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‘Squandered opportunity’

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Good or ...?

Apparently at the height of the Cold War the Soviet Union’s economic planning minister was interviewed by a western journalist. The journalist said: ‘If I asked you to describe the state of the Soviet economy in one word, how would you describe it?’ The planning minister responded: ‘Good’. Perplexed at this response, since Russians were lining up in queues for the most basic of food items, the journalist followed up: ‘If I were to give you two words to describe the Soviet economy, what would they be?’ The planning minister said: ‘Not good!’

Now I am not suggesting that ‘not good’ describes the state of the Australian economy over the last decade, what with its sustained economic growth and the lowest level of unemployment in 30 years. If I had to describe the Australian economy over the last decade in one word, it would be: ‘Opportunity’. But if I were given two words to describe it, I would say: ‘Squandered opportunity’.

Australia’s longest-ever economic expansion has been the product of two booms – a productivity boom during the 1990s and a resources boom that began in the early years of this century.

Without question, Australia’s two booms have delivered a big lift in national income. Governments reaping revenue windfalls from booms are expected to pass on some of the gains to the current generation to be spent how the people see fit. But governments have a second – and higher – responsibility; to invest some of the windfall wisely to secure ongoing prosperity and the expansion of opportunity for all Australians, present and future.

Has the government invested in the future?

The government seemed to acknowledge a responsibility to invest in the future with its release of the *Intergenerational Report* in 2002. The report presented a sombre outlook for

income growth in the face of population ageing. It projected, from the beginning of the next decade (now only four years away), the slowest rate of income growth per person since the decade of the Great Depression.¹

Now, it is true by definition that as long as real income per person continues to grow, no matter how slowly, future generations will be more prosperous than the present generation. But that doesn't mean we should be satisfied with a dramatic deceleration in the rate of income growth per person. For starters, in a society where income inevitably is not distributed equally, slow *average* income growth per person would involve many Australians going backwards as others go forward quickly. Second, long-term projections gloss over the likelihood that, at some stages over the next 40 years, the economy will move into recession. The former Reserve Bank Governor, Ian Macfarlane, considered it highly probable that Australia would catch a recession from the rest of the world in the fairly near future. A recession in an already weakly growing economy would cause great human suffering as vulnerable workers lost their jobs and marginal small businesses went under.

A third reason for aiming higher than the very slow income growth projected in the *Intergenerational Report* is that social disadvantage remains entrenched in Australia despite the economy having grown strongly for 15 years.

Around 730,000 children are living in households where no adult is in work, down only marginally on the 797,000 in 1995.² Last year, 46,000 cases of child abuse were substantiated – a doubling of confirmed cases in just five years.³

Poverty is rife among single parent families where relationships break down and the mother is left to fend for herself and her children.⁴

While the average life expectancy of Australians has risen by three years over the last decade, life expectancy among indigenous Australians is a staggering 17 years lower.⁵ Infant mortality among indigenous children is more than double that of non-indigenous Australians.⁶

Australians living in the most disadvantaged communities suffer potentially avoidable premature death rates more than 50 per cent higher than those in the most affluent areas. Death rates from cardiovascular disease and strokes are 60-90 per cent higher in the most disadvantaged communities than in the most affluent communities.⁷ The rate of hospitalisation is 50 per cent higher in the most disadvantaged areas.⁸

Alleviating social disadvantage is much easier in a strongly-growing economy. The Australian people will more readily accept extending opportunity to the disadvantaged out of growth rather than out of stagnation.

Australia's performance in lifting participation and productivity

How has the Howard government fared in averting the worrying projections of the *Intergenerational Report*?

We know that the main remedies to population ageing are to be found in the two other P's: participation and productivity.

Has the government boosted workforce participation?

Australia is experiencing historically high labour force participation rates. But how much of that lift is due to the resources boom and how much is due to structural reforms to increase work incentives?

Following the release of the *Intergenerational Report* the government made a number of minor changes aimed at lifting the workforce participation of older workers. These were fine as far as they went but, as the *Intergenerational Report* itself notes:

“... increasing the participation rates of groups with lower participation rates, such as older workers, would have only a limited impact on the overall participation rate”.⁹

Nevertheless, workforce participation of older workers has increased much faster than assumed in the *Intergenerational Report*.

Then the government implemented so-called welfare-to-work reforms for sole parents and disability support pensioners. For sole parents the government made the stick bigger and the carrot smaller. The bigger stick is a cut in income support payments for sole parents whose youngest child turns eight, as they are shifted from the sole parent pension onto unemployment benefit. The smaller carrot is a reduced free area of income before benefits are reduced and a sharper phase-out of benefits for income earned beyond the free area.

