Policy reforms in Australia and what they mean for Canada

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by Stephen Kirchner

with a commentary
by Sean Speer
and Jason Clemens

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Stephen Kirchner, Sean Speer, and Jason Clemens

Contents

Executive Summary

Sean Speer and Jason Clemens

Canada and Australia share many common cultural, economic, governmental, political, and socio-economic characteristics, yet few researchers have carried out comparative analyses of their public policy experiences. These two papers—the first by Stephen Kirchner, the second by Sean Speer and Jason Clemens—are another step in the Fraser Institute's effort to fill this gap.

Stephen Kirchner's study examines public policy reforms in Australia that are pertinent to policy in Canada today. The three policy areas covered are fiscal reforms made over the last two decades, Australia's experience in reforming its retirement savings system, and changes to Australia's labour laws governing unionization and collective bargaining.

Kirchner shows that successive Australian governments have pursued a set of policies in favour of sound public finances, a relatively market-based retirement savings system, and labour market liberalization. These policy changes helped to unleash the Australian economy in the 1990s, raising labour productivity and living standards. They continue to position the country as an economic leader relative to many other industrialized nations.

Fiscal Reforms

Beginning in the mid-1990s, Australia introduced fiscal reforms at both the federal and state levels. These reforms were designed to guide the conduct and implementation of fiscal policy. New legislative frameworks mandated the adoption of specific fiscal strategies and targets, and imposed reporting requirements, in an attempt to enhance fiscal transparency and political accountability.

Kirchner finds that these reforms are associated with a substantial improvement in Australia's public finances at the federal and state level. As an illustration, the federal budget has been balanced on average since 1996/97, notwithstanding the re-emergence of deficit spending in response to the financial crisis in 2008.

While these reforms are a positive step, Kirchner identifies some flaws in the policy framework and sets out some recommendations for improvement, including the introduction of specific legislated fiscal targets, an independent process for setting budgetary baselines, and an enforcement mechanism that would apply when governments fail to conform to the legislated fiscal rules.

Pension Reforms

The Australian government undertook significant pension reform in the early 1990s to address a gap in the country's retirement savings levels and an over-reliance on its government-funded, old-age pension benefit program.

The introduction of compulsory employment-based retirement savings accounts with mandatory employer contributions and preferential tax treatment has achieved positive outcomes with respect to Australia's pension coverage and national savings. These retirement savings accounts cover approximately 90 percent of the country's workforce and have been estimated to have raised the national savings by about 1.5 percent of GDP.

The system is also less costly than those found in other jurisdictions. Australian public spending of roughly 3 percent of GDP on pension benefit programs is the lowest among OECD countries. Kirchner notes that, if the current level of compulsory employer contributions to retirement savings accounts were financed out of the federal budget, the size of government in Australia would be 5 percent larger as a share of the economy.

In sum, the introduction of compulsory retirement savings accounts—when combined with other features of the Australian model including a means-tested, government-funded pension benefit program and voluntary retirement savings accounts—is providing Australians with a pension system that is frequently cited by pension experts as among the best in the world.

Labour Market Reforms

For the much of the twentieth century, Australia's labour market was heavily regulated. Wages were set across entire industries by industrial relations tribunals, and firms had little scope for rewarding productive employees or terminating unproductive ones. The system provided virtually no flexibility to account for individual needs of workers and firms. It contributed to a climate of low productivity, limited employment growth, and high levels of industrial disputes.

In the early 1990s, the Australian government liberalized its labour market regime and decentralized collective bargaining to the firm or employee level. It also sought to reform restrictive dismissal laws and to reduce the scope for legally protected labour action. These structural reforms were designed to introduce market impulses into Australia's labour market, and to provide greater flexibility for workers and firms.

Kirchner shows that these changes have produced significant positive outcomes. Since their implementation, the unemployment rate has fallen from 11.2 percent in 1992 to just over 5 percent at present, and real wages increased by 20 percent between 2000 and 2010.

What Canada Can Learn from the Australian Experience

Speer and Clemens consider the lessons from Kirchner's paper and seek to contextualize the reforms in the Canadian policy environment.

They find that Australia's experience with fiscal policy legislation is similar to the Canadian experimentation with fiscal rules in the 1990s. Some Canadian governments experimented with fiscal policy legislation, setting out balanced budget requirements during this period, and the outcomes match Kirchner's analysis. These balanced budget laws were associated with improved budgetary positions but were not necessarily effective in constraining spending growth. The key finding is that effectiveness of fiscal policy legislation depends in large part on the extent to which it is prescriptive and places firm constraints on spending growth and the size of government. Speer and Clemens conclude that Canadian governments ought to consider the Australian and Canadian experiences with fiscal policy legislation, and the lessons therein, as they seek to eliminate deficits and control their spending.

An examination of Australia's experience with compulsory, employment-based retirement savings accounts is timely, as Canada's Finance Ministers debate the efficacy and need for potential enhancements to the Canada Pension Plan. The Australian model seems to show that there are options to expand pension coverage and increase retirement savings apart from raising the CPP. Speer and Clemens conclude that Canadian governments ought to consider the applicability of Australia's compulsory retirement savings accounts to Canada's pension system before considering any changes to the CPP.

The lessons from Australia's experience with fundamental labour market reform are less applicable to the Canadian context, because Australia's regime was so centralized prior to the 1990s. The reforms that successive governments undertook to liberalize their labour market policies effectively brought Australia to a system like Canada's. This does not mean that Canada's labour market is not in need of reform, however. Speer and Clemens point out that a lack of standards between provinces with respect to occupational licensing and professional certifications is a barrier that needs to be addressed. This is an area of research that the Fraser Institute will focus on in the coming years.

1. How Australia Reformed its Fiscal System, Retirement Savings System, and Labour Laws

Stephen Kirchner

Australia and Canada have much in common, perhaps more so than any other two industrialized countries in the world. The two countries have a common history emanating from British colonization, which has resulted in similar institutions such as a federal system of government, bicameral parliament, and the rule of law. More than that, however, Australia and Canada have similar geography and economies. They both maintain large resource sectors that have delivered great prosperity, and both have small populations compared to their land masses. And yet, despite these enormous commonalities, these countries have made very little effort to learn lessons from one another. This study is a first step in a larger process for Canadians to begin to learn and benefit from the experience of Australia, so as to improve our own public policies.

This paper focuses on three critical areas of reform in Australia that are pertinent to public policy in Canada today. The first section describes and analyses the experience of Australia with several fiscal reforms made over the last two decades. The second section examines the experience of Australia in reforming its retirement savings system, with particular emphasis on the contrasts between how Australia has designed and implemented public retirement savings programs and how Canada has done so. The final section describes large-scale reforms made to Australia's labour laws governing unionization and collective bargaining. While the emphasis in the paper is on understanding the Australian experience, efforts are made in each section to highlight the relevance and implications for Canada.

1. Fiscal Reforms and Fiscal Outcomes

Australia introduced fiscal reform at both the federal and state levels beginning in the mid-1990s. These new fiscal policies laid out principles for the conduct of fiscal policy, mandated the adoption of specific fiscal strategies and targets, and imposed reporting requirements designed to enhance fiscal transparency and political accountability.

The reforms have coincided with a significant improvement in fiscal performance relative to previous periods, as well as to other countries. In particular, the federal budget has been balanced on average since 1996/97, although large deficits have re-emerged since the onset of the financial crisis in 2008. Federal debt was completely retired—in net terms—between 2005/06 and 2008/09. The return of deficits since 2008 has resulted in a sharp deterioration in the federal government's debt position, although there is a commitment to return the federal budget to surplus on the part of the two major political parties.

The Charter of Budget Honesty Act 1998

The following section highlights the key reform Acts. The adoption of federal fiscal responsibility legislation was a recommendation of the National Commission of Audit carried out by the Howard Coalition government in 1996, which also set the stage for a substantial fiscal consolidation. The Charter of Budget Honesty Act was passed by the federal parliament in 1998. The Act sets out general principles of sound fiscal management. The Act is non-prescriptive in relation to fiscal targets or outcomes. However, it mandates regular fiscal strategy statements that include fiscal objectives and targets for the next three years, as well as a longer-term fiscal strategy. Successive federal governments have committed to achieving and maintaining a balanced budget over the course of the economic cycle (usually interpreted as a modest underlying cash surplus). The principles allow for temporary measures (e.g., fiscal 'stimulus') to address cyclical conditions.

The Act also requires regular fiscal and economic updates. A Mid-Year Economic and Fiscal Outlook statement is published between annual budgets, a final budget outcome report is required within three months of the end of the financial year, and a Pre-Election Economic and Fiscal Outlook is prepared independently of government by the secretaries of the departments of Treasury and Finance within 10 days of the issue of a writ for a general election. The aims of these regular fiscal updates are to increase fiscal transparency and accountability in the intervals between the annual budgets, and to ensure better informed public debate on fiscal issues, especially during elections.

Intergenerational Reporting

One of the innovations contained in the Charter is a requirement for the government to prepare intergenerational reports (IGRs) every five years (minimum) that look at the sustainability of federal fiscal policy over a 40-year horizon. The first IGR was produced in 2002, with subsequent reports in 2007 and 2010. The Rudd-Gillard Labor government committed itself to producing these reports at three-year rather than five-year intervals.

Successive IGRs have highlighted a large prospective fiscal gap at a 40-year horizon based on the technical assumption that the tax share of GDP remains constant while expenditures under current policy settings continue to grow due to an aging population. The 2007 IGR, for instance, noted that "demographic and other factors are projected to place significant pressure on government finances over the longer term and result in an unsustainable path for net debt towards the end of the projection period" (Commonwealth of Australia, 2007). However, the word "unsustainable" did not appear in the 2010 IGR. Together with what were seen as overly optimistic short-term growth projections, this has raised questions about the politicization of the IGRs and the need for a more independent process for their compilation. (Kirchner, 2012a).

The IGRs have focussed public attention on the long-term sustainability of current government spending programs and encouraged debate about tax and expenditure reform. They have also lengthened the time horizon over which the budget implications of government programs are considered (Gruen and Spender, 2012). Recent budgets have sought to reconcile the regular budget fiscal strategy statements with the IGR projections to better connect short, medium, and long-term fiscal strategies. The IGRs were a significant innovation in fiscal reporting internationally, and have also been adopted by some governments at a state level.

State Governments

State governments have adopted broadly similar fiscal responsibility legislation. The Victorian government, for instance, introduced its Financial Management Act in 1994, ahead of the federal legislation. As with the federal charter, the Victorian legislation helped frame a substantial fiscal consolidation. Western Australia introduced a Government Financial Responsibility Act in 2000. Queensland enacted a Charter of Social and Fiscal Responsibility in 2004. New South Wales introduced its Fiscal Responsibility Act in 2005. This was replaced in 2012 with new legislation that includes two fiscal targets: keeping expense growth below long-term revenue growth (thereby achieving budget surpluses), and eliminating unfunded public pension liabilities by 2030. Australia's fiscal responsibility legislation has been an influential model internationally and influenced the OECD's development of its *Best Practices for Budget Transparency* (OECD, 2002).

