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Inquiry into raising the productivity growth rate in the Australian economy

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House Standing Committee on Economics

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Foreword

One of the key determinants of Australia's long-term economic prosperity is robust productivity growth. This is because productivity growth is strongly associated with high living standards.

Australia experienced a significant productivity growth surge in the 1993-94 to 1998-99 productivity cycle, averaging 2.3 per cent. This surge moved Australia to an internationally high level of productivity which it still enjoys. However, since the surge in the 1990s, productivity growth has declined, with an estimated decline of around 0.4 per cent in multifactor productivity in the incomplete cycle from 2003-04 to present. Ironically, much of this decline can be attributed to burgeoning growth in the mining sector which has brought unprecedented increases in Australian living standards since the start of the productivity cycle.

Income and productivity growth will occur in firms that embrace technological change and achieve technical efficiency. However, increases in the prices of outputs will not necessarily lead to increases in income or productivity. The high levels of income per capita that Australians currently enjoy are a result of favourable commodity prices and thus strong terms of trade. Therefore, in order to secure long-term economic growth Australia will need to focus on improvements in the technical efficiency of firms and their utilisation of technological advances.

The challenges presented by a larger and ageing population, climate change, and the current constrained fiscal environment, make strong productivity growth essential to Australia's economic future. Productivity growth is one way of generating the economic growth required to provide the goods and services the Australian community expects.

The Australian Government cannot directly drive productivity growth within firms. It can, however, facilitate aggregate productivity growth by maintaining a stable economic environment which fosters competition between firms and flexibility within workplaces. Australian governments also have an important role

in capability building by providing firms with access to appropriate public infrastructure and investing in the quality of Australia's workforce, our 'human capital', to facilitate more productive behaviour by firms. In addition, firms which have access to technological advances, employ innovative production processes, and have robust management and organisational capabilities enjoy higher levels of technical efficiency, that is, they are more productive.

Productivity growth is important; however it is not an end in itself. Productivity growth is desirable to maintain or achieve higher living standards. This means we need to be cognisant of the importance of sectors of the economy within which productivity growth is static. Some areas of the economy, which, by their very nature have low productivity growth, are vitally important to producing quality outputs that feed into the inputs of production. An example is education and skills training.

It should also be noted that productivity growth alone is not a good measure for evaluating public policy because productivity is not the sole determinant of community wellbeing. Notwithstanding this, nations with high living standards are more likely to display higher levels of community wellbeing.

However, the fact that productivity growth is not the ultimate goal does not mean Australia can be complacent about its recent decline.

The committee also recognises the difficulty in accurately measuring productivity growth in many industries in the services sector where outputs are not necessarily expressed in increasing volumes but may be seen in improved quality.

During the course of the inquiry, the committee received evidence on a range of issues, including measurement of productivity, productivity growth trends in Australia, challenges associated with raising the rate of productivity growth, and how governments can promote productivity growth in the economy. The committee has recommended that:

- the government introduce a national aggregate productivity growth target for the medium-term to 2030;
- a national productivity forum including governments, business, unions and non-government organisations be convened;
- the Council of Australian Governments adopt a specific national productivity agenda;
- the Productivity Commission undertake modelling on the effect of human capital investment on Australian productivity growth;
- the Australian Bureau of Statistics investigate alternate ways of measuring multifactor productivity in the services sector;

- cost-benefit analysis be mandatory for all policies aimed at increasing aggregate productivity growth; and
- any national productivity agenda should include public sector service provision.

On behalf of the committee I would like to thank all of the organisations and individuals that participated in this inquiry, particularly those who have written submissions or given evidence at public hearings.

Mr Craig Thomson MP
Chair



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Membership of the committee

Chair	Mr Craig Thomson MP	
Deputy Chair	The Hon Kevin Andrews MP (to 3/2/10) Mr Jamie Briggs MP (from 11/2/2010)	
Members	Mr David Bradbury MP The Hon Joel Fitzgibbon MP Ms Sharryn Jackson MP Ms Julie Owens MP Mr Jim Turnour MP	The Hon Bruce Billson MP (from 3/2/2010) Mr Luke Hartsuyker MP (from 3/2/2010) The Hon Sussan Ley MP (from 3/2/2010) Mr Scott Morrison MP (to 3/2/10)

Committee secretariat

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Terms of reference

Increased economic productivity has been responsible for much of the improvement in Australia's living standards over the last 25 years. However, Australia's productivity has declined since the 1990's.

The factors responsible for Australia's current lower rate of productivity growth should be examined, with the objective of identifying key 'levers' which will assist in returning the Australian economy to a trajectory of robust growth in productivity.

The Committee will inquire into, and report on, the key factors influencing Australia's productivity growth rate, focusing on, but not limited to:

- a) trends in Australia's productivity growth rate during the past 20 years and reasons for the recent trending decline
- b) trends in productivity growth rates against other OECD countries;
- c) the adequacy of productivity growth measures;
- d) the contribution made by microeconomic reform to the permanent improvement in the growth rate of productivity and the continuing effectiveness of the microeconomic reform agenda;
- e) the willingness and ability of small and medium enterprise to adopt best practice technology;
- f) the adequacy of the level of investment in physical capital;
- g) the adequacy of the level of investment in public infrastructure;
- h) the level of resources devoted to research and development;
- i) the adequacy of resources devoted to training and development of the labour force; and

- j) the key reforms and measures that can be undertaken to lift Australia's permanent rate of productivity growth.

In conducting the inquiry the committee should focus on how relevant factors contribute generally to the productivity growth rate. The committee should not undertake detailed assessments of individual industry sectors or specific industry assistance measures.



