
Making a Difference¹

I liked the title of this session the moment the organisers proposed it.

It was the theme that we used when I was a junior member of the group putting together the reform agenda for the Structural Adjustment Committee of Cabinet back in 1986 – the original microeconomic reform group of the Hawke-Keating era.

For public servants, often viewed as at best the implementers of the ideas of others and often as reactive guardians against systemic change, it was a novel experience to be told it was our job to make a difference.

We were helped of course by the circumstances: an economy struggling with a terms of trade shift, heavily regulated industries, ‘duopoly and a bit’ as the most common description of Australian markets, difficult industrial relations climate, currency in substantial decline, the banana republic sentiment ringing in our ears.

It wasn’t too difficult to imagine that we could make a difference.

But the distinction between imagination and permission in the public service is a very bright line.

Permission was very important; and permission will be a thread running through this address today.

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It is probably better accepted today than it was in the immediate aftermath of the Global Financial Crisis that our economy was not going to grow national income in the same way as it had for more than twenty years.

It was forecast even then that a combination of factors - the upcoming decline in the terms of trade; the cessation of a key driver of our private investment from China’s investment drive; the early negative demographic effects on participation; and poor domestic productivity growth - were going to see Australian income growth slow significantly this decade, absent serious remedial measures or another fortunate shift in demand.

The weakening of employment growth was seen as a likely natural outcome of this; and, unsurprisingly, so it has proven.

¹ Address to the Economic and Social Outlook Conference 2015 - *Rebuilding Foundations for Reform* - on 5 November 2015 in Melbourne.

At the time, and still today, much public focus was placed on the budget deficit.

Unfortunately, it was also quite predictable then that repair of the budget – desirable though it may have been in its own right – could not address this core problem of weak growth in income and employment, other than in the long term.

So, for the purposes of today's topic, what could make a difference in the more immediate term is structural reform.

The dirt-under-the-fingernails, messy stuff of altering incentives in favour of better productivity and higher participation, through two mechanisms:

- stronger investment, creating stronger employment
- reduced regulatory impedimenta.

Yet it is still questionable whether that simple message – focus on the micro economic stuff – has gained the wide acceptance needed to see it translate into actions.

Actions where it is important to know, but necessary still to accept, that some will win and some will lose.

And to ensure that we have a system where the social equity effects of this are sensibly addressed.

But overall to embrace it and allow productivity to lift.

Average - we celebrate now that labour productivity is back to average, over the current cycle - won't do it.

The ultimate expression of these two forces – new investment and the removal of regulatory impedimenta - for higher income growth is of course primarily in the hands of firms and their employees.

But to trigger it, government is a (perhaps the) most important enabler. Not just with rhetoric, but with actions.

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What actions can make a difference?

Tax reform has already been mooted.

If well-designed, it certainly has the scope to alter incentives.

But there are many other targets today being cited for tax reform than incentive to invest.

If incentives shift were to be made the pre-eminent objective, two things should naturally follow.

First, actual analysis. And we should ask to see it. This is not a throw-away line.

We really should ask.

It should no more be good enough simply to attach the label ‘investment enhancement’ or ‘productivity growth’ to a reform, and expect to see it celebrated.

Second, we would change attitudes to tax reform. People would see us being more hard-headed and less wishful in assessing which incentives are most likely to motivate investment and so translate into genuine improvement in their national income.

To avoid being mistaken, I am not arguing here for the usual suspects of selected investment allowances or R&D tax incentives. These have not shifted the productivity or investment dial in the past.

Why would we revert to them, time and again, even though we can see so little effect?

Will it really make a difference this time?

Even with the purported riches of GST change spread out before us, we will always have limited scope, in time and money.

We are unlikely to hit multiple targets, effectively. So we should apply the objective of incentives shift and use what we may have wisely.

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Staying with incentives established by government, it is not always the Commonwealth that should come under the microscope.

It seems reasonable to ask, if tax reform in the form of the GST is going to extend once-in-a-generation benefits to the States, as some have suggested, whether State-based policy and regulatory restrictions should not once again be on the table.

The States are the core owners of regulatory impedimenta that limits investment.

They can be incentivised again to become reformers, as they were back when national competition policy wrought a transformation of State regulation, by linking tax reform to regulation reform.

The Harper Review of national competition policy indicated:

‘The top five issues raised most often in submissions to our Draft Report [were] misuse of market power, retail trading hours, road transport, planning and zoning, and supermarkets’

And as a consequence, Harper recommended:

‘The Panel recommends that other regulations restricting competition be reviewed by each jurisdiction, with particular priority given to regulations covering planning and zoning.’