These changes create a strong extra incentive for single mothers to have another child, enabling them to return to the more generous sole parent pension for another six years. The loss of pensioner education supplement as a sole parent is shifted from the sole parent pension onto unemployment benefit sends a strong signal that the government is not interested in assisting sole parents to boost their workforce skills. No great lift in workforce participation by single mothers is likely from these changes – just some budget savings as poor single mothers are expected to work for as little as \$3 an hour after taking account of lost benefits, taxes paid, and travel and work costs.¹⁰

Indeed, the proportion of sole parent families facing effective marginal tax rates (EMTRs) of 50 per cent or more has almost trebled during the last 10 years and the proportion of couples with children facing these high rates has more than trebled.¹¹ Overall, 910,000 working-age Australians face EMTRs of 50 per cent or more.¹²

A key reason for the lack of progress in reducing work disincentives has been the lack of progress in reducing income tax rates. Windfall gains from the last four federal budgets have exceeded \$260 billion, of which the government has spent almost \$250 billion.¹³ More than half of that amount has been spent on income tax cuts and family tax benefits. Most of the revenue dedicated to income tax cuts has been used to increase the threshold levels of income at which particular rates apply. The government then relies on bracket creep to recoup those tax cuts, only to hand them back again, typically in the lead-up to elections.

Cutting the lower income tax rates is extraordinarily expensive, since all taxpayers – rich and poor – get the tax cut. More efficient devices, such as low income tax offsets and earned income tax credits, can tailor reductions in the bottom tax rate for particular groups who confront serious work disincentives. Sole parents are the classic case. A specially-designed

sole parent tax offset could be applied to exempt sole parents who move from welfare to work from income tax and the Medicare levy.

We need to be conscious, however, that the phasing out at higher income levels of tax credits or offsets pushes the high EMTRs further up the income tax scale. Care needs to be taken not to transfer the problem of work disincentives from one income range to another.

By increasing the low income tax offset from \$235 to \$600 in the 2006 budget, the government provided an effective tax-free threshold of \$10,000 for low-income earners. This was a useful reform – I *would* say that, since I advocated it in a pre-budget submission.

But the truth is – the government has purchased precious little genuine tax reform with the \$130 billion it has spent on tax cuts in the last four budgets. The tax and welfare systems remain incentive crushers.

If the government has not succeeded in reducing work disincentives in the tax and welfare systems, perhaps it has enjoyed greater success in dealing with the other great barrier to mothers participating in the workforce – child care. The OECD has identified the cost of child care for lower-income families as a huge disincentive to workforce participation.¹⁴ It has concluded that Australia has comparatively low child care subsidies by OECD standards, and that Australia's female workforce participation would be highly responsive to increased child care subsidies.¹⁵ Yet the main change in child care provision in the last few years has been the introduction of the child care rebate targeted not at low-income earners but at higher-income earners. The child care rebate might be a clever policy electorally but it is unlikely to provide any major boost to workforce participation by mothers.

Has the government boosted productivity?

There is now a general consensus that the economic reform program initiated by Labor in government and extended in some places by the Coalition has been responsible for Australia's modern prosperity.¹⁶ A productivity-raising economic reform program will not lift productivity growth immediately. In fact, it can take at least four years before a reform program can raise productivity growth and up to 20 years for the full benefits to be realised.¹⁷

Australian productivity growth surged during the 1990s on the back of Labor's reforms, averaging 2.05 per cent per annum and outpacing almost all developed countries including the United States. But by the turn of the century Australia's productivity growth had peaked. The Reserve Bank Governor observed last month that:

"The various measures of GDP growth per hour worked suggest there has been approximately zero growth in productivity since the end of 2003".¹⁸

Yesterday the ABS released revised productivity growth estimates, causing the Treasurer to proclaim that productivity growth:

"... is in line, or marginally in front of the last productivity cycle".¹⁹

A closer look at the figures reveals the average annual growth rate of labour productivity over the last two years has been just 0.9 per cent. The ABS report, from which the Treasurer has drawn comfort, also states that:

“Growth in Multifactor productivity (MFP) was flat in the market sector in 2005-06”.²⁰

Recall that the dismal projections in the *Intergenerational Report* of the slowest rate of income growth per person since the decade of the Great Depression assume productivity growth of 1.75 per cent per annum from 2005 onwards. At average annual productivity growth of less than 1 per cent the outlook is far worse than that!

Australia’s slow productivity growth is placing a severe speed limit on future economic growth. It has been estimated that at productivity growth of 1.5 per cent per annum the sustainable potential rate of expansion is now probably no more than 3 per cent per annum.²¹ But since productivity growth is slower than that the economy has been unable to achieve even that modest sustainable economic growth rate since 2004. The Reserve Bank is worried that unless this slowing in productivity growth is temporary, potential GDP growth from now on will have a two in front of it.²²

How has this state of affairs come about? The answer is that the present government has failed to implement a new productivity-raising reform program. Labor in government transformed the Australian economy from a closed, inward-looking economy to an open, competitive economy. Having opened the door to competition, the same door cannot be opened a second time. Instead, a 21st century reform program should have been developed and implemented.

On numerous occasions in the federal parliament the Treasurer has claimed that the *WorkChoices* legislation will lift the sustainable rate of economic growth. Whatever other claims the Treasurer makes for these industrial relations changes, he cannot legitimately claim that they are boosting labour productivity. Yet that is precisely what he claimed again in parliament yesterday. The *WorkChoices* legislation came into effect in March this year. Measured productivity growth for the ensuing three months was minus 0.7 per cent.

