The fraying generational bargain

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I would like to begin by acknowledging the Traditional Custodians of the Land on which we gather today, the Yugambeh people of the Bundjalung Nation. I pay my respects to their Elders past and present and am grateful for the opportunity to meet on this beautiful land.

Thank you everyone for being here, and thanks to the Centre for Independent Studies for inviting me to speak. As a former boss of a think tank, I appreciate the huge contribution institutions like the CIS make to the national policy debate – and often on a shoestring budget, although you perhaps wouldn't know it looking around!

Think tanks punch above their weight in policy debates for two reasons. First, they are packed with – and supported by – passionate and intelligent people who want to make a difference. Second their independence gives them freedom to explore and say things outside of the political party-sanctioned issues or talking points.

And that willingness to test boundaries, challenge prevailing wisdom and to push for change will continue to be critical if Australia is to grapple with some of the big challenges, I want to turn my attention to today.

The intergenerational bargain?

Today, I want to talk about the generational bargain: the implicit promise between generations.

The bargain is underpinned by a recognition of the obligation of one generation to another. We all of course understand cross-generational obligations. Families are built around them – we care for our children and grandchildren, and they in turn care for us in our older age or poor health.

And while our first concern is for those nearest and dearest, we also feel a wider duty of care. But in economic terms, what does one generation owe to the next?

The question generates an unusual alignment across ethical schools.

If we accept that people born at one point in time are no less deserving than others, then the egalitarian approach says that we should embrace the Principle of Intergenerational Neutrality: no generation should be preferenced above any other.[1]

In other words, each generation should stand on its own feet. Sounds reasonable. One exception the egalitarians advanced was that if there is a legitimate expectation of a major future shock to wellbeing – for example an environmental catastrophe – people should at least partly compensate future generations for that harm.[2]

Libertarianism too provides a foundation for considering intergenerational justice. While individuals may have the right of private output applied to property, this is justified so long as there is 'enough and as good' for those who follow.[3] Translated into intergenerational terms, this implies future generations should have the same opportunities as if the previous generation had done nothing.[4]

Importantly there is no ethical framework that justifies people taking more today at the expense of future generations.

In Australia's, and much of the world's recent history, the generational bargain has gone beyond what these principles would demand. The bargain has been both generous and hopeful: we aspire to leave the world a better place for future generations. And for most of recent memory, we have delivered on the hopeful bargain.

Parents and grandparents might delight in reminding us: "you kids have never had it so good". And generations of young Australians could roll their eyes, but hardly quibble.

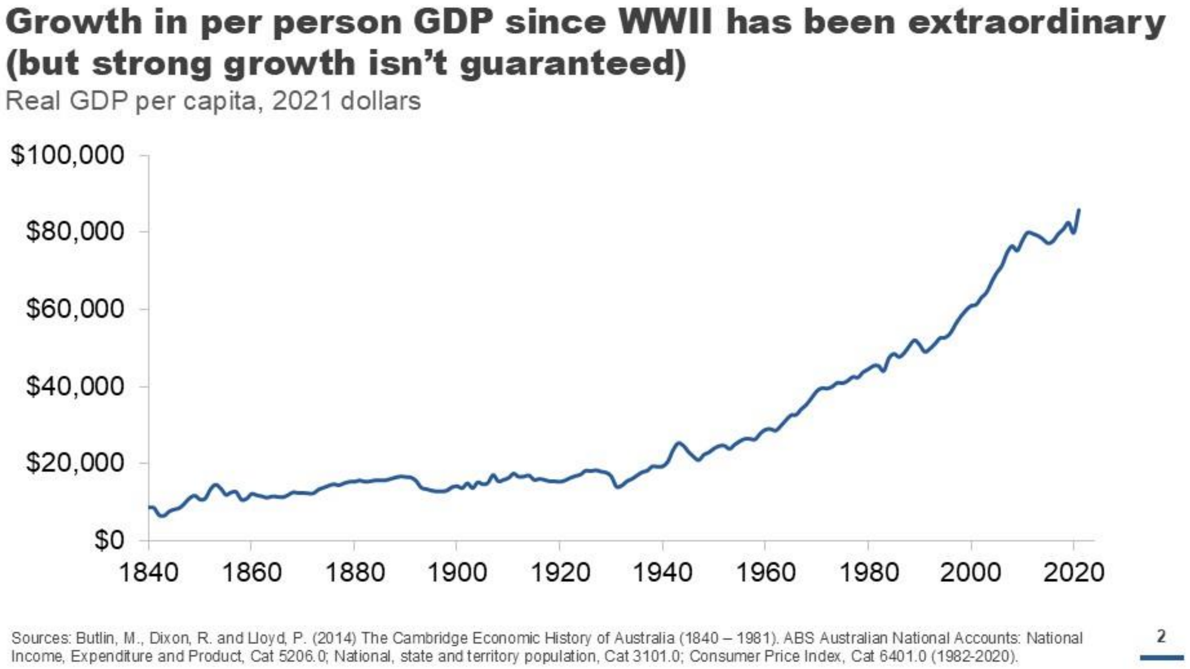
But say it now and I expect you will get a different response. And it's not just the young people with doubts. There is increasing societal unease that the lucky country was lucky for previous generations, but not so lucky for young Australians today.

Today I want to explore the some of the root causes of that unease – sluggish wages growth, unaffordable housing and an education system under pressure. Others like mental health and climate change I will put aside for today but are also an important part of the picture.

But I also want to push beyond 'admiring the problem' into possible solutions. Because restoring the hopeful generational bargain will require action.

Are you better off than your parents?

Australia has experienced an extraordinary expansion in living standards over time. Real GDP in per capita terms has quadrupled in the post-war era to over $80,000. And this lift in prosperity that has been spread reasonably equally across our society.[5]

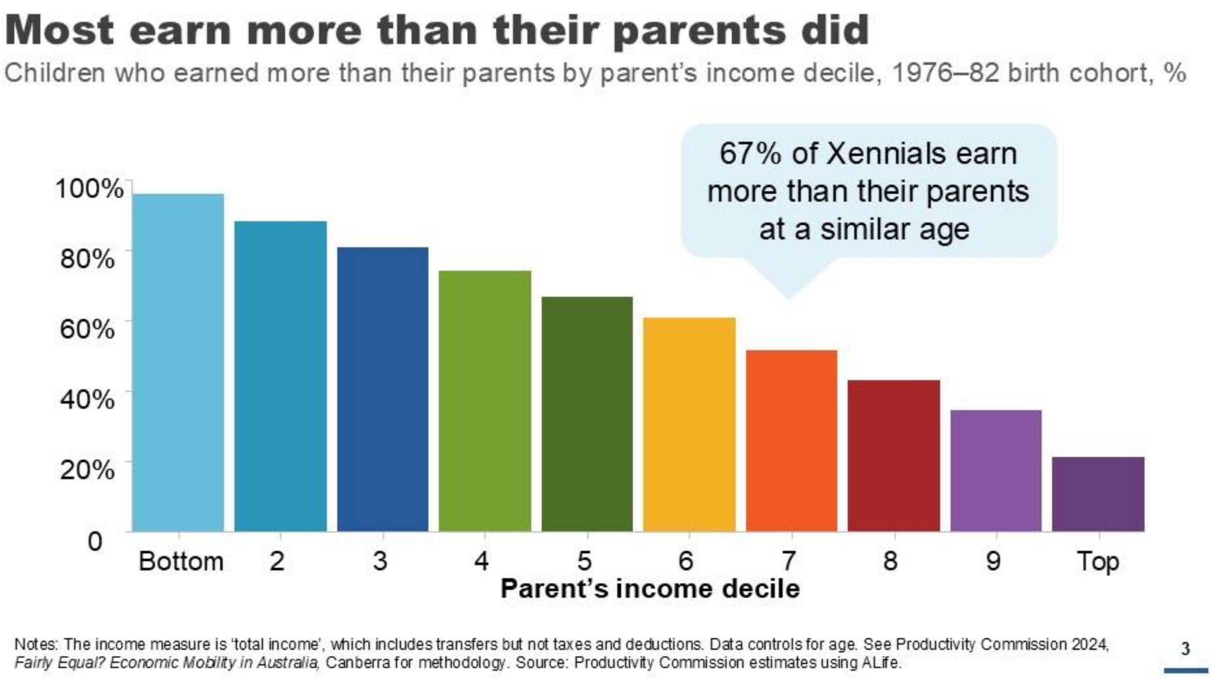


There have been incredible advances in the quality of the goods and services we can buy, from cars to dental treatment, to computers and communication tools. Say what you will about ‘Hey, Hey It’s Saturday’, but I would take my Netflix library any day of the week!