Limitations and Criticisms

The statutory charter model of fiscal responsibility legislation has a number of shortcomings. While significantly improving fiscal transparency and accountability, the lack of specific, legislated fiscal targets has allowed both federal and state governments to shift the goal posts on their fiscal policy commitments in response to changing economic and political circumstances. For example, the Howard government's fiscal strategy included a commitment to keeping the federal tax share of GDP below its 1996/97 level of 22.4 percent of GDP (e.g, Australia, 2000). The tax burden subsequently rose to nearly 23 percent of GDP by 1999/2000.[1]

Some fiscal targets were set as public commitments separate from the fiscal strategy statements under the Charter. For example, the Howard government made a public commitment to maintaining budget surpluses equal to 1 percent of GDP, although this was at a time when budget surpluses were typically in excess of 1 percent due to positive revenue surprises from booming terms of trade after 2003. Rather than restraining spending, this commitment became a rationale for increasing it to maintain the budget balance broadly steady as a share of GDP.

The Rudd Labor government assumed office in late 2007 with a public commitment to increase budget surpluses to 1.5 percent of GDP and to pay surpluses above that figure into the former Howard government's sovereign wealth fund, the Future Fund (Kirchner and Carling, 2012). The Rudd-Gillard government did not achieve a surplus or make any contributions to the Future Fund. In its fiscal strategy statements, the government also committed to holding the tax share of GDP below the 2007/08 level on average (Commonwealth of Australia, 2010: 37). This target has been met, although largely for cyclical rather than structural reasons. The 2010/11 Budget set out a 'deficit exit strategy' that included 'holding real growth in spending to 2 percent a year until the budget returns to surplus' (Australia, 2010: 3-5). Based on actual fiscal outcomes to 2011/12, federal expenditure has grown at a real rate of 2.2 percent per year, although projected growth remains below 2 percent on average. It remains to be seen whether this commitment is kept.

Another shortcoming is the lack of independent scrutiny or enforcement mechanisms under the Charter. The fiscal principles are for the most part too flexible in their expression to be enforceable, while the fiscal targets are entirely discretionary. The legislation specifies that "nothing in the Charter of Budget Honesty creates rights or duties that are enforceable in judicial or other proceedings." There is no provision for an independent audit of fiscal strategy statements or outcomes. In other words, there is no enforcement mechanism with respect to following these principles or meeting the targets, but rather these are expressed goals. This is in contrast to the United Kingdom's 1997 Code of Fiscal Responsibility, which provided for the National Audit Office to report to parliament on the government's budget statements.

It has been argued that Australia's fiscal responsibility legislation needs further reform to introduce specific legislated fiscal targets, an independent

1. Please note that subsequent years are not directly comparable due to tax reforms implemented in 2000.

process for formulating the budget's economic parameters and IGRs, and an enforcement mechanism that would apply when governments fail to conform to the legislated fiscal rules (Carling and Kirchner, 2009).

Fiscal Outcomes

The introduction of fiscal responsibility legislation from 1996 was associated with a significant improvement in fiscal policy outcomes. While fiscal responsibility legislation is not necessarily a causal factor in these outcomes, it can be argued that the legislation helped reinforce the political commitment to improved fiscal outcomes, and provided a framework through which politicians could better articulate this commitment. The reforms to Australia's overall macroeconomic policy framework saw an improvement in macroeconomic performance that in turn underpinned fiscal policy outcomes. It is thus conceptually and empirically difficult to separate out the specific contribution of fiscal responsibility legislation to fiscal policy outcomes relative to a counterfactual in which the legislation was not adopted.

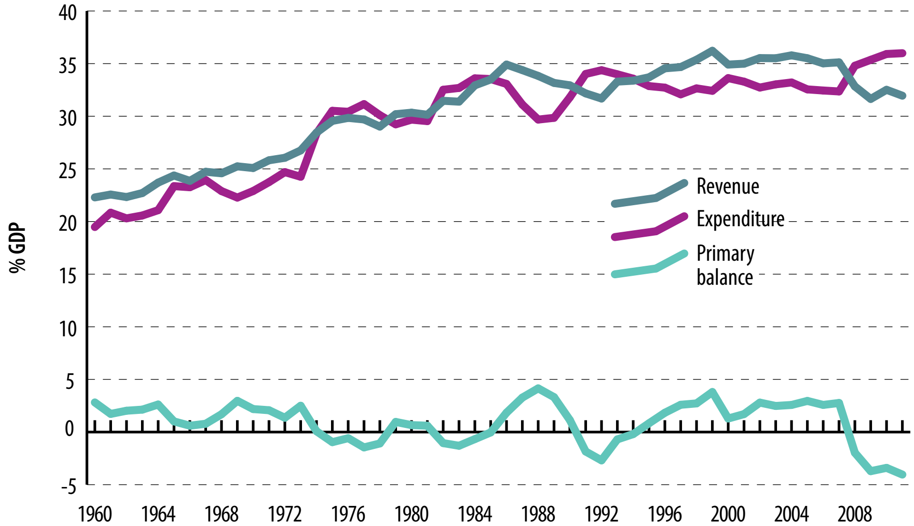
Figure 1 shows revenue and expenses for all levels of government in Australia, along with the primary budget balance (i.e., excluding interest payments on government debt) as a percentage of GDP.

The government spent much of the 1970s, 1980s, and early 1990s in deficit. However, from the mid-1990s, revenue and expenses were brought back into balance and budget surpluses maintained until the onset of the financial crisis in 2008. The financial crisis saw a large discretionary fiscal stimulus at the federal level, together with a cyclical deterioration in the budget balance at all levels of government. However, government expenditure in Australia has remained below previous cyclical peaks as a share of GDP, and the size of government has remained broadly steady as a share of GDP since the mid-1990s at around 35 percent, in contrast to the expansion in the size of government seen from 1960 to the mid-1980s.

The federal budget showed persistent budget surpluses from the late 1990s until the onset of the financial crisis in 2008, followed by a significant deterioration in the budget balance due a discretionary fiscal stimulus and cyclical downturn (figure 2). The federal government's expenditure share of GDP has remained broadly steady at around 25 percent, and below previous cyclical peaks, although this reflects a more moderate economic cycle as much as fiscal restraint.

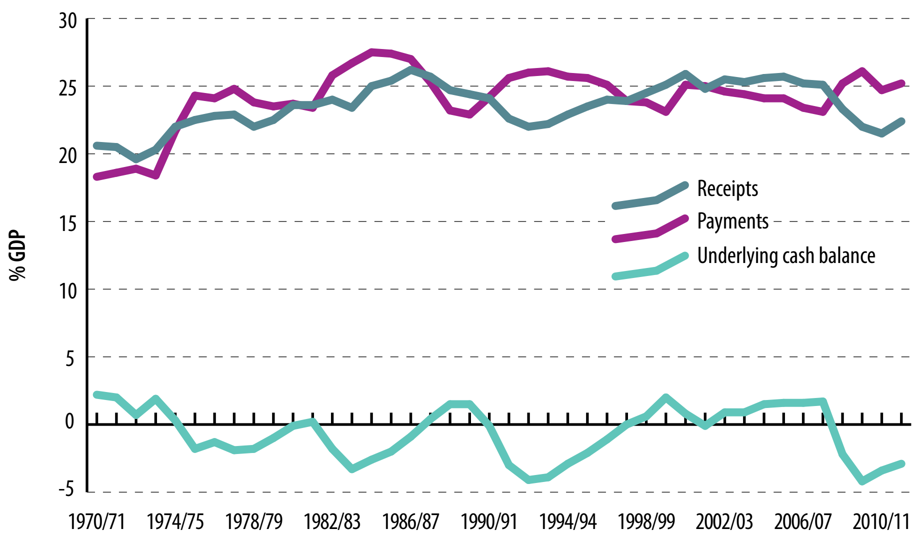
Persistent budget surpluses, together with the proceeds from the privatization of a number of federal government-owned enterprises, led to government net debt being eliminated in 2005/2006. Asset sales contributed around $61 billion to the reduction in net debt from its peak in absolute terms of $96 billion in 1996/97 (Reserve Bank of Australia, 1997). Major asset sales included the Commonwealth Bank, the airline Qantas, the telco Telstra, and federal airports. Asset sales were motivated primarily by microeconomic considerations, such as

Figure 1: Australia—Government Revenue, Expenditure and Primary Budget Balance, 1960–2011



Source: Mauro, Romeu, Binder, and Zaman (2013).

Figure 2: Australia—Federal Receipts, Payments, and Underlying Cash Balance, 1970/71–2011/12



Source: Australia (2013).

improving competition and efficiency, but nonetheless made a major contribution to the reduction in federal debt. Proceeds from asset sales were accounted for 'below the line' and not reflected in the federal budget balance. The federal government began accumulating assets in a sovereign wealth fund, the Future Fund, from 2006 onwards, yielding a negative net debt position until 2008/09. The federal government's net debt position deteriorated with the re-emergence of budget deficits from 2008 onwards, although it remains low by international standards (figure 3). The low levels of net debt have resulted in a significant saving in public debt interest (figure 4), while the reinvestment of the earnings on the Future Fund's assets has also served to tighten fiscal policy.

On average, the federal budget has been close to balance at -0.2 percent of GDP since 1996/97, and thus consistent with the objective of a balanced budget over the course of the economic cycle. Abstracting from the economic cycle, the federal budget is estimated to have been in structural surplus between 2001/02 and 2007/08, before going into structural deficit estimated at between -3.25 percent and -4.25 percent of GDP by 2011/12 (Parliamentary Budget Office, 2013). The Parliamentary Budget Office estimates that the federal budget will remain in structural deficit until 2016/17, although these estimates are subject to considerable uncertainty.

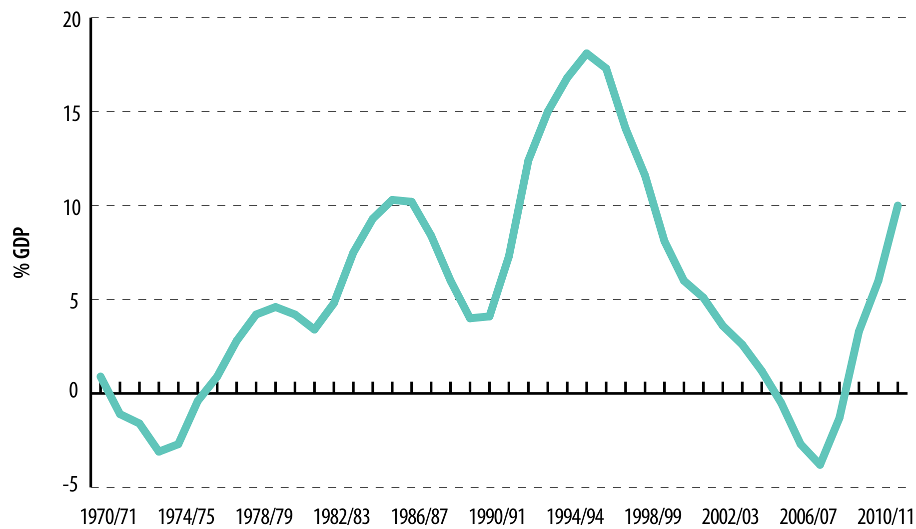
Australia's improved fiscal performance is also evident in a number of other indicators. The spread between Australian and US 10-year government bond yields narrowed significantly in the mid-1990s, coinciding with the introduction of formal inflation targeting and the Charter of Budget Honesty (figure 5). This suggests a reduction in sovereign default and inflation risk premia on Australian dollar-denominated assets, lowering Australia's cost of borrowing. This was a significant macroeconomic benefit from a more rules-based approach to both monetary and fiscal policy.

Australia's improved fiscal performance is also evident in rating actions by sovereign credit ratings agencies. Having been downgraded during the 1980s, Australia saw sovereign ratings upgrades from Standard & Poor's in May 1999 and February 2003, Moody's in October 2002, and Fitch in February 2003 and November 2011 (table 1). Australia's sovereign debt is currently rated AAA by all three main ratings agencies.