The extra workers being employed nowadays are less skilled and correspondingly less productive than those already in employment, so average labour productivity must fall, not rise. I am not arguing that strong employment growth is undesirable. But I am arguing that strong employment growth, unless it is coupled with active skills formation, will not lift productivity growth.

I am happy to acknowledge the Treasurer’s point that improved labour relations will boost labour productivity.²³ But the *WorkChoices* legislation will not improve labour relations; it will worsen them.

The \$260 billion windfall gave the government a wonderful opportunity to invest in a second round of productivity growth. But only a tiny share of that windfall was spent on productivity-enhancing measures.

Under present policy settings it is difficult to see where the next round of productivity growth will come from.

A reform agenda to lift productivity and participation

In an open, competitive economy like Australia's, the next big round of productivity growth cannot realistically come from widening a few roads or deepening a few ports. It took a fundamental reform of the Australian economy to achieve the last round of productivity growth and it will take a fundamental reform to achieve the next.

What remains to be reformed?

Certainly, as the Business Council of Australia points out in a paper prepared for this conference, there is enormous scope to reform our federation, reducing the wasteful duplication, overlap and cost-shifting between the Commonwealth and the states. After a promising start with the first Special Premiers' Conference in 1990 and the National Competition Policy reforms of the mid-1990s, little progress has been made on this front over the last 10 years. The case for further reform is clear and strong, and I will leave it to others at this conference to continue the advocacy.

This week the Productivity Commission's annual report was tabled in parliament. It identifies a reform agenda based on the National Reform Agenda being pushed by the Bracks government and includes reform of the health system, reducing the regulatory burden and investing in human capital.²⁴

Australia's education system is screaming out for reform.

In the 21st century, education stands alone as the paramount source of productivity growth. Education, too, improves health and wellbeing and lifts workforce participation. Education raises two P's in one go – productivity and participation.

Education is the key that opens two doors – to sustained prosperity in a strong economy and opportunity for all in a fair society. The campuses of our preschools, our schools, our TAFEs and our universities can be the places where economy meets society. They can be the rallying points for a crusade for a prosperous, fair, tolerant and compassionate Australia.

International and Australian studies have demonstrated the huge national benefits from extra years of schooling. An analysis of data from 21 OECD countries concludes that an additional year of schooling would increase per capita GDP by 6 per cent.²⁵ In Australia it is estimated that a one-year increase in the average level of schooling would not only eventually lift GDP by 8 per cent, it would permanently boost GDP growth by 0.5 per cent per annum.²⁶ These are very powerful effects – the best investment Australia can make.

Most of the rise in the proportion of young Australians entering year 12 occurred during the period of the previous Labor government, when the retention rate doubled from 36 per cent to 72 per cent. Since 1996 the retention rate has risen much more slowly, to 75 per cent.²⁷

Both the Productivity Commission and the OECD find that there was a deceleration in skills formation during the 1990s following the rapid acceleration of the 1980s. They conclude that in more recent times, skills formation has made no contribution to Australian productivity growth.²⁸

Drawing together the work of the OECD and the Productivity Commission, Eslake asks:

*“So why has education apparently not made any discernible contribution to the improvement in Australia’s economic performance over the past decade? The answer, unfortunately, seems to be that there has not been any discernible improvement in Australia’s educational outcomes – at least insofar as they impact on productivity growth during the period”.*²⁹

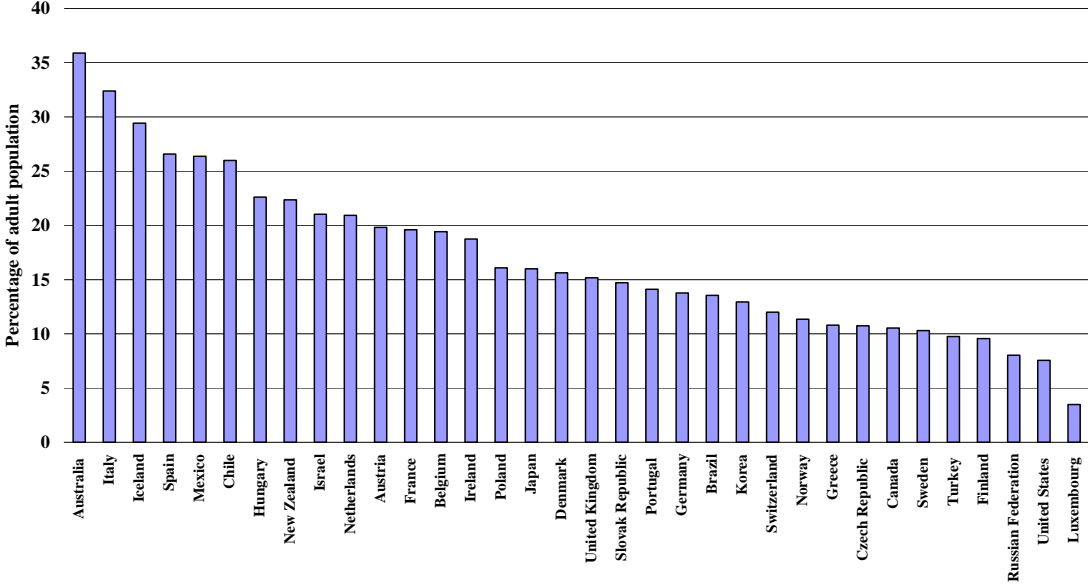
Based on detailed empirical analysis of Australia’s education effort, Dowrick reaches a similar conclusion:

*“... Australia’s educational report card should be marked: ‘Started well, but slackened off. Substantial room for improvement’”.*³⁰

The room for improvement is graphically depicted in Diagram 1, which shows that Australia has the highest proportion of the adult population with a lower-secondary level of education of any country in the OECD.

