



**AUSTRALIAN BANKERS'  
ASSOCIATION INC.**

**Strong banks – strong Australia**

# The outlook for Australia is strong - if we all pull together

Economic opinion

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## Economic growth - an Australian success story

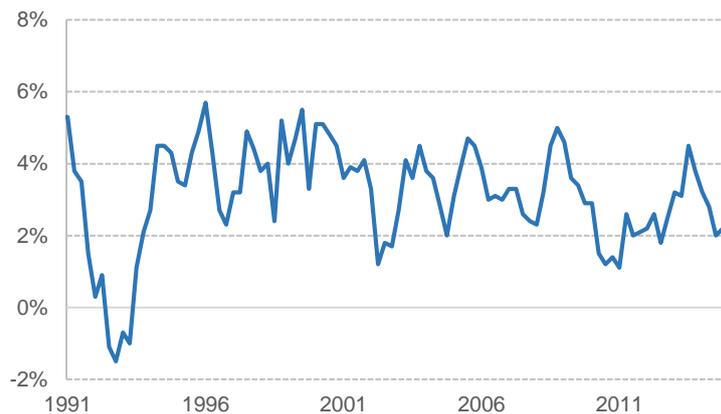
The performance of the Australian economy is one of the world's great success stories.

Australia's sustained economic growth is now entering its 25th year<sup>1</sup> with gross domestic product (**GDP**) reaching \$1.6 trillion in 2014-15<sup>2</sup>. This is a record of continuous economic expansion that few developed countries have matched.

This has not come about by accident or through good luck. The reform vision of past political, business and community leaders has meant Australia has been well placed to take full advantage of the opportunities that have come its way.

Recent growth has been below trend, but nevertheless resilient given the headwinds the economy has faced. These include the transitioning away from the mining investment boom towards other drivers of growth and, until recently, the persistent strength in the Australian dollar inhibiting necessary structural adjustments. Importantly, Australia's performance has been superior to some other economies facing similar environments, such as Canada, which has slowed significantly.

Figure 1: Real Gross Domestic Product



Source: ABS

The challenge for Australia now is to ensure it enjoys another quarter century of improved living standards and widely shared prosperity.

The banking industry believes that Australia has wonderful prospects. Every effort must be made to build on our success by facilitating economic adjustment and by directing ambitious reforms to sustainably lifting Australia's economic growth performance. To fail in this task will be to accept slower growth and potentially a decline in living standards. In the past Australia has shown it can rise to the challenge, and the nation can do so again.

The settings of the key macro-economic levers are pushing in the right direction. Fiscal policy is stimulatory (arguably overly stimulatory), monetary policy is highly expansionary, and the currency has now fallen to around US\$ 0.70 in line with the decline in the terms of trade.

<sup>1</sup> Australian Government (2015), *Budget 2015: Economic Outlook*, viewed 6 June 2015

<sup>2</sup> ABS, *Australian National Accounts, National Income, Expenditure and Product, June 2015*



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The Government has also made significant progress in reducing taxes on the supply side of the economy through the abolition of the carbon and mining taxes, cutting the tax burden for small business, reducing the regulatory red tape burden on business, improving the efficiency of the government process through cutting departmental budgets and reducing the number of government bodies, and boosting access to offshore markets through free trade agreements.

Australia needs to do more to build on this strong foundation. Good policy to boost productivity, economic growth and create jobs, and to achieve fiscal repair over the medium term, will be integral to achieving ongoing success.

The focus should be on determining the policy settings which underpin a strong economy of the future rather than to address the issues of the past.

The objective must be on growing the economy rather than redistributing the spoils of what we already have.

Other changes in the economic environment will need to be addressed over the longer term. These include the:

- Ageing of the Australian population, resulting in increased spending on health and aged care and financial support of retirement incomes.
- Continuing growth and importance of the Asian region as a trade and investment partner.
- Growing impact of technological advances, for example, on banking and financial services, with increased innovation in product and service delivery and competition from alternative providers.
- Increasing scarcity and cost of natural resources.

Australian businesses have a key role in driving the nation's standard of living and prosperity. It is business that generates jobs, income, exports and GDP. It is business that generates tax revenue, directly and through the jobs it creates, and it is that tax revenue that delivers public services, such as health and education and income support for those in need.

The banking industry is eager to continue playing its part in ensuring the economy adapts and capitalises on these changes, and realises the opportunities to build enduring prosperity.