The Parliamentary Budget Office

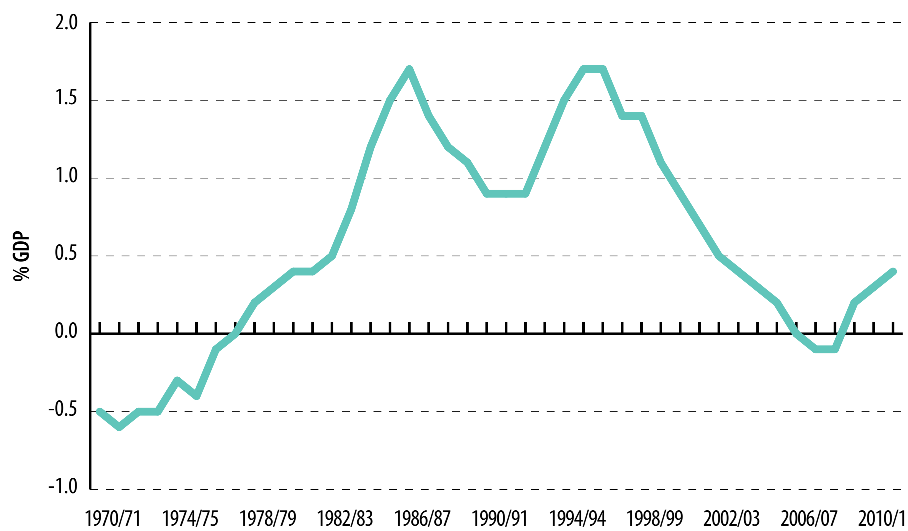
The Parliamentary Budget Office (PBO) is a relatively new fiscal institution that began in July 2012 as part of the "Agreement for a Better Parliament: Parliamentary Reform" negotiated between the Gillard Labor government and independent members of parliament following the 2010 federal election. The PBO is a parliamentary department and the Parliamentary Budget Officer reports to the parliament rather than the government. The PBO is expected to have a staff of 35 by 2013, approximately double the staff of its Canadian counterpart (Bowen, 2012: 2). The mandate for the Australian PBO is broader

Figure 3: Australia—Federal Government Net Debt, 1970/71–2011/12



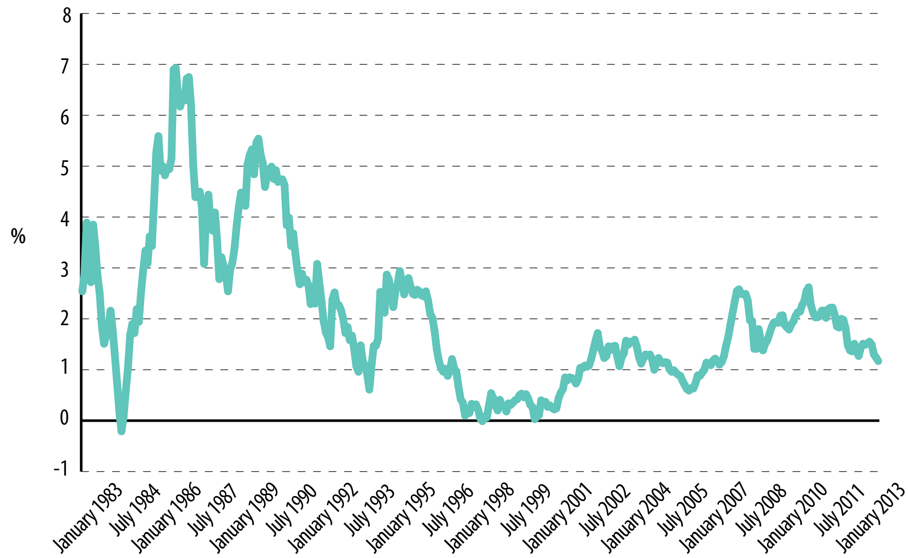
Source: Australia (2013).

Figure 4: Australia—Federal Interest Payments, 1970/71–2011/12



Source: Australia (2013).

Figure 5: Australia-US 10-Year Bond Spread, 1983–2013



Source: Reserve Bank of Australia (2013c); Federal Reserve Bank of St. Louis (2013).

Table 1: Australia—Sovereign Rating Actions

	Moody's	S & Ps	Fitch
November, 2011	AAA	AAA	AAA
February, 2003	AAA	AAA	AA+
October, 2002	AAA	AA+	AA
May, 1999	AA2	AA+	AA
January, 1996	AA2	AA	AA
October, 1989	AA2	AA	—
August, 1989	AA2	AA+	—
December, 1986	AA1	AA+	—
September, 1986	AA1	AAA	—
June, 1975	AAA	AAA	—
October, 1974	AAA	—	—
January, 1962	A	—	—

Source: Commonwealth Parliamentary Library (2013).

than for other comparable parliamentary budget organizations. Its role is to "inform the Parliament by providing independent and non-partisan analysis of the budget cycle, fiscal policy and the financial implications of proposals" (Bowen, 2012). The independence of the Parliamentary Budget Officer is similar to that of other statutory officers such as the Auditor-General.

The PBO is seen as addressing some of the shortcomings in the process for costing election policy commitments under the Charter of Budget Honesty, as well as the Charter's failure to provide a process for subjecting the government's fiscal policies to independent scrutiny. It remains to be seen how the PBO performs in practice, but it is potentially a significant reform that has drawn upon and learned from the Canadian experience with a similar office. A better model would be an independent statutory fiscal commission, as proposed by Carling and Kirchner (2009).

Concluding Comments

Australia significantly overhauled the legislative framework for fiscal policy at the federal and state level from the mid-1990s. The reforms were designed to provide for a more rule-based approach to fiscal policy that would complement the adoption of formal inflation targeting by the Reserve Bank of Australia. This new macroeconomic policy framework was associated with a significant improvement in macroeconomic outcomes that in turn provided a favourable cyclical backdrop for the conduct of fiscal policy.

The adoption of the Charter of Budget Honesty and similar state legislation was associated with a significant improvement in fiscal outcomes such as balanced budgets, declining debt, and lower interest costs. While these outcomes are attributable to a wide range of factors, fiscal responsibility legislation has nonetheless been important in focusing political attention on the need to maintain a sustainable approach to government taxing and spending. The reforms provided politicians with the commitment mechanisms needed to reduce incentives for fiscal opportunism. The achievement and maintenance of budget surpluses is now seen by the electorate as a benchmark of the government's performance—whereas, prior to the mid-1990s, the public were largely resigned to persistent budget deficits and rising public sector debt.

From the mid-1990s until the onset of the 2008 financial crisis, Australian governments ran primary budget surpluses. Together with the privatization of government-owned business enterprises, this enabled a significant reduction in public sector debt levels, including the elimination of federal net debt between 2005/06 and 2008/09, significant savings in public debt interest, and the accumulation of an asset position in the Future Fund.

The federal budget deteriorated in the wake of the financial crisis due to large discretionary fiscal stimulus measures, a cyclical downturn, and new ongoing spending commitments that have left the budget in structural deficit. However, the size of government measured by the expenditure share of GDP remains below previous cyclical peaks, in contrast to the expansion in the size of government seen in some other countries. There is a bipartisan commitment to returning the federal budget to surplus and paying down net debt, indicative of a change in political culture relative to earlier decades that fiscal responsibility legislation at federal and state levels both reflected and helped to create.

2. Privatising Provision for Retirement

As in Canada and most other industrialized countries, there is increasing interest and concern in Australia regarding the efficiency and sustainability of retirement savings programs. Australia's approach to retirement savings has three pillars. The first is the publicly-funded age pension that is intended to provide a safety net should the other two pillars fail to provide a minimum standard of living in retirement. This is similar to Canada's Old Age Security (OAS) and Guaranteed Income Supplement (GIS). The second pillar is compulsory saving through employer contributions to individual private saving accounts, known as the Superannuation Guarantee (SG), which was introduced in 1992. This is similar to the Canada Pension Plan, except that the accounts are individual rather than collective. The third pillar is voluntary private saving, including voluntary contributions to superannuation saving accounts over and above that mandated by the government's Superannuation Guarantee (Bateman, Kingston, and Piggott, 2011).

Each of the three pillars has benefited from reform in recent years. As a result of the reforms, Australia has one of the lowest-cost pension systems in the OECD. The main lesson from Australia's recent experience with retirement savings policy is that it is possible to substantially increase private provision for retirement, and reduce prospective demands on the budget from an aging population, while still providing a safety net for those who do not save sufficiently for retirement.

The First Pillar: Publicly-Funded Pensions

The basic pension is calculated as 25 percent of male average weekly ordinary earnings for individuals and 19 percent each for couples. There is no public pension defined benefit based on employment. In other words, a basic pension benefit is available to all Australians regardless of employment history or earnings of roughly 25 percent of average male weekly earnings.

Like Canada's OAS and GIS, eligibility for this public benefit is subject to a means test based on both income and assets (excluding the family home). Around 44 percent of Australian pensioners have their basic pension benefit reduced by the means test (82 percent of those based on income and 18 percent based on assets). This leaves around 56 percent receiving the full public pension (OECD, 2011: 194). However, roughly 80 percent of Australians over the eligible age receive some public pension benefit. The difference between the two relates to the reduction in benefits imposed by the means test. Like

Canada's OAS and GIS, the basic public pension is funded on a pay-as-you-go basis out of general government revenue, and there is no dedicated fund to finance spending.

While the means test limits pension costs, it also serves as a disincentive to labour force participation for those aged 65 and over, which in turn reduces the potential tax base from higher labour force participation by those over the age of 65. Indeed, by OECD standards, Australia has a low rate of labour force participation for those aged 50-64 (OECD, 2001: 41).

An important reform has been an increase in the eligibility age for the age pension, currently legislated to increase from 65 to 67 by 2020. This recognizes that growing longevity and changes in the nature of work give scope for longer working lives, and is designed to reduce future demands on the federal budget from an aging population.

The income replacement rate achieved through public pensions is only 47.3 percent in Australia, compared to 44.4 percent in Canada (including CPP) and an average of 57.3 percent for the 34 OECD economies (OECD, 2011: 119).

In 2007, Australia spent around 3.4 percent of GDP on public age pension and survivor benefits, compared to 4.2 percent in Canada (OECD, 2011: 155). According to the Australian Treasury's *Intergenerational Report*, the cost of Australia's age pension is expected to rise from 1.7 percent to 3.9 percent of GDP between 2010 and 2050 (Commonwealth of Australia, 2010). Using different assumptions from the Australian Treasury's, the OECD projects Canada's expenditure on pensions in 2050 at 6.3 percent of GDP, compared to 4.9 percent in Australia (OECD, 2011: 155). These projections highlight the benefits from a more tightly-targeted public pension.

The Second Pillar: Compulsory Superannuation

Compulsory Superannuation simply refers to mandatory contributions to individual retirement savings accounts similar to Canada's RRSPs. These superannuation accounts play an increasingly important role in providing retirement income for retirees in Australia. Superannuation provides for tax-advantaged, individually owned, and privately managed retirement saving accounts that can be drawn down only in retirement.

The nature of these accounts means that they avoid the problems of unfunded public pay-as-you-go schemes that have imposed and continue to impose enormous costs on other countries. In pay-as-you-go systems, contributions accrue to government revenue and are then spent, leaving an unfunded public pension liability. It also avoids the risks associated with defined benefit and company pensions, found in other countries, which often result in mismatched assets and liabilities.