Diagram 1

Educational attainment: adult population (2004)
Lower secondary



Source: OECD (2006c, p. 37).

However, as Day and Dowrick point out, the best is yet to come from the big lift in high-school completion rates that occurred during the 1980s and early 1990s, especially among girls.³¹ As the cohort of much better-educated young women make their way through their working lives, replacing less-educated older men, productivity growth and participation can be expected to increase. This will be an invaluable counter to the adverse economic consequences of population ageing.

The productivity boost from the earlier improvements in educational attainment is well underway. Yesterday the ABS released estimates suggesting that since 1983-84 the quality of labour has improved by 0.4 per cent per annum.³²

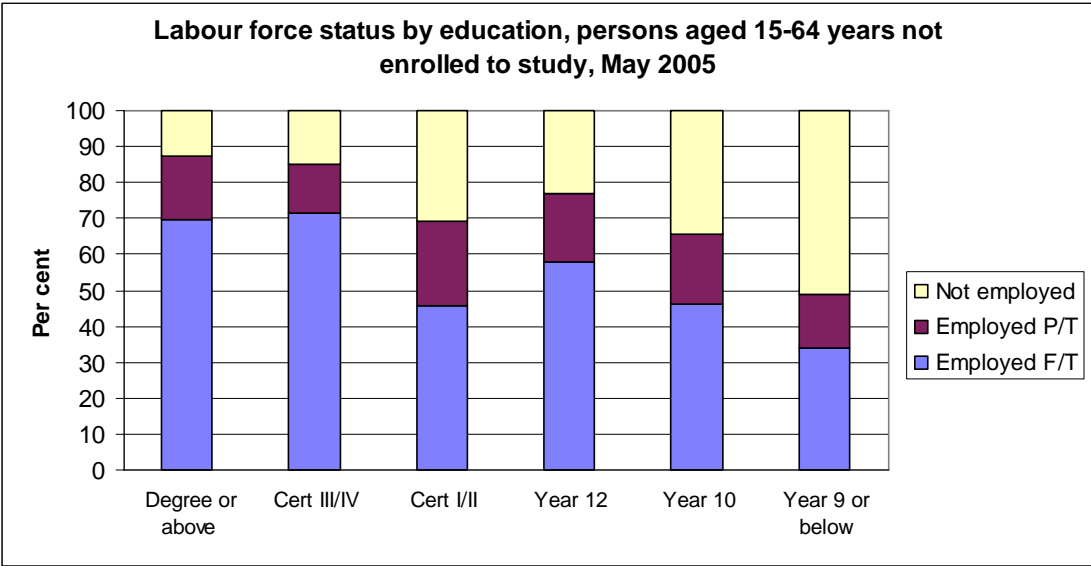
While educational outcomes are not totally reflected in the number of years at school – the quality of schooling and access to vocational training for early school leavers are important considerations – there is nevertheless compelling evidence that extra years of schooling matter a lot.

Early school leavers earn around 20 per cent less than those completing high school, who earn around 20 per cent less than young people completing vocational education who, in turn, earn on average 20 per cent less than university graduates.³³

In the feverish debate that followed my floating of the idea of compulsory high-school completion, a number of public figures protested that young people who are not academically inclined are better off leaving school early instead of wasting their time in classrooms and disrupting classmates. Yet there is strong international and Australian evidence that, even for those students with a low level of commitment to school, just staying at school for an extra year will increase a young person’s expected earnings by around ten per cent over his or her lifetime.³⁴

The Prime Minister is on record criticising the very goal of increasing high-school retention rates for Australian students.³⁵ To test the Prime Minister’s proposition that early school leaving is the better option for students who are not academically inclined, I have obtained previously unpublished data from the Australian Bureau of Statistics that describes the labour force status of Australians who are no longer studying. Using that data, I have been able to calculate how Australians with different levels of educational achievement are faring in the labour market. The results for working-age Australians are summarised in Diagram 2.

