SUBMISSION 12

NEW SOUTH WALES

TREASURER

Mr Craig Thomson
Chair
House of Representatives Standing Committee on Economics
Parliament of Australia
Parliament House
CANBERRA ACT 2600

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2 6 AUG 2009

Dear Mr Thomson

Australian Government: Inquiry into
Raising the Level of Productivity Growth in the Australian Economy

I refer to your letter of 2 July 2009 to the NSW Premier, in relation to the above Inquiry. The Premier has asked me to respond to your letter.

Raising the level of productivity growth is essential to Australia's long term economic growth, and to promote the material living standards of Australian people.

Please find attached, comments by the NSW Treasury in relation to the following terms of reference:
(a) trends in Australia's productivity growth rate during the past 20 years;
(d) the continuing effectiveness of the microeconomic reform agenda; and
(g) the adequacy of the level of investment in public infrastructure.

Yours sincerely

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Inquiry into raising the level of productivity growth in the Australian Economy: NSW Treasury comments on selected terms of reference

In relation to items (a) and (d) of the Terms of reference:

1. Importance of productivity growth

Productivity (real output per hour worked) is a measure of the efficiency of Australian industry compared to overseas peers. Australian industry's productivity is valued at US$36 (in 2006 purchasing-power-parity dollars). In comparison, industry productivity in the United States is valued at US$43. This productivity gap is an indication of how much improvement is needed for Australia to reach international best practice.

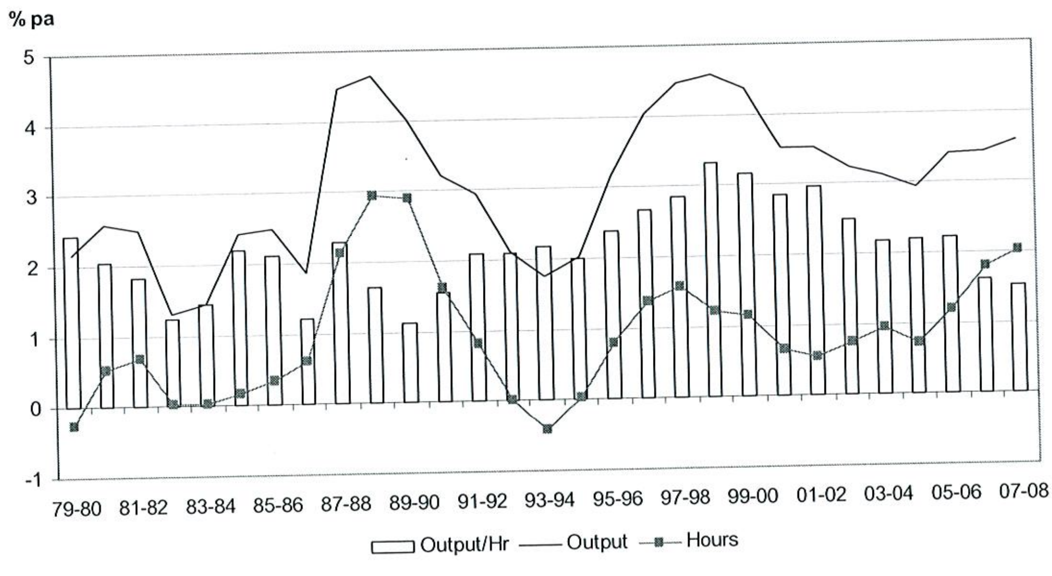
Productivity growth (annual increase in real output per hour worked) also provides one of the soundest measures of national economic progress. It provides a useful benchmark for sustainable (non-inflationary) growth in wage and salary rates.

Sources of productivity growth include increasing capital stock per worker, increased education and training, improved allocation and management of resources in the economy (by enterprises and governments), and improvements in technology.

2. Trends in productivity growth

Due to the volatility of output and employment (particularly across the business cycle), productivity trends are best measured over a run of years, and (given the difficulty of accurately pricing public sector outputs) are best limited to the market sector.

Productivity in the Market Sector
(five year moving average annual growth rates)



Source: ABS 5206 National Accounts, Table 30

Productivity growth in the market sector trended upward during the 1990s, reaching a peak at 3.3 per cent in the five years ended 1998-99. Growth has trended downward during the most recent decade, falling to 1.5 per cent in 2007-08.

3. Productivity Agenda

The latest annual OECD economic survey of Australia (October 2008) provides an independent assessment of the policy agenda for improving productivity:

- The far-reaching structural reforms of the past quarter century, which inter alia spurred competition, had positive repercussions on productivity in the latter half of the decade and made the economy more resilient. [However given challenges including] the expected negative impact of population ageing on growth potential and trends in living standards, well-designed structural reforms are needed to raise productivity gains, which have levelled off in recent years.

- In any case, margins exist to catch up with the best performing countries both for labour utilisation and productivity, even if it might be difficult to close the efficiency gap completely because of geographic handicaps such as the remoteness of Australia from large markets and its relatively small population (*Productivity Commission*, 2007). Reaping efficiency gains will be important to ease the adjustment required to achieve better environmental outcomes in the domains of water and greenhouse gas emissions and to maintain healthy progress in the standard of living despite an ageing population. Under unchanged policy, the average growth rate of GDP per capita could decline by ½ percentage point to 1½ per cent a year over the next 40 years because of the negative impact of population ageing on labour utilisation (*Australian Treasury*, 2007).

- Aware of these challenges, governments in Australia have launched the National Reform Agenda (NRA), and the more recent COAG reform agenda, which extend and widen past efforts to stimulate product market competition and reduce the regulatory burden, while also pursuing a new set of reforms to improve the education and health systems to increase human capital. This orientation of reforms is consistent with the main challenges identified in *Going for Growth* (OECD, 2008). Effective implementation, which is promoted by the COAG via seven working groups could yield important gains. According to the Productivity Commission, the competition and regulatory streams of the NRA could boost GDP by 2% in the long term and the human capital stream could boost GDP by 9%, two-thirds of which would come from a higher labour force participation and the rest from efficiency gains.

In relation to item (g) of the Terms of Reference:

In assessing the adequacy of public infrastructure investment, the Inquiry should consider the specific infrastructure needs and potential benefits of investment (versus costs), and not simply aggregate spending levels. Many areas of major public infrastructure investment, such as transport and water, are subject to very "lumpy" needs, where single major capacity investments can often provide many years, or decades of capacity for urban and economic growth. Economies of scale have a significant impact on the appropriate timing of infrastructure investment.