Superannuation funds are regulated along with financial institutions by the Australian Prudential Regulatory Authority (APRA). Regulation of the accounts is mostly non-prescriptive in relation to asset allocation and investment strategy, meaning that account holders are given a fair degree of flexibility.

Superannuation involves individual savers taking on investment risk, although these risks are effectively shared with the government both through the tax advantages offered by the accounts and through the first pillar of the system, which provides a basic guaranteed benefit. Specifically, poor investment performance results in a lower tax burden and increases eligibility for public age pension benefits.

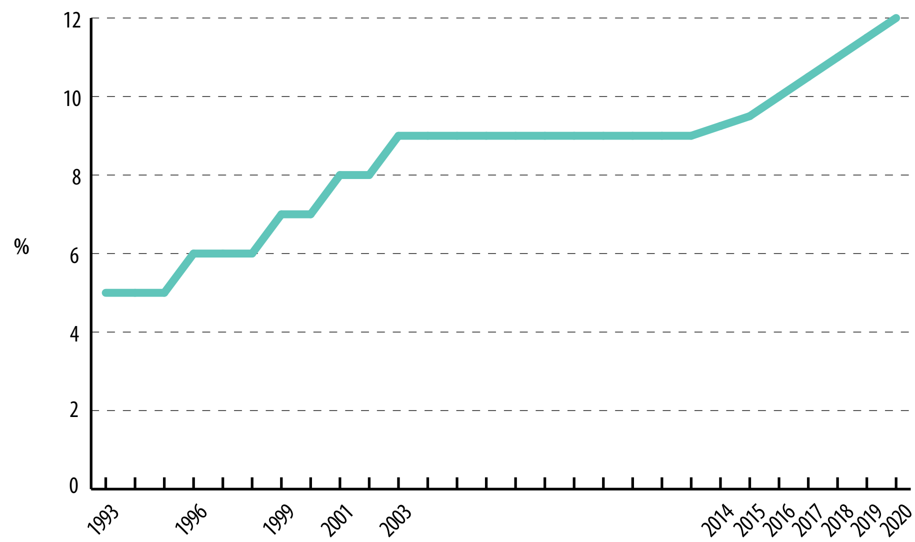
Individually owned superannuation saving accounts pre-date the introduction of compulsory contributions in 1992. In November 1991, around 78 percent of employees were already covered by some form of superannuation (CPA Australia, 2013). However, compulsion has been influential in extending the coverage of these superannuation accounts to around 90 percent of the workforce. Those left uncovered are the self-employed (in the absence of voluntary contributions) and those with a marginal attachment to the labour force who earn too little to be eligible for compulsory contributions.

The superannuation Guarantee is funded through compulsory contributions from employers equal to 9 percent of gross earnings for all employees aged below 70.[2] Most employers meet this obligation, but those that fail to do so can be levied by the government. The Superannuation Guarantee compulsory contribution rate has steadily increased from 5 percent in 1992, and is currently legislated to increase to 12 percent of gross earnings by 2019/20. The increase will be phased in with annual increments from 0.25 to 0.5 percentage points from 1st July, 2013 (figure 6; see Kirchner, 2012b). The rationale for the increase is to further improve retirement saving and reduce future demands on the budget from an aging population. If the current level of compulsory employer contributions were financed out of the federal budget, the size of government in Australia would be around 5 percent larger as a share of GDP (Grattan Institute, 2013).

Both the compulsory as well as potential voluntary contributions to the superannuation accounts are taxed at a concessional flat rate of 15 percent up to an annual cap, above which normal marginal income tax rates apply. This compares to a top marginal tax rate of 46.5 percent (including Medicare levy). Concessional tax treatment provides an incentive for additional voluntary contributions. Superannuation fund earnings are then taxed at a notional

2. As an addition to the cost of employment to employers, compulsory superannuation contributions come at the expense of what would otherwise be higher levels of take-home pay, hours worked, and employment. Because compulsory superannuation contributions are not perfect substitutes for take-home wages and other forms of saving, they reduce the demand for labour on the part of employers, without an equivalent increase in labour supply on the part of workers. Compulsory contributions are paid in lieu of higher gross earnings, redistributing income from working age to retirement years. Household net worth is only increased by the SG to the extent that financial constraints prevent individuals and households from dissaving via other saving vehicles to offset the contribution the SG makes to overall retirement saving. See Freebairn (2004).

Figure 6: Australia—Superannuation Guarantee Compulsory Contribution Rate, 1993–2020



Source: Australian Prudential Regulatory Authority (2012).

15 percent flat rate, although effective tax rates vary widely depending on the source of the earnings.[3]

Superannuation benefits are tax free if taken after the age of 60, although these tax-free benefits are subject to generous limits. Benefits can be taken as a lump sum or as an income stream through an annuity. This is distinctly different from Canada's savings programs, wherein earnings are accumulated tax free but withdrawals are taxed at normal income tax rates.

The availability of tax-free retirement benefits from the superannuation accounts at age 60, in combination with the age pension means test, creates incentives for early retirement and early dissipation of retirement benefits to maximize pension eligibility. Recall that eligibility for the public pension benefit starts at age 65.

Average retirement age is around 60, and post-retirement-age labour force participation rates are low by international standards (Chomik and Piggott, 2012: 350-361). It has been suggested that the eligibility age for tax-free superannuation benefits should be raised to that of the age pension—to increase labour force participation of those approaching retirement age, and to reduce incentives for early dissipation of retirement benefits. It has also been suggested that retirement benefits should be subject to mandatory annuitization (income

3. Over time, effective tax rates can be much higher because the tax wedge grows at the long horizons typical of retirement saving, and because of the lack of inflation adjustment in tax scales (Commonwealth of Australia, 2010b).

streams) to prevent early dissipation of retirement benefits in the form of lump-sum payments (Kirchner, 2012b).

Other observed problems with the superannuation accounts have been the reduction in individual choice and the costs of the funds eligible for investment. Compulsory superannuation contributions reduce consumer choice, creating a captive market for saving via superannuation as opposed to other saving vehicles.

Competition is further reduced by the role of collective employment agreements in determining the choice of superannuation fund manager. Many collective employment agreements favour industry-based fund managers with ties to the trade union movement. A lack of competition has contributed to high costs and inefficiencies in the management of superannuation funds. The 1997 Wallis inquiry into the financial system recommended the introduction of choice-of-fund legislation, which was not implemented until 1st July, 2005. However, collective employment agreements still override individual choice of fund for many workers. Reforms flowing from the 2010 Cooper Review of superannuation are expected to see a rationalization of superannuation products and administration that should lower costs and increase long-term retirement benefits for fund members (Commonwealth of Australia, 2010b).

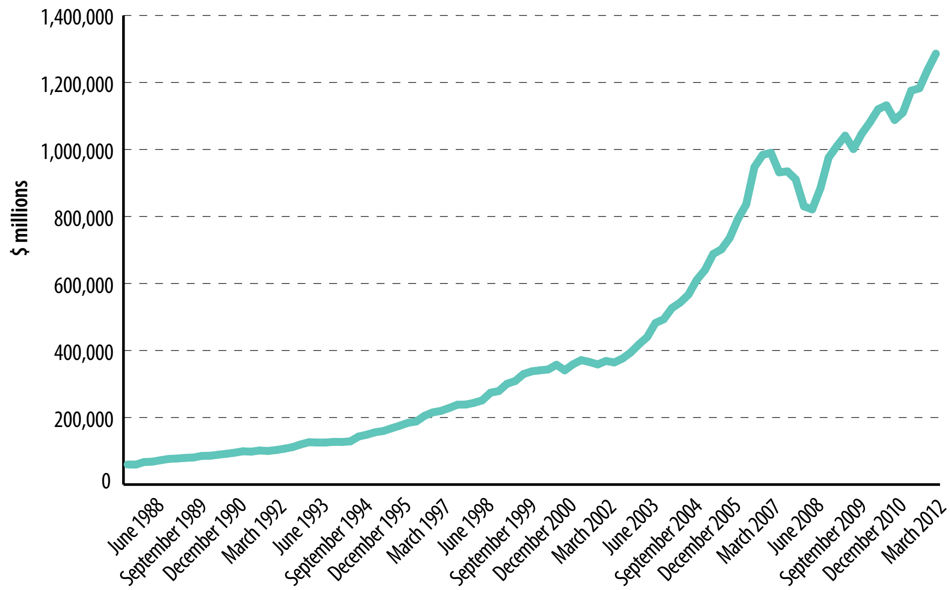
With respect to the main goal of providing post-retirement income to replace labour earnings, the SG can technically achieve income replacement rates of 90 percent for a median wage earner entering the workforce today and retiring at age 67 (Parkinson, 2012). This is a generous replacement rate relative to the commonly used benchmark of 70 percent. Total superannuation assets as of the end of 2012 were $1.286 trillion, or an average of over $100,000 per employed person (figure 7). This is roughly equal to Australia's nominal GDP and the capitalization of the local stock market. It is one of the world's largest pools of retirement saving and is entirely privately managed. The contribution that compulsory superannuation has made to household and overall national saving is difficult to estimate with precision, given the scope for substitution between saving vehicles and between public and private saving. However, official estimates suggest compulsory superannuation has raised national saving by around 1.5 percent of GDP (Kirchner, 2012b).

The Third Pillar: Voluntary Saving

Voluntary saving, including saving in superannuation accounts over and above that mandated by the SG, is an important source of self-provided retirement savings, and reduces the prospective burden on the federal budget from an aging population. Voluntary saving may occur through both financial and non-financial assets, including housing and business equity and consumer durables that yield a stream of services through retirement.

Public policy in Australia has been supportive of voluntary saving through concessional tax treatment of saving via superannuation and housing.

Figure 7: Australia—Total Superannuation Assets, 1998–2012



Source: Reserve Bank of Australia (2013a: Table B15).

Owner-occupied housing is exempt from capital gains tax, for instance, with the trade-off that mortgage interest and other expenses are not tax deductible.

The 1999 tax reforms that resulted from the Ralph Review of Business Taxation introduced a 50 percent capital gains discount for individuals and 33 percent for managed funds including superannuation funds. This corrected Australia's internationally anomalous taxation of capital gains at top marginal rates of income tax, which were also lowered through the tax reform process.[4]

It is sometimes argued that the concessional tax treatment of superannuation, owner-occupied housing, and capital gains is a distortion and a cost to the federal budget. However, the distortion arises from other forms of saving being taxed too heavily, rather than from superannuation or housing being taxed too lightly. Optimal tax policy, based on an expenditure tax benchmark, suggests that the tax burden on capital should be minimized to avoid distorting consumption and saving decisions. While tax concessions are a benefit to those who receive them, the cost to the budget is difficult to ascertain because behavioral responses to changes in tax rates are difficult to account for. To the extent that there is a cost to public saving through the budget, there is also a benefit to private saving. The tax reform process, including the introduction of a consumption tax in 2000, coupled with a reduction in income tax rates and

4. As predicted by the supply-side economists who advocated these reforms, an increase in the realization rate for capital gains led to an increase in capital gains tax revenue, while also promoting voluntary saving through both superannuation and other savings vehicles such as direct ownership of investment property or shares. See Kirchner (2011).

thresholds, has been critical in encouraging private saving and reducing future demands on the budget from an aging population.

Australia's household saving performance can be measured with reference to Australian Bureau of Statistics (ABS) data on net saving rates that reflect changes in real net wealth (ABS, 2003). At least until the onset of the financial crisis of 2007-08 and the subsequent European debt crisis, household net saving rates adjusted for changes in real net wealth were far more impressive than suggested by the more commonly reported household saving ratio. This resulted in steady gains in household net worth as a share of gross disposable income until 2007 (figure 8).

