

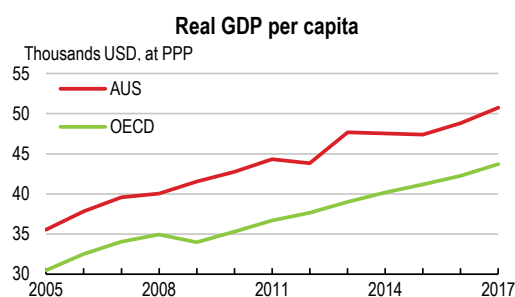
Executive Summary

Economic growth has been resilient...

Australia's long span of positive output growth continues, demonstrating the economy's resilience to shocks (Figure A). The labour market has been equally resilient, with rising employment and labour-force participation. Life is good, with high levels of well being, including health, and education.

Continued robust output growth of around 3% (Figure B) is projected in the near future. Exports and investment will support the economy, and wage growth and price inflation will gradually pick up. Risks to the outlook relate to the housing market, and uncertainty in export demand due to rebalancing in China and potential escalation of international trade disputes.

Figure A. GDP per capita performance has been strong



Source: OECD Productivity Database.

StatLink  <https://doi.org/10.1787/888933882864>

...but there are socio-economic challenges...

Globalisation and automation, while overall positive, have disrupted the life of several groups of people. This is the theme of the in-depth chapter of this *Survey*.

Certain groups are vulnerable with low labour force participation and high risk of poverty. The substantial gaps between

indigenous Australians and the rest of the population are narrowing too slowly.

... and climate-change policy still lacks clarity and stability

Australia has made little progress in reducing its environmental footprint in large part because frequent changes in core climate-change instruments have created uncertainty for emitters, which has also discouraged energy sector investment.

Biodiversity is also a core environmental issue for Australia. The country is host to around 10% of the world's biodiversity, with many fragile situations.

The housing market poses macroeconomic risks

Australia's housing market is a source of vulnerabilities due to elevated prices and related household debt (Figure C). House prices have fallen, although only gradually since late last year; the current trajectory would suggest a soft landing, but some risk of a hard landing remains.

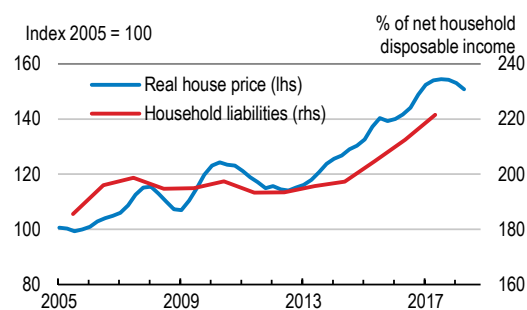
Figure B. Economic growth will remain robust

(annual growth rates, unless specified)	2017	2018	2019	2020
Gross domestic product (GDP)	2.2	3.1	2.9	2.6
Private consumption	2.7	2.5	2.1	1.7
Government consumption	3.7	4.4	3.2	2.8
Gross fixed capital formation	3.4	3.4	4.0	2.9
Exports of goods and services	3.7	4.6	4.1	3.8
Imports of goods and services	7.8	5.6	6.1	4.9
Unemployment rate (% of labour force)	5.6	5.4	5.3	5.1
Consumer price index	2.0	2.0	2.1	2.4
Government net lending (% of GDP)	-0.6	-0.1	0.2	0.5


Source: OECD Economic Outlook 104 database.

A direct hit to the financial sector from a wave of mortgage defaults is unlikely. However, if house prices collapse consumer spending could suffer, via negative impact on wealth, including from exposures to bank shares, which would encourage deleveraging. Together with reduced housing-related expenditures, this would put pressure on the whole economy.

Figure C. High levels of house prices and household debt pose risks



Source: OECD Analytical database.

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Financial supervisors and bank regulators should be prepared in the event of a hard landing in the housing market. They should also continue to address shortcomings in the financial sector identified in recent inquiries, particularly competition, misconduct and fraud.