Linkages like this are essential if we are to get decent bang for our buck out of tax reform. If you’re going to do the dirt-under-the-fingernails stuff, and cop the criticism that goes with it, do it thoroughly.

Make it clear that this is not simply a fiscal balance exercise but about again – by embracing regulation reform - changing the incentives for investment, new opportunities and employment.

Emphasise those gains, back them with analysis (ask to see it).

And attitudes may well shift.

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The Productivity Commission has published numerous reports that refer to the impact on investment of location-based or time-of-day-based planning restrictions, that impede business innovation and the prospect of additional employment.

In 2011, 2012, 2013, twice in 2014 and again (in Business Set-Up; the draft is public, although the report was recently completed) in 2015, we called for State based regulation reform.

The total response has been the sound of one hand clapping.

Probably, that’s because it is so hard. And so messy. And so apparently remote from what really matters.

Except it is what really matters to small and medium sized enterprises (and tiny start-ups too) who can’t afford to hire a lawyer or a retired town planner to navigate the maze and gain permission to invest.

Just permission.

And consequent on that, permission to employ more.

Surely if we are to offer once-in-a-generation tax reform, we should try to get once-in-a-generation regulation reform along with it?

Particularly when we know, five Productivity Commission reports in four years got next to no result and now the Harper Report is hanging in the balance, facing the same fate if you follow the odds.

We could make this a key selling point.

I won't run through all the examples in all the reports, many have become legend:

- restrictions on the location of aged care premises even though ageing in place (i.e. staying in your community) is accepted as essential to policy effectiveness
- restrictions on the location of big box warehouses, making for distribution issues and congestion in urban areas
- liquor licencing restrictions more about competitors than public safety
- continuing hilarious restrictions on selling wood heaters but not gas heaters, or outdoor lighting but not indoor lighting on Sundays

Reform should be about opportunity for investment, employment, innovation. It is a signal that risk-taking is welcome.

So States should welcome it.

And be asked to implement planning reform as part of these changes.

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One of the key beneficiaries of planning reform will be innovators.

We are hearing a lot about upcoming innovation policy. It would be deeply desirable to see this extend to regulatory reform.

After all, innovation is not always the action of a research incubator on a university campus. Or a digital disruptor.

If you consider innovators as just as likely to be starting out in someone's garage, as certain celebrated Silicon Valley entities did, you'll see the link to local planning and zoning.

Adding to it, let's make another observation.

When innovation is being discussed, it's often referred to as occurring hot spots.

This observation arises often in the rhetoric but appears rarely in final policy design.

Innovation hot-spots are just that - spots. So there is something inherently local about them. So again local regulation will be relevant.

At the Productivity Commission, we accept that a focus on innovation is a relevant consideration when a nation is thinking of how to lift its capability to generate higher levels of national income.

As Australia should be, given the slow income growth outlook.

But we have some reservations about how this is done.

In some of the public debate, policy is proposed in the expectation that breakthroughs or highly creative thinking **must** be commercialised locally.

Clearly, it would be nice to be a market with sufficient scale and agglomeration of interacting entities – researcher, entrepreneur, investor, marketer, consumer – that all ideas can be commercialised here.

But this would be unrealistic.

There are very few national markets capable of taking **all** the ideas generated internally and turning them into commercial realities.

Another observation illustrates this: we can all see that the world today is made up of increasingly interconnected markets and investors.

Digital disruption facilitated by the Internet exemplifies this; but so do intra-industry international trade flows, cross-border finance markets and global value chains.

And so we should accept that it is self-defeating for idea-generators **not** to take advantage of the benefits of that interconnectedness.

Seeing some ideas go offshore is thus not inherently undesirable.

If our markets and population structure suit the innovation, then perhaps it is desirable that opportunity exists at home.

But we cannot and should not expect a benign hand of public policy to support all the ideas which continue to spin off our institutions and innovators.

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The preceding remarks were to set a context, not to damn innovation policy.

So to take the thinking further, what is essential if we are to allow innovation to flourish and make a difference?

I could describe here quite a lot to do with effective market-oriented policy structures. I'm going instead to take that as understood. We cannot expect flourishing entrepreneurial researchers, or effective adaptors amongst small businesses, if we have poor fiscal and monetary policies.

But at the local level, where innovators live and we want them to flourish, the restrictive nature of regulation – not just planning and zoning, but **all** regulators facing off against **all** innovators – is a potential impediment.

To consider this, let's ask could we ever have expected Uber to have developed here first?

Facing differentiated taxi regulation between the States, over-investment in chronically regulated taxi plates, the potential interaction with the payments system, queries over application of employment laws and the question of GST, it is a daunting list.