Financial deregulation in the 1980s was associated not only with a significant increase in household debt but also with an offsetting increase in the stock of financial and non-financial assets, including the growth in superannuation assets. This in turn led to an increase in household net worth that is less apparent from flow-based measures of saving and from stock-flow comparisons, such as the ratio of household debt to income, that attract the most attention from commentators. The more appropriate comparison is between the stock of household debt and household assets, which has been relatively stable in recent decades (figure 9).

Scope for Further Reform

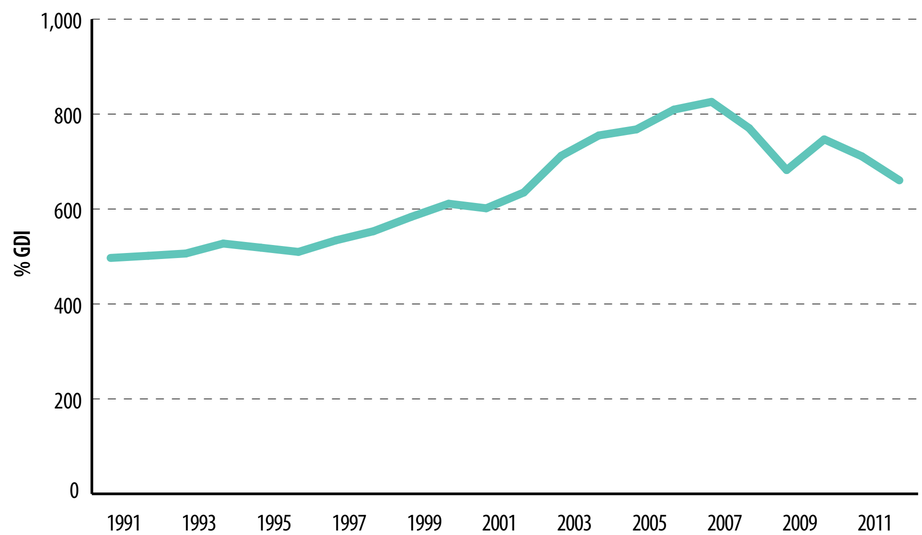
There is scope for further reform of the taxation of superannuation to promote private retirement saving and reduce future demands on the budget from an aging population. Removing taxes on contributions and earnings would allow for stronger accumulation of superannuation account balances. Superannuation benefits could also be made subject to mandatory annuitization, whereby retirees would be required to take their benefits as income streams rather than as lump sums. This would help prevent the early dissipation of retirement benefits. As Bateman and Kingston (2010: 7) note, "Australian policymakers have always fallen short of mandatory retirement benefit purchase." The early dissipation of retirement benefits has undermined the effectiveness of compulsory contributions in boosting retirement incomes and reducing future demands on the budget.

Concluding Comments

Australia has one of the lowest-cost public pension systems in the OECD, which has contributed to low levels of government net debt by international standards, although population aging is still expected to put significant pressure on federal and state budgets in future years. The combination of compulsory and voluntary superannuation makes possible high-income replacement rates in retirement, while containing public pension costs.

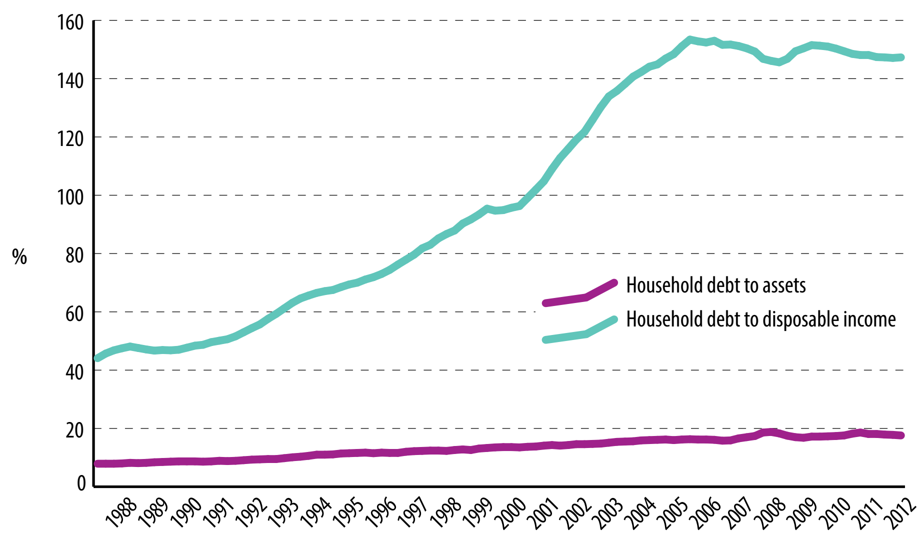
Public policy has focused on containing age pension eligibility through means testing and an increase in the public pension eligibility age. The introduction of compulsory superannuation contributions through the SG in 1992 has

Figure 8: Australia—Household Net Worth as a Percentage of Gross Disposable Income



Source: ABS (2012b: Table 38).

Figure 9: Australia—Ratio of Household Debt to Income and Assets, 1988–2012



Note: All year marks are at December datapoints.
Source: Reserve Bank of Australia (2013b).

given a significant boost to self-provision for retirement via defined contribution, individually vested and privately managed retirement saving accounts. The concessional tax treatment extended to superannuation contributions, earnings, and benefits, as well as to owner-occupied housing and capital gains on the part of individuals, and managed funds including superannuation funds, has also given a boost to private voluntary saving. This is reflected in strong gains in the real wealth of the household sector prior to the onset of the global financial and European debt crises. There is still considerable scope to improve the taxation of superannuation and other forms of private saving to boost private provision for retirement and reduce future demands on the budget from an aging population. However, Australia's system of retirement income provision compares very favourably to those found abroad, ranking number three on Mercer's Global Pension Index after Denmark and the Netherlands and above Canada at number six (Mercer and Australian Centre for Financial Studies, 2012).

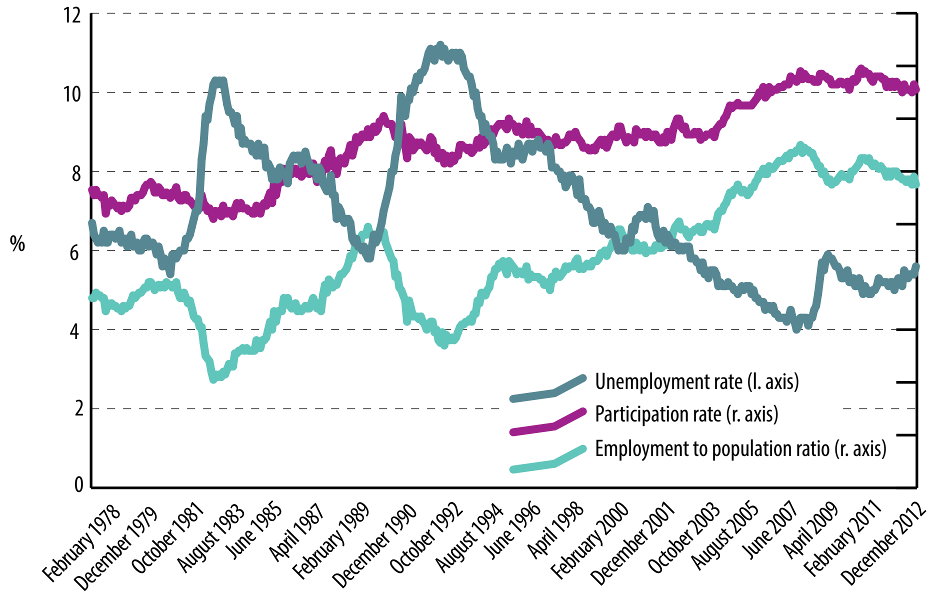
3. Reforming the Labour Market: From Centralized Wage Fixing to Enterprise Bargaining

One of Australia's three foundational public policies, established in 1901, was centralized wage fixing and compulsory arbitration of industrial disputes. Under this model, wages were centrally determined through a system of 'awards' handed down by state and federal industrial relations tribunals. These awards covered the majority of the workforce and set wages and conditions of employment. This one-size-fits-all model for setting wages was disconnected from the needs of individual workers and firms. Industrial disputes were also subject to compulsory conciliation and arbitration through these quasi-judicial industrial tribunals, and became part of the process through which unions sought wage increases.

Australian workers and firms were insulated from international competition by tariff protection and industry assistance, which allowed this inefficient model of labour relations to be sustained well into the 1980s. Workers and management had little incentive to eliminate inefficient work and management practices. Instead, high costs were passed on to Australian consumers. The results of these policies were poor productivity growth, high levels of industrial disputation, and unnecessarily high levels of unemployment (figures 10, 11, 12).

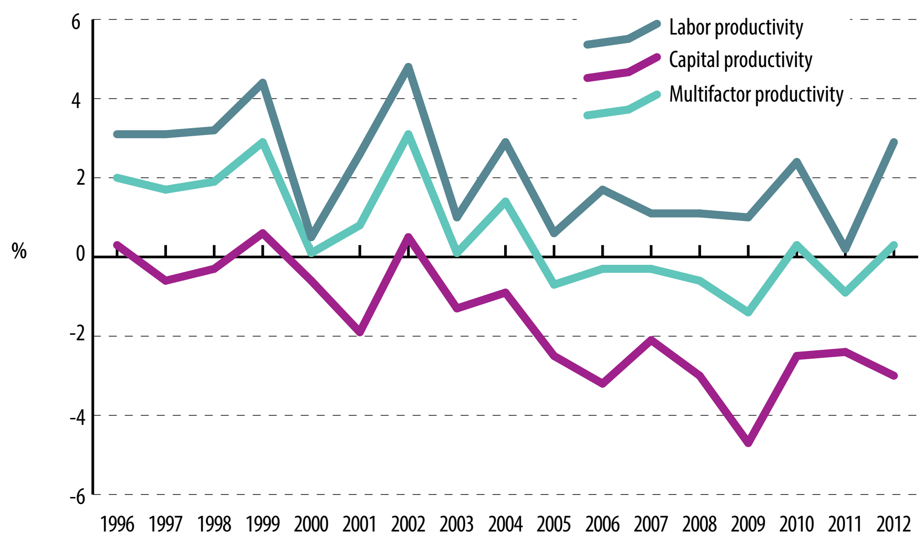
During the 1980s and early 1990s, a Prices and Incomes Accord between the Hawke-Keating Labour government and the Australian Council of Trade Unions provided a highly centralized and corporatist model of national wage determination. It was somewhat successful in managing wage demands in the context of a centralized industrial relations system and an economy that lacked a nominal anchor via monetary policy, but at the cost of reduced labour market flexibility. Improvements in the 'social wage', such as health and superannuation benefits, were traded-off against increases in real wages.

