Reviving Productivity: from why to *how*

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I feel honoured to have been invited to address the CEO Institute this evening. The invitation followed unexpectedly fulsome media coverage of an interview in March. I say 'unexpectedly' because I thought what I said about Australia's current policy failings amounted to little more than common sense. But it seems we have somehow got to the point where stating the obvious has become sufficiently uncommon to be newsworthy. Some even declared it brave!

That is not to say that I was under any illusion that my remarks would have an impact on government policy. It was tough enough to achieve that even when I headed the Productivity Commission.

Unlike the famous tale by Hans Christian Andersen, in which a vain and deluded emperor was ultimately forced to acknowledge his nakedness, our own rulers can persist with certain policies oblivious to arguments or evidence, confident that they are doing right simply by *wishing or believing* it so.

If that sounds unduly harsh I'm sorry, but a life lived too close to government for too long will do that to you. In any case, you may be advised to treat those remarks as a 'trigger warning' for what's to follow!

As business leaders, however, I suspect few of you would have difficulty with the proposition that it is largely the *private*, not public sector that accounts for wealth creation in our country – despite what the public has been led to believe.

Government is mainly in the distribution *or redistribution* business and, while this of course is an important business to be in – enabling fair access to a range of services and welfare transfers important to community wellbeing -- *'a government cannot redistribute what its economy has not produced'*.

As the tax surprises in Victoria's budget should remind us, a big spending agenda is hard to maintain without a strongly growing economy.

The trouble is that governments have not only been taking a bigger slice of the economic pie – which may or may not be regarded as a ‘good thing’ -- but doing so in ways that constrict its *growth*, which is clearly *not* a good thing.

This again should not be news to Victorians, with a number of economic indicators falling behind the rest of the country and a credit rating that recently lost one of its coveted stars.

In other words, when it comes to public policy, chickens come home to roost; or, as economists are fond of saying, ‘*there is no such thing as a free lunch’*. One might even call this the first law of economics.

The Australian public nevertheless appears to have retained a belief in ‘free stuff’. I sometimes wonder whether we should blame that on Norman Lindsay’s popular children’s classic, *The Magic Pudding*. However, a more likely explanation is in the claims made by governments themselves and, most recently, the ‘free money’ bestowed on the populace during the GFC and COVID.

Going forward, one might imagine that with interest rates normalising again, respect for the scarcity of capital should reassert itself -- provided the Governor continues to hold his nerve! But that’s only the half of it. There is also the legacy of fiscal excess and regulatory over-reach to deal with.

To pre-empt myself, I am starting to wonder whether the reforms needed to achieve this are achievable, with political understanding of what’s required seemingly at a low ebb.

But first, I’d like to address briefly the threshold question implicit in the title of my talk, namely:

Why does ‘productivity’ matter?

Just the other week I read that Mike Henry from BHP, in discussing prospects for his company, stated: “Our first focus for growth is to enhance productivity from our existing assets. That is far and away the largest value opportunity and it’s the one that’s most within our control.”

No doubt many here would share this perspective, even if your businesses are in a different space and not quite on the scale of his. Moreover, it is a perspective that can be scaled up further to our economy as a whole. After all, the return on the human and capital resources in an economy is little more than the accumulated returns from the many individual enterprises that make it up.

But what may simply be common sense to those running businesses ain't necessarily so to others. To many Australians, if they think about productivity growth at all, they see it as coming at the expense of workers.

This win-loss attitude is *ingrained* within the union movement; and could be said to be the *foundation of Australia's whole industrial relations system.* With what is effectively the political arm of the union movement now in power just about everywhere, this attitude is also more evident at the governmental level than it was – at least when it comes to policy choices -- a point to which I will return.

The fact remains, as my former organisation reminded us only recently, that productivity growth – getting more out of existing resources -- has been responsible for much of the sizeable increase in real wages in Australia since mid last century. Moreover, productivity-related wage gains have often coincided with rising labour force participation and stable or falling unemployment.