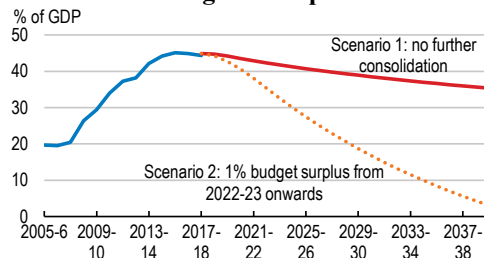
In the absence of negative shocks, policy rates should start to rise soon. Monetary conditions remain very accommodative, with the risk of imbalances accumulating further if the low-interest rate environment persists. In the absence of a downturn, a gradual tightening should start as inflation edges up and wage growth gains momentum.

Budget repair needs to continue


Fiscal discipline will still be required to bring fiscal balances to surplus. Robust output growth is helping lift revenues, however this can also prompt increased pressures to expand public spending. No further consolidation would bring only slow

reduction in public-debt-to-GDP ratio (Figure D).

Figure D. Fiscal policy needs to get to surplus



Source: OECD calculations based on OECD Analytical Database and Government of Australia.

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<https://doi.org/10.1787/888933882902>

The federal government has underscored commitment to small government by incorporating its tax-to-GDP ceiling in its fiscal strategy. There is welcome focus on lightening personal-income tax, reforming private-pension tax treatment and tackling tax avoidance and evasion. Yet there remains considerable opportunity for further tax reform.

Greater use of value added tax (the Goods and Services Tax, GST) would provide fiscal space for tax reform in other areas. At 10%, the GST rate is comparatively low and the coverage is at around the OECD average. An increase in the rate or base could fund the removal of less efficient taxes, and be used to further shift the tax mix.

Opportunities to improve infrastructure efficiency with environmental benefits include road transport, where there is scope to shift away from fees based on car-ownership towards those based on car use, such as distance charging or congestion charging.

Australia would benefit from higher public spending efficiency. Recent policy has sensibly focused on improving productivity in health care and long-term care. Accelerated spending on roads, telecoms infrastructure, disability support and defence needs to be monitored in terms of costs and benefits.

Urban environments need further improvement

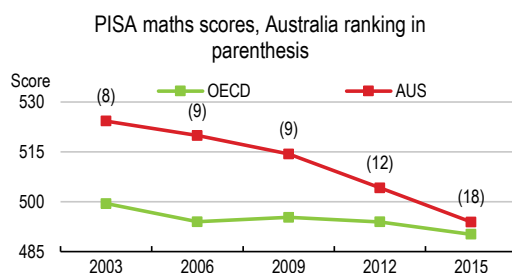
Rapid population growth is supporting Australia's economic growth but concentration in metropolitan areas is straining infrastructures and fuelling traffic congestion, noise and air pollution.

Major transport investment is underway, which is welcome. While political considerations will always influence project selection, decisions should be informed by transparent and rigorous cost-benefit analysis. Some metropolitan areas would benefit from amalgamations of local government or more shared service provision. Also, most of Australia's land-use zoning systems remain overly complex and restrictive.

Education reform and fine-tuning activation policy are crucial

Slippage down PISA scores and rankings (Figure E) signals a need to press on with education reform, especially in a context of fast technological change and globalisation. Focus on disadvantaged students in schools (notably, via funding reform) and early childhood education should continue, as a means of tackling gaps in educational outcomes.

Figure E. Australia's PISA scores have worsened



Source: OECD Program for International Student Assessment (PISA).

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<https://doi.org/10.1787/888933882921>

Vocational education and training (VET) needs to provide adequate skills for changing labour-market demands.

Immediate problems arising from an explosion of poor quality providers and courses look set to be resolved. Beyond this, the sector needs to better provide core skills to weak students. Also, there remains policy bias in student support towards university studies.

Australia's tertiary-education expansion, while welcome, has also brought challenges. Supply may have overshot as many graduates do not find degree-level jobs. Rapid expansion is also pushing up the fiscal cost. Better information would help students and providers connect choices and course content with evolving labour demand. In addition, new technologies in education, such as Massive Online Open Courses (MOOCs) should be nurtured.

There is still scope to encourage greater labour-force participation, helping reduce poverty and keeping individuals connected with evolving technologies and skills. Australia's system of contracted private employment services could be given greater incentives for long-term employment retention. A new focus on providing support to all displaced workers is promising. Australia's below-par participation of women with children will be improved by recent changes to child-care benefits, but more comprehensive support to mothers is needed.