Figure 10: Australia—Labor Market Ratios, 1978–2012



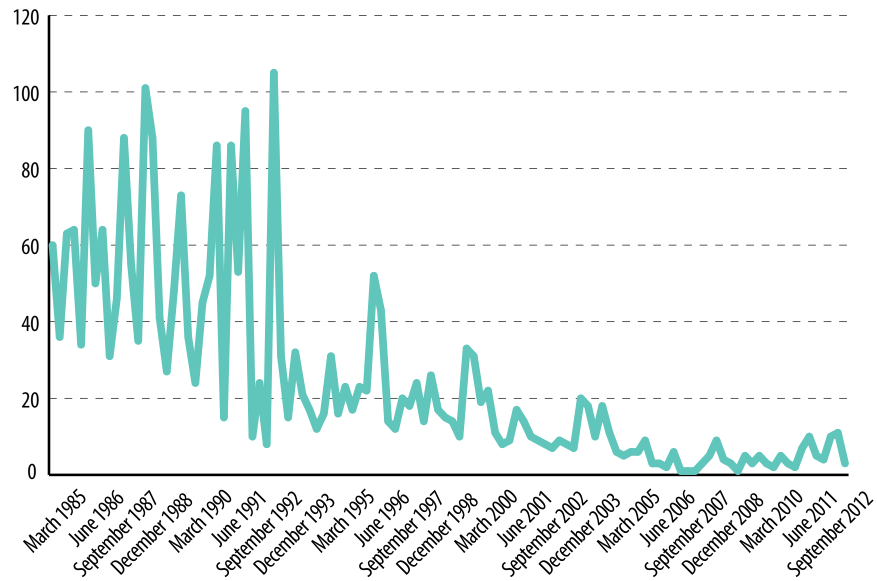
Source: ABS (2013).

Figure 11: Australia—Productivity Growth, 1996–2012



Source: ABS (2012b).

Figure 12: Australia—Working Days Lost to Industrial Disputes per 1,000 Employees, 1985–2012



Source: ABS (2012a).

There was an attempt to establish a stronger link between increases in award wages and productivity through the Accord process. Yet the Hawke-Keating Labour government and the trade union movement recognized that centralized wage fixing and restrictive work practices were limiting potential gains in productivity that could be realized through decentralized, enterprise-level bargaining. The opening-up of the Australian economy in the 1980s and 1990s through product and financial market deregulation put inefficient labour and management practices under considerable pressure.

Labour Market Reform

Three waves of labour market reform between 1993 and 2007 significantly increased the flexibility of the labour market. The key reform was a shift in wage determination from centralized wage fixing by industrial tribunals to enterprise-level bargaining and collective agreements between workers and employers. Individual common law contracts between workers and employers also assumed greater prominence. The scope of industrial awards was reduced to a minimum set of statutory conditions, including minimum wages. A more narrowly circumscribed right to strike reduced the scope for industrial disputation.

The thrust of each of the three waves of reform has been in the direction of increased labour market flexibility. A partial re-regulation of the labour market took place after the election of a Labour government in 2007, although this still leaves the Australian labour market considerably more flexible than it was in 1993.

The three waves of labour market reform have been associated with improvements in productivity and real wages, generational lows in the unemployment rate, and record labour force participation rates for peacetime. There has also been a significant decline in trade union membership and industrial disputation. It is widely thought that labour market reform played a role in these outcomes, although cyclical factors, structural change, and other reforms have also been important. Disentangling these competing influences on labour market outcomes is a formidable issue for researchers. Yet it is notable that the product, financial, and labour market reforms of the 1980s and 1990s, taken as a whole, have been associated with very positive outcomes for employees, contrary to the expectations of those critics who saw market liberalization policies as an attempt to 'turn back the clock' and reverse wages and conditions for workers. The main lesson from the labour market reform experience in Australia is that increased labour market flexibility benefits both workers and employers, as well as the economy as a whole.

Wave 1: The Industrial Relations Reform Act 1993 (IRRA)

After a nearly century-long commitment to centralized wage fixing, the Australian Council of Trade Unions adopted the principle of enterprise-level bargaining in 1991. The then labour market regulator, the Australian Industrial Relations Commission (AIRC), recognized enterprise bargaining in October of that year, although it was somewhat hesitant to promote it (Hawke and Wooden, 1998: 83). The Industrial Relations Reform Act (1993), which came into force in March 1994, sought to accelerate the adoption of enterprise-level bargaining and collective workplace agreements between employees and employers. This was done by making the centralized system of industrial awards subordinate to collective agreements negotiated at the enterprise level. Simply put, this change decentralized collective bargaining down to the level of the firm.

Previously, the labour market regulator could refuse to register enterprise-level agreements on 'public interest' grounds (Loundes, Tseng, and Wooden, 2003: 250). The new legislation removed this discretion from the regulator. Industrial awards were now seen as a safety net for those not covered by enterprise-level collective agreements. Enterprise bargaining agreements were subject to a 'no disadvantage' test requiring workers to be no worse off than under their former award before agreements could be registered with the labour market regulator. The Act provided for Enterprise Flexibility Agreements that could be negotiated between employers and employees without union involvement. However, in practice, most agreements under the Act had some union involvement, because these agreements were subject to less rigourous tests. Collective agreements now cover around 43 percent of the Australian workforce (ABS, 2010: Table 4), displacing the industrial awards that once covered as much as two-thirds of the workforce.

The IRA also provided for legally protected industrial action that served to more narrowly define the right to strike and limited the scope for industrial action. This saw a dramatic reduction in the number of working days lost to industrial action (figure 12).

Wave 2: The Workplace Relations Act (WRA) 1996

Labour market reform was given renewed impetus with the election of a Coalition government in 1996 that gave labour market reform a high priority. The Workplace Relations Act (1996) provided for individual agreements between workers and employers known as Australian Workplace Agreements (AWAs) that would be recognized as legally binding by the Industrial Relations Commission, without the need for union involvement (Hawke and Wooden, 1998: 83). AWAs overrode industrial awards, took precedence over collective agreements, and were subject to an overall 'no disadvantage' test in relation to previous employment conditions. These agreements became operational from 12th March, 1997.

The Act also limited the scope of industrial awards, with the AIRC restricted to setting only minimum wages and conditions. It provided for voluntary union membership, and increased the penalties for unsanctioned industrial action.

The take-up of individual Australian Workplace Agreements was very slow. By 2008, registered individual agreements accounted for only 2 percent of the workforce, although they were widely used in the mining sector. In large part, this is because of the long-standing availability of common law contracts, which are widely used in the private sector. Industrial awards provide a safety net in relation to terms and conditions for these unregistered individual common law agreements. Because common law agreements also allow greater flexibility, there was often little advantage for employees or employers in pursuing a registered individual agreement rather than a common law contract.

Wave 3: The Work Choices Act and Subsequent Backlash

The Howard Coalition government took control of both houses of federal parliament following the 2004 federal election. This allowed the re-elected government to pursue a more ambitious industrial relations reform agenda. This took the form of the Workplace Relations Amendment (Work Choices) Act (WCA) 2005. The WCA removed the safety net provided by the 'no disadvantage' test. It also sought to reform unfair dismissal laws and reduce the scope for legally protected industrial action. A Fair Pay Commission was established to determine minimum wages. The scope of federal industrial relations regulation was expanded at the expense of the states. These reforms met with considerable opposition from the trade union movement, which saw them as a threat to their power. Work Choices became a focus of the 2007 federal election campaign that unseated the Howard Coalition government after 11 years in office.

The newly-elected Labor government of Kevin Rudd introduced the Fair Work Act (FWA) 2009. The FWA abolished registered individual agreements and wound back the former government's changes to unfair dismissal laws. The FWA also introduced a 'good faith' bargaining requirement—similar to that in Canada—that was a feature of the IRA of 1993 but had been abolished under the 1996 legislation. These provisions limit the ability of employers to ignore unions in the enterprise bargaining process.

The FWA represented a step backwards in the labour market reform process that began in the early 1990s. However, the Australian labour market remains considerably more flexible than it was in 1993, when labour market reform began in earnest. Because of the low take-up rate of registered individual agreements under the Work Choices Act, their abolition was not expected to have widespread effects, although some sectors such as mining were adversely affected by the change. The FWA reduced the number and scope of awards, and provided for increased flexibility in their operation through a set of statutory National Employment Standards. Individual and collective agreements now cover 80 percent of the workforce, while awards cover only 15 percent of workers—compared to around half of all workers before the reform process began in the early 1990s (ABS, 2010: Table 4). The scope for legally protected industrial action remains limited under FWA, and industrial disputes remain at historically low levels (see figure 12).

The Benefits of Labour Market Reform

The benefits of labour market reform during the 1990s and 2000s are difficult to isolate against the backdrop of widespread product and financial market deregulation over the same period. Australia has also benefited from favourable economic conditions. There has not been a severe economic downturn in Australia since the early 1990s recession, although modest downturns were seen at the end of 2000 and in 2009. At least some of the improvement in labour market outcomes can be attributed to this extended period of economic growth, although this performance is not independent of the structural reform process, including labour market reform. Much the resilience of the Australian economy through the 2008/09 global financial crisis can be attributed to the increased flexibility provided by labour market and other reforms. The Australian economy has outperformed most of its developed-country peers in recent years, so this favourable growth performance owes at least something to country-specific structural factors, as well as global cyclical influences. It is difficult to isolate the impact of labour market reform from other structural and cyclical influences. For example, tax reforms, especially the shift in taxation from income to consumption taxes in 2000 and subsequent income tax cuts, could be expected to lead to an increase in labour supply and higher rates of labour force participation.

Unemployment and Labour Market Participation

Perhaps the most important test of labour market reform is its impact on the unemployment rate. Increased labour market flexibility should see a reduction in the unemployment rate and in labour underutilization. The unemployment rate fell from a cyclical peak of 11.2 percent at the end of 1992 to a cyclical low of 4 percent in February 2008 (see figure 10). This was the lowest unemployment rate since November 1974. The unemployment rate rose to 5.9 percent in the middle of 2009, in the wake of the global economic downturn, and has remained above 4 percent since then. Looking through these cyclical influences, there appears to have been a reduction in the natural or cyclically adjusted unemployment rate since the early 1990s, although it is difficult to quantify this precisely. As a rough guide, the inflation rate in Australia appears to accelerate at unemployment rates below 5 percent, suggesting a natural rate of unemployment around this level and a flattening in the short-run Phillips curve trade-off between inflation and unemployment relative to previous decades.

Whereas reductions in total hours worked during the cyclical downturns of the 1980s and 1990s came primarily through job losses, employment remained relatively steady during the 2000s, with average monthly hours worked declining instead, and with underemployment accounting for the larger share of the decline in total labour utilization. As Borland (2011: 200) notes, the reforms of the 1990s seem to have been the more significant in securing these outcomes relative to later reforms in the 2000s. They are consistent with increased labour market flexibility insulating workers from job losses during a downturn.

The labour force participation rate (the employed and unemployed as a share of the working-age population) rose to a record 65.9 percent in November 2010, compared to 63 percent at the end of 1993. This was despite an aging population that would otherwise be expected to put downward pressure on labour market participation. The employment to population ratio rose from 56 percent at the end of 1993 to as high as 63 percent in April 2008. These outcomes are consistent with expectations that labour market liberalization should lead to higher levels of labour market participation and improved labour utilization.

Productivity

An important motivation for Australia's labour market reforms has been to improve incentives for firms and workers to change inefficient labour and management practices and increase firm-level and economy-wide productivity. Productivity is difficult to measure directly and subject to a range of cyclical and structural influences. Labour productivity can be expected to improve over time because of additions to the capital stock and technological change. Increases in real wages as a result of labour market reform will lead to changes in the relative price of labour and capital, inducing capital for labour substitution. Labour market institutions can be considered part of the institutional technology of the economy and may be difficult to separate from other forms of technological change.

