
1 Sustaining Australia's productivity performance

The Australian economy is experiencing robust growth in productivity — mounting evidence of the reward for past efforts in implementing micro-economic reforms and establishing sound fiscal and monetary policy settings. This chapter draws together some insights from the Commission's work during the year which show how further reform can build on the substantial gains already achieved.

An impressive productivity performance

Australia's productivity growth — the major contributor to rising per capita incomes — continues to run at historical highs in Australia. In the four years from 1993-94, productivity growth in the market sector of the economy accelerated to 2.4 per cent a year — significantly above the previous average long-term rate of 1.2 per cent. **Australia's productivity performance since the early 1990s recession has been stronger and more prolonged than could be expected on the basis of past experience and goes well beyond the recovery shown after the 1980s recession (box 1.1).**

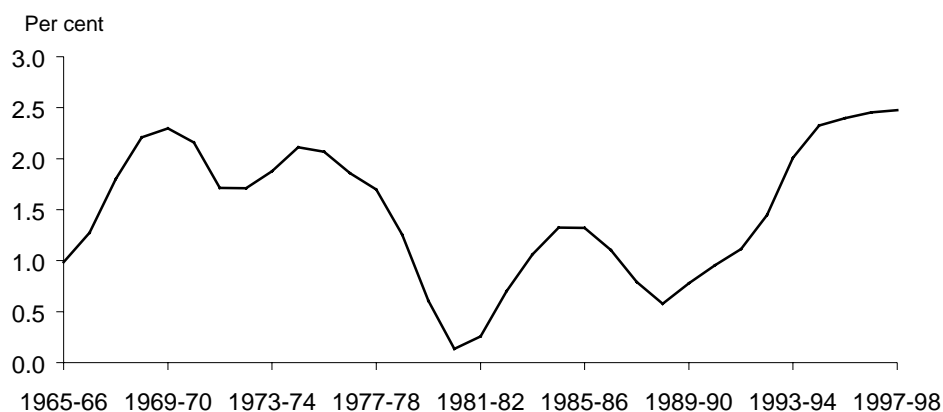
The recent surge in productivity appears to be a break from past trends, allowing Australia to pursue sustainably higher economic growth and living standards with fewer fears of inflationary pressures. Output per hour worked is estimated to be 15 per cent higher in 1997-98 than it would have been had Australia continued on its historical growth path. Put another way, the growth that would have taken 13 years on the old path has been achieved in just six years (Parham 1999, p. 22).

This improved productivity performance has not been accompanied by lower overall employment levels — labour and capital inputs, as well as output, all grew strongly in the four years to 1997-98. The proportion of the working age population in jobs has been running at or near its historical high and the unemployment rate has declined significantly since the early 1990s recession (Barnes et al 1999, p. xii).

Box 1.1 Australia's productivity performance

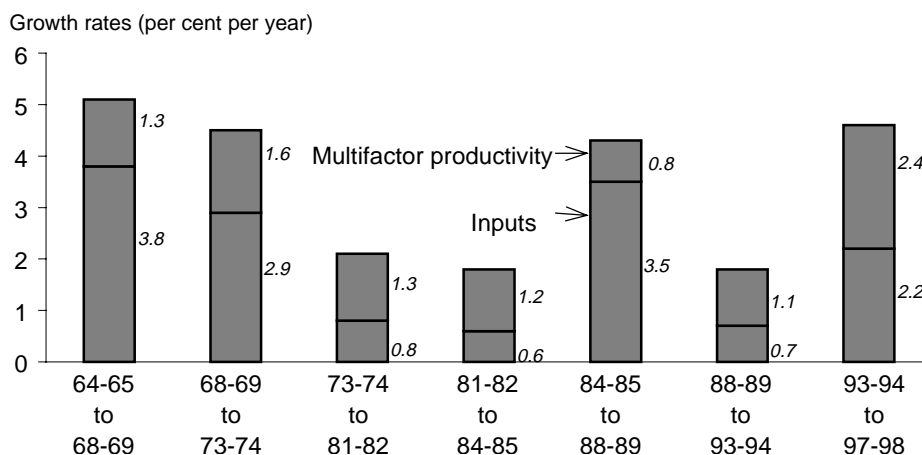
Australia's productivity performance has reached an all time high. Growth in *trend* multifactor productivity reached 2.5 per cent a year in 1996-97 and 1997-98 according to the latest ABS data. Trend productivity growth accelerated in the 1990s and has been sustained at high rates for longer than any other period on the statistical record.

