large-scale, long-term private investment in public infrastructure.

In the coming decades our ability to engage in the global digital economy of the twenty first century will be a key driver of our productivity growth.

Building a high-speed National Broadband Network will give Australia a platform of modern infrastructure that will allow business, education institutions and families to reap

the full benefits of participation in the global digital economy.

Broadband is a fundamentally transforming technology of the future.

Third, reform of the federation, including a wide agenda of business deregulation, represents another important engine of productivity growth.

The reform of Commonwealth/State funding arrangements and the use of outcomes-based payments will create powerful incentives for States and Territories to implement reforms and improve their effectiveness.

Later today the Treasurer will be speaking to you about the progress that we achieved yesterday at COAG in Adelaide.

COAG has identified 27 areas for deregulation and red tape reduction to improve efficiency and reduce the regulatory burden on the economy.

COAG has agreed that this deregulatory task must begin with the onerous task of creating a single national OH&S system.

Workforce participation

The flip side of the productivity agenda is lifting workforce participation.

As the post-war ‘baby boom’ generation moves into retirement, workforce participation will come increasingly into focus as a key driver of long-term economic growth.

An increase in the number of people participating in the workforce adds to the economy’s potential output and raises living standards.

The Commonwealth Treasury’s Intergenerational Report in 2007 estimated that over the next 40 years the proportion of Australia’s population over the age of 65 will double to around 25 per cent.

Over the same period, the proportion of the population participating in the workforce will decline from 65 per cent to an estimated 57 per cent in 2046.

With an ageing population, Australia must work to increase the proportion of working age people in the workforce.

Australia currently ranks 10th in the OECD on workforce participation.

While our participation rate is above the OECD average, in specific important cohorts Australia's participation rates are below other developed economies:

- for males aged 25 to 54 years, Australia ranked 25th among 30 OECD countries;

- for females aged 25 to 44 years, Australia ranked 23rd; and

- for older men and women aged 55 to 64 years, Australia ranked 13th within the OECD.

The 2007-08 Budget noted that Australia would have another 600,000 people in the workforce if we achieved participation rates as high as the top ranking comparable OECD country.

The Government's strategy to increase workforce participation includes:

- First, tax reform targeted at increasing the incentive to work – including, but not in the long term limited to, the tax cuts that were announced at the last election and that will begin to be delivered from July.

- Second, skills reform meaning that new workers are more highly skilled, and that school leavers make a smooth transition from school to work.

- Third, increasing access to affordable quality child care, by raising the child care tax rebate from 30% to 50% among other measures.

- Fourth, reforming the interaction of welfare and family payments with our tax system to remove unintended barriers to workforce participation for those currently on the margins of the labour force. Family and child care payments along with social security benefits provide important financial assistance to low and middle income working families. We need to ensure

they not only provide an enhanced standard of living but also support workforce participation.

- Fifth, a retirement incomes policy that provides a number of options to meet the financial needs of older Australians, particularly for those who choose to continue to work or re-enter the workforce.

The Government is engaged in long term work in each of these areas because having people unnecessarily outside the workforce represents a waste of economic capacity.

And as our demographic challenges become more acute, that is a waste we can ill afford.

Population

The third of the three Ps is population growth.

Australia's forecast population trends over coming decades underscore the importance of the productivity and participation agendas.

The Treasury's *Intergenerational Report* has forecast our annual population growth to slow down from an average of 1.4 per cent over the past 40 years to 0.8 per cent over the next 40 years.

This means that population growth is likely to add just 0.1 percentage point to Australia's average annual growth in living standards (measured by real GDP per capita). This compares with a 0.4 percentage point contribution to annual growth over the past 40 years.

With the birth rate expected to remain below the replacement rate, we must take further steps to make life easier for parents with young children. This means making workplace laws more family-friendly, improving access to quality, affordable child care and conducting a proper examination of paid maternity leave.

We must also maintain a significant skilled migration program, one can respond to specific needs such as current and future skills shortages.

At the same time, we must do a better job in planning for the physical and social infrastructure needs of a growing population.

We need the national imagination to build a big Australia – by encouraging natural population growth; by maintaining support for a continued expansion of the migration program consistent with the long term needs of the economy; and by investing to ensure that the long-term infrastructure needs of a growing population are met.

Immigration helps keep a nation young – a challenge which Australia must embrace if it is to avoid the decline already evident in a number of competitor economies.

Conclusion

I am determined to lead a reformist government for the future that develops innovative, long-term solutions to Australia's long-term economic challenges.

That means tackling immediate threats like rising inflation and global financial turbulence. It also means moving forward on the long term agenda to raise productivity growth, workforce participation and population growth.

And the central organising principle underpinning this national agenda of economic reform is boosting Australia's long-term global competitiveness.

Nobody owes Australia its future.

Our responsibility is to build Australia's future.

And that is the new Government's policy resolve.