Civil Service College Singapore

Public Institutions and the Productivity Imperative

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OPINION

CONTENT

An independent public institution could better identify, analyse and communicate the reforms necessary to improve national productivity.

Despite unprecedented "pump priming" by government authorities since the global financial crisis, investment and growth have languished in most developed economies. Conventional and unconventional macroeconomic measures alike have been found wanting, serving mainly to push up share prices and land prices, rather than production and real incomes.

The resulting historically low interest rates and high debt levels have left many governments little room for further manoeuvre. Yet, with living standards for the average citizen stagnating or declining in many countries and unemployment persistently high, political pressures on governments to turn things around have been mounting.

So what can governments do? And how might their public administrations assist them?

THE FUNDAMENTALS OF ECONOMICS PROGRESS

In seeking answers to these questions, it is important to recognise that there are really only two means by which the incomes of a country's citizens can be increased over time: by producing more output from available resources, or by getting higher (world) prices for what is produced.

In practical terms, only the former is directly amenable to government policy, since movements in a country's terms of trade are driven in large part by developments on world markets.

Further, the policies needed are those that can improve the functioning ("efficiency") of the *supply* side of an economy, rather than merely serving to stimulate demand. Policies to support productivity growth and labour force participation are both important in this respect, since they affect how much is produced relative to the population. That said, while scope exists to do more in both domains, there are obviously limits to increasing the average hours worked by the population. (High labour force participation in itself need not mean high per capita incomes, as the experience of the some of the world's poorest countries attests.)

This leaves productivity as the key ongoing mechanism for increasing per capita output and incomes. As Paul Krugman from MIT has put it, "productivity isn't everything, but in the long run it is *almost* everything".[1]

THE PRODUCTIVITY IMPERATIVE

As the post-GFC malaise moves from "short run" to "long run" phenomenon, the underlying failure of productivity growth is increasingly implicated. For example, taking the OECD as a whole, labour productivity growth has been in decline for at least the past 15 years. In Australia, a productivity boom in the 1990s was eclipsed by a terms of trade boom in the early 2000s; but although the terms of trade have fallen again, productivity has not attained earlier growth rates and per capita incomes are falling.[2] In Singapore, labour productivity growth has been sluggish and in domestically oriented sectors has actually been negative over recent years. In both countries, the need to raise productivity has become elevated in policy discussion.[3]

While monetary and fiscal policy can potentially stimulate aggregate demand and employment, they generally have little bearing on productivity. This has been acknowledged by G20 countries, who in their Brisbane Declaration of 2014 committed themselves to a range of structural reforms across product, labour and infrastructure markets. The IMF estimated that those reforms had the potential to lift global GDP by some 2%.[4] However, despite good intentions, little progress could be reported at the G20 meeting a year later.

THE POLITICAL OBSTACLES

The reality is that some of the policies most needed to promote productivity growth are ones that face the strongest political opposition. Pro-productivity policies must not only address "enablers" such as education and training and essential infrastructure, which have been attracting more attention, they must also target the incentives for firms and industries to be more productive, and the flexibility they need to respond to market challenges and opportunities. That means, for example, reforming regulations that inhibit competition or rigidify labour markets, or that otherwise impose undue cost burdens and constraints on production, investment and innovative activity.[5]

And while innovation within firms is central to productivity improvement, so too is the displacement of poorer performing firms by better performing ones — what economists since Schumpeter have labelled "creative destruction". Indeed international empirical studies attribute between 20% to 50% of productivity growth to such compositional changes.[6]

It follows that reforms needed to improve productivity and income growth can be expected to create some losers in the short term. With the losses typically being more concentrated and immediate than the (larger) gains, mooted structural reforms generally face more active opposition than support. Indeed, interests opposing such reforms will often gain the sympathy and support of sections of the community who would most benefit.

This inherent asymmetry in the politics of reform can be compounded by a government's own administrative structures. In most countries, public administration tends to be segmented along sectoral lines (industry, transport, education, environment etc.). Such administrative systems promote engagement and information flows useful to policy development in those areas, but are less capable of articulating the economy-wide effects of policy or, worse, can involve bureaucratic sponsorship of sectoral interests.

INSTITUTIONAL REMEDIES

"Pro-productivity" policies would benefit from having distinct institutional sources of information that not only help identify what policies and reforms are likely to be most nationally beneficial, but that can also serve to improve community understanding about why that is so, despite the protestations of pressure groups.

The importance of such institutions to better policy outcomes has been recognised by the OECD, which in its country reports has increasingly addressed not just the technical "what" of better policies, but also the political "how".

In a recent initiative, the OECD has established a Global Forum on Productivity, with an agenda that includes institutional support mechanisms. In a paper commissioned by the OECD for its first meeting in Mexico City in 2015, I reviewed the experience internationally, assessing different institutional forms against features judged necessary to support pro-productivity policies and reforms.[7]

Key design features for such institutions include:

- a strong research and analytical capacity;
- a mandate to illuminate the economy-wide or community-wide impacts of policies and reforms;
- links to policy decision-making processes, albeit with sufficient independence to be immune from undue influence;
- operations that are open to public participation and outputs (findings and advice) that are subject to public scrutiny.
- Ultimately of course all policy is political. (The French language makes no distinction!) The purpose of such institutional features is simply to ensure that policy decisions bearing on economic performance and living standards can be well informed from a national perspective, and to help create a more receptive political environment for reform.

