Productivity reform and COVID recovery*

Gary Banks

Introduction

It is a pleasure to be speaking again at an event hosted by the Queensland Productivity Commission, even without the enjoyment of being in Queensland itself. It is even more pleasing given the collaboration with four other Productivity Commissions. Only two of these organisations existed (including the NZPC) when I retired from Australia's federal body eight years ago.

As the Australian Productivity Commission reminded us last week, a country's productivity performance is the primary determinant of the incomes and living standards of its population. While policies to promote productivity growth should therefore be a good thing at any time, they are especially important right now, as we grapple with the COVID pandemic and strive to recover from the recession it has induced.

Spending programs of unprecedented magnitude are resulting in equally unprecedented government debt. Given the Australian Government's commitment not to raise taxes, and the wider reluctance to cut public expenditure – and disregarding MMT as a 'solution' - this puts a premium on policies to promote the future income growth needed to rebuild 'fiscal buffers'.

Moreover, I suspect it will be a considerable time before governments are able to depend as heavily as before on the tax dividends from immigration (and preferably shouldn't). Together with a shaky outlook for international trade and the possibility of what *The Economist* has called a '90 per cent economy' -- due to ongoing effects on activity of public health measures and a lingering reticence by consumers and investors -- producing 'more from less' has become more important than ever.

What I'd like to emphasise here though is that pro-productivity policies and reforms are desirable not just for the widely acknowledged benefits for living standards over the long term. There is a view in some circles that micro reforms are something to consider only after macro measures have brought about a recovery. There needs to be greater recognition that, as my successor at the PC recently pointed out, supply-side reforms can make an important contribution to recovery itself. While some have faced political obstacles, the current crisis represents a 'burning platform' that should enhance the prospects of success.

A special 'structural' recession

Adam Smith famously observed that 'there is a lot of ruin in a nation'. We have already seen jobs start to rebound in jurisdictions where health restrictions have been lifted. Some analysts have even been predicting a 'beautiful' recovery. However, history tells us that the adverse labour market effects of recessions can have a long tail, regardless of the extent of monetary and fiscal interventions targeting aggregate demand.

For example, it has been observed that after the Global Financial Crisis – which broke new ground in expansive macro policy -- it took a dozen years for unemployment to regain its previous level. It seems more than coincidental that this period was marked not only by a paucity of structural reform, but also renewed rigidities in the labour market itself.

This recession has features that pose particular challenges for policy. For one thing its depth and rapidity have been unprecedented. But unlike another recession 'we had to have', this resulted from the enforced closure of businesses, not higher interest rates that merely raised their costs.

Secondly, the consequent impacts on production and employment have been highly uneven. They are concentrated mainly on 'face-to-face' service industries comprising mainly smaller businesses, younger and lower-wage workers, and urban rather than regional areas. At the same time, a range of other businesses and industries have hardly been affected, while some (including the public sector) have actually benefitted.

In other words what we have been experiencing might best be labeled a *structural* recession. And, unlike the more typical downturn, its effects on the labour market have been structural in nature from the very outset.

Furthermore, this structural recession is more likely to bring enduring changes in the patterns of consumption and trade, as well as in production methods and work practices (of which working from home is but one example).

It follows that a quickish recovery to match our quick descent cannot be taken for granted, especially in the labour market, regardless of developments in treating the virus. Meeting employment targets is likely to depend more than ever on the adjustment capacity of firms/industries and the flexibility of the labour market – in other words, on the 'dynamism' of the economy's supply side - not just on the state of aggregate demand.

It calls for structural reforms

As a recent research study by the QPC has shown, the sort of reforms needed to enhance an economy's 'resilience' or adaptability – with benefits for the speed and extent of recovery -- are typically ones conducive to raising productivity itself. In large part, such policies work by addressing the 'drivers and enablers' of innovation and other productive changes within enterprises, organisations and industries. The Productivity Commission has traditionally categorized these policies according to their influence on *incentives, capability and flexibility.*

Notwithstanding many recommendations from a host of inquiries and reviews, it has to be said that, in contrast to the 1980s and 90s, productivity reforms have not been Australia's strong suit in more recent years. The period prior to COVID was marked by historically low growth rates for productivity and incomes. And indicators of innovation and 'dynamism' slumped. Just as our monetary and fiscal position was stronger when we last faced an economic crisis, the functioning of our markets arguably was too.

That is not to say that reform efforts are not being made, or especially, that there is no time to do more. Indeed the next few months could be crucial. The question is whether we are prepared to take up the opportunity. As the title of this conference implies, this is not unrelated to how the perceived obstacles might be overcome.

What *is* being done (on the supply side)?

In conjunction with the Budget, the Australian Government announced (or reiterated) a number of initiatives to 'make our economy more dynamic, competitive and resilient' and to 'increase the productive capacity of the economy'. This is indeed what is required.

In terms of productivity drivers and enablers, noted earlier, the supply-side focus has been mainly about building capability and creating incentives, and largely dependent on financial transfers, subsidies and tax relief.

A key example is the 'wage credit' for younger workers. This program, along with subsidies for (re)training, is motivated by the problem that younger workers have been disproportionately affected and may have lost motivation and skills, such that employers may perceive the value of their 'marginal product' to be below the wages they must be paid. However, wage subsidies can invite 'churn' in the labour force and, when they come to an end, any underlying causes of youth unemployment (which was high before COVID) are likely to remain.

