

## Introduction

### Background

- 1.1 Australia has performed well in the fall-out from the Global Financial Crisis, being one of the few developed countries to avoid a technical recession. It continues to be a country prospering on resources income, albeit experiencing measurable negative impacts of the global downturn. However, the relative buoyancy of the economy has masked an underlying trend – that of a declining productivity growth rate in the face of ongoing real GDP growth.
- 1.2 The average real incomes (adjusted for inflation) of Australians have been rising for several decades and on this basis living standards in Australia have also been rising. This significant increase in living standards was observed recently at the Reserve Bank of Australia's 50<sup>th</sup> Anniversary Symposium:

...the past half century has witnessed the greatest economic success in human history for any comparable period in bringing living standards and the quality of life to levels heretofore not dreamt of.<sup>1</sup>
- 1.3 Improvements in and maintenance of living standards are unambiguously good for today's Australians and for future generations.

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1 Reserve Bank of Australia, 50<sup>th</sup> Anniversary Symposium, Sydney 9 February 2010, "Increased Understanding of Supply Side Economics", Anne O Krueger, Professor of International Economics, John Hopkins University, Ritch Professor Emeritus, Stanford University, p. 3.

- 1.4 There are a variety of reasons for the significant improvement in the living standards of Australians over the last three decades.
- 1.5 One of the main factors attributed to this increase is that productivity growth surged in the economy during the 1990s, going from an average of 0.95 per cent in the 1980s to an average of 1.65 per cent in the next decade – with five years of this growth at a massive 2.3 per cent growth.<sup>2</sup> In the simplest terms this meant the economy was operating in a very efficient way, optimising the use of inputs for any given output in the production process. At the peak of the country's measured growth rate, it performed 2<sup>nd</sup> only to Finland in a set of 18 OECD countries.<sup>3</sup>
- 1.6 Australia's average annual productivity growth has performed relatively well in OECD comparisons since 1985, approximating the OECD average, and ranking 12<sup>th</sup>, one below the US, the country considered to be at the 'productivity frontier'.<sup>4</sup>
- 1.7 The productivity growth rate has, however, been in decline since the 2003-2004 productivity cycle, with growth rates averaging -0.2 per cent per year.<sup>5</sup> This has been widely reported as the 'productivity paradox' due to the continued growth in real GDP.<sup>6</sup>
- 1.8 Given the decline in the productivity growth rate, and the fact that robust productivity growth has been strongly associated with increasing living standards, the Treasurer, the Hon Wayne Swan MP asked the House of Representatives Standing Committee on Economics to inquire into, and report on, the factors responsible for Australia's declining productivity growth and to identify key levers to return Australia to robust productivity growth.

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2 Australian Bureau of Statistics (ABS), *Australian System of National Accounts*, Cat 5204.0, 2007-08, p. 43.

3 Productivity Commission (PC), *Submission no. 20*, p. 15, Figure 2.5.

4 B Dolman, D Parham, S Zheng, *Can Australia Match US Productivity Performance?*, PC Staff Working Paper, March 2007, p. x and p. 3. Despite the US ranking 11<sup>th</sup> in the OECD growth tables it is considered the most meaningful productivity leader because some European countries are only exhibiting high productivity growth due to industry mix and policy and institutional distortions in labour markets.

5 PC, *Submission no. 20*, p. ix. From 2003-04 to 2006-07.

6 Albeit declining GDP growth in the 2008-09 financial year from 3.7 per cent in 2007-08 to 1.2 per cent in 2008-09.

## Objectives and scope

### Scope of the inquiry

- 1.9 The impact of productivity on economic growth has been frequently analysed and much debated. Even where economists agree on the theory and the appropriate measurement of national productivity there is divergence in the views about policies which stimulate productivity growth.
- 1.10 It is also an area where few countries have undertaken rigorous cause and effect modelling of public policies designed to boost productivity growth.
- 1.11 For these reasons, coupled with the nature and resources available for a parliamentary inquiry, a detailed economic analysis of all the probable factors of productivity growth is beyond the scope of this inquiry. Similarly, the committee will not be modelling the link between specific public policies directed at increasing national productivity growth and productivity growth outcomes.
- 1.12 This report provides a high-level overview of the recent status of productivity growth in Australia and the probable mechanisms that could be used to improve the current flagging growth rate.