In other words, higher productivity is fundamentally a *win-win* for businesses and employees alike. Not necessarily in every place at every time, of course, but demonstrably so over time for the economy as a whole. What's more, unlike the surge in export prices for coal and gas that saved the day in the Federal Budget (but don't tell anyone!) it is a gift that keeps on giving.

Indeed, as you'd appreciate, the magic of compounding means that even a small improvement in productivity growth goes a long way. For example, after much nagging, the Commonwealth Treasury finally conceded in this Budget that it needed to downgrade the projected average productivity growth rate from the customary 1.5 per cent to 1.2 per cent, to be more in line with performance so far this century.

Such an apparently small reduction in projected productivity growth, if realised (it could easily be worse) translates to GDP being 10 per cent lower by 2040 than it would have been. If we could repeat the productivity performance of the reformist 90s, it has been estimated by the CIE that within a decade per capita incomes would be $10,000 greater than otherwise, with GDP gains comparable to another mining boom.

Far from scaling those heights, however, the average rate of productivity growth in the last decade has been the lowest for 60 years. Labour productivity today is no greater than it was three years ago – and it was nothing to brag about even then.

Raising Australia's productivity growth would not only ameliorate our current fiscal difficulties and take some of the pressure off taxes and spending; it would help secure the *holy grail* of economic policy: namely, non-inflationary (real) wage growth.

In short, to echo Nobel Laureate Paul Krugman "*productivity isn't everything, but in the long run it is nearly everything*".

To that I'd add the rider that it's not *just* about the long run, as our policy-makers seem to believe. There are things we could do *right now* that would yield benefits in the short run too. After all, as Lord Keynes – who's well and truly back in fashion – once put it, "*in the long run we're all dead*". I'm sure you'd agree that it'd be better not to have to wait that long!

Growing sense of urgency

Achieving successful reform needs to commence with recognition that we have a *problem*. When it comes to productivity, I think there has been a step change in that direction recently.

For example, while the RBA has in my view too often neglected the supply side of the economy in its narratives, Governor Lowe said last week "I want to make it clear that the main problem is weak productivity growth". He warned that without a pickup in productivity growth, the wage increases that government and the unions have been pushing for – and have just secured -- will flow through to higher inflation, requiring interest rates to be higher than otherwise – I note today's news -- and leaving people worse off than otherwise.

And while Treasury has traditionally been more pre-occupied with matters macro than micro, Secretary Kennedy in his post-budget speech was explicit about the adverse consequences of the productivity malaise and the importance of restoring 'dynamism' to the economy.

And importantly, the Treasurer himself recently observed "whether we can lift living standards will be determined by whether we can put the woeful productivity performance of the last decade behind us" (*original paraphrased*). What the Treasurer left unsaid was whether we *can* do that will depend above all on the policy settings that condition business decision-making and the allocation of the nation's resources.

What can be done?

Some have used the fact that productivity growth has been pretty weak in other OECD countries too, to suggest that it's a secular or exogenous phenomenon about which governments can do little. But the fact that a slowdown is evident elsewhere in the industrialised world, does not rule out policy-related causes in common.

And if the 'productivity frontier' is destined to expand more slowly than before, as some economists predict, it becomes more important than ever that a country like Australia that is operating *behind* the frontier takes every opportunity it can to at least realise its potential.

The public would be excused for being confused about what policies or reforms are needed to that end, given mixed messages from government. Just as almost any policy or regulatory initiative these days is labeled a 'reform' – regardless of whether it's likely to improve things – most are said to promote productivity, when in fact many won't and some will do the opposite.

To be worthy of the description 'pro-productivity', policy initiatives must be shown to be capable of promoting the more productive allocation of resources across the economy, and more productive behaviour within individual organisations. Broadly speaking, this can be achieved through measures that either improve incentives, enhance capabilities or enable greater flexibility and adaptability.

It follows that in seeking remedies for Australia's productivity malaise, there can be no single cure-all. Moreover, policies obviously need to be consistent with or *complement* each other. As observed about fiscal and monetary policies, there is no point having one foot on the brake and the other on the accelerator.

