
The Productivity Reform outlook – creating an expectations effect, in support of continuous reform*

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Thank you for the opportunity to be here today.

This is my first formal address as Chairman of the Productivity Commission.

I hope today to give you a feel for how I will approach the job; and to raise a question which has bothered me for a couple of years now, on how to improve the future micro economic reform agenda.

I have been a practitioner in market reform and economic development at the micro economic policy level since the mid 1980s. During that time, I have been a great admirer and user of reports from the Productivity Commission and its predecessor organisations, as a mechanism to put the potential design of, and benefits from, public policy reform on public display.

For much of that time, I have worked for governments of both the major political persuasions as a problem-solver, ultimately concerned with applying *the art* of the most possible - Bob the Builder for the government, my younger daughter once told her school class. Once I worked out who Bob was, I took that to be a compliment.

Whereas the PC is ultimately about the science, *the science* of the first best.

Good public policy problem-solving is about bringing the art and the science together.

Yet in my previous positions, that work necessarily also brought with it the need for a rather low public profile.

*Tasman Transparency Group Productivity Agenda seminar, Sydney, 1 May 2013.

So I have to tell you that a Google search on me will reveal very little. Generally, I have served in the sort of places where getting on the public record was a clear mark of failure.

And you'd have to go to a library to find occasions where despite great efforts, word still did slip out.

And you'd have to read a book.

So very much not the 21st century.

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But I now have a new job. One with a public profile. I guess I will get used to that, eventually.

We all do due diligence before we take up new jobs.

I learned the need for this by joining Ansett in 2001. Others of you in this audience will have required less confronting an education.

One question I have always found worth asking is, who actually am I working for here?

In the public service, this question might seem trickier to answer than in the private sector. And consequently all the more worth asking.

In the case of the Chair at the Productivity Commission, the job is unique. The employer is - sort of - not there.

Of course, there are people with whom you must keep effective working relationships - the Treasurer and Assistant Treasurer and the Secretary to the Treasury come quickly to mind.

But it's not like my last couple of jobs, running Departments.

When you run a Government Department, you work in effect for a Minister - but at the choice of the Premier or the Prime Minister. They sign your contract, they receive the report to get rid of you if you are not up to it or out of favour. You seek to match the aspirations of the Government of the day with the longer term public interest, as best you can see such a fabled beast from an office in Canberra or Sydney or Melbourne.

And in the end, the choice of taking up that advice lies always with the relevant Minister and where relevant the Cabinet. It was all pretty clear, in my last few jobs.

So what's my point with this?

It's that the position of Chairman of the Productivity Commission doesn't fit any of the traditional moulds – either in the public or private sectors.

Its independence makes it one of those few positions where the right to judge what is, on the evidence, the best course to take in reforms at the industry or sector level, lies with the Commission itself. And the Commission acts in the long term interests of the community as a whole.

It wasn't made statutorily independent for no reason. So this independence is to be exercised - but with deftness, certainly. After all, References come to the Commission only if the Government of the day is prepared to expose an area to our unique process of rigorous assessment.

So how best to apply what I have learned as a practitioner in the change environment to this new role?

I have asked this question, both of my predecessors as Chair and among those in business and sectoral representation who have worked a lot with the Commission.

The clearer part of their answer is that the Chair's job is to ensure rigour in the process of reform analysis and to promote to Governments the solution to problems referred to the Commission.

The subsequent task of making the case for change - to the public, and among those affected - is less clearly allocated. It *is* part of the role, but there is no simple script to follow.

Because the innate worthiness of our work at the PC - if I could put it that way - will not make the case to the public, or to those most seriously affected, by itself, I think more can be done from the Chairman's position to share the burden of explanation of the productivity case. And to assist the Government of the day in creating a public consensus in favour of reform, indeed preferably in favour of *continuous* reform.

I hope to make a start on that today.

In my view, those who argue the reform case can contribute in this task by describing not just **what** we want to see change and why; but **how** it can be done.

For in my experience by far the hardest thing for Governments is **how** to justify reforms, particularly when brought forward piecemeal:

how to impose adjustment costs across the community, particularly when the case for change is not self-evidently made by a very immediate threat or shock?

how to apparently single out the protected interest of one sector, and yet make the case when other sectors are not being apparently singled out?

how to press for lower rates of assistance when it means serious consequences for one region?

how to make the case for continuous change, when the Australian economic environment has often been so apparently benign, over twenty years of persistent growth and rising incomes?

This aspect of being ‘singled out’ is particularly problematic. It needs to be addressed, and I will come to that.

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I should divert for a moment here to note here that I will usually in my public remarks talk about Governments in the plural. Although the Productivity Commission is a Commonwealth entity, it is quite clear to me from experience that a good deal of what is of consequence in the productivity agenda cannot be achieved sustainably in Australia by one level of Government acting alone.