## Banks and the economy prosper together

Banks' success is inextricably tied to the economy. When Australia does well, banks do well.

Banks have been a key contributor to Australia's economic success and are an important industry in their own right. Banks underpin the economy, facilitating the mobilisation of savings to fund the houses we live in, the places we work, and the goods and services we enjoy. The banking industry is an integral part of the lives of almost all Australians, whether they are depositors, borrowers, investors or users of the payments systems.

To ensure banks continue to play their part as a critical enabler of economic activity and growth, the burden of government regulation and tax should be kept as low as possible - consistent with the integrity and stability of the financial system, the protection of customers, and the fair contribution to government revenue.

The key contributions of the banking industry include:

- **Economic growth:** The finance and insurance industry is Australia’s equal biggest industry, along with mining, contributing around 9 per cent of Australia’s GDP.
- **Exports:** Financial services contribute 5.6 per cent of Australia’s exports of services and 1.1 per cent of Australia’s total exports.
- **Employment:** Around 150,000 Australians have jobs with banks. In 2015, banks paid \$25 billion in wages.
- **Tax:** Banks provide governments with considerable tax revenue. In 2015, banks paid \$13.5 billion in corporate tax. Taxes are also paid to state and local governments.
- **Dividends:** About three quarters of bank shares are owned by domestic shareholders. In 2015, banks paid around \$24 billion in dividends to their shareholders.
- **Community:** Banks are a major contributor to community services and programs around Australia, donating funds, time and effort. In 2014, the banking industry donated over \$600 million in funds and in-kind donations.<sup>3</sup>

## Productivity, participation and population

Economic growth is the net outcome of productivity, participation and population.

### Productivity

Underlying the recent weakness in economic growth has been a soft performance on productivity. Lifting the rate of growth in productivity is critical because at the end of the day productivity is the primary source of real economic growth and higher living standards.

The recent softness in productivity growth has reflected a range of factors. These include high investment activity in the resources and utilities sectors; the fading impact of past policy reforms; reduced competitive pressures from generally benign economic conditions through the 2000s and increased regulatory burden.

**Figure 2: Multifactor productivity**



Source: ABS

<sup>3</sup> Estimated by the Australian Bankers’ Association

There are a range of policy actions which will lift productivity growth, including:

- **Boosting infrastructure** – This adds to growth today through economic activity and jobs and contributes to growth in the future by adding to the productivity capacity of the economy. Infrastructure can be funded directly by government, public/private partnerships, or wholly by the private sector. Banks can play a role in facilitating private sector participation in infrastructure. The challenge is to create conditions that are attractive to private sector investors. This will include easing the impediments to investment in infrastructure by superannuation funds and insurance companies.
- **Microeconomic reform** – Much of the benefit from microeconomic reform comes from increased competition in both domestic and international markets. Australia has benefited from reforms in trade and the financial markets through the 1970s and 1980s, as well as more recent reforms in taxation, industrial relations and corporate law. The recent free trade agreements with Japan, Korea and China, and the Trans-Pacific Partnership, are a further advancement. There are proposals in the Competition Policy Review (Harper Review) which are worthy of consideration.
- **Minimising the regulatory drag from governments**, including the cost of complying with regulations and taxation – Regulation and tax reform needs to support, rather than impede, the ability of business to maintain Australia’s economic growth.
- **Upskilling and maintaining the workforce** – This includes education, training and re-education policies. Improving core skills in science, maths and literacy in schools is equally as important as upskilling for specific jobs and professions. The quality of ‘human capital’ is a key driver of productivity.
- **Innovation and commercialising innovation and technological change** – Banks, for example, have a proven record in technological innovation and driving change which delivers meaningful outcomes for customers.

The key benefit of stronger productivity growth is a bigger and more efficient economy. It is important that the benefits of this be shared.

### Participation

Australia can do more to lift labour force participation and boost the proportion of Australia’s working age population which is employed, including by increasing participation of younger Australians and women and retaining Australians in the workforce for longer.

**Figure 3: Labour force participation**



Source: 2015 Intergenerational Report – Australia in 2055



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The unemployment rate in 2015 has been as high as 6.4 per cent, the highest in almost 13 years. Youth unemployment (aged 15 to 24 years) is very high at around 13 per cent. There is also a significant group of people who are discouraged from looking for work or who would like to work more hours.