## Key factors influencing Australia's productivity growth rate

### From the 1970s to the end of the century

- 1.13 Australian productivity growth started to wane in the 1970s compared to other OECD nations. This relative decline in the 1970s led the federal Government in the early 1980s to focus on lifting productivity growth through a series of microeconomic reforms, targeted at the activities of producers at the firm level and opening up the economy to global trade.
- 1.14 The thrust of the reforms was to promote improved competition between firms and increase flexibility in firm working arrangements. It was very much focused at assisting the efficient operating environment of firms in Australia.
- 1.15 In tandem with the flow-on effects of microeconomic reforms which commenced in the 1980s, Australia, like most western countries, was also exposed to rapid technological change in the 1990s. Australian firms were rapid adopters of advanced Information and Communications Technology (ICT) produced by other countries. The multifactor productivity growth

rate in the period 1993-94 to 1998-99 was 2.3 per cent – outranking that of the US, a producer of ICT products, by a considerable margin.

- 1.16 There are conflicting views as to the main impetus for the elevated productivity growth rate in the 1990s. The prevailing view is that extensive microeconomic reforms which commenced in the 1980s led the productivity growth climb. Another is that this was the era of rapid technological change and that ICT capital deepening and/or technological adoption realised these productivity gains.
- 1.17 Another proposition is that there were measurement distortions at play which inflated the growth rate. Measurement of official national productivity has its limitations, and these will be discussed further in Chapters 2 and 8, however this particular theory also included the proposition that inputs to the productivity equation were underestimated.
- 1.18 Irrespective of what was at play leading to the boost in the average national productivity growth rate in the 1990s, it is clear there has been a significant shift in the productivity growth story since the turn of the century.

### Declining growth since the 2003-04 productivity cycle

- 1.19 There are fewer diverging theories on what has caused the declining productivity growth rate since the last full productivity cycle than there are for the surge of the 1990s.
- 1.20 The recent productivity growth decline seems to be more a story of exogenous sectoral impacts in the economy. Declining mining productivity is at the forefront of this explanation, along with impacts of the drought on the agriculture and utilities sectors coupled with climate change mitigation in the latter. Other views are that the impact of the reforms of the 1980s and 1990s, and/or the significant technological advances embraced by Australian firms in the 1990s delivered a once-in-a-generation boost to productivity.
- 1.21 The important challenge for Australia now is not so much what caused the decline between the last two decades, but what strategies should be engaged to get productivity growth back on an increasing trajectory.
- 1.22 Although national productivity has a cyclical nature, improving Australia's productivity growth rate involves a long-term strategy. There are no overnight solutions to improving this measure which makes focussing on productivity growth even more compelling.

## Public policy backdrop

### 1980s 'first wave' reforms

- 1.23 The reforms instituted in the 1980s started with the opening up of the domestic economy to the global market, with the focus on increasing firm-level efficiency in the face of increased competition.

### 1990s 'second wave' reforms

- 1.24 Measures to improve firm-level competition within the domestic economy followed, through corporatising and privatising nationally owned businesses and infrastructure and implementing National Competition Policy.
- 1.25 Microeconomic reforms targeting improving firm efficiency included policies to reduce burdensome red-tape and regulatory duplication borne by firms at various levels of government. Stock-takes of regulations impacting businesses were undertaken and reviews of these followed. Systems of analysing the impacts on business of proposed new regulations were also introduced at national and state levels.
- 1.26 In tandem with these reforms the Australian workplace environment changed from an industry specific focus to a firm-level focus, with the introduction of enterprise bargaining.
- 1.27 These reforms strengthened firm-level efficiency and flexibility.

### The 'third wave' of reforms

- 1.28 There is an ongoing agenda to complete some of the reforms which commenced in the 1980s and 1990s that focus on firm-level efficiency, competition and market openness.
- 1.29 The Council of Australian Governments (COAG) National Reform Agenda, agreed to in February 2006, and strengthened in 2008 with the introduction of the COAG Reform Agenda, continues to focus on competition related reforms and regulatory reforms. In addition, it also includes reforms designed to improve Australia's 'human capital'.
- 1.30 Government policies and approaches by firms which target the improvement in the quality of labour inputs are referred to as 'human capital' reforms. These reforms are designed to improve the efficiency of labour inputs and as such they rely heavily on investment in appropriate education and skills development and in maintaining a healthy workforce.