Australia experienced a surge in labour productivity from 1994 until the early 2000s, relative to its previous trend and holding the capital-labour ratio constant (Loundes et al., 2003: 249). Productivity growth was particularly pronounced in labour intensive industries. As Loundes and colleagues (2003: 250-251) note, "such findings are consistent with the claim that changes in labour market arrangements may be at least partly responsible." Productivity growth subsequently slowed, coinciding with the onset of the terms of trade boom in early 2000s. However, this decline in productivity growth is more pronounced in the case of capital rather than labour productivity. Between 1994/95 and 2011/12, annual labour productivity growth averaged 2.2 percent, while capital productivity declined 1.6 percent, with multifactor productivity averaging just 0.6 percent. This suggests that the capital deepening associated with increased mining investment on the back of the terms of trade boom has been slow to yield increases in output given long lead times. Similar trends are evident in the Canadian economy over this period. Multifactor productivity growth averaged -1.1 percent in both Australia and Canada between 2006 and 2010, although Australia outperformed in the decade from 1996 to 2005, with average growth of 0.6 percent compared to 0.2 percent in Canada (Productivity Commission, 2013: 40).

Productivity improvements were reflected in the growth of real wages. Average real weekly earnings increased by around 20 percent between 2000 and 2010, with gains seen across the income distribution (Borland, 2011: 173).

Industrial Disputes

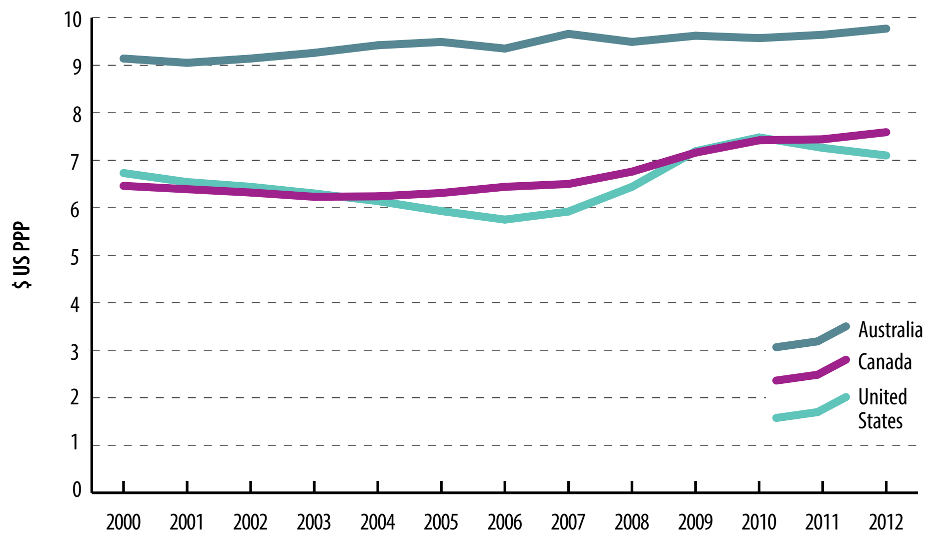
There has been a dramatic reduction in the number of working days lost to industrial disputation since the first wave of labour market reform in 1993. Between 1985 and 1993, an average of 51 working days per 1000 workers were lost due to industrial disputes each quarter. Between 1994 and 2012, this fell to an average of 12 working days lost (ABS, 2012). The decline in industrial disputation can be partly attributed to the more narrowly circumscribed right to strike embodied in industrial legislation from 1993 onwards. The shift in employment from unionized to non-unionized sectors of the economy has also been important.

There was a modest pick-up in the level of industrial disputation immediately following the introduction of the Fair Work Act in 2009, but this has moderated subsequently.

Minimum Wages

Australia's real minimum wages remain relatively high by OECD standards and above the levels found in the US and Canada (figure 13). The minimum wage is relevant mainly to the 15 percent of workers still covered by the award

Figure 13: Three-Country Comparison: Real Minimum Hourly Wages, 2000–2012



Source: OECD (2013).

system, although it helps set benchmarks for individual and collective agreements. Market wages are above the minimum wage for the majority of workers, so relatively few workers are likely to find the minimum wage a binding price floor resulting in unemployment. Further reductions in unemployment could be achieved by lowering or abolishing minimum wages, although this has not been widely advocated in Australia.

Australian and Canadian Labour Markets Compared

Table 2 compares labour market outcomes, institutions and policies in Australia, Canada and the rest of the OCED. While any snapshot of labour market outcomes is influenced by the current state of the two economies, the loose correlation between the Australian and Canadian business cycles means that labour market outcomes in any given year should be broadly comparable.

Australia enjoys a lower rate of unemployment and youth unemployment than Canada, although has a higher rate of long-term unemployment. Minimum wages and the unemployment benefit replacement rate are more generous in Australia and Canada. This may account for the higher level of long-term unemployment in Australia. Purchasing power parity-adjusted wages are higher in Australia than Canada, while hours worked are fewer. Employment protection is similar in both countries, while Australia has a lower level of unionization. Both Australian and Canadian labour markets compare favourably to the rest of the OECD, although the OECD standard is a low one.

Concluding Comments

The industrial relations reforms of the 1990s, and to a lesser extent the 2000s, have transformed the Australian labour market. A centralized wage fixing

Table 2: Labour Market Outcomes and Institutions—Australia, Canada, and the OECD

	Australia	Canada	OECD
Labour market Outcomes (2001)			
Unemployment rate (%)	5.2	7.5	8.2
Youth unemployment rate (% of 15-24 year-olds)	11.3	14.1	16.2
Long-term unemployment (>12 months, % of unemployed)	18.9	13.5	33.6
Employment rate (% working age population)	72.7	72	64.8
Average annual hours per worker	1,693	1,702	1,776
Average annual wage (2011 USD PPP)	44,983	42,253	44,757
Labour Market Policies and Institutions (latest year)			
Ratio of minimum to median wage	0.54	0.43	0.48
Employment protection (0-6 scale)	1.4	1.3	2.1
Unemployment benefits (replacement rate %)	21.2	15.2	26.1
Union membership (% of employees)	19.0	27.3	18.4

Source: OECD (2012).

process and compulsory arbitration through industrial tribunals has become a decentralized system of enterprise-level bargaining based on collective agreements and individual common law contracts. Alongside financial market deregulation, product market and tax reform, this has seen a significant reduction in the unemployment rate to generational lows, record rates of labour market participation, improvements in labour productivity and real wages and a reduction in working days lost to industrial disputation.

Labour market reform remains an unfinished project. Although awards only cover around 15 percent of the workforce, their role in setting benchmarks for individual and collective agreements continues to reduce flexibility in relation to terms and conditions of employment. There is scope for further reform through the abolition of awards and their replacement with minimum statutory conditions, along with lowering or abolishing minimum wages. However, further reforms are likely to yield relatively modest benefits compared to the substantial reforms of the 1990s and 2000s.

The main lesson from Australia's experience with labour market reform is that increased labour market flexibility benefits both employers and employees, as well as leading to improved macroeconomic outcomes, insulating workers from job losses in economic downturns.

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2. What Canada Can Learn from the Australian Experience

Sean Speer and Jason Clemens

Stephen Kirchner's paper provides useful analysis of Australia's experience with fiscal, pension, and labour market reforms over the past two decades. These series of reforms have contributed to Australia's strong public finances, high rates of retirement savings, and well-performing labour market.

The paper prompts the question: what can Canada learn from the Australian experience? This short commentary will focus on key reforms in the three policy areas described in Kirchner's paper and consider their relevance and applicability to Canadian public policy.

Further analysis is required to tailor the lessons from Australia for the Canadian context, and to better understand how these specific reforms would be implemented here in light of historical and jurisdictional differences. Kirchner's paper—"How Australia reformed its Fiscal System, its Retirement Savings System, and its Labour Laws"—provides an important foundation for this future work.

Australia's Experience with Fiscal Policy Legislation

As the paper outlines, the Australian parliament passed the Charter of Budget Honesty Act in 1998 to bring greater rigour and transparency to the government's budgeting process. The legislation does not impose specific numerical targets for debts, deficits, or spending growth. Instead it requires the government to release regular medium-term budgetary plans, including its own non-binding fiscal targets and reports on its success in meeting these objectives. This is an important distinction: the Act is non-prescriptive, in that it requires the government to set its own fiscal targets rather than codifying specific, enforceable targets in statute.

While an improvement over the previous status quo, the statute is not perfect. Kirchner's essay discusses the lack of statutory fiscal targets, an independent audit function, and a robust enforcement mechanism as deficiencies that put it offside with the best practices identified in the economic literature.[1] In another paper, Kirchner and a colleague at Australia's Centre for Independent Studies have recommended a series of improvements to the Act's regime, including the introduction of binding statutory fiscal targets and an independent review mechanism in order to address its deficiencies (Carling and Kirchner, 2009).

Still, despite these flaws, Kirchner argues that the current law has helped to establish greater political accountability for fiscal policy and to impose a real discipline in the budgetary process. It has achieved this by creating a political impetus for fiscal discipline and contributing to a shift in public expectations for fiscal policy. As he explains, the law is important "in focusing political attention on the need to maintain a sustainable approach to government taxing and spending." His paper shows that, as a result, Australia's experience with fiscal policy legislation is associated with improved public finances. Notwithstanding recent stimulus-induced deficits, the federal budget has been balanced on average since 1996/97. But the lack of statutory targets—specifically with respect to the size of government and expenditure growth—has meant that the Act has served at times to justify spending increases rather than to constrain the growth of government.

Australia's experience with fiscal policy legislation is similar to those of several Canadian governments in the past two decades. Virtually all Canadian governments now have fiscal policy regimes that require multi-year budgeting and specific, measurable fiscal goals.

Some provinces experimented with different variations of fiscal policy legislation setting out balanced budget requirements in the 1990s. These statutes tended to be introduced as part of the respective government's deficit reduction plan, and in most cases the statutory targets were more prescriptive than Australia's. The research shows that on balance these laws contributed to a narrowing of the gap between revenues and expenditures in the short run, achieving balanced budgets in the medium term, and beginning to reduce debt over the longer run, but were not necessarily effective in constraining spending growth.[2] Most of these legislative rules tended to succumb to the focus on fiscal stimulus in recent years due to the financial crisis in 2008.

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1. The literature shows that fiscal responsibility legislation can serve to depoliticize the policymaking process and help to impose some constraints on deficit spending, but that its degree of effectiveness depends largely on its stringency and prescriptiveness. Clear fiscal targets, independent economic forecasting and audits, and a strong enforcement mechanism are seen as critical features of effective fiscal policy legislation (Auerbach, 2012; Fatas and Mihov, 2006; Poterba, 1996).

2. A 2003 study by the Fraser Institute found that the presence of fiscal responsibility laws in Canada has promoted the balancing of revenues and expenditures. This research, which looked at the provinces' experiences with fiscal responsibility laws in the 1990s, showed that seven of eight provinces with such

Alberta's experience with fiscal policy legislation in the early- to mid-1990s is notable. The province's legislation exhibited many of the features that Kirchner recommends should be incorporated in Australia's statute. Specifically, Alberta implemented the Deficit Elimination Act, which prescribed a four-year path to a balanced budget. It did so by setting out scheduled reductions in the province's deficit and requiring that any slippage from the targets be made up with deeper spending reductions in the subsequent year. The four-year timetable imposed a 20 percent reduction in program spending.

The legislation achieved its stated objectives. The Alberta government significantly cut spending and eliminated the deficit in only two years. The government then made debt reduction a post-deficit priority. The province's net debt was eliminated in 1999 and net financial assets of $36 billion were accrued over the subsequent fourteen-year period.[3] Alberta became a model for fiscal reform across Canada, and helped contribute to a period of considerable improvement in the country's collective public finances.