‘To do lists’ in waiting

Fortunately (or is it *un*fortunately?!) there is a large number of well-researched and publicly tested policy options at governments’ disposal. Many have come from the institution expressly designed for this purpose: my *alma mater* the Productivity Commission.

In addition to in-depth studies in specific areas, the Commission has been producing periodic stocktakes of where things have got to. The first of these dates back to 1998, when the PC was established to replace the Industry Commission and EPAC. I compiled a ‘to do list’ of my own on leaving the Commission some fifteen years later, which comprised a range of reform recommendations from that time that were still ticking.

This was followed several years later by a more substantial report titled (rather optimistically) ‘*Shifting the Dial’* . It contained a particular focus on how to do better in the services sector, particularly the burgeoning government funded segment.

As you may be aware, the latest such report has just been released. Titled ‘*Advancing Prosperity’* it contains over 70 specific recommendations covering workforce and workplace issues, innovation, competition, social infrastructure, energy transition and other policy areas.

Some of you may have guessed by now where I am going with this… While a few recommendations from the earlier reports have been picked up, at least in part, most have gone begging. As the PC recently expressed it, most recommendations ‘*remain relevant’* -- a euphemism for very little having been done.

As for what policy actions might be expected from the latest report, I must say as a long-time reader of governmental tea-leaves, the signs are not propitious. For a start, the Treasurer sought to downplay expectations even before the report was released. And on its release, he depicted it merely as ‘an addition to the debate’, with little indication of areas to be followed up.

Critical reform areas rejected

What he did do was dismiss out of hand the Commission's recommendations in the very areas where, in my view, reforms are most needed -- in terms of the depth, breadth and immediacy of the productivity gains on offer.

One is the *energy sector*, where governments have contrived to maximise the cost to the nation of reducing carbon dioxide emissions. The other is *workplace regulation*, which has been regressing to the sort of centralised and prescriptive regime that preceded the Hawke/Keating reforms.

Historically, an abundance of low-cost energy in Australia tended to offset the self-imposed burdens of our rigid labour market. But I'm afraid that's no longer the case. The impact of this on competitiveness and growth are becoming all too apparent, especially in the manufacturing sector.

In its latest productivity report, the PC stated that 'how well we manage the energy transition will be a major determinant of living standards in the future'. What it refrained from saying, at least directly, is that we have been managing it *badly*.

I have been quoted making the observation that in Ukraine, power stations are being destroyed by the Russians, while in Australia we blow them up ourselves. And we are doing so without a way to replace the important 24/7 service they provide. As has been said, Australia's energy transition 'is happening back to front'.

At the same time, governments are making it hard for gas to step up as the natural transition fuel (including for crucial 'firming' purposes) and forfeiting the longer-term potential of emissions-free nuclear power.

As for industrial relations, this has been a policy disaster zone for as long as I can remember (and I'm getting on!). The current flurry of regulatory changes, under the banners of 'getting wages moving', 'job security' and 'equality', are likely to impede the flexibility and 'dynamism' that is integral to productivity growth and higher real wages, as the Treasury Secretary himself hinted at Estimates last week.

Among other policy areas detracting from productivity and living standards: Australia's distortionary, incentive-killing tax system must rank highly; much infrastructure spending has more to do with short-term politics than calculations of long-term economic benefit; and regulatory obstacles to new projects, especially in the resource sector, are becoming almost prohibitive.

The new 'values-based' reform agenda has instead prioritized public expenditure in areas such as skill development, the care economy and manufacturing technology. In most such cases, any productivity payoffs will be distant and will critically depend on how well the money is actually spent. Where performance of government-funded services is measured, outcomes are rarely commensurate with the extra expenditure. In the important case of school education, for example, the evidence seems clear that we are going backwards, despite the Gonski funding boost.

Productivity gains in the short as well as long term are more likely to come from removing or revamping regulations that distort decisions, raise risks, stifle innovation or impose undue transaction costs. Such influences have undoubtedly contributed to the stagnation of private investment, a key transmission vehicle for productivity improvements.

What prospects of real reform?

So what are the prospects of combining pro-productivity rhetoric with policies that would *make a difference*? How might we actually 'shift the dial'?

