

ADDRESS TO THE TRANSPORT POLICY COLLOQUIUM

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ADDRESS TO THE TRANSPORT POLICY COLLOQUIUM

Thank you for inviting me to speak to you today.

I want to take the opportunity to review the broad demographic, economic and fiscal environment for transport in the years ahead, and to say something about some of the implications of this environment for transport policy. In that area, my remarks will focus on issues in road transport. But I hope they might serve to set some sort of framework for a consideration of issues in other transport areas.

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I'm going to start by outlining, briefly, four key drivers of economic and social outcomes. Because they have such powerful impacts, and because those impacts include things for which governments have traditionally assumed a degree of responsibility, these drivers are also likely to be principal motivators of policy development for many years — indeed, for some decades.

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First, demography. The size and rate of growth of our population is changing. But so too is its composition. In particular, our population is ageing. Another population driver emerges from the choices people make about where they will live.

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Second, technology. In addition to the familiar scientific and industrial dimensions of technological change, including new information and communications technologies, financial innovation has become a key driver of economic outcomes.

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Third, international integration — globalisation if you like. This has several dimensions; trade in goods and services; foreign investment; people mobility through migration and tourism; the international transmission of ideas; and of course the transmission of disease — the latter affecting people, other animals and plants. All of these dimensions of international integration have been with us for many decades. On some measures — covering trade and investment — the world is not obviously more integrated now than it was a century ago. But surely there can be no period in human history in which ideas could be transmitted across international borders so quickly and disseminated so widely.

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And the fourth driver I want to identify is environmental degradation, encompassing impacts on physical amenity — air quality for example, salinity, climate change and resource depletion.

Each of these four drivers is having an impact on transport policy thinking. But, of course, their impacts go well beyond transport.

To frame a context for transport policy, I am going to focus initially on some of the wider policy issues raised by the first of the four drivers – demography.

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Forty years ago our population was growing at about 2¼ per cent a year. Today, with a population of some 19.6 million, it is growing at something less than 1¼ per cent.

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Our population growth rate is slowing because of declining fertility. Thirty years ago an average female would have expected to have three children. Today, the average female would expect to have about 1¾, and that number is still falling. The replacement rate — that is, the number of children that an average female would have to have in order that births match deaths — is 2.1. So if it were not for immigration our population would, at some point, start falling.

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And the net immigration flow has been relatively flat — if rather volatile — averaging about 90,000 a year over the last forty years.

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With these fertility and net migration rates, our population growth rate will continue to fall. Forty years from now it will barely be growing at all — on present trends, our population will stabilise at some 25.3 million people.

Insert Slide 11

With the fertility rate below the replacement rate of 2.1 comes population ageing.

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One way of illustrating population ageing is to break the population into age cohorts — 0 to 14, 15 to 54, 55 to 64, 65 to 84 and 85+ — and to normalise the present population in each cohort at 100.

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So how might the pattern look twenty years from now?

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Twenty years from now there will be fewer people in Australia in the age group 0 to 14.

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The number of people in the prime working age group of 15 to 54 will be a little higher — but only a little.

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On the other hand, there will be many more people in the 55 to 64 age group.

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The 65 to 84 group will grow at an even faster rate over the next 20 years.

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And the 85+ group faster again.

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The total population will be about 20 per cent bigger than today.

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But it is over the subsequent 20 years — from 2022 to 2042 — that things get really interesting.

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Over that 20-year period the number aged 0 to 14 will decline even further.

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The number of people of prime working age will barely move at all.

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And while the number aged 55 to 64 will continue to grow, the rate of growth will be modest.

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The number aged 65 to 84 will, however, continue to grow strongly.

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And there will be an explosion in the number of people aged 85+ — more than four times as many people aged 85+ as there are today.

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Over the next 40 years our total population will grow by some 5.7 million people. Just on 5 million of these extra people will be aged 55 or more.

As you might expect, those demographic events will have far-reaching economic and social consequences. One obvious consequence is for the rate of growth of gross domestic product.

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The 1990s were a good decade for Australia in GDP growth terms — a high average and relatively little volatility.

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Looking ahead, we have the Budget forecasts of 3¾ and 4 per cent,

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then the out-year projections of 3 per cent.

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Beyond that, the IGR projections are shown,

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with an average annual rate of growth over the next 40 years of about 2¼ per cent.

Insert Slide 13

GDP growth comes from three broad sources: population; participation and productivity — the ‘3 Ps’.

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The first contributor is growth in total population. But population doesn’t add to GDP if all of it is below working age.

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So to see what population is actually contributing to GDP growth, I need to know what is happening also to the proportion of the population of working age.