We can derive some lessons from Australian and Albertan experiences with fiscal policy legislation. As Kirchner's paper shows, governments are more likely to exercise restraint when given the right instruments and incentives. At minimum, fiscal policy legislation can help to impose more accountability and discipline on governments in their fiscal decision-making and contribute to a greater focus on balanced budgets. But the Alberta experience shows that properly designed legislation with enforceable statutory rules can not only contribute to balanced budgets but also place firm constraints on spending growth and the size of government. In effect, Alberta's fiscal results in the mid-1990s seem to indicate that Kirchner's recommendations for a more stringent fiscal policy regime in Australia are on the right track.

Canada's governments have increased spending in recent years and are now struggling to return to balanced budgets. The adoption of fiscal responsibility legislation with statutory fiscal targets, an independent process for establishing the budget's economic baseline, and an enforcement mechanism that would apply when governments fail to conform to the statutory rules could be a step in the right direction.[4]

laws in place experienced material decreases in the five-year average deficit (Clemens et al., 2003).

3. Crowley, Clemens, and Veldhuis (2010) examine Alberta's experience with fiscal policy legislation and its outcomes.

4. The scope of the fiscal targets is an important consideration. There is a distinction, for instance, between balanced budget legislation and expenditure limitations. Targets can apply to the annual budgetary balance or they can set out parameters for expenditure growth. Legislation that focuses on balancing revenues and expenditures can be effective at achieving balanced budgets, but does not necessarily constrain spending growth (Clemens et al., 2003).

Private Retirement Accounts: Australia's Approach to Retirement Savings

Australia's pension system is cited as among the best in the world by many pension experts, including the Mercer Group, and is increasingly looked at as a model for other jurisdictions to follow (e.g., Kadlec, 2013; Summers, 2013; Agnew, 2013).[5] In particular, its combination of a means-tested pension benefit program (similar to Canada's Old Age Security/Guaranteed Income Supplement) and compulsory employment-based pensions held in individual accounts represents a unique alternative to traditional, government-run retirement savings plans.

As Kirchner's paper explains, the Australian government established compulsory employment-based retirement savings accounts in 1992 to address a gap in the country's retirement savings levels and an over-reliance on its government-funded old-age pension benefit program. The compulsory retirement savings account model combines the principle of universality through mandatory employer contributions (currently set at 9.25 percent of gross earnings and taxed at a concessional flat rate of 15 percent) with the benefits of private asset management that is carefully regulated.

To put it in perspective, what this means is that Australia has a government-funded pension benefit program similar to Canada's Old Age Security, which provides a basic, means-tested benefit to all eligible citizens regardless of employment experience. It does not, however, maintain the equivalent of our Canada Pension Plan (or Quebec Pension Plan). Instead Australia requires employers to contribute into individually-owned, privately-managed retirement savings account on behalf of their employees. Employees can then also make voluntary contributions into their plans. The outcomes of this model have been positive.

As Kirchner shows, Australia's retirement income savings per person now rank among the highest in the world and, as of the end of 2012, Australians held more than $1.2 trillion in superannuation assets—an average of over $100,000 per employed person. It has only taken twenty years for the superannuation plans to become one of the world's largest pools of retirement savings, and it is entirely privately managed.

Australia's experience shows that there is actually a range of policy options available to governments concerned about the adequacy of the retirement income system. Australia opted to forego a state-managed, employment-based pension fund and instead has applied the principle of universality through mandatory participation in a privately-managed system. When combined with a means-tested, publicly-funded pension benefit program for low-income seniors, this approach has given Australians a retirement income system

5. The Mercer Group (2012) ranks the Australian system number three on its global pension index. Canada is ranked sixth.

that provides for broad pension coverage at a low cost.[6] As Kirchner puts it, "the main lesson from Australia's recent experience with retirement savings policy is that it is possible to substantially increase private provision for retirement, and reduce prospective demands on the budget from an aging population, while still providing a safety net for those who do not save sufficiently for retirement".

The Canadian policy debate about retirement savings has evolved quite differently from the Australian experience, and this is where the real lesson for Canada lies. The Canada Pension Plan (CPP) was created as a mandatory, government-managed pension fund in 1965, and has grown into a large pool of capital distributing approximately $44 billion per year in benefits to over 6.5 million recipients (Canada, 2012: 193a). This historical experience with a large state-managed fund has invariably coloured political discussions about reform. To the extent that reforms have been considered in recent years, they have been limited to expanding CPP or introducing new privately-managed savings vehicles to supplement the mandatory, government-administered plan, rather than to overhaul or supplant it.

A recent example of the latter approach is the Tax-Free Saving Account (TFSA), which was first introduced in 2009 as a general purpose individual savings account in which Canadians can earn tax-free investment income including interest, dividends, and capital gains. Individuals can contribute up to $5,500 into a TFSA each year—using after-tax income, but with income earned in the account and any withdrawals being tax free. TFSAs have become a retirement savings vehicle for many Canadians because of the preferential tax treatment, and because withdrawals do not affect eligibility for means-tested benefits such as Old Age Security and the Guaranteed Income Supplement. According to the latest data, approximately 8.2 million Canadians hold a TFSA, and financial assets held in the accounts exceed $62 billion in market value (Canada, 2013: 31b).

There has not been much debate about more sweeping reforms, such as expanding the role of employment-based, individual accounts. The debate has become polarized, and the policy options have come to be characterized in binary terms based on whether one is in favour of or opposed to a CPP hike. The Australian experience illustrates that there are other options to expand pension coverage and increase retirement savings. Canada's political debate on this issue is far from over. It is expected to dominate the agenda at the federal/provincial/territorial Finance Ministers meeting in December 2013. Ministers ought to look more closely at the lessons from Australia before signing on to any ill-conceived increases to the CPP.

6. Over 90 percent of Australia's labour force is now covered by the compulsory retirement savings accounts (OECD, 2012). Australia's public spending of roughly 3 percent of GDP is the lowest among OECD countries (OECD, 2011).

Reforming Australia's Labour Market

Of the three major policy areas Kirchner covers in his paper, Australia's labour market reforms of the mid-1990s may be the most dramatic. This is in large part because the country's labour rules were at the time so divorced from market forces. Prior to the reforms, Australia's labour market was ruled by the bureaucratic impulses of state and federal industrial tribunals.

As Kirchner explains, for much of the twentieth century industrial wages in Australia were set by industrial relations tribunals across entire industries, and were disconnected from the needs of individual workers and firms. This centralized model impeded productivity and employment growth, and contributed to a high level of industrial disputes. By the early 1990s, it was increasingly recognized that reforms were desperately needed.

The 1993 Industrial Relations Reform Act broke the monopoly of the industrial relations tribunals and decentralized collective bargaining to the firm or employee level. The transformation was dramatic. In 1990, roughly half of Australia's workforce had their pay and conditions set by industrial awards. By 2010, just 15 percent were covered by such contracts (Philipatos, 2012). This meant that the traditional tribunal system was effectively reduced to matters specifying minimum wages and certain workplace conditions. This deregulation reform reintroduced normal market signals into the collective bargaining process.

Dr. Kirchner shows that Australia's labour market reforms have produced significant improvements across a range of economic indicators. Since their implementation, the unemployment rate is down, labour market participation has increased, labour productivity has grown, and real wages jumped twenty percent between 2000 and 2010.

Canada does not have quite the same experience with a *dirigiste* labour market. Enterprise-level bargaining, or bargaining at the firm level rather than the industry level, has long been a central feature of Canada's labour relations regime, and there has been only limited experience with industrial wage settlements such as the imposition of wage controls during World War II.

But this does not mean that Canada's labour market regime is not in need of reform. Studies have documented the extent to which different occupational licensing and professional and skill certification rules between provinces complicate the movement of workers. One 2010 study, for instance, identified 51 professions in Canada regulated in two or more jurisdictions (Knox, 2010). Different licensing standards and processes are an impediment to interprovincial labour mobility. The lack of a harmonized system of licensing standards and approvals between provinces has contributed to a "border effect" whereby provincial borders are negatively associated with migration flows and discourage individuals in these professions from pursuing employment in other provinces (Amirault, de Munnik, and Miller, 2013).

The Fraser Institute intends to carry out research on this subject in 2014. The goal of any policy recommendations ought to be the reduction of barriers to the free flow of workers in Canada. Australia's experience with liberalizing its labour market shows the considerable benefits that can accrue from reform.

Conclusion

In light of the similarities between Australia and Canada, there is an opportunity to study and compare public policies with the goal of learning from the two countries' experiences and adopting best practices.

Kirchner's paper makes an important contribution to our mutual understanding in three specific policy areas. Notwithstanding some jurisdictional and historical differences, it is clear that Canada can learn from Australia's experience in fiscal, pension, and labour market reform.

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About the Authors

Dr Stephen Kirchner is a Research Fellow at the Centre for Independent Studies in Sydney, Australia, and a Senior Fellow at Canada's Fraser Institute. Previously, he was Senior Lecturer in economics at the University of Technology Sydney Business School. He has worked as a financial market economist with Action Economics, LLC, and Standard & Poor's Institutional Market Services, based in Sydney and Singapore. He has also worked as an adviser to members of the Australian House of Representatives and Senate. His articles have appeared in leading academic journals, including *Public Choice* and the *Australian Economic Review*, as well as the *Wall Street Journal*, *The Straits Times*, and the *Australian Financial Review*. He has a BA (Hons) from the Australian National University, a Master of Economics (Hons) from Macquarie University and a PhD in economics from the University of New South Wales. His web site is http://www.institutional-economics.com. He can also be found on Twitter at @insteconomics.

Sean Speer is Associate Director of the Fraser Institute's Centre for Fiscal Studies. He previously served in different roles for the federal government, including senior economic advisor to the Prime Minister and director of policy to the Minister of Finance. He has been cited by *The Hill Times* as one of the most influential people in government and by *Embassy Magazine* as one of the top-80 people influencing Canadian foreign policy. He also served as a researcher for Brian Lee Crowley's best-selling book *Fearful Symmetry: The Fall and Rise of Canada's Founding Values*. Sean holds an MA in History from Carleton University and is a PhD candidate in economic history at Queen's University.

Jason Clemens is the Fraser Institute's Executive Vice-President. Mr. Clemens held a number of positions with the Fraser Institute between 1996 and 2008, including Director of Research Quality, Director of Budgeting and Strategic Planning, and Director of Fiscal Studies. He most recently worked with the Ottawa-based Macdonald-Laurier Institute (MLI) as Director of Research and held a similar position with the San Francisco-based Pacific Research Institute for over three years. Mr. Clemens has an Honours Bachelors Degree of Commerce and a Masters Degree in Business Administration from the University of Windsor as well as a Post Baccalaureate Degree in Economics from Simon Fraser University. He has published over 70 major studies on a wide range of topics, including taxation, government spending, labour market regulation, banking, welfare reform, health care, productivity, and entrepreneurship. He has published nearly 300 shorter articles, which have appeared in such newspapers as the *Wall Street Journal*, *Investors' Business Daily*, *Washington*

Post, *Globe and Mail*, and *National Post*, as well as a host of US, Canadian, and international newspapers. Mr. Clemens has been a guest on numerous radio and television programs across Canada and the United States. He has appeared before committees of both the House of Commons and the Senate in Canada as an expert witness and briefed state legislatures in California. In 2006, he received the coveted Canada's *Forty under 40* award presented by Caldwell Partners as well as an *Odyssey Award* from the University of Windsor. In 2011, he was awarded (along with his co-authors) the prestigious Sir Antony Fisher International Memorial Award for the best-selling book, *The Canadian Century*.

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