So I will be seeking close relationships with State entities, as part of this job.

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Governments in my view are collectively very well aware that productivity growth is the central element in improving our national welfare in future. I sometimes feel that this is not well enough recognised.

It is a very rare Minister who is not in favour of productivity growth, and few do not know instinctively that it is our flexibility, our workforce capabilities and our competitive environment, rather than the swings in the terms of trade or the commissioning of any big project, that determine the economy our children will inherit.

For a productive economy, we need a continuous commitment to innovation; early adaptation to new technology; the regular updating of business process; removal of impediments to competitive entry; and a constant effort to upgrade the skills of employees.

And we are in an environment where much adjustment will be necessary:

as the global economy goes digital and wreaks brutal but innovative change across whole industries and even aspects of national advantage;

as a deteriorating age-dependency ratio affects us and many Western nations, shifting consumer demand and altering the revenue-generating capacity of governments globally; and

as the needs and desires of the strongly developing nations of Asia take ever greater hold of the international trading environment.

Australia will need to compete aggressively, with skills and technology, in such an environment.

And with global confidence in our economy reflected in the relatively high Australian dollar, to offset that by investing and working smarter.

Along with productivity, the other primary factors of enhanced economic welfare and income are the participation rate and population growth.

In decades past, our population grew significantly and participation levels - of women in particular - improved noticeably, yet in the overall story of national economic welfare, they each added only a modest amount.

In future, participation and population seem destined by the inexorable force of demographic change to play an even more limited part, perhaps a negative one.

And so we are left with the need to press our productivity reform agenda, again.

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It is important to recognise that in making the case for change that government is not always part of the answer. There are times when it is unreasonable, even unhelpful, to call on Governments to intervene. We rely on firms to address the productivity task, across most markets.

And for good reason.

We are all generally well aware that when Governments do directly invest in particular firms, the success rate is pretty low. And once involved, even at the sector level, extricating itself can be particularly hard.

But governments do set the framework for the economy. So in provision of infrastructure and services where risks or ability to capture benefits are beyond the scope of any one firm, or where regulatory structures or factors outside the control

of firms discourage efforts to improve productivity, or where allocative efficiency is not delivered due to market impediments, it is legitimate to look to Governments.

There is a good supply of advice to Governments on the scope for such changes.

Supply indeed seems not to be the larger problem.

Supply includes what has become known as the Commission's 'to do' list, of advice previously tendered.

And there is a plethora of COAG reform processes looking at important matters such as energy markets; the national operating environment for business; and health management.

And there is the Productivity Commission's pipeline of work: we currently have References on electricity networks, mineral and petroleum exploration, major project approvals, access regimes and the interaction between small business and regulators. We hope to receive a few more References in crucial areas shortly. These too will yield yet more proposals for enhancing our productivity.

A number of State Government review and reform exercises are also extant.

And this is only describing the agenda as described in government processes - the business community and social policy groups have further ideas and proposals.

All this is indicative of an agenda of change, albeit made up of many parts at different stages of development and varying prospects for success.

Less evident is the same amount of effort, at Commonwealth and State level, to establish the need for reform in the public mind. Put another way, to improve the *demand* for continuous reform in the face of the challenges mentioned earlier.

We perhaps rely too much on crisis to establish in the public mind the demand for reform.

And it is quite ironical that our own success in crisis may count against us: in Australia, we have surely been quite good at managing a crisis.

Commencing with the 1986 Banana Republic warnings and subsequent recession; the March 1991 statement and Working Nation; the response to the Asian currency crisis of 1997; the GST reforms; and most recently the response to the global financial crisis.

The threat creates the opportunity. Never waste a crisis, we used to say.

In each of these examples, the politicians and the policy makers, the businesses and the educators in this country did reasonably well, on any fair assessment.

The overall result has been that the Australian economy has allowed an entire generation to be born, gain an education, enter employment and save for the future without the damage of a major down-turn and the consequent loss of that desirable path to economic opportunity.

And so to today, where it could almost be said that we have no crisis. Or in any event not of the kind that motivated some of these past plans.

But we do know, quite factually, that our recent productivity performance indicates our prospects of maintaining this pathway of improving living standards is at some risk.

Our labour productivity has recently recovered after a significant period of decline. It will, however, take persistent growth to return to the long-term average performance expected of an economy like ours at its best.

And the possibly more policy-relevant indicator of Multi Factor Productivity remains very weak, as it has now for much of the past decade.

This matters quite a lot because, as Nobel winner Paul Krugman has said, 'productivity isn't everything, but in the long run it's almost everything'.

And our demography - the ageing of our population, the fall-off in participation and worsening of the dependency ratio - will make sure that is true.