List of abbreviations

ICT	Information and Communications Technology
COAG	Council of Australian Governments
ABS	Australian Bureau of Statistics
PFP	Partial Factor Productivity
TFP	Total Factor Productivity
MFP	Multifactor productivity
PC	Productivity Commission
GDP	Gross domestic product
ANZSIC06	Australia and New Zealand Standard Industrial Classification 2006
ACCI	Australian Chamber of Commerce and Industry
NCP	National Competition Policy
RBA	Reserve Bank of Australia
CLE	Centre for Law and Economics
IMF	International Monetary Fund
ABARE	Australian Bureau of Agricultural and Resource Economics
GST	Goods and services tax

EGW	Electricity, gas and water services
SSDS	Singapore Skills Development System
GFC	Global Financial Crisis
GVA	Gross value added
R&D	Research and development
DEEWR	Department of Education, Employment and Workplace Relations
NBN	National Broadband Network
DBCDE	Department of Broadband, Communications and the Digital Economy
HMR	Health and medical research
DIISR	Department of Innovation, Science and Research
AMTA	Australian Mobile Telecommunications Association
NPA	National Partnership Agreement
PM&C	Department of the Prime Minister and Cabinet
OH&S	Occupational health and safety
CRC	COAG Reform Council



List of recommendations

5 Australia's future productivity growth rate—the challenge

Estimating multifactor productivity (MFP) for the services sector is very difficult as it requires carefully assessing the quality of services – quality is more likely to change in this sector than quantity of input or outputs. Capturing quality changes in data is challenging. The committee believes the Australian Bureau of Statistics should undertake work to consider alternative ways of estimating the economic contribution of industries which do not have neatly quantifiable outputs.

Recommendation 1 (paragraph 5.108)

That the Australian Bureau of Statistics (ABS) investigate alternative ways of measuring the optimal available use of economic resources used in services industries in the economy, either by:

- *Excluding those services sectors which do not have straight-forward quantifiable input and output data from the aggregate MFP estimates and instead developing a separate services sector index which is not necessarily based on traditional productivity constructs; or*
- *Investigating ways to develop robust services sector MFP estimates for all services industry categories for inclusion in the aggregate MFP estimates.*

The government should ensure that the ABS is funded appropriately to conduct the study.

Achieving MFP growth rates above Australia's long-term average of 1.1 per cent is a critical long-term national goal. The committee supports the adoption of a national productivity growth target for the market-sector. This will ensure productivity remains a key consideration in relevant policy development.

Recommendation 2 (paragraph 5.115)

That the Australian Government introduces a national aggregate productivity growth target for the medium-term to 2030; and that modelling is undertaken by the Productivity Commission to assess the appropriate level for the target.

7 Promoting future productivity growth

The committee believes that public policy to boost the aggregate productivity growth rate should be primarily directed at maintaining competition in the economy and allowing firms flexibility in their workplace arrangements. In addition to policies which improve the macroeconomic and microeconomic environment that firms operate in, the Australian government's role in supporting productivity growth should be through assisting to strengthen firm capabilities. Key aggregate capabilities include Australia's human capital stock and enabling firms to utilise evolving technology by ensuring there is appropriate infrastructure for these new platforms. Access to evolving technology will stimulate innovation.

The committee notes that significant investment in information technology and communications, infrastructure and R&D will contribute to future productivity growth. The committee also recognises that measures to increase workforce participation are also essential for future economic growth.

Improving Australia's productivity growth rate is a broad nationwide challenge which should involve all levels of government. The committee therefore believes a summit represented by all levels of Australian government, together with relevant business and union and non-government organisation representation, be convened by the federal government to discuss and lead the establishment of a specific and integrated productivity growth agenda.

Recommendation 3 (paragraph 7.127)

That at the commencement of the 43rd parliament the federal government convenes a national forum represented by all levels of government, business, unions and non-government organisations to discuss the key ingredients of a national productivity growth agenda.

The committee supports the development of a specific national productivity agenda to be agreed by COAG which incorporates aspects of the current COAG reform agenda but which extends upon this.

Recommendation 4 (paragraph 7.129)

That COAG adopts a specific national productivity agenda. This agenda should be guided by the outcomes of the national forum outlined in Recommendation 3.

The committee believes investment in an ambitious long-term human capital agenda is not only important to boost Australia's capabilities but that it will automatically feed into the inputs of all firms in all sectors. The committee recognises that prioritising a long-term broad human capital agenda over other public policy investments has opportunity costs. The committee therefore believes more accurate modelling of potential human capital investments, and likely returns, should be undertaken to ensure Australia's investment in its aggregate capabilities is optimised.

Recommendation 5 (paragraph 7.136)

That in the next eighteen months the Productivity Commission undertakes modelling on various aspects of human capital investment on productivity outcomes in the Australian economy and the likely time-line for returns.

8 Beyond official productivity statistics

The main aim of economic policy is to improve community wellbeing, with improved living standards central to this. Productivity growth is one way of achieving improved living standards however using productivity as the sole policy evaluation criteria is limited because it is only one determinant of community wellbeing. The potential for policies aimed at improving productivity to have a positive or negative impact on other government objectives highlights the need for a policy evaluation framework that will consider all of the impacts of a policy aimed at improving productivity.

Recommendation 6 (paragraph 8.27)

The Australian Government mandates cost benefit analysis for all policies aimed at improving aggregate productivity growth.

The official market sector productivity estimates do not include government services, yet the quality and efficiency of government services can have a significant impact on aggregate productivity growth. Additionally, government services are an input into the production processes of businesses and the quality of

these services can affect the productivity of these businesses, which will be captured in the official productivity estimates.

Recommendation 7 (paragraph 8.40)

Given the size and importance of government service provision in its own right and as an input into the production processes of other businesses it is important that any national productivity agenda includes public sector service provision.