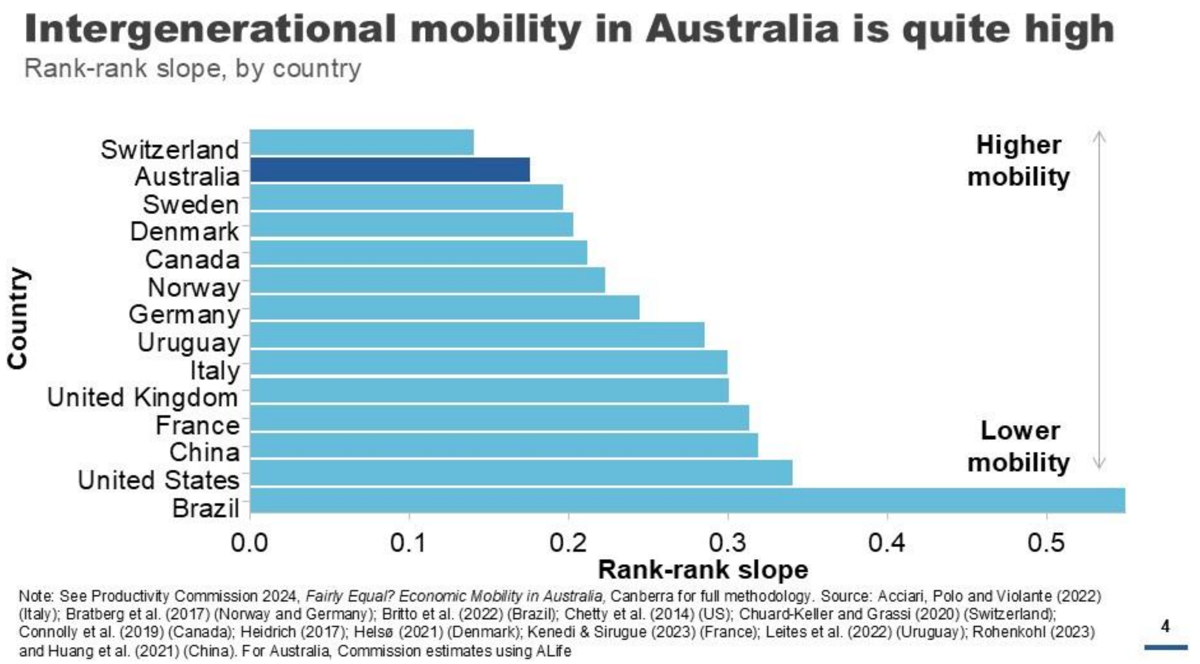
Overall, this steady upward march in GDP per person has helped deliver a nation where each generation is healthier, better educated and better housed than the one before.

This generation-on-generation progress was brought home in the Productivity Commission’s (PC’s) recent research paper ‘Fairly equal’, which used administrative data sets to examine economic mobility in Australia.[6]

We found that two-thirds of today’s 40-somethings – those born at the intersection of Generation X (the greatest generation, of course) and Millennials – earn more than their parents did at the same age.



Encouragingly, for this same group of Australians born between 1976 and 1982 we also found a high level of *relative* income mobility.



A 10 percentile rise in a parent's place in the income distribution is linked to a quite small 1.8 percentile rise in the child's ranking in that same distribution.

In other words, your parents' income doesn't determine yours.

Although we do find greater stickiness among very high and very low income earners – but to find out more on that point you'll have to read our report.

You'll also see from the chart that we can boast to be one of the most economically mobile countries in the world, behind only Switzerland across several selected nations, and above Sweden and Denmark – nice to beat out some of the Scandinavians for once right?

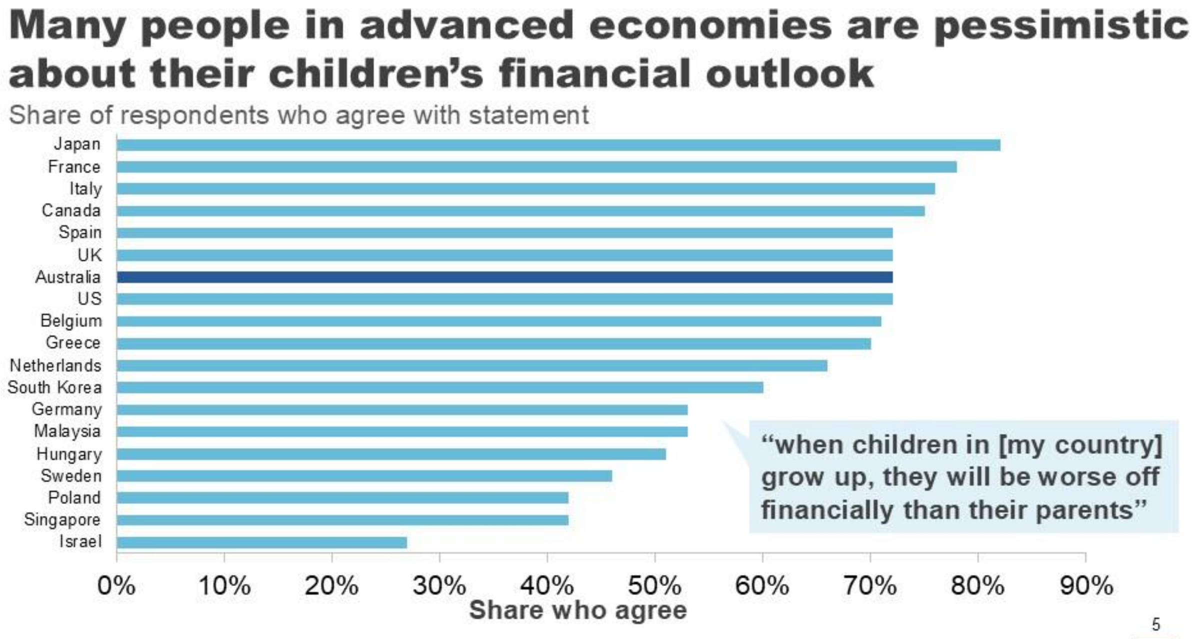
All of which is to say, the fair go is alive and well – at least for my generation.

A bargain in doubt

But there is a cloud of pessimism which seems to overlay this seemingly good news story. Nearly three in four Australian adults believe the current crop of children will be financially worse off than their parents.

And we're far from alone.

That deepening pessimism about our kids' prospects is echoed around the developed world.