Diagram 2



Source: ABS unpublished data

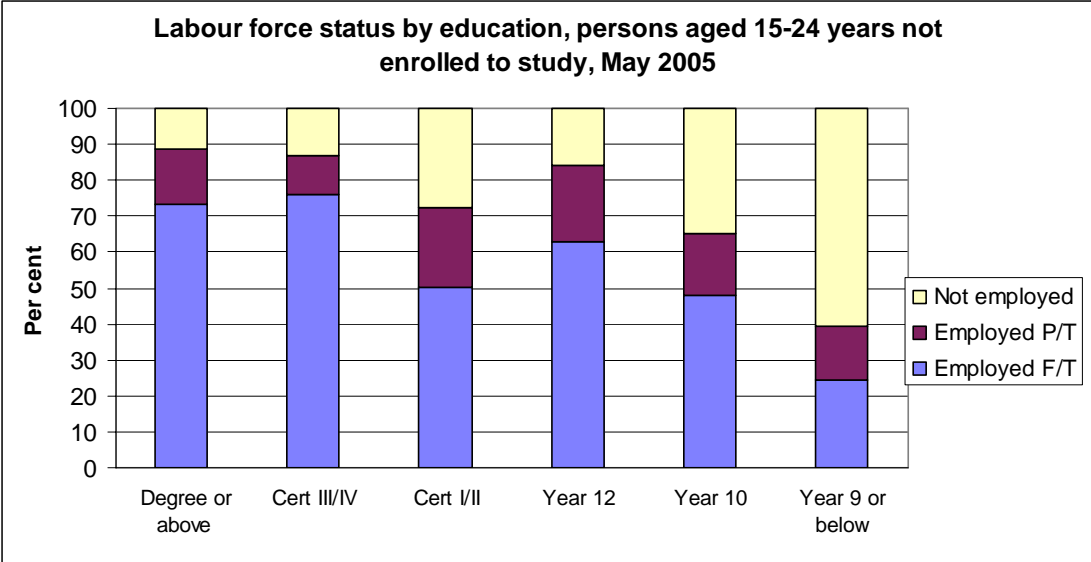
Diagram 2 confirms that, at height of the resources boom and the lowest unemployment in 30 years, more than half of those working-age Australians who failed to finish year 10 are *not* employed. They are either unemployed or have dropped out of the labour market altogether. Of those who finished year 10, more than one-third are not employed. This compares with less than one-quarter of high-school finishers.

Critics of the goal of high-school completion claim that a vocational education is just as good. But 30 per cent of working-age Australians who have obtained a Certificate I or II are not employed, compared with 23 per cent of high-school finishers. To have better employment prospects on average than high-school finishers, it is necessary to have an advanced trade (Certificate III or IV), an advanced diploma or a university degree.

Having previously argued that high-school completion should not be a policy priority, the federal government recently announced a skills package directed at working-age Australians over the age of 24 who failed to finish high school and who need remedial literacy, numeracy or training.

Why the concentration on over-24s to the exclusion of younger people who left school early? As Diagram 3 reveals, the employment prospects of young Australians who leave school early are even worse than those of older working-age Australians. A staggering 60 per cent of 15-24 year-olds who left school before finishing year 10 are *not* employed. Almost 30 per cent of those with Certificate I and II qualifications are not employed. By comparison, only 16 per cent of high-school finishers and 13 per cent of advanced trade certificate holders are not employed, and just 11 per cent of university graduates fall into this category.

Diagram 3



Source: ABS unpublished data

In September 2006, when jobs were in abundance, almost 110,000 young people under the age of 25 were on unemployment benefits. An astonishing 54,000 of them were long-term unemployed; they had been unemployed for more than a year and in receipt of unemployment benefits.³⁶

These startling statistics explode the myth that it is okay to leave school early. Leaving school early without obtaining an advanced trade qualification is the pathway to welfare. This is true even at the height of an employment boom. I shudder at the prospects of these young people in an economic downturn or during the periods of slow growth projected in the *Intergenerational Report*.

And yet more and more young people *are* leaving school early. Table 1 presents previously unpublished data for 2005 of high-school completion rates. It reveals that fully one-third of students in 2005 did not finish high school. Almost 40 per cent of boys did not finish high school. Early school leaving is rife in disadvantaged communities. Almost half of boys from disadvantaged backgrounds failed to finish high school last year compared with less than a quarter of boys from more privileged families.

Turning to a state-by-state breakdown of completion rates, in the mining boom states of Western Australia and Queensland only about half of boys from disadvantaged backgrounds finished high school last year, whereas three-quarters of boys from more privileged backgrounds did so. In the Northern Territory, a tiny 13 per cent of boys and 18 per cent of girls from disadvantaged backgrounds finished high school.

The Howard government seems to consider this social stratification to be the natural order of things. But if leaving school early and doing a trade is such a good idea, why do so few young people from privileged backgrounds choose this path? Wealthy parents know their children are better off finishing high school and going to university and that's what most of their children do. If it's good enough for them and their children, why isn't it good enough for disadvantaged families? Is it the government's assertion that the children of poor parents just aren't as bright as those of wealthy parents?