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Once I have these two bits of information I know what is happening to the total population of working age.

Not everybody of working age actually wants to work.

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The proportion that does is referred to as the participation rate. And, of course, not everybody who wants to work will actually get a job —

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some will be unemployed.

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Finally, in this cluster of participation factors, I need to know how many hours the average worker works.

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Once I have all of this information I know what is happening to the total number of hours of work performed in the economy.

The last cluster is productivity. This tells me how much output is produced by an average hour of work. Productivity has two components:

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capital deepening

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and multi-factor productivity. The first measures the impact of giving workers more capital to work with — for example, giving a trench digger a back-hoe to replace his shovel. The second component measures everything else that allows a worker to produce more output. At the level of the firm it captures improved efficiencies in the production process and the utilisation of new technologies. At the level of the aggregate economy it captures all of these firm specific effects but, in addition, the impact of resources moving from lower to higher productivity activities. Hence, it captures the impact of microeconomic reform.

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The ‘three Ps tell us how much GDP we have.

Insert Slide 14

How much have these three factors contributed to GDP growth in the past, and what does the future hold?

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First, the past.

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Over the last 40 years the population factors — growth in the size of the population of working age — have contributed 2 percentage points a year to our GDP growth. Population growth alone has contributed 1½ percentage points. The other ½ of a percentage point has come from the ageing of the population — a higher proportion of working age.

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The participation factors have detracted one-quarter of a percentage point a year. A larger proportion of those of working age have wanted to work — especially with increasing female participation in the workforce. But this effect has been more than off-set by a higher unemployment rate and a decline in average hours worked from just under 40 hours a week at the start of the 1970s to something less than 35 hours a week by the early 1980s. Since then, average hours have drifted down a fraction lower — but not much.

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Productivity growth has, however, contributed a further 2 percentage points a year.

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So, over the last 40 years, GDP grew by about $3\frac{3}{4}$ per cent a year.

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What about the next 40 years?

Well, demography will be the big driver.

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The growth in the size of the population technically of working age — the definition I am using is 15 or more years of age — will continue to be a positive for GDP growth. But instead of contributing 2 percentage points a year, it will contribute only $\frac{7}{8}$ ths of a percentage point — $\frac{3}{4}$ per cent from population size and $\frac{1}{8}$ th of a percentage point from continued population ageing. But the population ageing effect is illusory.

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In fact, because older people do not have the same desire to work as younger people, nearly half of the $\frac{7}{8}$ ths will be eroded by lower workforce participation rates.

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Our productivity projection is simply the average of the last three decades — some $1\frac{3}{4}$ per cent a year.

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Adding these up we get GDP growth of about $2\frac{1}{4}$ per cent a year — $1\frac{1}{2}$ percentage points less than what we managed in the last 40 years.

Obviously, if you are wondering about transport infrastructure requirements, the size of the population, its composition, and the income it produces (ie, GDP) are important.

Insert Slide 15

But the population itself is most likely to be interested not so much in the totals as in income per person. This is subject to the same set of demographic influences.

GDP per capita growth is the difference between GDP growth and population growth.

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Over the last 40 years

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we would start with $3\frac{3}{4}$ per cent,

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subtract $1\frac{1}{2}$ per cent,

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and find GDP per capita growth averaging $2\frac{1}{4}$ per cent a year.

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Over the next 40 years GDP per capita growth will be significantly lower.

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With GDP growth of $2\frac{1}{4}$ per cent

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and population growth of $\frac{3}{4}$ per cent,

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GDP per capita will grow at about $1\frac{1}{2}$ per cent a year — some $\frac{3}{4}$ per cent a year lower than over the last 40 years.

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This difference compounds to one-third over 40 years.

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The Intergenerational Report, released with the last Budget, presented projections for budget spending over the next 40 years.

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These projections are driven by demographic effects,

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but also by increasing average costs of certain programmes.

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In the case of health spending, the latter is the principal driver,

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contributing about $\frac{3}{4}$ of the projected increase of $4\frac{1}{4}$ per cent of GDP.

Insert Slide 17

Aged care is likely to cost about 1 per cent of GDP more in 40 years time.

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Payments to individuals — including the age pension, but also family payments and so on — will rise by some ½ per cent of GDP.

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Education and the other demographically sensitive components of Commonwealth spending will likely fall by ½ per cent of GDP.

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All up, the most demographically sensitive components of Commonwealth spending could increase by a little over 5 percentage points of GDP.

Insert Slide 21

The policy choices are straightforward.

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Allow spending to increase, and public debt to build up.

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Or increase the tax to GDP ratio by some 5 per cent of GDP.