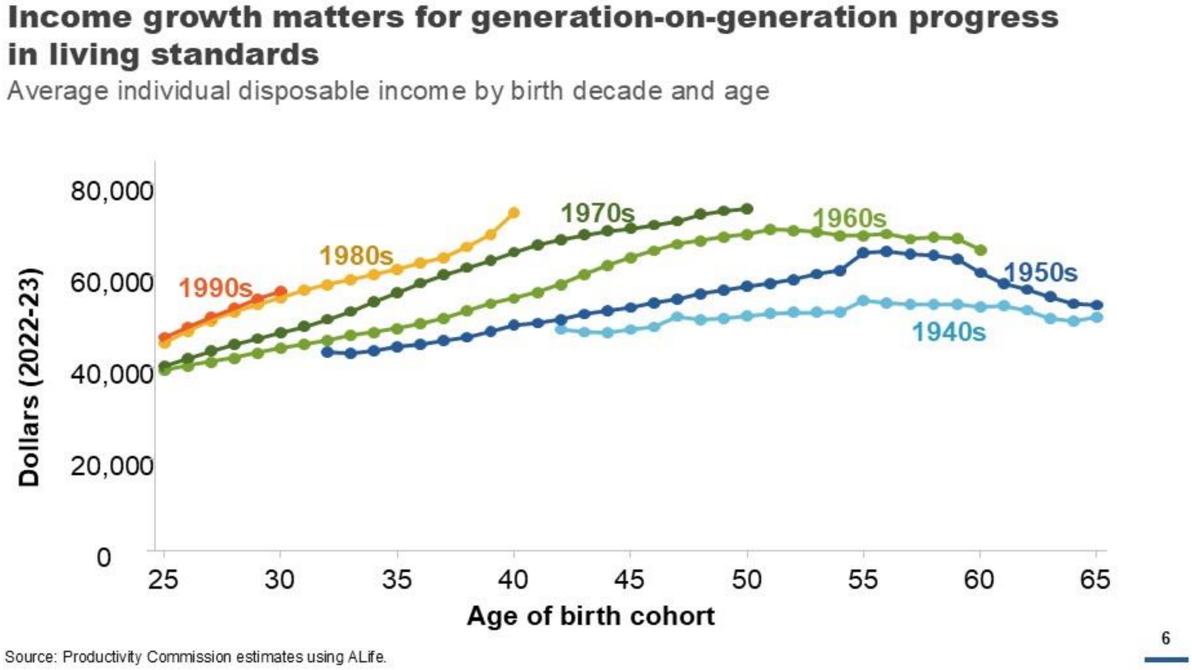
Source: Pew Research Centre 2022, *Spring 2022 Global Attitudes Survey*, Q2.

The UK, US and Canada report similarly dour views, as do European countries such as Italy, Spain, Belgium and Greece. In France, the proportion is even higher at 78%, while 82% of Japanese adults believe their children will be worse off than them – the highest among the 19 mostly rich populations surveyed by Pew. [7]

So what sits behind the current outbreak of pessimism? Is this just another variant of the 'vibecession' where negative sentiment belies the seemingly positive economic data, or are parents responding to real economic signals?

Not just the vibes: stalling outcomes for young people

This chart is my favourite for tracking economic outcomes across generations. It shows quite clearly the generation-on-generation progress mentioned earlier.

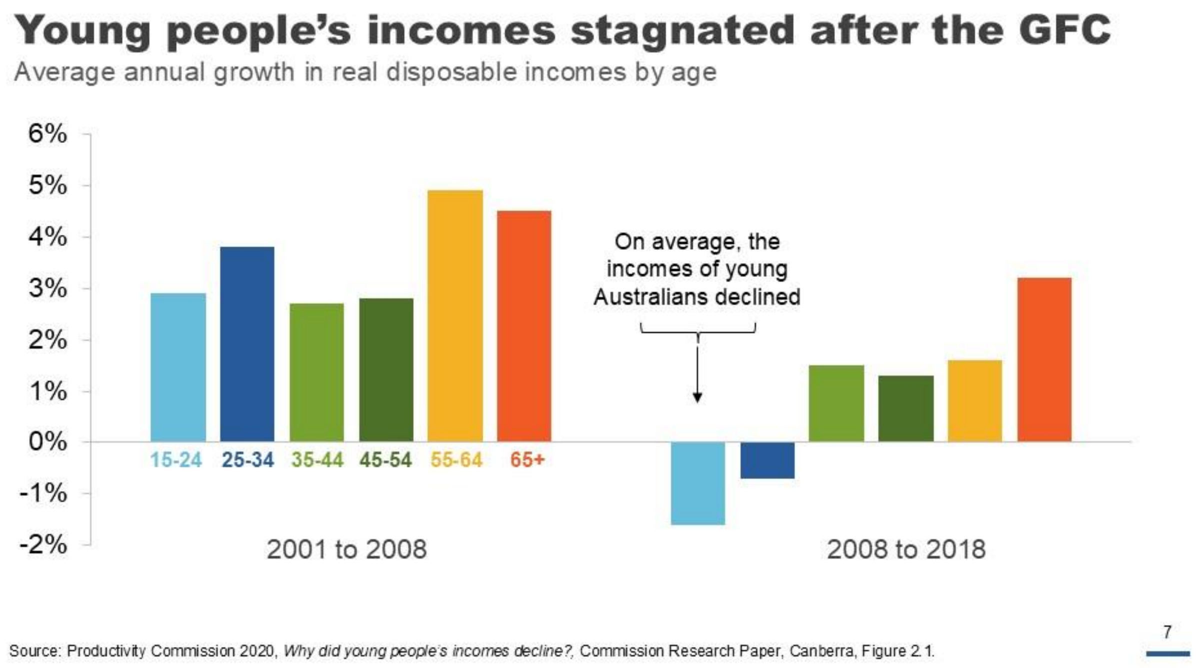


People born in the 1950s on average earned more than those born in the 1940s at every given age, while those born in the 1960s earned more than those born in the 1950s, and so on.

But there's a sting in the tail of this chart.

It shows that those born in the 1990s are the first cohort to miss out on substantially higher incomes than their predecessors. In fact, Aussies aged 25-30 have experienced almost no growth in incomes compared to those born in the 1980s at the same age.

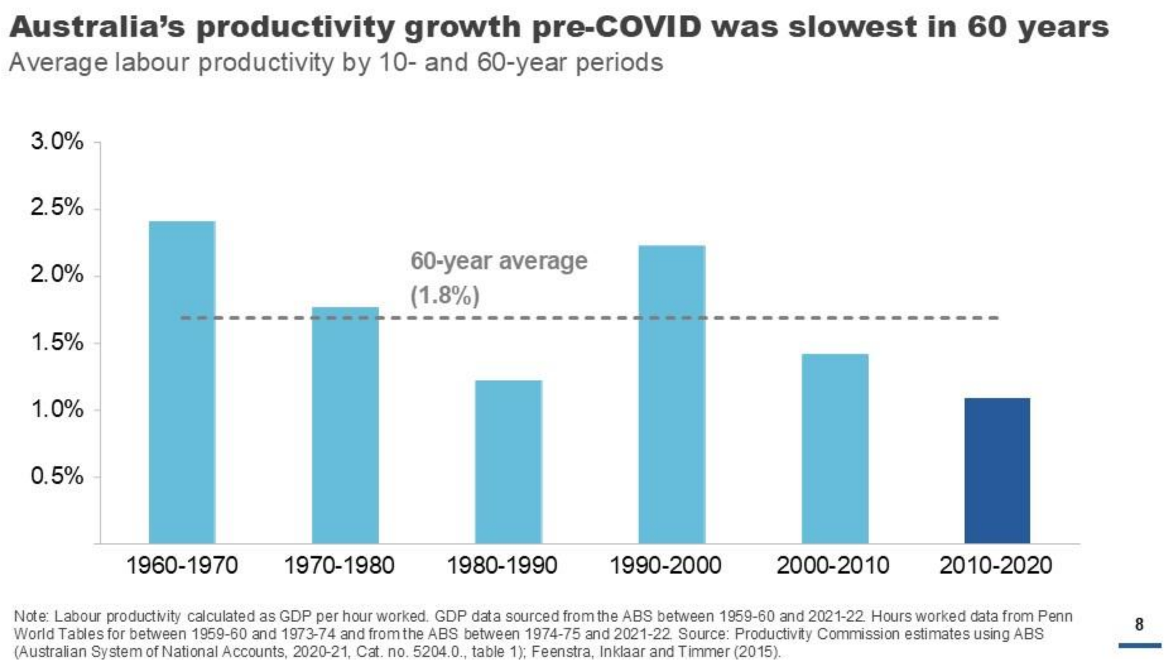
We can see this same phenomenon in PC research showing that average real disposable incomes for young people went *backwards* in the decade before COVID.[8]



