Executive summary

The main challenge for policy is managing a sustained recovery by promoting important structural changes. *Australia has continued to weather the global economic crisis well reflecting sound macroeconomic policies and strong demand from China. Growth temporarily slowed in 2010 and 2011 as stimulus was withdrawn and households became more cautious. Non-mining tradable sectors have struggled with the strong exchange rate driven by the mining boom. However, fundamentals remain solid with the unemployment rate close to its structural rate and inflation and public debt low. Growth strengthened in 2012, and the outlook is positive, even though there are mainly negative risks stemming from the external environment, to which Australia is however less vulnerable than many other OECD countries.*

The current monetary and fiscal policy mix is appropriate to sustain recovery, and Australia is in a good position to respond to risks. *Monetary easing in the context of low inflation is supporting activity while the budget is being rapidly returned to surplus to restore fiscal space. In case of a sharper-than-expected cyclical weakening, the central bank should loosen further and the fiscal automatic stabilisers should be allowed to work, even if this postpones the return to budgetary surplus. While monetary policy should be the first line of defence, if a new, full-scale global crisis of a similar magnitude as in 2008-09 breaks out, fiscal expansion to support activity would be warranted.*

Stronger medium-term fiscal institutions would be better able to cope with volatility in natural resource revenues. *The medium-term objective of reducing net debt is welcome. The authorities should consider creating a stabilisation fund to accumulate mining-related revenues when they are unusually high to insulate budget and spending, thereby reducing the risk of pro-cyclical fiscal policy.*

The structural changes stemming from the mining boom can be facilitated by maintaining flexible markets and introducing tax reforms. *Australia should promote smooth reallocation of resources by taking advantage of new opportunities prompted by growth in Asia, and should minimise adjustment costs by preserving a decentralised and flexible labour market. In particular, public subsidies should not be used to retain resources in sectors where Australia's comparative advantage is declining. Tax reforms, including a lower corporate tax rate, a broader resource rent tax and more efficient state taxes would facilitate ongoing structural adjustments. At the same time, a fair sharing of the burden and gains of adjustment would facilitate acceptance of change.*

Continued good performance will require lifting productivity growth. *Part of the slowdown in multifactor productivity growth is temporary, as key resource or infrastructure projects have not yet come on stream and the structurally weaker industries gradually adjust to the new conditions. Nevertheless, sustaining broad-based increases in living standards calls for policies to improve vocational and higher education outcomes to meet future skill needs, enhanced innovation performance through closer collaboration of key players, resolving infrastructure bottlenecks through* *better planning and more efficient financing and use of infrastructure, as well as stronger competition.*

Recent progress to promote more sustainable growth based on efficient environmental policy is welcome and should continue. *The introduction of a carbon price, together with accompanying measures, should encourage investment in clean energy technologies, and help enhance competitiveness in a carbon-constrained world. More efficient allocation in the use of water resources may be achieved by better water pricing and suppression of barriers to water trade through swift implementation of the National Water Initiative.*

Box 1. **Key policy recommendations**

Macroeconomic policy

- The current shift in the policy mix is appropriate. If the cycle weakens, ease monetary policy and let the automatic stabilisers work. While monetary policy should be the first line of defence, if a full-scale global crisis of similar magnitude as in 2008-09 erupts, be ready to adopt prompt fiscal expansion.
- Consider creating a stabilisation fund to better insulate public spending from revenue changes caused by volatile terms of trade.

Tax reform

- Pursue business tax reforms including reducing the corporate tax rate and a possible extension of the loss carry back scheme to unincorporated firms.
- In pursuing tax reform promote the use of less-distorting untapped fiscal resources, including cuts in subsidies to irrigation infrastructure and the automotive sector. Review tax credit for business for excise taxes on fossil fuels in sectors not covered by the new carbon tax.
- Broaden the mineral resource rent tax (MRRT) coverage. Consider replacing state royalties by a mining rent tax modelled on the federal approach, allowing states to set their tax rates.
- Rationalise other state taxes: reduce or remove conveyance duties and the progressivity of the state land tax; broaden the state land tax base by eliminating exemptions for owner-occupiers; cut subsidies to first-home buyers; broaden the base of the goods and services tax (GST) and consider increasing its relatively low rate.

Labour market reform

- Preserve the existing framework of direct and decentralised bargaining as it has yielded good results so far. Avoid substantive changes to the framework to minimise the costs of adjusting to frequent regulatory changes.
- Consider minor changes to the industrial relations framework including allowing employers commencing a genuinely new business to negotiate collective agreements both directly with potential future employees and/or unions.
- Investigate sector-specific working conditions affecting the flexibility and equity issues negotiated between employers and employees to help move the efficiency/fairness debate forward and focus it on practical questions that are potentially easier to solve through negotiations and compromise.

Box 1. **Key policy recommendations** *(cont.)*

- To improve the effectiveness of employment services, link funding of employment services more closely to job seekers, possibly by introducing a voucher system. Consider linking the remuneration of service providers more tightly to their outcomes measured by the "Star Rating" performance evaluation system.

Enhancing productivity for sustained growth

- Implement competency-based apprenticeships in line with the skills strategy. Proceed with efforts towards developing strong quality assurance mechanisms for training.
- Ensure improved information flows for prospective tertiary students on course quality and outcomes. Monitor completion rates and learning outcomes in higher education following the uncapping of places in universities. The funding arrangements in the new system should ensure an effective supply of student places.
- Programmes to support collaboration and networking between universities and businesses should be simple and flexible to reinforce their impact on innovation.
- Improve infrastructure outcomes by reducing the complexity of governance and provision of infrastructure investment and ensuring a more effective planning. Remove barriers to private participation in financing infrastructure investments. Continue efforts to increase the effectiveness of public-private partnership processes and improve approaches to managing risks of such projects.
- Broaden the use of road user charges. Introduce location-specific and time-varying congestion charges for road infrastructure in large cities. Move towards more cost reflective prices in the water sector. Install advanced metering infrastructure ("smart meters") for electricity to promote energy-efficient consumption choice.

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