Growth in market sector productivity^a 1964-65 to 1997-98



High productivity growth is contributing to the recent strong growth in Australia's output and average incomes. Growth in national output can come from greater productivity or by using more capital, labour and other resources. Productivity growth is making a greater contribution to growth in Australian output than at any time in the last 33 years.

The importance of inputs and productivity growth to growth in output^b



^a Market sector, percentage change from the previous year. Source: unpublished ABS trend multifactor productivity data. ^b To avoid spurious business cycle effects, the ABS partitioned the 33 year period into productivity cycles corresponding to intervals between productivity peaks. Source: ABS 5204.0

Australia's improved productivity performance in the 1990s stands out among high-income countries, suggesting that domestic explanations are important. Examination of industry and firm level evidence, together with the lengthening period of faster growth now observed, point to a substantial role for microeconomic reform in tapping Australia's productivity potential (PC 1999e, Parham 1999). Sound macroeconomic management has also been an important contributing factor.

The Reserve Bank (1999, p. 1) has stated that the current combination of strong economic growth and exceptionally low inflation in Australia is quite unlike the experience of the preceding 30 years — a performance even more remarkable given the Asian economic and financial crises. In pointing to important longer term influences behind the Australian economy's recent strength and resilience, the Governor of the Reserve Bank has said:

the economy has achieved improved productivity growth as a result of the microeconomic reforms of the past fifteen years. The main changes have been reductions in tariffs, privatisations, financial deregulation, competition policy and labour market reforms. Of course, businesses have also become much leaner and more adaptable as they have responded to increased competitive pressure. The key piece of evidence for this is the higher growth of multifactor productivity in Australia in this expansion compared with previous ones (Macfarlane 1999).

While many Australians are seeing the flow of benefits from appropriate macroeconomic settings and a decade or more of microeconomic reform, the reform process has inevitably involved adjustment pressures for some individuals, groups and regions.

If Australia is to meet the challenges of a more competitive and rapidly changing world — and to sustain improvements in its productivity and living standards — it must continue to build a more responsive and flexible economy. That means completing existing microeconomic reforms. It also means acting to identify and initiate the next generation of reforms, given the lags that can occur between the implementation of policy changes and receipt of the full benefits. But it also means taking care in the way reform is implemented, including accounting for any significant adjustment implications.

The inquiry and research work undertaken by the Commission over the past year bears directly on the ongoing reform agenda and adjustment issues. The remainder of this chapter brings out some key messages and insights which have implications for future reform options and associated policies.

Competition policy

When all Australian governments agreed to National Competition Policy in 1995, this was clearly with the expectation that these and associated reforms would be drivers of improved economic performance in Australia. Governments have made progress in implementing competition policy, with observable national benefits.

That said, a substantial task lies ahead in completing the agreed program of reform and in extending competitive disciplines across the economy. For example, the Commission's inquiry on progress in rail reform found that most government-owned railways still make losses or are barely viable, even after the inclusion of payments for non-commercial services. A mix of competitive contracting and franchising, privatisation and the entry of new operators is required to bring a greater commercial focus and the investment needed to secure the industry's future.

Improved community understanding of reform and its results is also necessary. The Commission's inquiry into the impact of competition policy in rural and regional Australia found that the purpose and effects of reform are not well understood. Unless addressed, this lack of understanding represents a danger to the continued implementation of nationally beneficial reforms. In particular, the scope for national competition policy processes to take account of social, regional and environmental impacts needs better explanation.

The Commission found that many people in country areas have been adversely affected over the last decade by a range of market-related developments and government policies — but there is only limited awareness of the real drivers of change. As a result, government reforms such as National Competition Policy are being blamed for most adverse economic and social results. At the same time, people also have an incomplete appreciation of the direct, let alone indirect, benefits they are receiving from reforms.

The facts are that national competition policy reforms are having diverse but mainly beneficial effects on industries and people in country Australia. While implementation of the reforms still has some way to go, country-based industries are benefiting from reduced costs of major inputs such as energy, rail transport and communications. Country households are also gaining from lower charges, most notably for long-distance phone calls, though the concessional pricing of services such as electricity and water depends on community service obligations being maintained. The available evidence on the quality of service provision — such as electricity outages and phone connect times — shows a mixed picture, but no systematic bias against people in rural areas.

Some competition policy reforms have contributed to a loss of jobs and other adjustment pressures in rural and regional communities, but other long-term sources of change are generally more important. These include substantial declines in commodity prices, introduction of new technologies, changes in lifestyles and shifts in consumer spending patterns. The contrasting fortunes of the wheat/sheep and some mining regions compared with those involved in wine growing and tourism are evidence of these broader influences.