In general, income growth in the decade was pretty lacklustre. But while older Australians still enjoyed *some* increase in purchasing power on average, the average 15-34 year old had *lower* disposable incomes in 2018 than the average person in the same age group in 2008.

So what's behind this sharp slowdown in income growth through this period?

We can't be definitive, but no prizes if you guessed that part of the explanation is our well-known and widely lamented slowdown in productivity growth.



Productivity growth in the most recent decade slumped to its weakest rate in 60 years.

And as we all know, productivity growth is the overwhelming driver of real wage growth over the long term.

PC research has shown that had we been able to maintain productivity growth from 1995 to 2023 at the 2.2% average of the 1990s, real annual average incomes for most workers today would be $25,000 higher.[9]

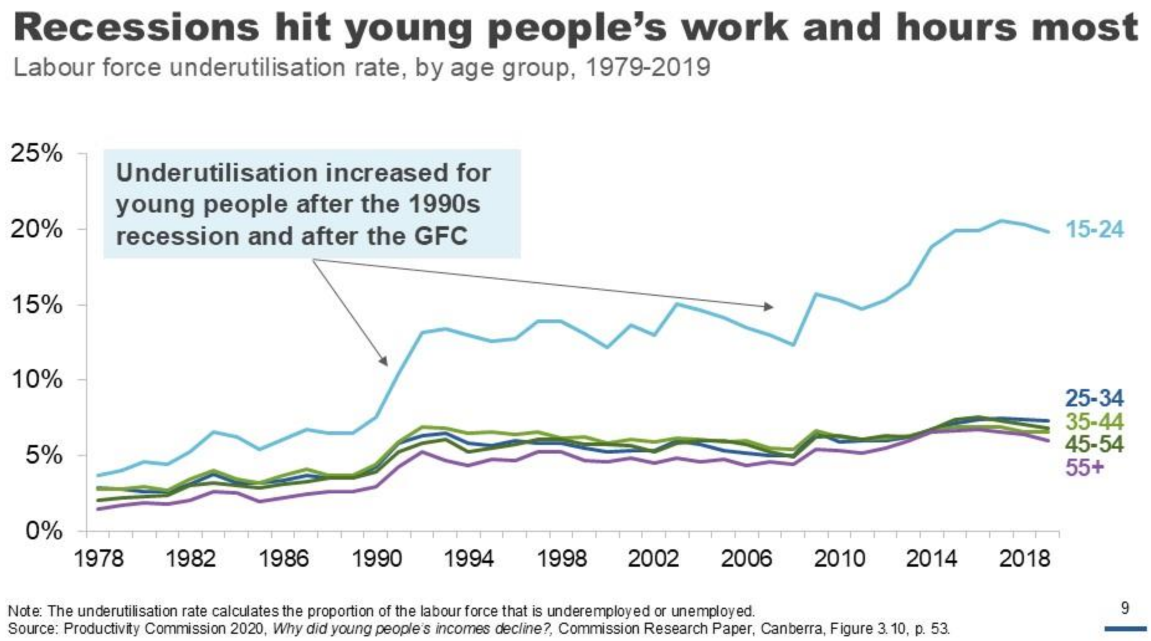
Adding to this grim picture was a generally weak macroeconomic backdrop. Unemployment through the period after the GFC was on the high side, as businesses were reluctant to invest in people and capital.

In this pre-Covid period of falling interest rates, advanced economies struggled to exit the 'low-growth trap' of weak demand and inflation - as hard as that is to imagine today.

None of that meant a great environment for rising wages.

But that still begs the question: why did the earnings potential of young Australians get hit so much harder than that of older workers?

A clue is in the labour market.



In the 10 years to 2019, the underutilisation rate among 15–24 year-olds – which sums the unemployment and underemployment rates – nearly doubled, as this chart shows.

In contrast, this measure barely budged among older workers.

One explanation is that in a weak labour market, new entrants are most vulnerable to missing out. And when there are a lot of young Australians competing for relatively few jobs, then it makes sense that some would have to settle for occupations that don't make the most of their qualifications.

This is sometimes described as 'falling down the jobs ladder'. This fall has cascading effects – young people who drop down a rung or two push other younger workers to lower rungs again, and those near the bottom ultimately pool in the lowest-paid casual retail and hospitality jobs, or end up unemployed.

Drawing on a ranking of occupations based on educational requirements and earning potential, our report showed that after 2008, young people found work in lower-scored occupations than comparably-skilled young people before 2008.

Overall young workers with the same qualifications were worse off in 2018 than in 2001. Indeed, we found that while young workers still moved up the ladder in the years after graduation, they never make up the lost ground relative to the previous crop of graduates.[10]

It remains to be seen whether recent strong labour markets – albeit with real income gains offset by high inflation – might reverse some of this dynamic. Critically important will be the path of future growth – a point I will return to.

Home ownership is increasingly out of reach

But as challenging as labour market outcomes have been for younger generations, the frontline in the so called 'generational wars' has been elsewhere.

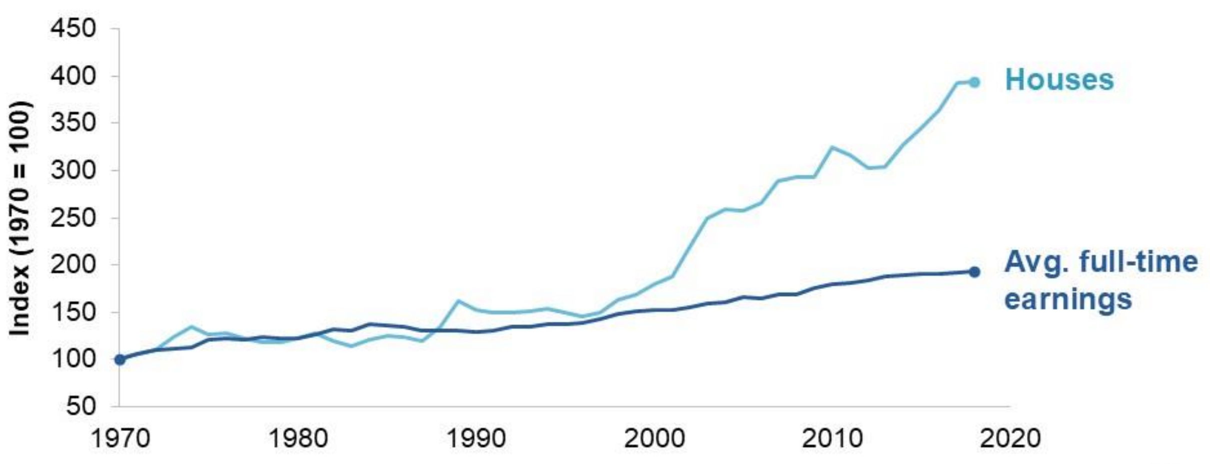
Other than climate change, nothing feeds the sense of intergenerational betrayal more than the outcomes in the housing market.