A second example is the Australian Government's $1.5bn 'Modern Manufacturing Strategy', a five year plan to 'leverage co-investment' in six selected industry sectors. It is not clear from the announcement why those sectors have been singled out or what the economic rationale for subsidizing them might be, beyond an implied 'infant industry' case. While job creation is cited, this appears an unpromising way of achieving it, especially given an acknowledged deficiency of the requisite skills locally.

It seems unlikely that lack of finance or collaborative potential represents a major impediment to these or other industries 'scaling up'. Capital has never been more abundant. Rather, as this extract from the statement accompanying the Strategy points out:

> 'For any business to succeed, the underlying economic conditions need to be right. They need access to skilled and productive labour; low energy costs; a fair industrial relations framework; a competitive taxation system; efficient regulatory mechanisms and favourable trade arrangements'.

Reforms to improve flexibility and adaptability within firms and industries are key. Many of these are regulatory in nature and need to be addressed directly.

In this category, the Australian Government is thus far proposing to amend 'responsible lending' laws which had effectively converted the age-old principle of '*caveat emptor*' into what might best be described as '*caveat venditor*' , with predictable results. There are also proposals to reduce rigidities in insolvency law and to reduce export transacting costs. Moves are also being made (yet again) by the states to establish an effective mutual recognition regime, which would be a boon to skilled labour mobility, and by one state and territory (so far) to replace stamp duty on housing. All useful initiatives.

The vexed issue of labour market reform

The dog that is yet to bark, when it comes to the reform of regulations bearing on the performance of the economy's supply side, is Australia's system of workplace regulation. Legacy of a bygone era, it comprises detailed, prescriptive provisions concerning how labour can be utilized and rewarded within businesses across the country. Further complexities, delays (and Catch 22s) confront those enterprises and their workforces attempting to secure mutually beneficial variations. It is the antithesis of the sort of regulatory system needed to secure efficient enterprise adjustment and job creation, or even equitable treatment of the wider workforce.

Prompted by the jobs crisis, the Government selected several of the more problematic areas of this 'system' for detailed investigation, including the nature of awards and agreement-making themselves, where the right reforms could be expected to have a big payoff. This applies especially to those labour-intensive sectors like retail and hospitality that are burdened by some of the more inpenetrable awards (as anyone puzzled by the recent cases of 'wage theft' in those sectors might have discovered).

Carefully considered reform options can be found in past reports by the national PC, among other sources, which in the current difficult circumstances could usefully be taken further. It seems unlikely, however, that such an outcome could emerge directly from the tripartite working group model adopted by the Government, which comprises union and business representative bodies with (conflicting) institutional interests of their own. Rather than be constrained by what these parties can agree on, it is to be hoped that the Government would use those lengthy discussions to gain public credibility in making its own call, drawing on wider information. Legislative proposals are yet to appear. However, the PM recently observed that any changes will be 'pragmatic, *realistic* and balanced'.

That a Coalition Government might remain appropriately cautious in dealing with IR reform after the failure of its last major attempt, even if 15 years ago now, is perhaps understandable. After all WorkChoices is widely attributed with it losing office. And, in the end, nothing was actually achieved; or *less* than nothing, as the next government reversed those reforms (and then some). However, the failure of WorkChoices was arguably predestined by the absence of a justification for it that the public could understand. The economy was in good shape. And the Government, with a rare majority in the Senate, did not try very hard to make its case. Neither should apply today.

The institutional dimension

What is 'realistic' with respect to reform need not be a given. Australia's policy history (and no doubt that of NZ) is littered with examples of successful policies and reforms previously dismissed as 'unrealistic' or 'impossible'. Structural reforms of the kind discussed here invariably face opposition, since there will always be those who benefit from, or simply prefer, the *status quo*.

That notwithstanding such opposition the majority can be persuaded to support generally beneficial reform, is fundamental to democratic governance. Indeed, it is a proposition on which the Productivity Commission's original forebear, the Industries Assistance Commission, could be said to have been founded. The Commission's public processes since then have served not only as a source of information and a way of testing policy ideas, but also as a means of educating stakeholders and the community about what is at stake in reform.

Sir John Crawford, whose report provided the blueprint for the IAC, labeled the model of policy-making centred on such a public inquiry institution 'domestic transparency'. In form, if not always substance, it has become one of our exports to the world (thanks in part to the OECD). However, if Sir John were alive today he might consider that, in light of the recent proliferation of PCs, there is less transparency in Australian policy-making than he might have imagined.

He might, for example, point to the Australian Government's COVID Commission, given the absence of public information relating to its evolving policy advisory role. He may take a particular interest in its contribution to industry policy, given his familiarity with Australia's protectionist past and the risk of such bodies, operating behind closed doors, becoming a conduit for rent-seekers.

That due process might have become a casualty of the crisis is of course not surprising. Crises bring a need for speed. And good policy process can take time. That said, returning to the role of the PCs, there has been sufficient time since the pandemic began for them to have been able to publicly inform government decisions on a range of matters if asked - or even if not. (I note that New Zealand's PC recently self-initiated a detailed cost-benefit assessment of different lockdown strategies in that country.)

No doubt some of this will have been happening informally. To the extent that it draws on work undertaken previously this is fine, though it provides little scope to help build public support. Being asked to undertake special projects on a confidential basis would be another matter, especially in policy areas that are contentious or that have distributional implications. That would be contrary to the institution's role and would pose risks to its effectiveness in the future.

* Opening presentation to the conference '*Productivity Reform in Australia and New Zealand: Barriers and Opportunities*', a cyber event jointly sponsored by the Australasian Productivity Commissions, Brisbane, 24 Nov 2020.