The adverse effects from these other influences would not disappear if governments failed to proceed with competition reforms. Instead, the community, including country people, would be denied the benefits of further reforms.

Improving workplace productivity

Recent Commission studies of workplace arrangements in container stevedoring, black coal mining, meat processing and large capital city building projects, show the importance of such arrangements to enterprise performance and productivity growth. While there have been some significant improvements in recent years, further change is needed to underpin the competitiveness of those industries — and their downstream users — and the security of employment in them.

The studies identified a variety of restrictive workplace arrangements which raise costs and reduce productivity. Such arrangements can also impede the flexibility which firms need if they are to respond promptly to changing market circumstances, variable workloads and customers' needs.

Unproductive work arrangements strongly reflect incentive structures. For example, an overtime culture had long been prevalent in container stevedoring, whereas a 'short Friday' custom developed in meat processing. These contrasting practices did not arise by accident. They can be traced to the differing rewards from manipulating work flows, given the nature of those industries and their markets. This was reflected in high shift premiums and penalties for rostered shifts on the waterfront and the operation of the tally system in abattoirs.

Greater competition in product markets, as well as more appropriate labour market regulation, unlock higher workplace productivity. For example:

- Increased competition among suppliers in the international coal market has focused attention on work arrangements which unnecessarily restrict productivity as the major means of improving the industry's competitiveness.

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- Greater competition, both internationally and domestically, is the major factor driving the move away from highly prescriptive tally systems in enterprise agreements in the meat processing industry.
 - The severe downturn in building activity in the early 1990s emboldened clients to move to fixed-price contracts for large capital city building projects. These in turn have been one of the major factors leading to the reduction in delays caused by inclement weather and site-specific disputes and the completion of projects on time.

There has been some progress in achieving more productive work arrangements in the four sectors studied, but it has been uneven. This can be attributed to variability in competitive pressures as well as to the remaining influence of mindsets developed under a centralised and adversarial industrial relations framework. For example, limited competition between container stevedores, together with a 'closed shop' for stevedoring employees, have made the process of unwinding inflexible and prescriptive work arrangements on the waterfront both difficult and protracted.

There is considerable scope for managers and workers to improve workplace productivity, including through better use of the increased flexibilities provided by the Workplace Relations Act. For instance, the Commission found that there were still many productivity-restricting work arrangements which raised unit labour costs in Australian black coal mines that could be addressed within the existing regulatory framework.

However, the Commission's four studies also identified aspects of workplace legislation where options for greater flexibility should be explored so as to facilitate further productivity-enhancing outcomes. These include the range of allowable matters in awards, sanctions against unprotected industrial action, choice in union membership and the regulation of agreement making.

Industry assistance

Demands for industry-specific assistance measures — whether in the form of protection against imports or special investment incentives — need careful scrutiny to ensure that broader community interests are served. Calls for retaliatory action against the trade barriers of other countries, or for linking reductions in assistance for Australian industries to progress by other countries, should be subject to this same test.

The adverse effects that tariffs and other forms of selective industry assistance have had on industry costs and productivity are now generally recognised, and Australia

has made significant progress over the past decade or so in reducing such measures. For example:

- The average effective rate of assistance to the manufacturing sector is now around 6 per cent compared with 19 per cent in 1987-88, the year before the phased general tariff reduction programs commenced.
- As the Commission's latest estimates show, rates of assistance to most agricultural industries are also low — although there can be substantial year to year variation (PC 1999f). Assistance arrangements for highly protected agricultural activities (including tobacco and sugar) are being unwound, and farmgate support for dairying will be substantially transformed once Victoria deregulates its dairy industry.

Some argue that Australia has rushed headlong into tariff reform to such an extent that we now 'lead the pack' and should therefore delay further reductions until other nations catch up. Although recent comparisons do show Australia to be among the group of OECD countries with the lowest tariffs and the least pervasive use of non-tariff barriers, most other countries liberalised their tariff barriers much earlier (OECD 1999). More importantly, decisions about Australia's remaining assistance measures need to be informed by analysis of their *domestic* impacts, not by reference to international rankings.

In the traditional area of border protection, a few remaining pockets of high assistance stand out — notably passenger motor vehicles and textiles, clothing and footwear. The tariffs applying to the products of other industries, though low, also continue to be a cost impost on user industries. The Government has accordingly announced that it will ask the Commission to examine the benefits and costs of reducing tariffs of 5 per cent or less. In advance of that inquiry, the Government has announced the removal from 1 November 1999 of 400 'nuisance' tariffs on imported goods that are also not made in Australia.