Despite the parade of articles claiming a new generation of willing renters and avocado toast preferencing hedonists, most young people still want a place of their own. Indeed, amongst the Generation Z non-homeowners, 93% say they want to own their own a home.[11]

But the financial reality is that this has become harder.

Growing house prices relative to income created generational divide in wealth

Real growth, 1970-2018



Note: See source for methodology. Source: Wood, D 2023a, 'Creating a Better Future for Generation Next', Grattan Institute, Giblin Lecture, Hobart, 30 August 2023 10

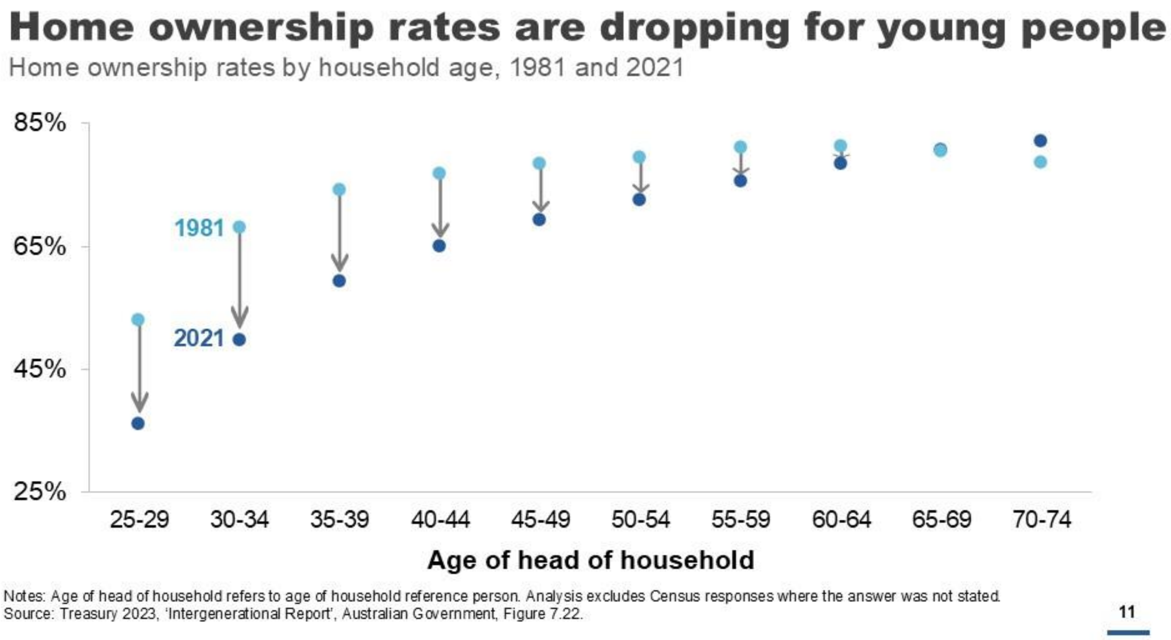
Until the 1990s, home prices pretty much tracked growth in incomes.

But between 1992 and 2018, property values grew at nearly triple the rate of pay.

The result is one well known to us all: that it is now much tougher to get on the property ladder in the first place.

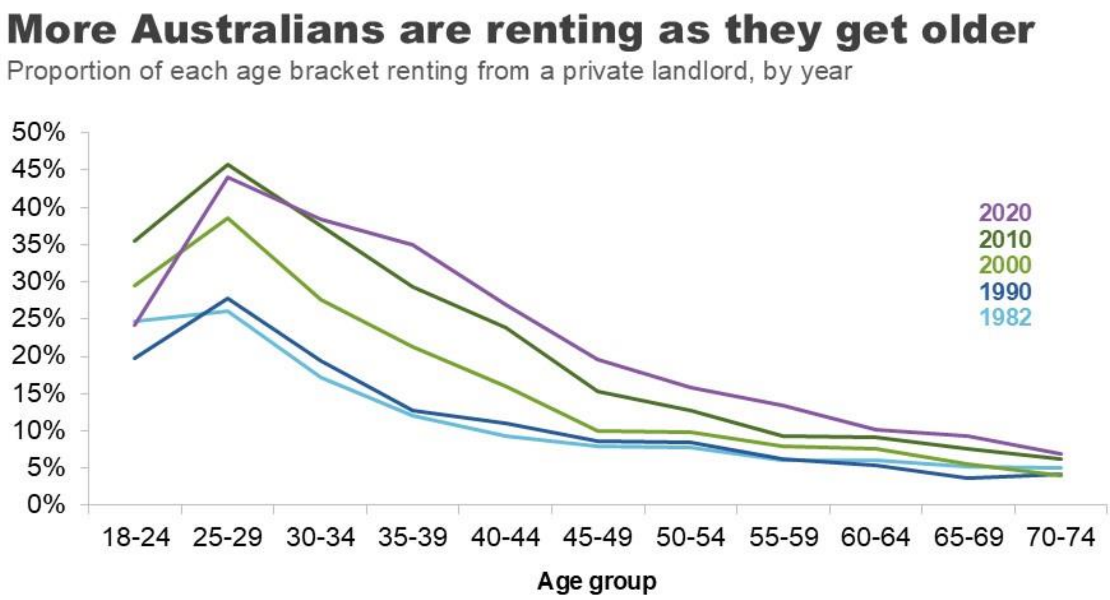
And it's not just about the upfront cost. Over the lifetime of home ownership, a typical boomer paid about 4 to 5% of their income on principal and interest repayments to buy a typical house. For those of us who bought their first home in the early 2000s, that is 10%. For younger households, at current rates, it is forecast to be 16%.[12]

The obvious outcome is declining home ownership.



In the early 1980s, 70% of those in their early 30s owned their own home. Fast forward four decades and that share had slumped to 50%. And the drops have been particularly acute amongst low-income young people.[13]

The flip side is that 25% of Australian households rent. This group is disproportionately younger and lower income, but more and more households in their 30s and early 40s, in the peak years for raising families, are also renting. Indeed, the share of renters in these age cohorts has more than doubled over the past 40 years.



Source: Productivity Commission 2022, *In need of repair: The National Housing and Homelessness Agreement*, Commission Study Report, Canberra, Figure 9.1a, p. 297.

From an affordability perspective, rents broadly moved in line with incomes for the best part of two decades. But in the past three years rental growth has far out-paced broader income growth. And this particularly squeezes the poorest households. Even in the more benign rental markets pre-COVID, the typical low-income household was paying 43% of their income on rent.[14] One in 5 had less than $250 a week after paying rent –to cover every other expense from food, electricity to transport.[15]

It is younger people that are more commonly on this frontline of the fallout from the dysfunctional housing market.