There are strong economic and social benefits in achieving full employment and providing jobs to everyone who is willing to work.

This requires greater job creation in the private sector. Business is the driver of jobs, but government can assist through policies which boost workforce engagement.

Participation policies should encourage workforce diversity. This is something banks do well – for example, about half of bank employees are women.

## Population

There is widespread belief that population growth is beneficial for aggregate economic growth. The reasoning is simple - more people equates to a bigger economy. The size of the population can be influenced by government through the immigration program and financial incentives to have children.

There is however, a growing debate about the overall benefits of a bigger population for the standard of living. There is no correlation between population and GDP per capita (otherwise the Philippines and Bangladesh would be rich while Switzerland and Singapore would be poor). Also, a larger population has significant costs which reduce the non-monetary aspects of living conditions, including environmental degradation, increased congestion, and pressure on infrastructure such as water and transport, and government services like health and aged care.

The policy lesson is that for a bigger population to be good for both aggregate economic growth and the standard of living, there needs to be adequate investment in infrastructure and services as well as careful management of negative impacts.

## The role of tax reform

The mix of taxes is an important policy arm of government and can be a key driver of economic growth and jobs. Appropriate tax policy can help to grow the economic pie.

At its core the aim of tax reform must be to improve the supply side of the economy by boosting investment and productivity and reducing the economic drag from taxes. The banking industry supports reforms which improve the tax system's efficiency, equity, simplicity and international competitiveness.

The banking industry also believes it is important for ongoing confidence in the tax system and the notion of fairness that everyone pays their fair share. In this regard, the industry supports efforts to ensure that corporate tax is paid in the country where the real economic activity occurs.

A first step in reform of the tax system is to cut the company tax rate. This is the single most effective reform to promote stronger investment and create jobs.

Consideration should also be given to reducing and standardising taxes on savings, eliminating inefficient state taxes and harmonising taxes across states, tightening exemptions, and reducing complexity and compliance costs.

The package of reforms should be revenue neutral if the objective is to achieve a more efficient and growth-boosting tax mix.

## Fiscal repair

The state of the Australian budget and some state budgets attract a lot of commentary, but there is no agreement on the urgency of the problem, its causes, or how the issues should be resolved.

A broken budget imposes significant economic and social costs.

Persistent deficits and accumulating government debt will compromise economic growth in the long term as more of our scarce resources are devoted to servicing the interest bill. In 2015-16, the interest bill on the gross Australian Government debt outstanding will be \$15 billion.

Further, increasing deficits may affect the confidence of markets and threaten Australia's AAA rating, although that is a medium term consideration rather than a near term risk.

Most critical of all, there is a fairness issue in leaving a debt burden to future generations. How much do we want our children to pay to support today's lifestyle?

There are four ways in which these fiscal challenges can be addressed:

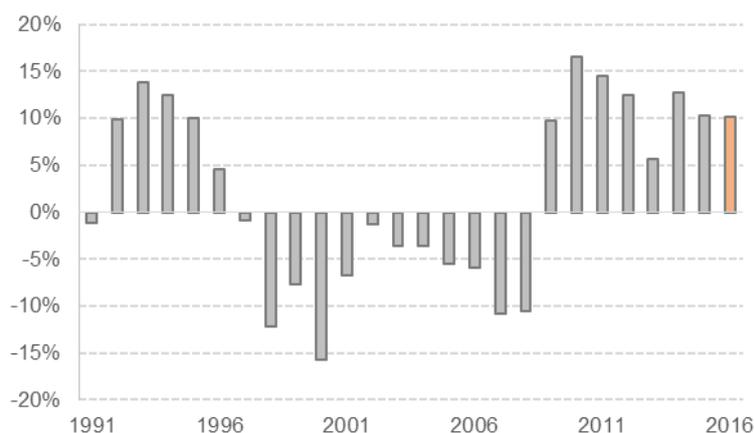
- 1) Lift economic growth
- 2) Reduce spending
- 3) Increase the tax take; and
- 4) Privatised the provision of services and implement more user pays.

There is a need to open a community discussion on the appropriate balance of options.

That discussion must be based on a rigorous analysis of the cause of the fiscal problem.

Recent Australian federal governments have had a problem in living within their means. By the end of 2015-16, Australia will have recorded eight years of continuous budget deficits, some the biggest on record. Eight years after the global financial crisis (**GFC**), the Federal Government is still borrowing 10 cents of every dollar it spends.