The latest OECD education report could not be clearer about the consequences of early school leaving. In a major analysis of the experience of member countries, the OECD finds that:

"... a persistently large share of young people do not complete secondary school, today's baseline for successful entry into the labour market ... people who have not completed upper secondary school, and particularly women, continue to face serious labour-market penalties" [emphasis added].³⁷

Federal Treasury agrees with these findings. One of its studies concludes that:

"For both males and females, those who had not completed year 12 schooling had noticeably lower participation rates than those who had completed year 12".³⁸

So, too, does the Business Council of Australia, concluding on the basis of modelling by Access Economics of a 10 percentage point increase in Australia's high-school completion rate that:

"Lifting retention rates could potentially play a major role in offsetting some of the damaging impacts of population ageing and a stagnating workforce [and there are] compelling social and community reasons to support young people who would otherwise be at the margins of the economy because they leave school early or drop out of training".³⁹

Table 1

Year 12 estimated completion rates (a) by socio-economic status (b) and gender, Australia, 1997-2005 (per cent)												
	Low Socio-economic Status deciles			Medium Socio-economic Status deciles			High Socio-economic Status deciles			Total		
	Males	Females	Total	Males	Females	Total	Males	Females	Total	Males	Females	Total
1997	53	67	60	57	70	63	71	79	75	60	72	66
1998	55	69	62	59	73	66	72	80	76	62	74	68
1999	55	70	62	60	74	66	73	82	78	62	75	69
2000	55	71	63	60	74	67	74	82	78	63	75	69
2001	56	69	62	60	73	66	72	80	76	62	74	68
2002	56	70	63	61	73	67	74	82	78	63	75	69
2003	56	69	63	62	72	67	75	83	79	64	75	69
2004	53	66	59	60	72	66	75	83	79	62	73	68
2005	52	66	59	58	72	65	76	83	79	61	73	67

Footnotes

(a) These figures are estimates only. They express the number of Year 12 completions (Year 12 certificates issued by State Education Authorities) as a proportion of the estimated population that could attend Year 12 in that calendar year.

It is important to note that there are variations in assessment, reporting and certification methods for Year 12 across States and Territories.

(b) The Index of Relative Socio-Economic Disadvantage (IRSED) has been used to calculate SES on the basis of postcode of students' home addresses. 'Low' SES is the average of the lowest three deciles, 'Medium' SES is the average of the middle four deciles and 'High' SES is the average of the top three deciles.

Source: DEST, derived from data supplied by State secondary accreditation authorities and the ABS.

Table 2

Year 12 completion rates (a) by socio-economic status (b) and gender by State, 2005 (per cent)

State	Low Socio-economic Status deciles			Medium Socio-economic Status deciles			High Socio-economic Status deciles			Total		
	Males	Females	Total	Males	Females	Total	Males	Females	Total	Males	Females	Total
New South Wales	56	70	62	58	70	64	75	81	78	62	73	67
Victoria	54	67	60	55	72	64	77	88	83	63	77	70
Queensland	53	68	61	62	75	68	74	76	75	61	73	67
Western Australia	48	59	53	58	73	65	75	81	78	61	72	66
South Australia	46	65	56	57	74	65	75	90	83	60	77	68
Tasmania	37	49	43	52	64	58	69	72	71	47	58	52
Australian Capital Territory	(c)	(c)	(c)	(c)	(c)	(c)	77	83	80	77	82	79
Northern Territory	13	18	15	40	50	45	(c)	(c)	(c)	29	37	33
Australia	52	66	59	58	72	65	76	83	79	61	73	67

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(c) The populations in the High SES deciles of NT and the Low and Medium SES deciles of ACT are too small to give meaningful results.

Source: DEST, derived from data supplied by State secondary accreditation authorities and the ABS.

In its recent minimum wage decision the Australian Fair Pay Commission found that low-paid workers were more likely to be educated below year 10.⁴⁰

So the OECD, Treasury and the Business Council of Australia regard increasing high-school completion rates as a top policy priority – but not the federal government.

That's why it is unsurprising that an increasing proportion of young Australians are leaving school early. A strong job market is enticing them into early school leaving, and the mediocre quality and variety of school education experiences in disadvantaged communities is driving young people from school.

Australia's high-school completion rate of 70 per cent is well below the OECD average of 81 per cent and the club-of-ninety – those countries with completion rates in the nineties – Norway, Germany, Korea, Ireland, Japan, Finland and Denmark.⁴¹

An indication of a lack of federal government policy priority in education is a reduction in Commonwealth spending on education and training from 2.1 per cent of GDP in 1996 to 1.7 per cent in 2006.

The Howard government cut TAFE funding in 1997 and now, at a time of acute skill shortages, funding is lower in real terms than in the last year of the previous Labor government. Since 1995, Australian government spending on tertiary education has declined by 7 per cent, while in other OECD countries it has increased on average by 48 per cent.⁴²

The need for fundamental not incremental reform

The problem is that, in discussing education reform, we are thinking incrementally, not fundamentally. Like the school systems of other western countries, Australia's school system was designed in the first quarter of the last century to provide mass education to an eighth grade level of literacy. But through globalisation, workers in high-wage countries will increasingly need a much better education to be able to cope with and generate new ideas.⁴³ They will need to be creative and innovative. Muscle and manual dexterity will not do. Assembly lines, large factory floors and manual jobs will be in low-wage countries like China, India and Bangladesh.

All developed countries and many developing countries confront the challenge of population ageing. Over the next half century a smaller and smaller proportion of the population of the developed world will be working. Parts of the world that are able to generate, attract and retain creative talent will be the most prosperous places on earth.⁴⁴ Conversely, places that fail to attract creative talent will languish, producing low-value products for low wages.

