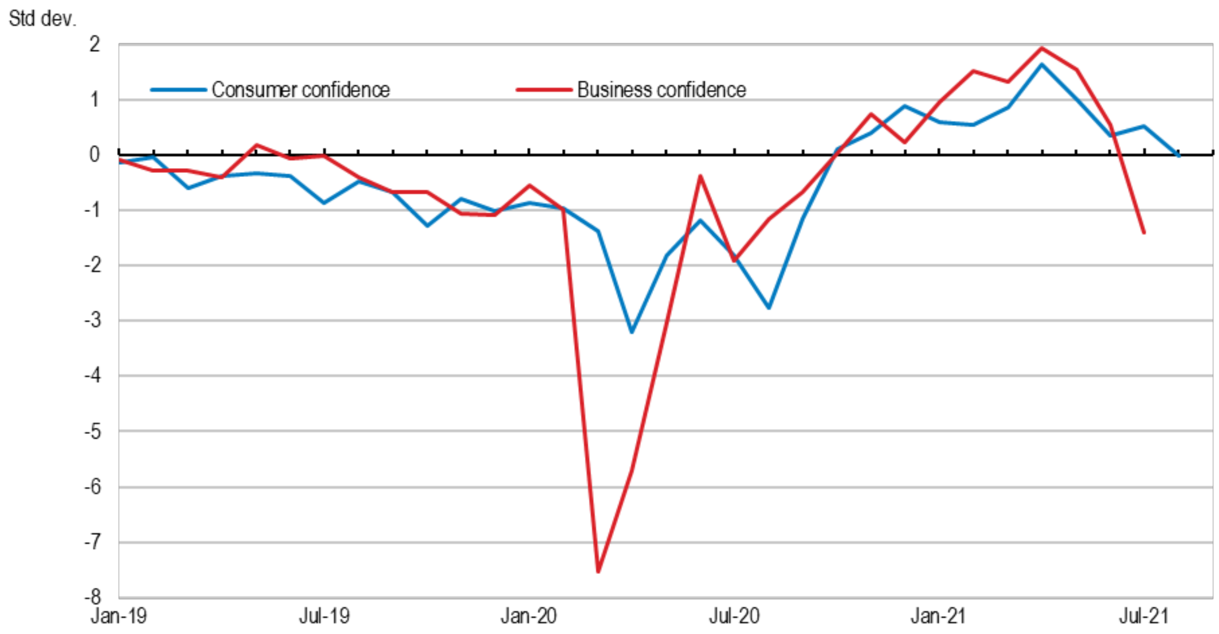
Australia: Five takeaways from the new OECD Economic Survey

By Patrick Lenain, Christine Lewis and Ben Westmore, OECD Economics Department

In Australia, the recent outbreak of the COVID-19 Delta variant has prompted the government to adapt its public health response. Instead of attempting to suppress the virus (“zero tolerance”), efforts are now being made in New South Wales and Victoria to contain the virus together with a more active campaign to vaccinate the population. The current strict lockdowns in these states will result in GDP declining in the third quarter of 2021. In an environment of higher community transmission of COVID-19 and lingering uncertainty, the eventual recovery will remain gradual even when restrictions are eased. In the medium-term, the new Economic Survey says that Australia has the potential to return to sustained growth if complementary structural reforms are undertaken. Policy changes can also make growth work for all and put Australia on path toward achieving net zero greenhouse gas emissions. Five takeaways from the report are summarised below.

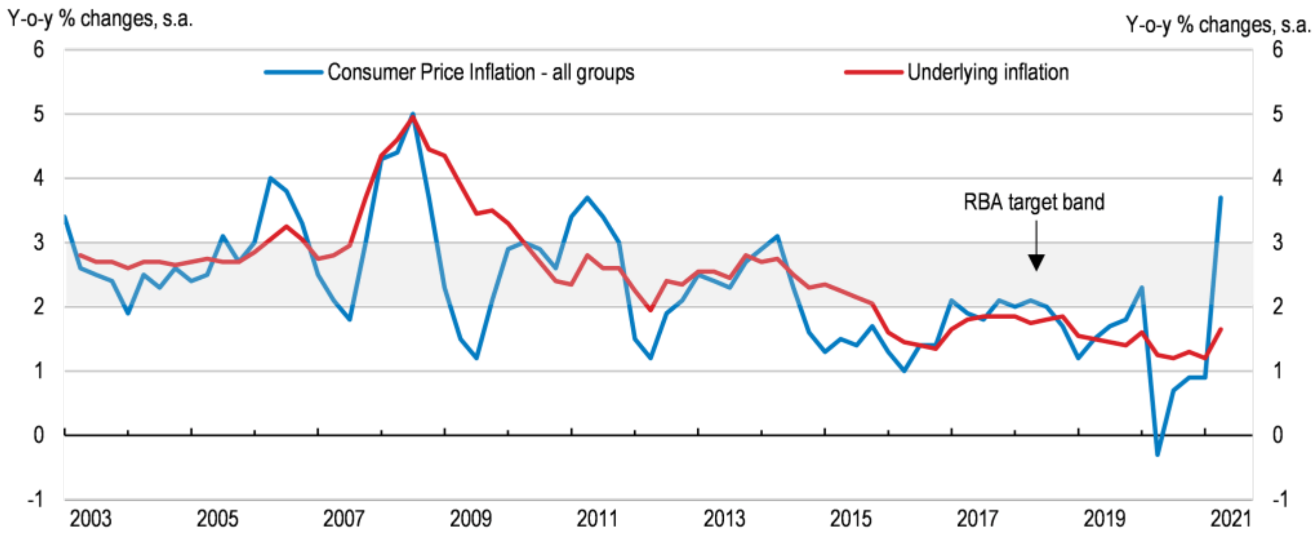
Figure 1. Confidence has fallen recently