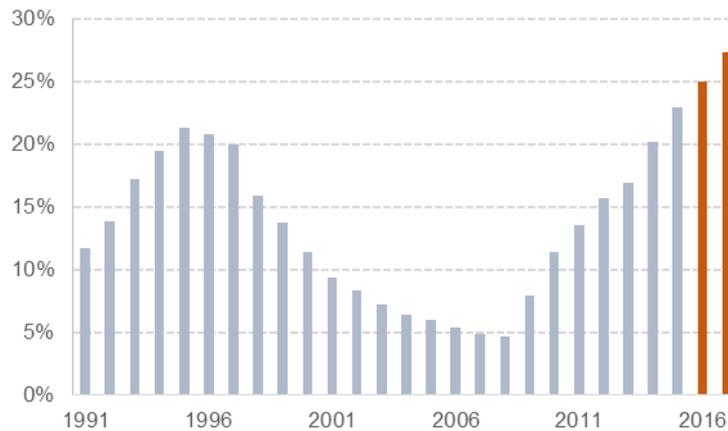
**Figure 4: Proportion of Federal Government spending which is borrowed**



Source: Federal Government Budget Papers 2015-16

As a result, the face value of gross debt - which is the amount the Government has to pay back – is rising rapidly. Over the forward estimates debt will increase by \$151 billion. In 2016/17 the ratio of debt to GDP will be 27.3 per cent, the highest level since 1970-71, the start date for the publication of this data in the Budget papers.

**Figure 5: Gross Debt to GDP**



Source: Federal Government Budget Papers 2015-16

The most recent Federal Budget suggested budget balance would not be achieved until 2019-20, however, that would require a sustained rebound in economic growth to rates not seen since the GFC.

In 2015-16, Federal Government spending - measured as the call on resources - is forecast to increase to 26.7 per cent of GDP, the highest level for 29 years. Federal Government receipts (taxation receipts and non-taxation receipts) are projected to increase to 25.2 per cent of GDP by 2018-19, the last year of the forward estimates. This will be the highest share of the economy since 2005-06, but the budget will still be in deficit.

Those simple metrics suggest there is limited scope to further lift revenue and that much of the budget repair effort must be directed to optimising spending.

These budget metrics predate the new Coalition economics team, but show there is still much work to do to achieve fiscal sustainability and make a start on repaying Australia's obligations.

There are also long-term issues with the sustainability of state and territory budgets, particularly linked to projected increases in health expenditure. Health expenditure over the past decade has increased for all age groups.<sup>4</sup>

What is required is political and community recognition that there is a problem and acknowledgement on the cause of the fiscal problem. From this, we should look to build consensus on the way forward to repair budgets and achieve fiscal sustainability.

The banking industry supports the need for a clear plan and bipartisan agreement to return budgets to a sustainable surplus over the medium term.

<sup>4</sup> Davey, J., McGannon, C. and Savage J. (2013) Budget pressures on Australian governments, Grattan Institute. Available at: [http://grattan.edu.au/wp-content/uploads/2014/04/187\\_budget\\_pressures\\_report.pdf](http://grattan.edu.au/wp-content/uploads/2014/04/187_budget_pressures_report.pdf)



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The banking industry recognises and endorses the social covenant to protect the vulnerable - with an imperative that government income support must be directed only to the vulnerable. Government must also ensure the delivery of services is efficient and embodies technological advances so that there is a low cost 21st century delivery platform.

Ultimately, restoring fiscal sustainability will require sacrifice – there are no painless solutions. It will be fair if everyone makes a contribution, no matter how small, rather than demanding ever more from those who are already contributing the most.

## A flexible and high wage workplace

The Australian economy is continually evolving and is increasingly reliant on the contribution of the services sectors. It is rapidly incorporating new technologies.

The regulation of the labour market needs to be flexible in order to adapt to, and meet the needs of this changing world. This requires a framework which allows business to be nimble and meet workers 21st century preferences and lifestyles. The workforce and workplace relations system must be adapted for the future, not the past.

Preserving Australia's high standard of living requires the preservation of high wages. The qualification is that high wages must be justified and based on high productivity. Flexibility should be directed to underpinning a highly productive workforce and a strong productivity agenda.

Australia needs to be an attractive place to work and must be able to attract talented people. The economy must be based on high quality and sustainable jobs. A flexible and adaptable workplace is a key element in this.