A great divide will open up between regions with abundant creative talent and those populated by poorly-educated people. The poorly educated living in communities that lack a pool of creative talent will compete with physical capital in the performance of manual tasks. If the cost of their labour rises, employers will substitute labour-saving devices by turning to more heavily automated processes. In high-wage countries like Australia, tasks like road maintenance and hole-digging will be almost fully mechanised.

A global market for unskilled migrants will develop, with migrant workers taking on jobs that the unskilled citizens of the host country refuse to do at the prevailing low wage levels.

These trends are already underway, through guest-worker programs in Europe, and through illegal immigrants entering Europe and the United States on a large scale – helping to create the largest immigration wave in US history.

Workers in more affluent parts of the world who do not have a university degree but have good trade qualifications and on-the-job training are likely to fare pretty well. Creative people earning high wages and who place a high premium on their leisure time will increasingly hire domestic staff. Qualified child-care workers, aged-care workers and hospitality workers will be in increasingly short supply, as will skilled tradespeople. They will work alongside creative people and, although they will be paid much less, they will live in open, tolerant communities. In many cases, they will become part of the families of creative people – a new egalitarianism.

The great divide will be between creative people in open, tolerant, affluent communities and poorly-educated people in closed, violent, welfare-dependent, dysfunctional communities.

Australia already has a great divide, as demonstrated graphically by the work on the distribution of social disadvantage of Tony Vinson⁴⁵ and my colleague, shadow treasurer Wayne Swan, in his recent book *Postcode*.⁴⁶ Underprivileged people tend to cluster together in communities where housing is cheap and social services are readily available. These welfare-dependent communities typically are afflicted with high levels of under-employment, domestic violence and drug use. Vinson finds that early school leaving is strongly associated with social disadvantage including unemployment and criminality.

A bold reform program

Reforming Australia's schooling system must start with reforming the teaching profession. Australia's 266,000 teachers should be put up on a pedestal. They are the most important professionals for the nation's future. Yet the pay and career structure of teaching more closely resembles that of an occupation than a profession – and not many occupations at that. In most states, teachers are paid according to years of service, not the quality of their teaching. Over the period 1996 to 2004, the starting salaries of Australian teachers rose by more than 30 per cent,⁴⁷ but this has been slower than the starting salaries of comparable occupations.⁴⁸ Experienced teachers have received much smaller salary increases, giving Australian teachers one of the flattest pay scales in the OECD.⁴⁹ It takes an average of only nine years for Australian teachers to reach the top salary scale, compared with an average of 24 years for the OECD as a whole.⁵⁰

Teachers, like everyone else, respond to incentives and to disincentives. Most teachers are motivated by altruism. But they are also responding predictably to the archaic, flat, uncompetitive pay structure. The average quality of the teacher intake has declined sharply over the last two decades⁵¹ – notwithstanding the continuing

entry into the profession of highly motivated and wonderfully talented new teachers. Teachers are leaving government schools in droves – to non-government schools, to teaching overseas and to other professions.⁵² In three years' time, well over one-third of Australia's teachers will be over the age of 55.⁵³

I have been arguing for some time that Australia cannot expect to achieve a second round of productivity growth and extend opportunity to all without increasing the rewards from teaching, especially in disadvantaged areas. Kim Beazley has announced plans to do just that. I have also argued that the quality of school principals is crucial in influencing the quality of schooling and that the best principals should be given pay rises of 25 per cent.⁵⁴

The next essential reform is a more competitive, needs-based funding model for schools. Extra funding would be allocated to students with learning difficulties or behavioural problems. Instead of being heavily concentrated in poor government schools, needy students would be sought after in a competitive system, since they would attract substantially more funding. Secondary schools would be encouraged to specialise above and beyond a core curriculum through the abolition of the archaic zoning system.⁵⁵

Official estimates of the cost of a needs-based funding model come in at \$2.4 billion in 2003 prices⁵⁶ – or \$2.7 billion in today's prices. Sixty per cent of the additional costs are in teacher salaries, as more teacher and teacher-aide time is deployed for more intensive tuition of needy students.

An expansion of alternative settings to mainstream school could be expected under a needs-based funding model, but in any event it should be deliberate government policy. These alternatives are emerging but their availability is patchy. In Queensland, the Edmund Rice Foundation, supported by the state government, has established six alternative schools in disadvantaged communities. They offer what the students describe as their 'second chance' at school. Children who have been expelled from, or simply can't cope with, mainstream school are given much more personalised tuition and pastoral care. Indigenous children attending 'second chance' schools are taught their culture by indigenous teachers – crucial to lifting their self-esteem and gaining the respect of their classmates.

Mainstream students who are not academically inclined should be offered vocational education alternatives while remaining at school. By undertaking school-based apprenticeships, students entering the vocational stream can complete high school while being half way to obtaining a trade certificate. Students who try the vocational stream but don't like it would retain the option of switching over to the academic stream.

Having put in place this variety of alternative settings for learning, there would be no excuse and no justification for leaving school early to sit at home on the dole. In a job market with the lowest unemployment rate in 30 years and in an ageing population we need all the young people we can get. Australia cannot afford to have up to 54,000 long-term unemployed young people – neither working nor studying to improve their skills.