Growing wealth divide

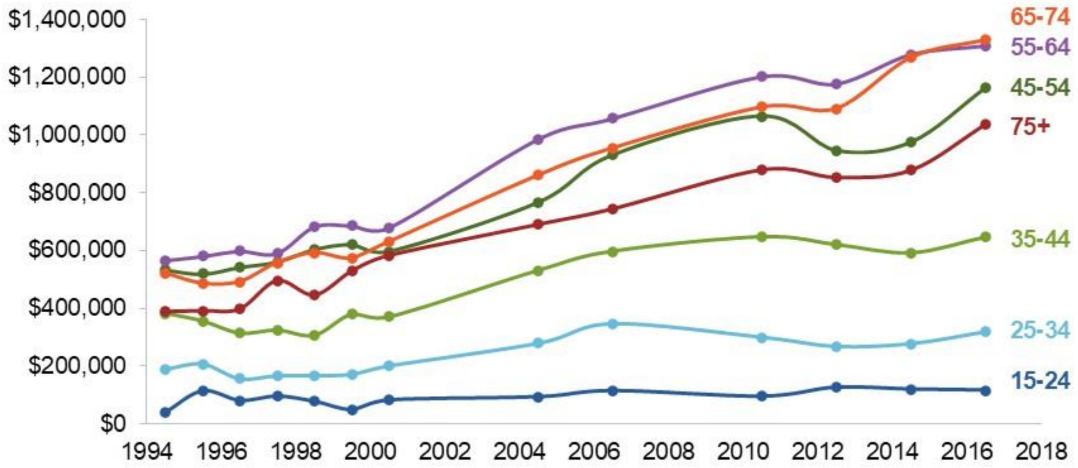
Strong growth in house prices has also contributed to a growing wealth divide.

While younger households find it harder to save for a deposit and service a loan, the strong rise in home values has been a windfall for those already on the property ladder.

Older households have always had more wealth than younger ones, but the explosion in property values has led to a far greater disparity in wealth between the different age groups.

Wealth is growing faster for older households

Average household net worth by age of head of household, 1994 to 2016, $2016



Source: Wood, D et al., 'Generation gap: Ensuring a fair go for younger Australians', Grattan Institute, Figure 2.1

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The average wealth of households in their 50s and 60s more than doubled in the space of 15 years.

Over the same period the wealth of young people flatlined. A household headed by someone in their 20s or early 30s in 2016 was not much wealthier than Australians of that age in the early 2000s, as the chart shows.

And these generational disparities are making transfers across generations more important to outcomes.

A report by the PC in late 2021 found that these supports are important in helping younger households get on the property ladder. If the 'bank of mum and dad' was an actual bank it could be up to the fifth biggest lender in the country.[16]

More generally, inheritances and gifts had more than doubled since 2002, and could quadruple in real terms by 2050 as household wealth grows and the population ages.[17]

These transfers will undoubtedly help some of those Gen X and Millennial children achieve greater financial comfort, albeit generally later in their lives. On the flip side, this means that we can expect in the future people's financial position will become more tethered to the financial position of their parents than their own hard work or talent.

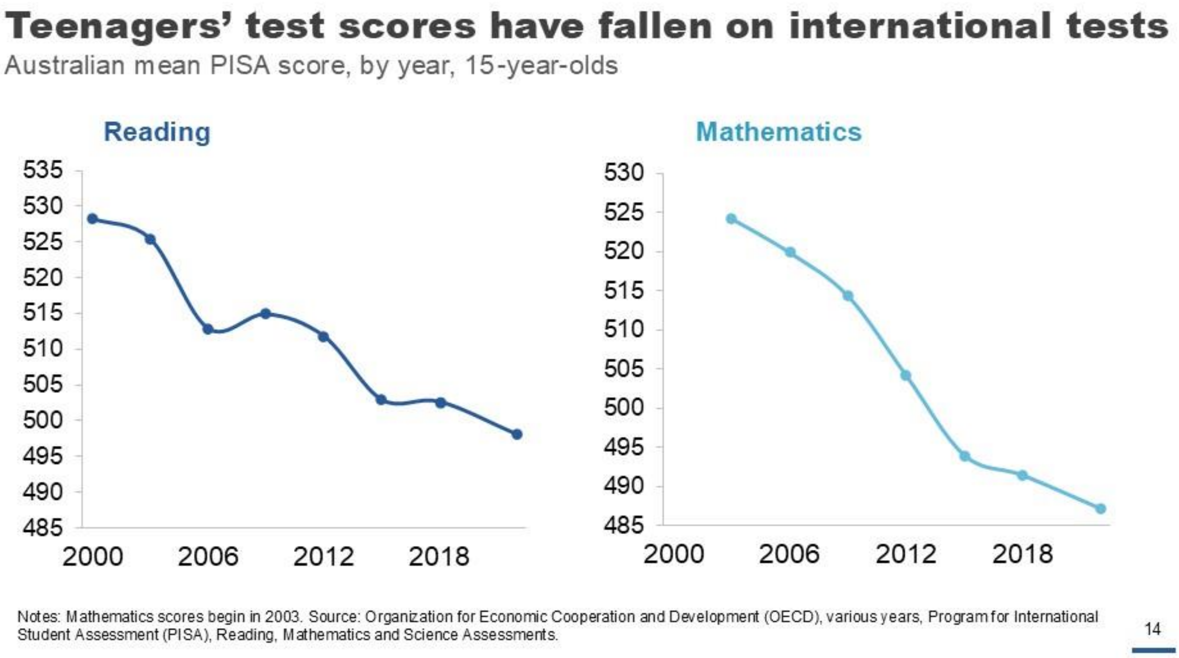
Building on shaky foundations

One of the ways that Australia has underwritten generational improvements in living standards is through a strong system of school education that supports opportunities across the population.

But as research from the CIS and others has reminded us: we are not doing as well as we once did.

Indeed, despite growing funding in recent years, Australia's school system is not delivering the results we want for our young people.

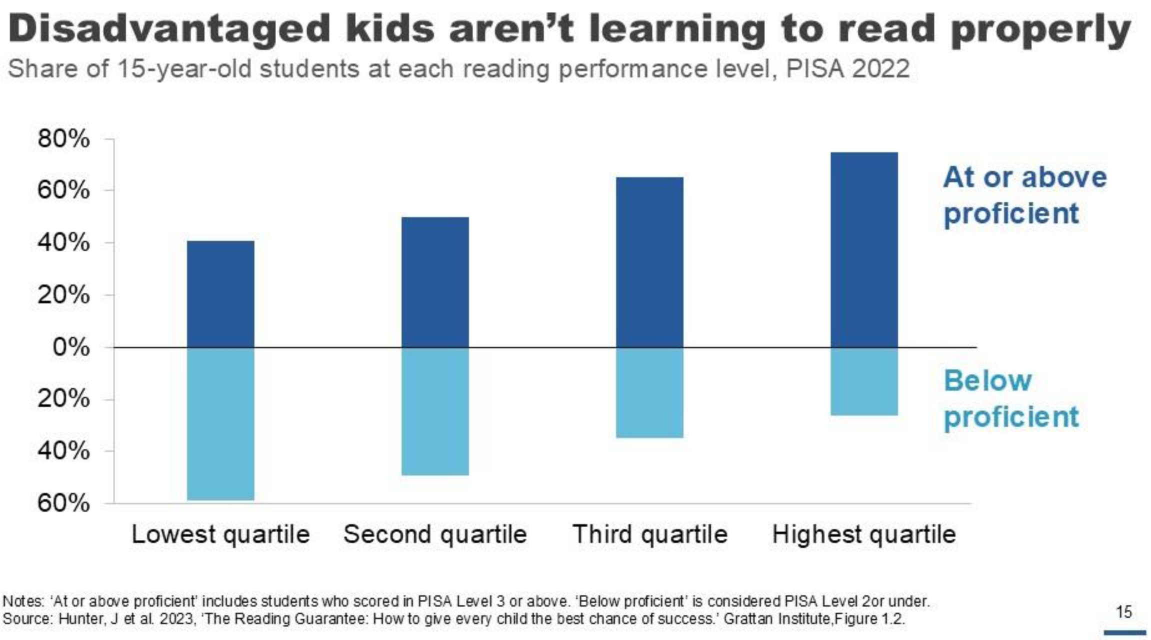
Data from the OECD show that the performance of Australian school students in Reading and Maths – both compared to other countries AND to our own performance over time – is going backwards.



