
Productivity Reform in Australia and New Zealand: Barriers and opportunities

Australian and New Zealand Productivity Commissions' forum, 24 November 2020

Michael Brennan, Chair

In my remarks today I will focus on the task facing PCs, policy advisers and the economics profession.

My first contention is that just as we seek to shape events, we have to accept that we will be shaped by them.

Change, reform and innovation can't just be for everyone else.

Also, we should do our work in a positive, optimistic spirit.

No doubt much can be improved in Australia and New Zealand, and it's our job to point out where this is so.

But, looking across the world, when it comes to economic performance, institutions, quality of governance and policy processes, isn't it reasonable to ask: with whom would we willingly swap places?

That is not to argue for complacency.

Quite the opposite – my point is that the public square is in good order and policy makers are looking for new, good, well-articulated ideas.

Of course, there is competition for influence. But that's neither new nor unhealthy.

So, I will talk about three areas where I think we need those new, well-articulated ideas.

They are all forward looking; they relate to forces taking shape, or currently at large.

In each case, we have some answers not as many as we would like. We could refresh the research agenda accordingly.

The most pressing is the recession and recovery.

In the depths of a downturn, we rightly reach for the big macro levers like fiscal and monetary policy.

But as I have said elsewhere, even in a recession – especially in a recession – micro still matters.

It matters because every recession (certainly this one) sets off a reallocation of resources; and every recovery rests on countless small creative acts by those starting businesses, investing, hiring and taking risks.

Policy settings – in regulation, skills, planning, tax and labour mobility – affect the ease and speed with which that reallocation and recovery come about.

Now, all these policy areas are familiar to economists, but the approach is subtly different from the traditional allocative efficiency story – it's not so much the triangle in a partial equilibrium diagram.

The issue is less about moving from one (distorted) static equilibrium to a better, less distorted, one.

It is about improving the adaptability of the economy – the ability to cope with change. And it comes about through the cumulative impact of flexibility on multiple small fronts.

The second theme is the rise of the service sector and what it means for productivity growth.

Our economies have shifted gradually but fundamentally over many decades. In 1900, agriculture employed a quarter of Australian workers. By 1950, manufacturing did the same.

Today those two industries combine to employ fewer than 10 per cent of workers. Services are around 90 per cent.

You can't be a rich country in the 21st century without a high productivity service sector.

But my contention is that our understanding of productivity growth hasn't kept pace with that shift.

We need to better understand the drivers of productivity in services and the policies that support it.

We know a bit about how productivity growth unfolded in agriculture, mining and manufacturing – with automation and use of other technology – often making production more efficient.

Some services might follow a similar path, but many will not. Many services are intangible, delivered in person and are hard to automate.

It's possible that many service industries will innovate less through R&D and more through new business formation and new business models.

In many cases, productivity growth could come almost entirely in the form of increased quality, rather than increased output from less labour.

Of course, that has been partly true for many goods – cars, TVs, computers. But it could be much more salient in a service dominated economy.

My third theme relates to non-monetary sources of value.

We focus a lot on per capita incomes because they are a pretty good first approximation for living standards.

But as we get richer, it's natural to ponder whether there is more to life...

... partly due to the suspicion that as we get richer, we are sacrificing other important things.

In fact, economic progress has improved life on many dimensions – less disease, cleaner air, safer workplaces, more leisure and longer lives.

But it's hard to bring that together into a composite index of wellbeing to sit alongside GDP. It's not clear that we need to.

A clear strength of microeconomic analysis is that it tries to get at the benefit – or surplus – that isn't fully reflected in the dollar value of transactions.

For example, in our mental health inquiry, we estimated the total detriment from mental ill health in Australia at up to \$220 billion annually.

Less than one third of that figure was actually a cost to the economy (lost participation or productivity or higher health spending) – that would affect GDP per capita.

The rest was the non-monetary personal costs of living with a mental illness, or – tragically – dying prematurely as a result.

Similarly, when we assessed the impact of reform, the overwhelming bulk of the benefits came from improved quality of life, with only a smaller gain to economic growth.

This analysis was based on quality adjusted life years – a stylised concept to be sure, but one that gets at what people care about over and above economic growth.

Crucially, it allowed us to compare the cost effectiveness of different interventions and reforms.

So, you can have analytic rigour without succumbing to the monomania of making it all about per capita incomes.

In all these areas – recovery from recession, productivity in services and measuring non-monetary impacts – we rely as best we can on evidence.

But we also face a lot of uncertainty. 2020 has reminded us how much we don't know.

Evidence is often missing or incomplete.

It's one thing to say we want evidence based policy – that's not the hard question. The real dilemma is: to what standard of proof?

If you require the criminal standard (beyond reasonable doubt) you might find yourself saying very little.

We can't just tell governments what not to do.

Governments legitimately want to do things, to solve problems; alleviate suffering. I'm not defending activist policy per se: sometimes reform involves reducing the role of government in the economy.

My point is we can't allow the limitations on available evidence ex ante to become an argument for the status quo.

Sure, we can advise as to the trade-offs and caution against imprudent methods.

But we also have to be part of the solution.

In the 3 areas I mentioned – and with other emerging issues – to be great, influential policy advisers, we need to keep building, keep cultivating a number of capabilities.

I will nominate four:

- a commitment to, and nuanced understanding of, evidence
- curiosity about the broader world
- a strong conceptual framework
- that mysterious, intangible quality known as judgment.

I look forward to the discussion.