At this point, I can't help but recall the old Irish joke in which a tourist seeking the way to Limerick is told by a local 'it would be better not to start from here'. The obstacles to heading in the right direction for good public policy are significant. But unlike the hapless tourist, we *should* know the way, as we've surmounted such obstacles before.

The OECD has identified the Hawke-Keating era as the high point of successful pro-productivity reform in Australia, both in what was done and how it was achieved. Albanese and Chalmers have on occasion portrayed themselves as in the mould of those earlier Labor leaders, while asserting that today's policy needs are rather different from what they were then.

While that is certainly true in part, the way in which that earlier Labor Government went about the policy-making *process* in those days remains instructive. It was an approach informed by solid research and wide public consultation; one that in presenting a substantiated case for change could, in Keating's terms, more easily 'bring the public along' -- as well as being less prone to 'unintended consequences'. Reforms from that era have as a result mostly stood the test of time (IR aside).

A comparable 'evidence-based' approach to policy has been more the exception than the rule in recent years. We have too often witnessed policies appearing 'out of the blue', formulated with little or no consultation with those affected and lacking clear public interest rationales, or even an assessment of their costs. That has meant that certain reforms worth doing have failed to be implemented, due to lack of necessary public support, while other policies have been implemented that should *not* have been.

I'd go further and say that there has been a distinct shift in governments' approach to policy-making from 'bringing the public along', to keeping them in the *dark*. Examples can be cited from both sides of politics, and not just at the Federal level. But the Albanese Government's use of a so-called 'small target' strategy to keep IR, tax, immigration and other sensitive policy topics in 'the bottom drawer' until after the election would seem to have broken new ground.

Moreover, once in power, policy initiatives in these and other areas, like the regimes for gas pricing and pharmaceutical prescriptions, appear to have been launched with little or no consultation with the business interests most affected.

Further, in marked contrast to the Hawke and Howard eras, when genuine efforts were made to inform the public about what was at stake, more recent so-called policy 'conversations' have often done the opposite. It is no accident I think that our two biggest problem areas, energy and industrial relations, have been characterised by a partial, and it must be said, less than honest explanation to the public.

An ill-informed, or worse, *mis*-informed public increases the scope for policies that pander to special interest groups and ideologies.

Regaining momentum

The Productivity Commission and its forebears (the IAC and IC) were created to alert the public to the costs as well as benefits of such policies, and thereby provide a counterweight to the disproportionate influence of special interests. Naturally this has not been universally welcomed. Indeed the Commission is currently being subjected to an in-house review by Treasury, after the ACTU called for its abolition following a report that exposed poor work practices on the waterfront.

A Treasurer from the ‘reform era’ has subsequently remarked that the Commission gave him the ammunition for good policy and he simply fired the bullets. However the current stance is looking more like a case of *shooting the messenger*.

Business has in the past played an important role as an advocate for good policy process as well as publicly highlighting the adverse consequences of certain policies and the benefits of reform. I think that part of the problem more recently is that the organisations representing business have been too passive or even compliant. Rear-guard actions when the penny finally drops, such as we’ve seen in recent days, come too late by definition to influence policy at the front end where it matters most.

I mentioned at the start the tale of the Emperor’s new clothes. I was reminded of this when reading an interview with Paul Broad, the former CEO of Snowy Hydro, who used a non-parliamentary word to describe the state of play in energy policy. He observed that the transition to renewable energy is more likely to take 80 years than eight, despite what governments have been telling us. This seemed to give other industry leaders permission to voice their own concerns. And since then we’ve started to see a bit more realism emerge at the political level.

It prompted the further thought that corporate leaders could usefully play a bigger role in educating governments (and alerting the wider public) about the impacts of policy proposals and where the existing impediments to their performance lie. After all, the productivity gains that governments want to see nationally will only come about if individual businesses are able to raise their performance.

I know from my time at the Commission, that business CEOs generally have important perspectives to offer on policy impacts. They also have the public credibility from being ‘hands on’ that can elude peak bodies. It would be great to hear more of them speaking up.

I will end there and look forward to hearing your own views as well as taking questions. Thank you.

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