- 1.31 Human capital reforms are considered the 'third wave of reforms' (opening up the economy was the first wave and domestic microeconomic reforms the second). The third wave reforms target firm-level capabilities rather than capacity – market competition and firm-level flexibility as part of previous reforms improved firm capacity.
- 1.32 Capability reforms are considered more difficult to achieve. They centre on life-time learning and preventative health outcomes and are thus long-term measures.
- 1.33 The added difficulty with introducing and tracking the success of these reforms is that they result in outcomes that are currently difficult to accurately measure in terms of their direct productivity contribution.

### **Key growth rates and reform timeline since the 1980s**

- 1.34 Table 1.1 summarises the average Australian productivity growth rates in each productivity cycle since the introduction of the widespread microeconomic reform agenda in the 1980s.
- 1.35 It also highlights key microeconomic and macroeconomic events and other economy-wide and global features of the cycles.

Table 1.1 Growth rates and economic reform backdrop for productivity cycles since 1981

<b>Productivity Cycle</b>	<b>Average MFP Growth rate</b>	<b>Key Microeconomic reforms</b>	<b>Key Macroeconomic reforms</b>	<b>Other features of the cycle</b>
1981-82 to 1984-85	1.1	Deregulation of the financial market 1983	Floating \$A December 1983 Original Accord February 1983	Mining Boom Recession
1984-85 to 1988-89	0.8	Entry of foreign banks 1987 Increased exports Award restructuring & removal of demarcations	Accord III: efficiency offsets for wage rises March 1987	Wall Street Crash, October 1987
1988-89 to 1993-94	1.0	Tariff reductions 1988-1991 Quota & subsidy reductions	Compulsory national superannuation scheme introduced Accord VII: enterprise bargaining October 1991	Recession 1990-1992 Immigration
1993-94 to 1998-99	2.3	Tariff reduction Nov 1996 National Competition Policy introduced		Asian Financial Crisis 1997-98 Australia's growing services sector Late 1990s China's rapid urbanisation and industrialisation
1998-99 to 2003-04	1.1		Goods and Services Tax, July 2000	Dot-Com Crash March 2001 Terrorist Attacks on US, September 2001 Australian Resources Boom from 2003—
2003-04 to 2007-08 Incomplete cycle	-0.3		Workchoices 2006	Chinese growth rate 13 per cent, 2007 Collapse of Lehman Bros Bank, Sept 2008 Global Financial Crisis 2008— RBA cash rate falls 200 basis points Sept-Nov 2008

Source Data - ABS, Australian System of National Accounts, Cat. 5204.0, 2007-08.

## Conduct of the inquiry

- 1.36 The inquiry was first publicised on 25 June 2009 in a media release which was subsequently loaded to the committee's website. The first national advertisement of the inquiry appeared in *The Australian* newspaper on 8 July 2009.
- 1.37 Both the media release and newspaper advertisement called for submissions with a closing date of 21 August 2009. Advertisements on the inquiry program were periodically placed in *The Australian* throughout the conduct of the inquiry.
- 1.38 A total of 33 submissions and six supplementary submissions were received by the committee and authorised for publication on the committee's website.
- 1.39 The committee conducted nine public hearings between 23 October 2009 and 11 March 2010. Hearings were held in Canberra, Sydney and Melbourne, the majority being held in Canberra.
- 1.40 The committee utilised audio-conferencing at three Canberra hearings to gather evidence from four interstate witnesses. The taking of audio evidence is provided for under House Standing Order 235(b). Utilising this technology provided these witnesses with convenient and cost-effective access to the parliamentary proceedings and also provided efficiency gains for the committee.
- 1.41 A list of submissions and exhibits received and public hearings conducted may be found at appendices A, B and C respectively.

## Reader guide and structure of the report

- 1.42 This report has been structured in an easy-to-read format. In discussing each issue, evidence and other material is provided, followed by the committee's conclusions and then, in some areas, recommendations for action. Recommendations are also listed at the front of the report.