In 2018, the average Australian 15-year-old student was eight months behind in reading compared to where the average student of the same age was at the turn of the century, and results have more or less flatlined since.[18] We've seen even sharper declines in mathematics scores, where the decline by 2018 was worth more than a year of learning.

And a stalling education system can compound disadvantage. Children from disadvantaged backgrounds fare substantially worse when it comes to these foundational skills.

More than half of the most economically disadvantaged 15-year-old students in Australia are not proficient readers.

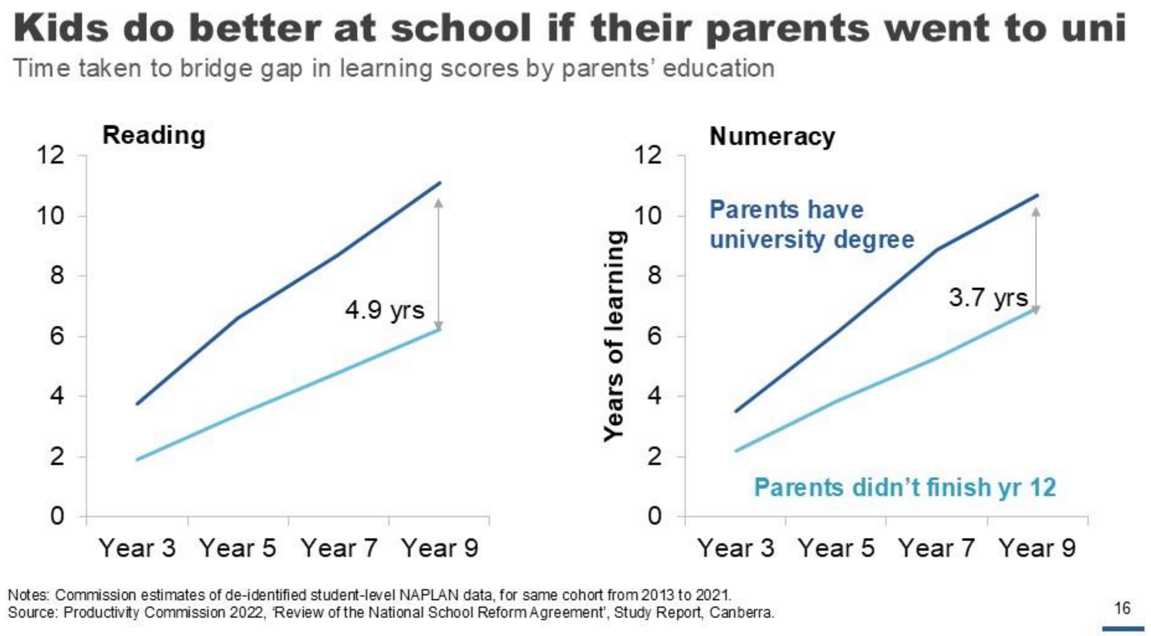


Analysis from the Grattan Institute shows that the disparity in outcomes was worse in Australia than in Canada or the UK, and on par with the US.[19]

And these gaps in performance *widen* through the schooling process.

The PC looked at this using NAPLAN data.[20] We compared the average reading outcomes of students whose parents did not finish high school to those whose parents have a bachelor's degree or higher. We found the learning gap – equivalent to almost two years of reading achievement in year 3, progressively widens to an almost 5-year learning gap by the time students reach the age of 15.

For mathematics, the gap widens from 1.3 to almost 4 years.



Beyond the obvious and frankly concerning implications for future social and economic outcomes, this is another fraying strand of the generational promise.

We cannot set the next generation up to thrive if we do not give them the right foundations. And this is particularly important if we want to maintain the economic mobility which opened the door of opportunity to previous generations.

All of this begs the question: how do we ensure that our children's economic outcomes surpass our own?

What can we do?

Kickstarting productivity growth

I'm sure there is an element of 'preaching to the converted' selling the benefits of growth at a CIS conference. But let's drive home why it matters: it is the only way to restore the expectation of generation-of-generation progress that will see our children and grandchildren live richer, healthier and more fulfilled lives than us.

The right question on growth as a solution for intergenerational inequality is: how do we get more of it?

First, I think we should start by acknowledging there is a lot about the path of future growth we cannot control. Broad structural shifts in the economy and the frontier of technological progress sit largely outside the hands of any Australian business or government.

I'm personally optimistic about the potentially transformative impacts of technologies like AI – but there are different views, and what we do in Australia will only have small impacts on the global frontier.

Second, productivity is not just a government problem. What happens inside businesses matters at lot. Australian adoption is well down the international league tables in important areas like AI and data analytics.[21] We should also reflect on the role that better management and a more enterprising culture could play in driving greater innovation, investment and productivity growth.

But third, nothing I just said means that policy is irrelevant. Governments influence the enablers of growth – the institutions, infrastructure and human capital development – as well as the incentives to grow through things like tax and regulatory settings.

So what does pro-growth policy look like?

I apologise for the cliché but there is really no silver bullet when it comes to government policy settings and productivity growth. Productivity policy is a game of inches: governments have to do a range of things that each make a modest difference.

And in growth, small differences add up over time. The average difference between Argentina and Australia's productivity growth rates over the past 75 years was just 0.8 percentage points but that gap has contributed to a difference in average incomes of almost US$55,000 today, from a similar start in the early 1900s.

My PC colleagues in their most recent 5 yearly productivity review have helpfully pointed to some of the areas where the biggest opportunities lie. Across 1000 pages with more than 70 recommendations, it gives you a sense of the breadth of the challenge but also the range of opportunities to pursue productivity enhancing policies.

First is building our human capital and deploying our workforce to make the most of our talent pool. This includes: [22]

- Building a strong early education and school system that delivers foundational skills for all students – more on this in a moment
- Boosting incentives for quality teaching in universities and the VET sector
- Reforming our skilled migration system to make it more targeted to the people with the skills our economy needs

- Making sure our labour laws, like industrial relations and occupational licencing, aren't an unnecessary impediment to jobs growth or better matching of workers to roles.

Second is supporting our business to be at the frontier of digital and knowledge adoption.[23] Actively promoting the diffusion of new knowledge and best practice across the business community is a key part of this. Also important will be designing regulation that manages the risks of new technologies, such as AI, without stifling their potentially transformative productivity benefits. For example, the PC has cautioned against building a whole new framework to manage the potential risks of AI when it may be more effective, and simpler, to address gaps, if any, in existing privacy, defamation or consumer laws.[24]

Third is supporting a more dynamic economy – essentially removing regulatory or other policy impediments that gum up the movement of resources to their highest value use.[25]

This includes:

- Removing barriers to competition in regulated markets
  - The Competition Review Taskforce is currently working away on this. I am very excited in particular about the announcement to revive National Competition Policy. This would be a process involving state and federal governments to remove regulatory barriers to competition.
- Transitioning the tax system to invigorate productivity growth, for example by encouraging skilled labour supply and improving neutrality in respect of savings and investment
- Creating an investment environment that allows the right activities to happen in the right places, for example by efficiently pricing road use and streamlining planning and zoning rules
- Continuing to support free trade – Australia's economic success has been underpinned open trade and globalisation, and any moves away from this model should not be taken lightly. This means moves to support industry based on climate goals or supply chain resilience should be subject to rigorous cost-benefit analysis.