Note: The measures are normalised over the period since 1997.
Source: Refinitiv.

Institutional reforms would strengthen resilience. Fiscal policy is now being conducted in an environment of higher public debt and will be called to play a more active role given the limited space for conventional monetary policy at the lower bound. At the same time, underlying inflation has undershot the target band of the Reserve Bank of Australia (RBA) for an extended period (Figure 2). When the economy fully recovers, the government should outline a medium-term fiscal strategy that is associated with specific timeframes or conditional on measurable economic outcomes. Future fiscal strategies should also be regularly evaluated and monitored by an independent fiscal institution, such as the Parliamentary Budget Office. As in other OECD countries, the RBA should conduct a monetary policy framework review that is broad in scope, transparent and involves consultation with a wide variety of relevant stakeholders.

Figure 2. Underlying inflation has undershot the RBA target for a prolonged period

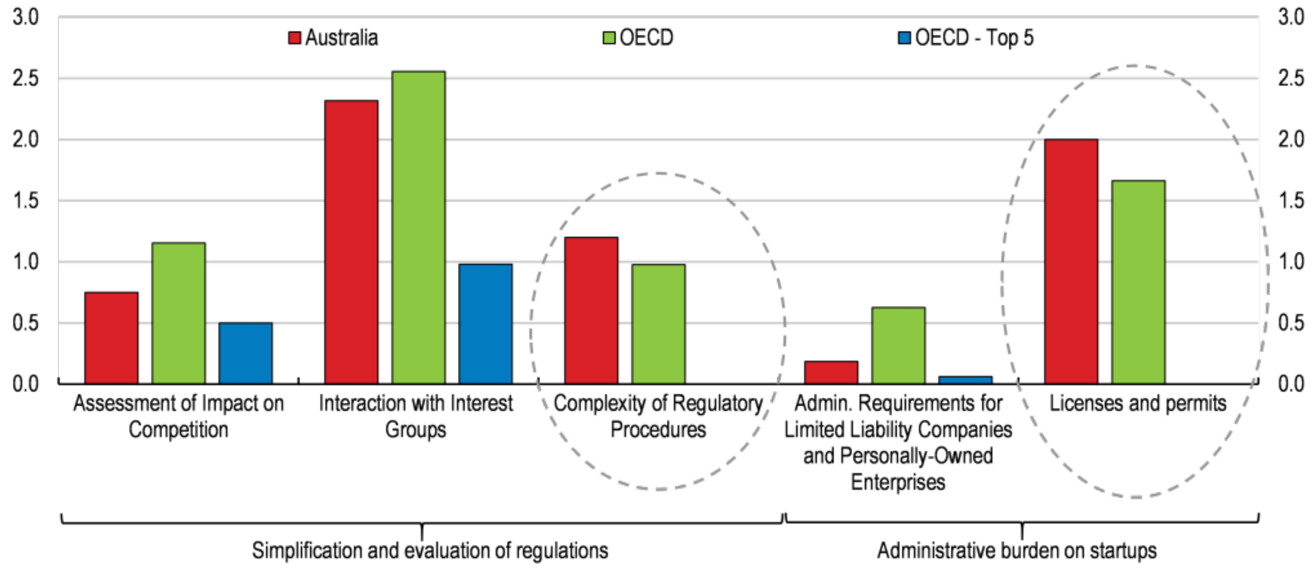


Note: The measure of underlying inflation is the arithmetic average of the Trimmed Mean and Weighted Median.
Source: RBA.