Business needs to be competitive and innovative

Follow-up of a major competition-policy review (the "Harper Review") continues, and conditions for firm dynamics have improved thanks to amendments to insolvency legislation. Nevertheless, there remains scope for improving market functioning.

Targeted business policy continues to focus on innovation. Recent policy moves have included announced reforms to refocus the R&D Tax Incentive towards supporting high-intensity R&D and progress in reforming intellectual property legislation. However, there has been no pruning of the large number of SME support programmes.

MAIN FINDINGS	KEY RECOMMENDATIONS
Monetary policy, housing market and financial regulation	
Upswing in activity continues and inflation is projected to rise gradually.	In the absence of a downturn, gradually remove monetary accommodation through a policy rate increase.
Elevated house prices and mortgage debt remain sources of risk.	Prepare contingency plans for a possible significant correction in the housing market including a loss-absorbing regime (including bail-in provisions) in the case of financial-institution insolvency.
Competition is lacking in the banking sector and inquiries have revealed misconduct.	Assure strong accountability, transparency and competition in the financial sector including an appropriate response to the banking Royal Commission.
Fiscal policy, tax and spending reform	
Deficit reduction remains on target but continued fiscal discipline is required.	Ensure fiscal balances remain on track to reach surplus ("budget repair").
Taxation should support welfare and economic growth.	Further shift the tax mix from direct taxes (corporate and personal) and inefficient taxes (including real-estate stamp duty) and towards the Goods and Services Tax and land taxes.
Improving the efficiency of public services is important given current and upcoming spending commitments and continuing budget repair.	Follow up on the recommendations for improving public services made by the Productivity Commission's "human services" inquiry, notably those in health care and long-term care.
Improving transport, urban environments and utilities	
Rapid population growth is supporting Australia's economic growth but concentration in metropolitan areas is straining infrastructures and fuelling traffic congestion, noise and air pollution.	<p>Improve infrastructure project selection by raising the prominence of cost-benefit analysis and economic returns.</p> <p>Accompany accelerated road investment with improved road charging, including distance charging and urban congestion charging.</p> <p>Strengthen urban-area governance through greater leadership from federal and state initiatives in planning, and continued efforts to amalgamate small local authorities.</p>
Deepening skills and increasing inclusiveness	
Students' performance in PISA tests is worsening and skills demands are shifting.	<p>Continue focus on disadvantaged students in early childhood education and schools.</p> <p>Improve VET education including by improving basic-skills provision and reducing policy bias in favour of university education.</p> <p>Provide better information for education choices including through a single platform with career information, education pathways and employment outcomes.</p>
Activation policies could be better geared towards long-term outcomes and labour force participation among women with children is below par.	<p>Incentivise jobactive providers to achieve longer job retention, provide better quality training and on-the-job support.</p> <p>Focus further on lone-parents in terms of childcare availability and affordability, and career guidance and training.</p> <p>Give indigenous communities a greater role in policy design and implementation.</p>
Ensuring competitive and innovative business	
Australia's business environment is good but impediments to market functioning remain in specific areas.	Reforms should include adopting lighter product standards, paring back professional and occupational licensing, and reducing operating restrictions in shipping.
Environmental sustainability	
<p>Frequent change in core climate-change instruments has created uncertainty in emission reduction and discouraged energy sector investment.</p> <p>Australia contains around 10% of the world's biodiversity and more than 1 800 species are listed as threatened.</p>	<p>Stabilise and strengthen climate-change policy. Develop and implement a national, integrated energy and climate policy framework for 2030 based on a low-emission development strategy for 2050, in line with the Paris Agreement objective. Guide the energy transition through an emissions reduction goal for the power sector supported by a market-based mechanism.</p> <p>Give greater priority to biodiversity in project approval and land use.</p>



From:
OECD Economic Surveys: Australia 2018

Access the complete publication at:
https://doi.org/10.1787/eco_surveys-aus-2018-en

Please cite this chapter as:

OECD (2019), "Executive Summary", in *OECD Economic Surveys: Australia 2018*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/eco_surveys-aus-2018-2-en

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