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Either of these essentially passes the fiscal problem to future generations.

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The alternative is

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to tackle the average cost of programmes

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or implement policies that would facilitate a faster rate of GDP growth.

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This shows what would have to happen to the Commonwealth tax to GDP ratio in order to maintain budget balance. Initially things look pretty good. The implication is that policy does not have to respond immediately — we have time. But policy will need to respond at some point if we are to avoid the future accumulation of public debt or the need to increase taxes.

Insert Slide 23

Growth policies may be classified into three types:

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population policies;

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participation policies;

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and productivity policies.

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The first category includes, in principle, immigration and fertility policy. I won't say anything more about these today, other than to note that: first, neither would stimulate sufficient additional GDP to prevent the tax to GDP ratio from rising in order to maintain budget balance; and second, while increasing the size of the population may be a means of increasing GDP, it is not the most obvious means of increasing GDP per capita. The solution to these two issues has to be found elsewhere.

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Participation policy includes policies aimed at increasing the labour force participation rates of age cohorts with relatively low rates — older workers in particular — and of other groups with relatively low rates, including those on disability benefits of one form or another.

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Productivity policy includes, most obviously, microeconomic reform, but also the maintenance of sound macro policy frameworks. Without the latter, capital deepening would be threatened.

Insert Slide 24

Productivity growth is crucial.

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As noted earlier, the IGR projects future productivity at the average rate of the last three decades — $1\frac{3}{4}$ per cent a year. In order to generate the level of GDP needed to avoid the need for the tax to GDP ratio to rise,

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annual productivity growth would have to be $\frac{1}{2}$ percentage point higher. This might not seem like a lot. But that rate, of $2\frac{1}{4}$ per cent a year, would match the very impressive performance of the second half of the 1990s. Can we sustain that sort of performance for 40 years?

Insert Slide 25

How does transport, and transport policy, come into this picture?

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First, go back to the framework that explains the sources of GDP: population, participation and productivity. The first source, population, has a number of dimensions:

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total size,

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age composition

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and physical location.

The drivers of GDP are not independent, of course.

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In particular, I have noted already that the age composition of the population has implications for workforce participation. But it also has implications for productivity — for example, and recognising that this is a sweeping generalisation, it is probably the case that younger people absorb new ideas more readily than older people. The physical location of the population also has implications for economic participation and productivity.

Insert Slide 26

Now we can see how transport fits in.

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The principal drivers of the demand for transport services are our population characteristics — total size, age and physical location — and GDP.

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The actual delivery of transport services makes a direct contribution to GDP. This is made up of the wages and other returns paid to people working in the transport industries, and the return on funds invested in the sector.

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But transport makes a larger contribution to GDP in other ways — as an input to a lot of other economic activity. Another way of saying this is that transport makes an important contribution to economic participation and productivity — both capital deepening and multi-factor. In particular, without transport, a geographically dispersed population simply would not be able to get together to undertake joint economic activity.

Of course, the economic welfare contribution of transport infrastructure is not fully reflected in GDP. For example, most of the benefits enjoyed by private motorists and passengers are not bought and sold in the market, and are not therefore directly measured in GDP. But that does not deny their importance.

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The way in which the demand for transport services translates into actual service delivery is, of course, impacted significantly by transport policy, and by other elements of the policy framework — like tax policy, and greenhouse policy, for example.

That provides a very broad articulation of the place of transport in the drivers of GDP.

Insert Slide 27

Let me now turn quickly to roads, before making some general remarks about the possible dimensions of future regulatory change.

Insert Slide 28

The commonwealth will spend something like \$1.7 billion on roads this financial year. In fiscal terms, road infrastructure is clearly the key transport focus for the Commonwealth.

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The non-bulk freight component of truck traffic needs

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is driven by GDP and the physical location of the population.

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Bulk freight needs

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are driven by the factors that drive the commodities contribution to GDP: supply conditions and export demand.

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Inter-modal competition has a role to play, of course. But you can see that GDP growth is going to be the principal driver of truck traffic needs.

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And because GDP grows more or less exponentially, so too should truck traffic needs.

Insert Slide 29

Passenger traffic is a different story. The drivers of passenger kilometres travelled are:

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cars per person;

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average kilometres travelled per car,

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and total population.

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Cars per person is probably close to saturation.

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Average kilometres travelled per car — which is presumably linked to the age composition and physical location of the population — is flat.

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So population size is the principal driver of passenger kilometres.

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And the population growth rate is slowing.

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The growth rate of passenger kilometres is therefore likely to slow.