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So how in such a context can Governments at all levels translate that to a form which creates community recognition - demand, as I term it - for the kind of continuous reform that can offset an ageing population and sustain higher productivity levels and incomes?

And preferably in a way where the limits I noted earlier to *how* Governments may press for reform - the singling out, the focus on a particular region, the lack of a wider context - are better addressed.

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Part of the answer may lie in our policy-making structures. And the expectations they create. Expectations are very powerful things.

When I refer to our policy-making structures, I do not mean the Departments of State or the Ministries. I mean, rather, the means that we use to deliver our economic plans.

Do we have the necessary structures that offer an incentive in favour of productivity-oriented reform, on a continuing basis?

Our current economic policy structures have evolved over many years.

There is an annual Budget and we use it to promote and implement macro-economic objectives. Fiscal policy is thus institutionalised in a structure via a process that has been built up over many decades.

And it is still adding to its weight, with the MYEFO assuming a greater significance than it has had in the past.

Monetary policy too has increasingly come to have an institutional public framework, in the profile accorded to the monthly meetings of the Reserve Bank Board and the issuing of Minutes.

Both these arrangements have a substance beyond that of the decisions they communicate. They are structured opportunities that create the *expectation* that change will be promulgated, or reasons advanced as to why circumstances do not justify change, *on a continuous cycle*.

Indeed, the Vice Chairman of the US Federal Reserve has recently gone so far as to describe communication – as she has put it, “the mere use of words” - and resultant conditioning of expectations as a primary tool of monetary policy.

Consequently, proponents and opponents of change in fiscal and monetary settings lobby in anticipation of these known points of decision-making in the macro economy. Debate occurs, statements are made and the nation is generally better informed as a consequence.

Most importantly to my case today, Governments do not need to ‘bring on’ fiscal change or monetary change, as they need to do with individual firm or sectoral level reform.

Rather, these structured arrangements determine that the opportunity for action occurs regularly, and draw in almost by definition the need to act, or explain why not, *on a continuous basis*.

For the micro economy, or reforms at the sector level, there is no such structured opportunity.

Instead, proposals for change are initiated occasionally; then make their individual way towards implementation, often alone in a sea of criticism, sustained only by a report or inquiry that is aimed almost always at solving a problem rather than making the case in a wider context of the productivity impact on the national economy. Many sink. Others disappear, never to be heard of again.

The environment is one where we expect that the innate goodness of the worthy report will see it through. It is often not enough.

In my time, I worked on a number of the Statements of the Hawke-Keating era, and also on reforms complementing the quality of the Howard-Costello GST package.

I recall one of the key catch-cries against reform in that period was ‘if it ain’t broke, don’t fix it’.

Seriously.

As if only in crisis should we act, something that might be called the ‘just too late’ philosophy. Some of this thinking may still persist today.

My suggestion today is that we need a mechanism under which continuous reform is invited. Surely Governments would be deeply advantaged in pressing the case for productivity reform in the future if there was a regular opportunity - similar in principle to the focus established by formal statements of fiscal and monetary policy - to put a comprehensive series of reforms and the narrative to accompany it.

An opportunity to better explain the problem and lock in recognition of the case for higher productivity.

An integrated approach, where the voice of any one affected sector or region may not dominate; and where the breadth of necessary changes and the combined potential for economy-wide gains can be clearly set against any costs.

I am not proposing today any specific aspects of what such an approach could encompass. This is more about establishing a generic way forward. But clearly there is scope in this idea for a regular, wide-ranging review of productivity-oriented reforms, including those generated by the Productivity Commission.

This is not a concept that can be created overnight. If pursued seriously, the effort involved means it may not even be an annual event.

Yet to be successful, there are also some things it should not be. I am not talking, for example, about a Budget paper, a document of record.

The consequent focus on our productivity would be anticipated, debated and become an *expected* part of the national economic psyche. Powerful thing, expectations.

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I have struggled to assess in writing this whether it will be viewed as a comment on mere process, as if process is unimportant, and perhaps consequently seen as a limp policy lettuce leaf.

Or at the other extreme, represented as a crude incursion into the political world in this, an election year. After all, to be sustainable such a concept would require endorsement over time across the political spectrum.

I hope it is viewed as neither. It is not intended as such. It is an idea about expectations, about improving the conditions in which policy reform might be pursued, drawn from asking when I first thought about this job of Chairman: *do we have, in microeconomic reform, all the tools that they find so useful in fiscal and monetary policy?*

As a final point in support of further discussion of this idea, I would note that we have conditioned public expectations in this way before, on occasions. Primarily in crisis, of course.

Looking back, we celebrate these occasional reform Statements.

We celebrate them, but we have yet to replicate them out into the long term.

In the future effort to lift our productivity, perhaps we should.