Regulatory reform will be key to business dynamism and higher productivity growth. Small and young Australian firms have contributed a large share of job creation and business investment over the past decade. However, the creation of new companies was trending down prior to the pandemic and the lockdowns have been particularly harmful to small young businesses. The regulatory landscape is ripe for reform, particularly the licensing and permit system (Figure 3). The government should continue to simplify its regulations and lower administrative barriers. For example, further reforms to the occupational licensing regime and land use regulations are needed.

Figure 3. The licensing system and regulatory complexity are ripe for reform

Product Market Regulation Indicators, subcategories 2018

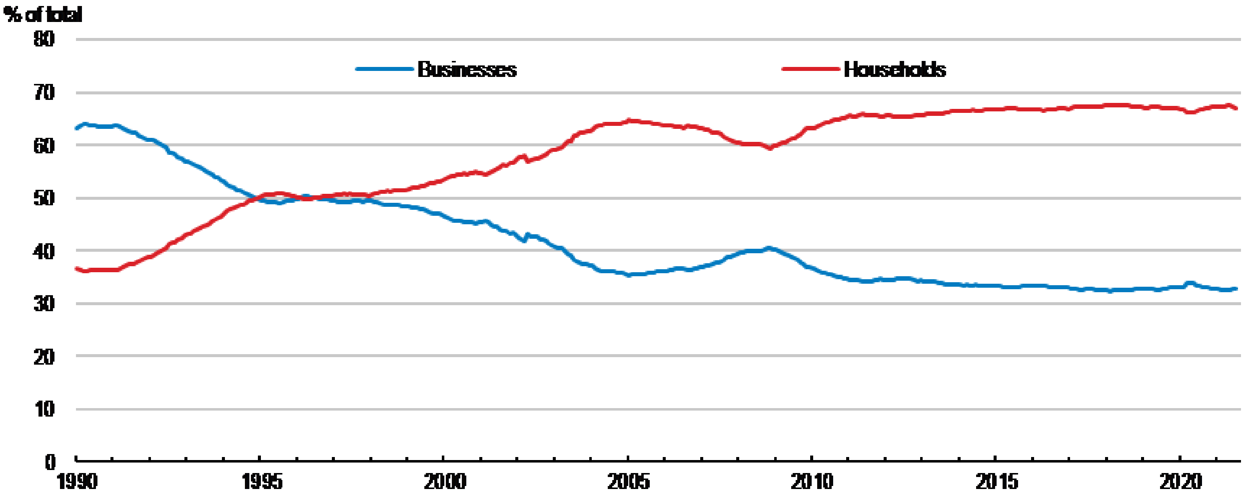


Source: OECD 2018 PMR database.

Banks have provided financial buffers during the pandemic and will play an important role during the economic recovery. Australia's banks are well capitalised and many firms have availed of loan deferrals through the pandemic. However, lending has become increasingly skewed towards the household sector (Figure 4) and a relatively high proportion of innovative firms are constrained by access to finance. The digital revolution in financial services can improve lenders' ability to assess credit risk and provide new forms of competition to the banking sector. For example, open banking is expanding information available to lenders and should be extended to facilitate switching of providers, accompanied by appropriate protections. By facilitating intangible assets to be used as collateral, improvements to the existing Personal Property Securities Register can also support young innovative enterprises.

Figure 4. Lending has become increasingly skewed towards households

Credit by sector



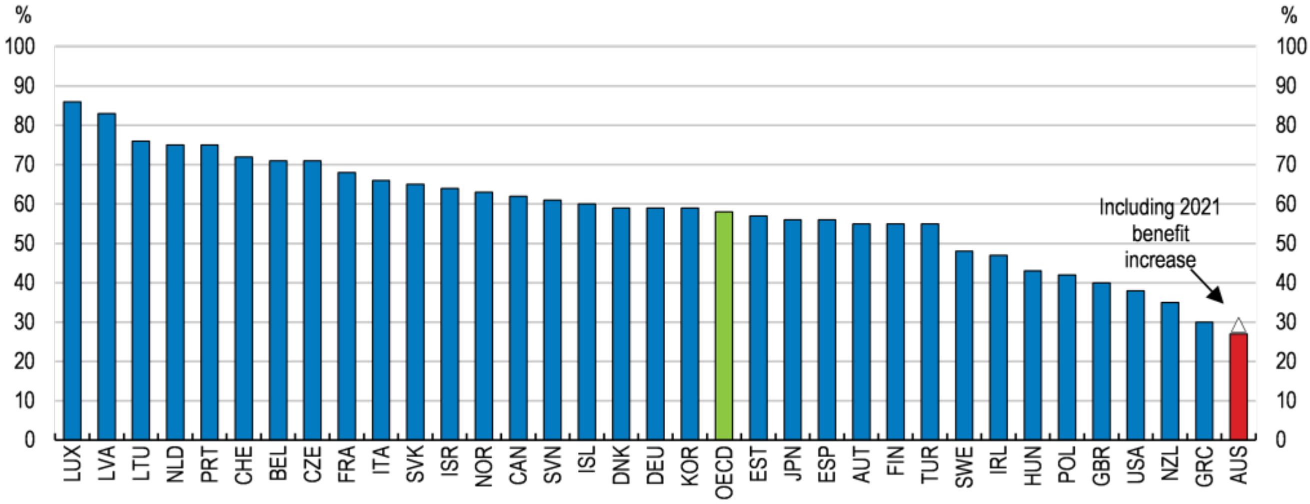
Source: RBA.
Preview(opens in a new tab)