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The BTRE projections have GDP growth averaging 3¼ per cent a year. That looks a little high for a future 15-year average. Even so, it's worth considering its implications. As the BTRE has noted, that rate of GDP growth would imply tonnages moved by road Australia-wide increasing by some 4 per cent a year — or 80 per cent over 15 years, with interstate tonnages more than doubling over that period. Even with significant increases in the sizes and loads carried by trucks, those projections would seem to imply

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growth in truck kilometres travelled of some 50 per cent over 15 years, or about 2.7 per cent a year. Interstate kilometres travelled could grow by something like 75 per cent over that 15 year period. Clearly, that is a very challenging scenario.

Insert Slide 31

Urban car traffic is likely to grow at a much slower rate —

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by about 20 per cent over 15 years, or 1.2 per cent a year. Including urban commercial traffic, the figure is likely to be more like 23 per cent.

Insert Slide 32

Even those apparently relatively modest rates of growth in urban traffic raise important issues,

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especially of urban congestion — and, of course, urban air quality.

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And truck traffic projections raise questions about the capacity and quality of maintenance of our highways.

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Road traffic also raises greenhouse issues.

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Not dealing with these issues now amounts to passing a very challenging set of problems to future generations.

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Policy response can take two forms:

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Higher budget outlays on road infrastructure —

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which also raises questions of intergenerational equity (who is going to pay for the higher budget expenditure?).

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Or regulatory change. The latter offers the prospect — at least in principle —

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of productivity improvement and an enhanced contribution to GDP.

Insert Slide 33

What are the possible dimensions of regulatory change? My aim here is not to advocate any particular policy direction, or any specific policy proposal, but rather to identify some issues that are likely to frame debate. I am not, here, confining my scope to road transport — but neither am I attempting to identify all of the regulatory issues of significance to transport.

Broadly, there are two dimensions of possible regulatory change.

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The first looks to the demand side and enquires about the price signals confronting users of transport infrastructure.

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The second looks to the supply side and enquires about the systems for financing new transport infrastructure.

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The former inquiry is really about discovering the scope for moving user prices closer to the social marginal costs of usage. Most of the possible action here concerns road transport.

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The BTRE suggests that road pricing in congested urban areas could reduce the need for new road infrastructure by some 20 per cent.

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And jurisdictions continue to think about charges, both explicit and implicit, faced by heavy vehicles for access to road infrastructure.

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The second inquiry is about discovering the scope for greater private provision of transport infrastructure, better performance in intergovernmental provision and more effective intermodal linkages.

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Income tax: s51AD and Div. 16D

Provisions of the income tax legislation — section 51AD and Division 16D — are designed to ensure that those who provide infrastructure privately do not obtain a non-transparent subsidy from the taxpayer. These provisions have been around for some time and are to be over-hauled. The replacement provision for Division 16D will focus, in part, on the extent of risk transfer to the private sector.

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Part IIIA of the TPA

A fortnight ago the Treasurer released the final report of the Productivity Commission on the Review of the National Access Regime — Part IIIA of the Trade Practices Act. The regime allows third parties to seek access to the services of essential infrastructure facilities, like rail track. The focus of improvements in the National Access Regime will be on its objectives and scope, finding ways of using the regime to encourage efficient investment in new infrastructure, strengthening incentives for commercial negotiation and improving certainty and transparency.

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Competition provisions of the TPA

You would be aware also that the Government has commissioned a review of the competition provisions of the Trade Practices Act. The review is scheduled to report in November. The competition law framework should facilitate private sector involvement in the provision of transport infrastructure by reducing the likelihood of anti-competitive behaviour.

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Private Financing Principles

The Minister for Finance and Administration released the Commonwealth Policy Principles for the Use of Private Financing just on a year ago. The core principles are value for money, transparency and accountability. Under the principles the Commonwealth commits to assessing proposals for private provision case by case, on a whole-of-life and whole-of-government basis.

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SPPs

The Commonwealth has focussed recently on the need to improve the transparency and accountability of both Commonwealth and State levels of government in the implementation and management of Specific Purpose Payments (SPPs). The Commonwealth is seeking a clearer focus on the achievement of policy objectives. Reporting of agreed financial information and performance indicators will be required in all new or extended SPP agreements.

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AusLink

The proposed AusLink initiative is about improving the way in which governments make decisions about land transport infrastructure provision. Because that initiative is still in the design stages, and more importantly because I do not have carriage of it, I don't propose saying any more about it today.

It has to be said that this is a substantial list of issues for any sector to be grappling with. You have your fair share of challenges. But the national imperative of securing improved outcomes in respect of economic participation and productivity, and the significant role that transport can play in pursuing those goals, underlines the importance of those challenges being met and mastered. I wish you well in your work.