Fourth is pursuing productivity gains in the non-market sector.[26] Government spending is worth more than 35% of GDP in Australia[27] – and so how governments deliver goods and services, and their own productivity, matter for the national picture. Important levers include:

- Better government procurement – the federal government spends $65 billion each year on infrastructure and defence alone.28 Everyone agrees bang for buck matters, but poor planning and procurement continues to cause waste through cost overruns and cancelled projects
- Modernisation of care models in health. Recent moves to support models of team-based care in general practice are welcome, but there is much more that can be done to ensure professionals such as nurses and pharmacists can expand their scope of practice and to push care into lower cost settings (where quality outcomes can be upheld) outside of hospitals.

Fifth is the net zero transition, this is a major economic transformation happening very quickly. The policy mix will be crucial for how quickly and efficiently we get there.[29] That depends on creating policy settings that enable and respect private adaptation decisions, but also using price or market mechanisms – like the safeguard mechanism – to increase investor certainty and give us emissions reduction at the lowest cost. These policies should be favoured in place of very high-cost interventions like FBT tax concessions for EVs, which has an effective cost of between $1,000 and $20,000 per tonne of abatement.

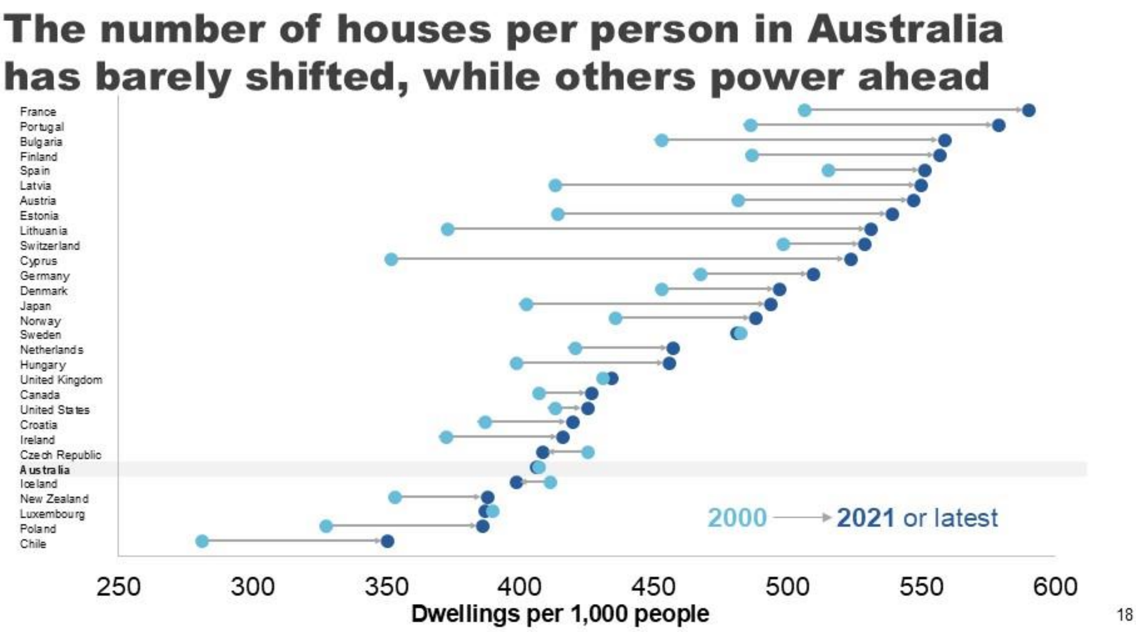
Fix the housing mess

I also want to say a special word about housing, giving it is so central to the intergenerational bargain.

Where we find ourselves essentially represents a failure of policy over an extended period.

On the one hand the problem is easy: it's supply, stupid.

Over two decades, Australia has grown its housing stock less than most developed countries on a per person basis.



Source: Grattan Institute 2021, *How to make housing more affordable*, Submission to the parliamentary inquiry into housing affordability and supply in Australia, Figure 2.1.

Failure to build enough houses, in the places where people want to live – near jobs and amenities – over an extended period, is at the heart of our housing problem. We are indebted to people like your own Peter Tulip that have been banging this drum for a long time.

At its heart, NIMBYism is an intergenerational transfer. It prioritises the preferences of existing homeowners – more likely to be older – to preserve neighbourhoods the way they are, over the interests of potential residents. These are mainly younger Australian who would like to live near family, jobs and amenities.

After years of watching the 'housing market frog' slowly boil, I think the importance of supply is finally gaining political traction.

The federal government has put money on the table to incentivise states to meet ambitious targets for new housing. And some state governments are relaxing planning constraints that should make it easier and faster to build more.

But even with the policy energy, much more will need to be done to meet the government's aspiration to build 1.2 million homes over the next five years under the National Housing Accord.[30]

Other planning challenges – the need for a range of relevant approvals, and in the case of Greenfields builds, infrastructure connections – loom large.

The NSW Productivity Commission has recommended improved processes – including a coordination mechanism – to resolve some of the planning bottlenecks after development applications.[31]

In building, time is money, and changes to streamline what has become a drawn out and complex process, can improve feasibility and speed up new supply.

Once approvals are in place, it is the productivity of the construction sector that puts the speed limit on new supply.

The PC has a piece of work underway looking at how the sector has fared.

What we find is a sector in the productivity doldrums – with labour productivity worked *falling* over three decades, while across the rest of the economy it has expanded by almost 50% over the same period. The regulatory environment, workforce challenges and lack of innovation have all contributed.

We will have more to say on what can be done in coming months, but suffice to say that it will take political will, and governments committing to make housing supply a core priority.

An education revolution?

School education is fundamental to supercharging opportunities for the next generation.

And while some of the problems our system faces are thorny, some of the solutions are surprisingly straightforward.

Our focus should start with getting the basics right – our schools should be supported and held accountable for delivering basic levels of literacy and numeracy.[32]

I know this is topic on which CIS has been a tireless advocate. Similarly, my former colleagues at Grattan have called for a 'Reading Guarantee' – whereby governments would commit to ensuring at least 90% of Australian students learn to read proficiently at school.[33]

Supporting schools and teachers to deliver on these basics would require:

- Making sure all teachers adopt evidence-based teaching practices such as phonics decoding for reading[34]
- Providing all schools and teachers access to a bank of well sequenced high quality curriculum materials[35]
- Reducing low value tasks for teachers to free them up to spend time on what really matters,[36] and
- Providing better career paths to help schools attract and retain top teachers, and allowing top teachers to support and develop others in the profession.[37]

I suspect of all the policy issues we will cover this weekend – this is the one where we are likely to find an incredible degree of unanimity.

Restoring the bargain

A bargain that has been fulfilled through most of Australia's modern history now seems to be fraying.

Each generation has always had their own challenges and worries. So it can be tempting to simply dismiss the issues I have touched on today as yet another turn of the generational wheel, which will roll on regardless.

But I hope I have gone some way to convince you that we need more than a 'business-as-usual' approach.

We need to focus on lifting our growth potential by driving the productivity uplift that will underpin higher wages.

We need to work hard to build more homes and restore the great Aussie dream of home ownership and to support affordable rentals.

We need to do better in our schools to give kids the educational foundation to fully participate in a modern economy.

We can't simply fall back on the simple, corrosive and ageist tropes that have allowed Australians of different generations to retreat to our corners.

Whether that's the dismissive "OK boomer" or claims that young peoples' problems are simply because they are more interested in expensive brunches than saving for a home.

We need to take steps now to give our kids - and their kids - the best chance to live better lives than we did.

This generational bargain has underwritten a level of societal harmony and political stability that we have all enjoyed and taken for granted.

We shouldn't take it for granted today.

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[1] Gosseries, A. 2004, *Penser la justice entre les générations,* section 3.2
[2] *ibid*. The other is differences in population size, that might require positive savings to ensure that each generation has equivalent access to resources.
[3] Peter Singer (2002) *One World: The Ethics of Globalisation,* p. 31.
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