Today's economic note comes to you as I head to Canberra to start off a very important week. Tomorrow I'll be joining the PM and our state and territory counterparts at a COAG meeting where we'll be trying to reach agreement on a major economic reform and the biggest improvements to the health system since Medicare. On Wednesday I'll be flying out to New York to talk with the finance sector that was at the epicentre of the global crisis, before travelling on to Washington for the G20 Finance Ministers' Meeting. Just as we've defied global economic gravity through decisive action and international cooperation, so too can decisive action and working together with the States build real improvements to our health system and put health spending on a sustainable footing.

Health Reform

I'm very pleased that State Treasurers will be at tomorrow's COAG meeting because health reform isn't just about addressing critical issues in our health and hospital system – it's also about the nation's finances and the long-term viability of state budgets. The Australia to 2050 Intergenerational Report released earlier this year made it clear that business as usual in health funding is a recipe for financial disaster. It showed that without reform, health spending alone would absorb more than the entire revenue collected by all the States by 2045-46 – and earlier in some States. Put simply, if we don't fix the system now it's going to buckle under its own weight and state budgets will be swallowed up.

As part of our reform plan, we have announced an extra $3 billion in funding for critical investments in our hospitals, training for more doctors and allied health professionals, aged care, and better care of those with chronic disease. This comes on top of the $64 billion healthcare agreement we agreed with the States in 2008 (a 50 per cent increase on the previous agreement), and the $90 billion in total funding we are providing to the States this year which is more than an 11 per cent increase on the previous year.

Just this week we advised each State Treasury that GST revenues will increase by around $13 billion over the forward estimates. This is because stimulus kept customers coming through the doors of businesses and boosted confidence, which has supported a more sustained pick-up in consumption. That means another $2-3 billion more funding we will provide to the States each year as part of the dividend of keeping our economy growing through the global recession.

It's important to keep in mind that indirect taxes like the GST recover much more quickly than other tax revenues which go to the Commonwealth. GST is driven by the level of spending in the economy, which held up remarkably well during the downturn thanks to economic stimulus payments to households and other stimulus measures. In comparison, Commonwealth revenues are determined mainly by changes in business and household incomes, which were both heavily impacted by the global crisis. As I explained in a recent economic note, the weakness in business profits and income growth, and the accumulated losses that built up during the downturn, mean that there is a significant lag between the rebound in the real economy and the recovery in Commonwealth revenues like company tax, capital gains tax and personal income tax.

Failing to reform our health and hospital system will be a drag on the productivity growth of our country into the future. With added pressures around health, and total health system costs trending towards 19 per cent of GDP by 2049-50 (up from around 9 per cent today), we can't afford to be funding these pressures in a way that constrains productivity growth across the rest of the economy. That's why Monday's discussion at COAG on health reform is so critical, not only to the sustainability of our hospitals, but to our long-term economic prosperity.

Banking Competition and Small Business

And with household incomes and small business profits still recovering, I'm as focused as ever on supporting smaller lenders to ensure the continued flow of credit at competitive interest rates. Competition in the mortgage market continues to be supported by our decision to direct the Australian Office of Financial Management (AOFM) to invest $16 billion in Triple-A rated residential mortgage-backed securities (RMBS). Sherman Ma, CEO of smaller lender Liberty Financial, recently wrote to me saying that "the RMBS purchase program … played a key role in stabilising … securitisation markets. As a result, Liberty Financial has been able to provide much needed competition in the bank-dominated mortgage market through companies such as BEAT Home Loans. BEAT Home Loans guarantees to beat the standard variable rate of any major bank, which has been possible due to the improved market conditions underpinned by the efforts of the AOFM."

Of course I also understand how tough conditions have been for small business. That's why I included the extra objective of supporting lending to small businesses in the Government's second $8 billion investment in the RMBS market. As a result, lenders who seek support under the RMBS program are asked to outline how active they are in lending to small business and to allocate part of the proceeds to these loans. It's expected that nearly 10 per cent of the funds raised by lenders so far during this second investment phase will be lent to small business.

G20 Finance Ministers' Meeting

Difficulties in the securitisation market and reduced credit supply for small business are just two of the impacts of the global financial crisis in Australia. But it's also worth remembering that I'll be going into this week's G20 Finance Ministers' Meeting with Australia's unemployment rate at 5.3 per cent and GDP growth of 1.4 per cent in 2009. By contrast, last week's World Economic Outlook from the IMF pointed out that "one legacy of the Great Recession will likely be persistently high unemployment rates in several advanced economies", saying that "although employment growth will turn positive in many advanced economies in 2010, the unemployment rate will remain high through 2011." In addition to the Euro area's 10.0 per cent unemployment, we're now seeing unemployment rates of 7.3 per cent in New Zealand, 7.8 per cent in the UK, 8.2 per cent in Canada, 8.6 per cent across OECD economies, and 9.7 per cent in the US.

It's also worth remembering that a year ago the global economy was in the midst of the most dangerous financial and economic crisis since the Great Depression. Global share markets had lost more than 60 per cent of their value, virtually every advanced economy had slid into deep recession, and the world economy went backwards for the first time in living memory. Unsurprisingly, the G20 meetings I was attending at this time last year were pretty bleak affairs, but they were vital because they gave me a sense of the carnage around the world and helped crystallise what we needed to do here at home.

This week's meeting of G20 Finance Ministers in Washington is one of a series of meetings this year dedicated to finding the right balance between global action and national flexibility. It's in Australia's national interest to continue to do the heavy lifting on the international stage while maintaining the flexibility to do what's right for our own economy. In fact it's impossible to frame a sensible budget without having a firm handle on progress in the global economy and that's why these meetings are so important for Australia, so we can convert our success during the crisis into enduring gains for Australians.

Wayne Swan
Treasurer of Australia
Sunday 18 April 2010

www.treasurer.gov.au
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