In addition to working, studying or training, long-term unemployed young people would be given two further options – military service or voluntary work at home or abroad.

Military service would remain a voluntary option. But with Australia's defence forces experiencing great difficulty attracting new recruits, there is every reason to highlight military service as one of the options for young people to consider. The federal government has announced a scheme to permit school leavers to join the armed forces for 12 months on a trial basis. The scheme appears to be remarkably similar to the previous Labor government's Ready Reserve scheme which was abolished by the incoming government. Under that scheme recruits received 12 months full-time training to achieve high readiness competency and then had university or training fees paid in exchange for a further three-year commitment to the Ready Reserves.

The opportunity for voluntary work at home or abroad could be pursued through a government-sponsored Peace Corps that allowed young Australians to work at the grass roots level on community infrastructure in Australia or in developing countries. It could come under the banner of the Australian Peace and Community Team (A-PACT) announced by Kim Beazley early this year.

Given Australia's special responsibilities to the local region, it is natural that the focus of overseas volunteering would be on the South Pacific. Not only would such a scheme put a personal face on our aid efforts in the region, it would help build the enduring people-to-people links that need to underpin our relationship with our near neighbours.

When the range of alternatives that I am advocating is put in place, the dole should not be available to unemployed young people beyond six months. They would receive income support payments for studying, training or participating in the Peace Corp but not for sitting at home, twiddling their thumbs on play station or x-box.

Where does the money come from?

The reforms I am advocating could be implemented at a cost of less than \$5 billion a year, to be shared between the Commonwealth and the states. The Business Council of Australia has concluded, on the basis of economic modelling, that lifting high-school completion rates by 10 percentage points would produce a net *gain* to the Commonwealth budget over time, as the productivity and workforce participation gains kick in.⁵⁷ In the shorter term, the last Budget increased spending by \$20 billion over four years while making savings of only \$2 billion over the same period. Is the government seriously suggesting there is no room to lift its investment in education in the middle of a mining boom when Australia so urgently needs a new round of productivity growth – especially when such investment can be expected to be positive for the budget over the period covered by the *Intergenerational Report*? If so, what alternative, cheaper productivity-raising plan would the government implement?

The government may question whether Australia can afford to make a bold new investment in a reformed education system. I ask: can afford not to?

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Endnotes

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- ¹ Commonwealth Treasury (2002, p. 30). For comparisons with earlier decades see Eslake (2003, p. 8).
- ² ABS (2006).
- ³ Australian Institute of Health and Welfare (2006a, pp. 17-18). These increases partly reflect improved procedures for notification and substantiation but they also raise serious concerns about the prevalence of child abuse.
- ⁴ See, for example, Harding, Vu, Percival and Beer (2005, p. 196).
- ⁵ Indigenous life expectancy estimates from ABS/Australian Institute of Health and Welfare (2005, p. 148).
- ⁶ ABS (2002, p. 23).
- ⁷ Australian Institute of Health and Welfare (2006b, p. 1).
- ⁸ Gillard (2006, p. 4).
- ⁹ Commonwealth Treasury (2002, p. 28).
- ¹⁰ For calculations of returns for single mothers from working see Harding, Vu, Percival and Beer (2005, p. 204).
- ¹¹ NATSEM (2006, p. 16).
- ¹² NATSEM (2006, pp. 1, 9, 12 & 18).

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- ¹³ See Eslake (2006, p. 39).
- ¹⁴ OECD (2005b, pp. 167-8).
- ¹⁵ OECD (2005a, p. 169).
- ¹⁶ See, for example, Productivity Commission (2003, p. 6), (2005, p. 52); OECD (2003, p. 90); OECD (2004, p. 82); IMF (2003, p. 14); Henry (2004, pp. 2-3); Productivity Commission (2006, p. 3).
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- ²⁰ ABS (2006b, p. 1).
- ²¹ ANZ (2006, p. 12).
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- ²⁵ Bassanini and Scarpetta (2002).
- ²⁶ Day and Dowrick (2004, pp. 9-10).
- ²⁷ Note that the year 12 retention rate is the proportion of students who begin year 12, while the year 12 completion rate is the proportion who finish it.
- ²⁸ Banks (2003, p. 5); OECD (2003, pp. 37-38).
- ²⁹ Eslake (2003, p. 6).
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- ⁴³ See Sclafani and Tucker (2006, p. 8).
- ⁴⁴ See Florida (2003), (2005).
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- ⁴⁷ OECD (2006, p. 394).
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- ⁴⁹ OECD (2006, pp. 385 & 394).
- ⁵⁰ OECD (2006, p. 385).
- ⁵¹ Leigh and Ryan (2006).
- ⁵² In 2004-05 alone, 8,400 teachers left Australia, twice the number who left a decade earlier.
- ⁵³ MCEETYA (2005, p. 127).
- ⁵⁴ Emerson (2006a, p. 49).
- ⁵⁵ For more detail, see Emerson (2006a, pp. 104-107).
- ⁵⁶ Schools Resourcing Taskforce Secretariat (2005, Section 1.8).
- ⁵⁷ Access Economics (2005, p. iii).