A TAXONOMY OF EXISTING INSTITUTIONS

Many countries already have institutions that to varying degrees embody some or all of those features. Principle examples include:

- **Think tanks and research centres:** such as the Institute of Policy Studies at the National University of Singapore, the Brookings Institute in the United States and Australia's Centre for Independent Studies and Grattan Institute. Such organisations vary greatly in governance, funding and areas of focus. While active contributors to public discussion, many lack the linkages with government needed to inform policy decisions in a timely way.
- **Research bureaus and strategic agencies within government:** these are better placed to be directly influential, and often have strong research capacity, but commonly lack sufficient independence and public transparency.
- **Advisory councils:** instituted to enable governments to tap expert or representative advice, these bodies can also promote consensus around reform needs and agendas. Singapore has a number of them, including a National Productivity and Continuing Education Council, as does Australia and other countries in the region. Varying in form and focus, most operate primarily as sounding boards or consultative mechanisms.
- **Ad hoc policy "taskforces" and inquiry bodies** have also been used in many countries. Again they vary greatly, but have commonly been headed by eminent experts and resourced to conduct research and public consultations. For example, Canada has engaged "review panels" on a variety of policy topics, including competition reforms. New Zealand formed an influential "Working Group" on taxation reform. Singapore has a high-level Committee on the Future Economy, with industry and ministerial representation. Australian governments have commissioned public inquiries into financial markets, competition policy and red tape, among many other topics. Denmark and Norway also recently established independent "productivity commissions" with wide remits to investigate the causes of lacklustre productivity and propose measures to revitalise it.
- **Standing review and inquiry bodies:** only a few countries have created institutions with an ongoing remit to provide information and recommendations on policies to promote productivity and living standards. The oldest of these is Australia's Productivity Commission. An equivalent organisation was recently created in New Zealand. Both have statutory independence, strong research capabilities and undertake public inquiries on policy topics assigned by government. A body with a similar role has also been created in Chile.

HAVE THEY MADE A DIFFERENCE?

Unsurprisingly, although various institutions in these categories have made a positive contribution at different times, the ones providing most support for productivity-enhancing reforms have generally been those established expressly for that purpose. For example, the institution I know best, Australia's Productivity Commission, is generally recognised as having been instrumental in a program of structural reforms that transformed Australia's economic performance.

Comparing the last two categories, permanent institutions would seem better able to build capability and public credibility over time; ad hoc bodies have the advantages of flexibility and a lesser budgetary commitment. However, in practice, the impact on policy outcomes has often depended more on such factors as the choice of what policy issues to review and when; the calibre of appointments; and, not least, how well governments handle the reports.[8] No such institution can be effective if the government is not amenable to a consultative, evidence-based approach.

HOW TRANSLATABLE

Clearly there can be no "one design fits all" institutional template. Nevertheless, scope exists in most countries to devise tailored institutional arrangements that would satisfy the broad requirements.

A way forward for some countries could be to extend or adapt the role of an existing institution. (Australia's Productivity Commission has distant origins in a statutory body called the Tariff Board.) Another option is to make greater — or more effective — use of special taskforces to conduct public reviews in specific reform areas or, as in the Scandinavian model, to perform a stocktake of the policy landscape to identify priorities. In some countries, such arrangements could be precursors to establishing permanent institutional arrangements.

This suggests considerable potential for governments to learn from each other's experiences. As noted, the OECD provides one platform for such learnings, but so too could regional forums and organisations such as APEC and the Asian Development Bank. Singapore and Australia have been strengthening their bilateral ties over recent years, and there would seem to be much scope for institutional learning in both directions.

With productivity growth being the core determinant of a society's living standards in the long run, efforts to enhance administrative capability in this area of policymaking have the potential to bring large rewards.

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NOTES

1. Paul Krugman, The Age of Diminishing Expectations: US Economic Policy in the 1990s (Cambridge, Massachusetts: MIT Press, 1994).
2. Productivity Commission 2016, *PC Productivity Update*, April.
3. S. Tharman, "Dinner Address and Dialogue", Singapore Forum: Asia and the World – Shared Opportunity, Shared Prosperity, 1 April 2016, Singapore.
4. IMF, OECD & World Bank 2014, *Quantifying the Impact of G-20 Members' Growth Strategies.*
5. Productivity Commission 2009, *Raising the Level of Productivity Growth in the Australian Economy*, Submission to House of Representatives Inquiry, Canberra, September.
6. B. Doman & D. Gruen, "Productivity and Structural Change", paper presented to the 41st Australian Conference of Economists, 10 July 2012, Melbourne.
7. Gary Banks, "Institutions to Promote Pro-Productivity Policies: Logic and Lessons", OECD Productivity Working Papers, no. 1, November 2015.
8. See note 7.