More can be done to make the recovery work for all. Australian workers losing their jobs face larger income losses than any other OECD country (Figure 5) due to low unemployment benefits. As well as increasing the unemployment benefit rate, there should be continued attention to ensuring the network of private employment service providers are incentivised to facilitate training for those out of work. Improving financial literacy in some cohorts is also a priority, especially for Indigenous Australians who have lower levels of financial literacy than the general population.

Figure 5. Unemployment benefits remain very low by international standards

Unemployment benefit net replacement rate, 2020 or latest available year

Preview(opens in a new tab)

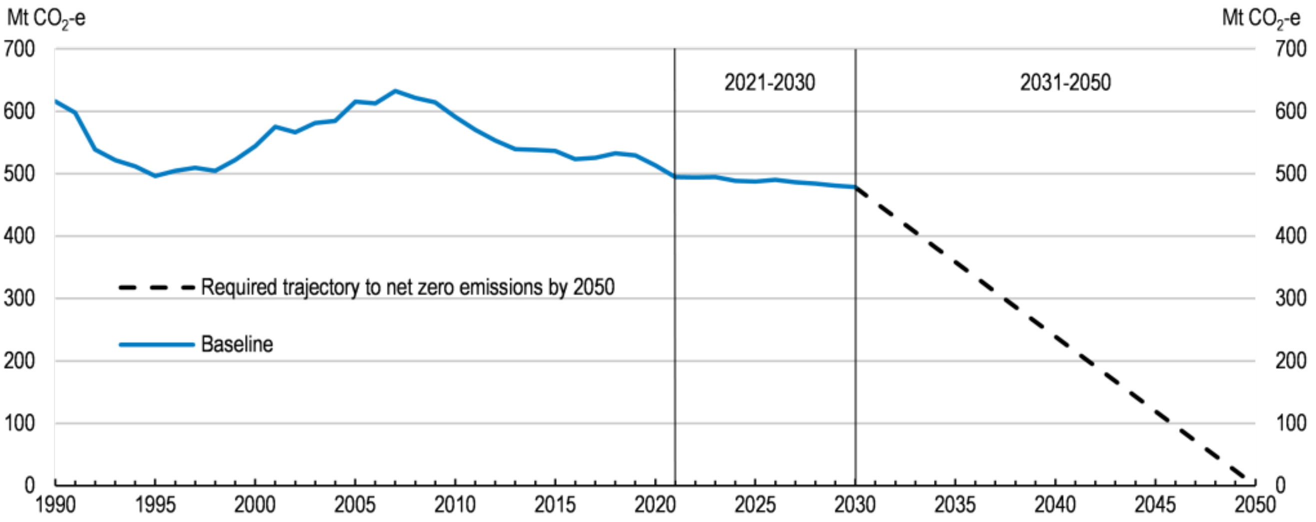


Note: Calculation includes social assistance and housing benefits.
Source: OECD Tax-Benefit Models, www.oecd.org/els/social/workincentives.

Greenhouse gas emissions have been declining, but need to fall at a faster pace if net zero by 2050 is to be achieved. Australia is uniquely vulnerable to climate change, but it is also uniquely placed to benefit economically from the global move towards carbon neutrality due to a large (and windy) land mass, high solar radiation, plentiful ocean access and strong human capital to form the basis of innovation in carbon abatement technologies. A coherent and coordinated national strategy that defines clear goals and corresponding policy settings for the path to achieving net zero emissions “as soon as possible and preferably by 2050” is needed. The incentives for the invention and adoption of low emission technologies will be enhanced by increasing the pricing of carbon emissions from relatively low levels. This should be accompanied by policies that support the transition of workers out of fossil fuel generating industries.

Figure 5. Emissions will need to decline faster to achieve net zero emissions by 2050

Greenhouse gas emission projections and required trajectory to achieve net zero emissions at 2050



Note: The data for 2021-2030 correspond to government projections under the department's baseline scenario as at December 2020. The measure includes land use, land use change and forestry.

Source: Department of Industry, Science and Energy Resources; OECD calculations.

References

OECD (2021), *OECD Economic Surveys: Australia 2021*, OECD Publishing, Paris. https://doi.org/10.1787/ce96b16a-en.