As the general level of tariff protection has fallen, the significance of other forms of industry assistance — antidumping and emergency protection measures, some quarantine restrictions, firm-specific investment incentives and other budgetary support — loom larger. Because these measures have consequences for the economy beyond the industries concerned — including the signal they provide to other producers to seek similar preferment — recent developments in the provision of such administered assistance need to be monitored closely.

Internationally, Australia is a major user of antidumping and countervailing measures against imports. Significant changes to antidumping procedures — involving abolition of the Anti-Dumping Authority, implementation of a faster, single-stage investigation, and a revised review and appeal mechanism — became effective in July 1998. The potential for the antidumping system to be used as a

mechanism for industry protection means that rigorous and transparent decision-making processes are paramount. The effects of recent institutional and procedural changes thus warrant close examination in the impending legislation review required under the Competition Principles Agreement.

Industry pressure for increased protection against pigmeat imports saw the Commission undertake Australia's first 'safeguards' inquiry under GATT/WTO rules since 1984. The Commission found that a short period of additional tariff assistance — initially set at 10 per cent, phasing to 5 per cent after one year and to zero after two years — could be justified under the WTO's narrow safeguards criteria. Nevertheless, it gave reasons as to why adjustment assistance was a better option.

The Government's acceptance of the Commission's reasoning was a timely reaffirmation that adjustment, not protection, is the effective path to world-competitive industries. It is regrettable that the US decision to restrict lamb imports was not influenced by a similar logic. Having taken its pigmeat decision, Australia is well placed to call for agricultural protectionism to be addressed seriously in the upcoming WTO Round of trade negotiations.

The Government began to provide firm-specific assistance under its Strategic Investment Incentives program this year. It committed \$40 million to Visy Industries' pulp and paper mill at Tumut (of which \$15 million comprises an additional investment incentive) and has offered more than \$100 million to Comalco to expand an alumina refinery in Gladstone. The Government has indicated its support for the principles enunciated by the Commission to minimise the economic risks of such assistance (IC 1998). Nevertheless, lack of transparency in how the selection criteria are being applied makes it difficult to assess the anticipated net benefits for the community of the subsidies offered thus far (PC 1999f).

Innovation plays a key role in productivity growth and is an area in which carefully designed government programs can improve on market outcomes. For example, the R&D tax concession has helped to address what otherwise would be underinvestment in research by Australian industry. That said, in a report released this year, the Commission found that the design of the tax concession was not as effective as it could be in stimulating genuinely new R&D (IC 1998). The Commission suggested ways of improving the tax concession, including by targeting it to incremental R&D. This could also provide scope to raise the rate of assistance while decreasing expenditure. The Government has expressed concerns about potential administrative complexities, but the Commission sees benefit in a more detailed examination in the context of the proposed Innovation Summit next February.

Addressing adjustment and social concerns

Reforms which make the Australian economy more productive and adaptable in the face of change can, in themselves, cause adjustment problems for some members of the community. Governments can assist by removing impediments which make it more difficult for people to adjust and through provision of other programs to help them cope with change. If this is handled well, unnecessary transitional costs can be reduced and support for the reform process strengthened.

As the proceedings of the Commission's workshop on structural adjustment policy issues show, dealing with the adjustment and social consequences of change raises many complex conceptual and practical issues (PC 1999b). This demonstrates the importance of processes and institutions which can generate the best possible information for governments on which to base policy choices and to help them explain the basis for those choices to the community.

Policy makers not only need information on the prospective benefits of reform. They also require information and analysis to identify any adverse consequences, to assess the varying claims about adjustment which often accompany reform proposals, and to put the likely adjustment consequences into perspective. The unpredictable nature of adjustment processes in a dynamic economy means that information can never be perfect. But early analysis can help to ensure that individual reforms are implemented in ways which ease adjustment pressures and to determine whether prevailing social safety nets are sufficient or whether other adjustment measures are required. Adjustment pressures and policies are the subject of a major stream of research within the Commission.

The importance of information on the social and economic impacts of policy choices has been demonstrated in the Commission's inquiry on Australia's gambling industries. The Commission found that decisions in the 1990s to increase significantly the range and accessibility of gambling opportunities were often taken without adequate information and advice about the potential social and economic impacts. Community consultation, especially at the local level, has also been deficient.

The Commission's work on service provision — now in its sixth year — continues to shed light on the efficiency *and* effectiveness with which social infrastructure services are being provided in Australia. Because of the importance of these services, both to Australia's economic performance and to community wellbeing, some of the steps needed to ensure better outcomes are discussed in chapter 2.