What might off-set it is a culture of permission to have a go. You'll see I'm back to this permission thing, again.

These might not all be issues in reality. But who would know? How could you test it, as a nascent innovator?

Unless and until you can expect - *without thinking about it much at all* - to be permitted to try to make the idea work, the incentive structure is actually set against innovation.

This alone – the uncertainty of the regulator's response - must slow innovation.

Now it may that the field you are working in, as an innovator, is unregulated. Some still are.

But if it involves consumers, payments, investors, safety, environment, buildings, sounds, smells or day of operation, it's safer to assume it is regulated.

And if it is purchased by government or competes with it, it may be restricted as well as regulated.

So the culture of the regulator (and purchaser, in the case of government) is crucial to the innovator.

In informal exchanges with the Harper Inquiry last year, the Commission hypothesised about a new model, to provide all Australian regulators the right to make temporary exemptions from regulation for innovative business models.

This was **not** a right for every innovator to an exemption, but an opportunity to consider such.

But it would offer a significant culture shift across regulators, at no budgetary cost.

There's a first.

It would amount to permission from Ministers to regulators, to allow pioneer models to be trialled.

A generic change to all regulator models, Commonwealth and State.

Pretty much as we have done, generically, to require all regulators not to discriminate; or all regulators to support privacy.

But in this case, it would be all regulators to **consider** new delivery models, not immediately reject them if the laws are not designed with this breakthrough in mind.

And so an Uber-style innovation in the Australian environment might not fall at the first regulatory hurdle.

Today's black letter laws in most cases could not really have comprehended the kind of advances that big data analytics can create for service provision.

Uber, Airbnb, Gumtree, Airtasker and their ever-increasing equivalents are all mechanisms for allowing the aggregation and reuse of information on consumer needs and demands, to make a new market. One that disrupts old markets, for sure. But is in fact its own marketplace, based on data flows that did not exist or existed only in rudimentary form before being enabled by smart phones and data management.

And they are all, in the classic sense of the term, more efficient allocations of resources. Resources otherwise unused but invested in are now at work.

It seems likely that this type of innovation will continue for some time. The creation and deep analytics of big data is the principal characteristic of the digital age.

But only rarely in the historical record are the gains of innovation translated to productivity immediately or even self-evidently.

The advent of the electrical engine in the late 1800s was innovative, but simply adding it to a factory floor designed for steam didn't lift productivity. It took a generation - thirty years - before revised factory lay-outs with the use of lots of small electric motors resulted in the startling productivity gains of the second industrial revolution.

Likewise, the gains from aggregating information, analysing it and offering it to consumers as new services will take time to learn.

But it is only limited by the absence of data itself, not by technology.

Stretching the analogy, we now have the data motor but where do we put it to maximise the gain?

We should prepare our regulators with the discretionary ability to allow new models to develop.

Otherwise, there will be at least two adverse consequences:

- First - we will surely send more ideas offshore.
- Second - we will be late to the party in adopting the innovations of others.

This second point is arguably more important than the first.

Very few businesses, here or overseas, are genuine innovators.

Maybe 1 or 2 per cent in this country, and higher in the US but still small. Again, we have the data to show this.

We want more, for sure, but even at 5% (a huge leap) that leaves 95% to take up the role of adaptors, and preferably rapid ones at that.

The gains to rapid adaptation across the economy are likely to exceed the gains of extra innovators.

Or more worryingly, the impediments to it are going to cost us much more.

That's again not to damn innovators, but simply to recognise reality.

This adaptation may be defensive or offensive but it generally involves efforts to act more efficiently, which means better resource allocation, higher productivity, improved income and a stronger economy.

This was Australia's experience in the 1990s as the introduction of much higher levels of international exposure and domestic competition policy pressed businesses to grow, adapt, or get out.

Employment levels shifted in particular industries but grew overall and productivity outperformed the long run average.

The net benefits of this are established to most people's satisfaction these days – although they were once highly disputed – and are still with us.

So action to ensure the bulk of businesses are **exposed to** innovation and do adapt – whether it is domestically-generated innovation or foreign – is a tool for better resource allocation in the same way as trade and competition policy were in the 80s and 90s.

My point in differentiating the two groups is to allow some recognition, seemingly missing in the innovation policy debate, that the rapidity of adaptation is what will affect the bulk of the economy and so it is there that much of the policy effort should lie.

This is where it will help greatly if regulators are **given permission to expose** industries to adaptation.

This will again require joint comprehension and action by State and Commonwealth acting together.

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Finally, some governments against which we might benchmark ourselves – NZ and Singapore, for example - are utilising entrepreneurialism as a closer policy proxy for innovation than traditional measures.

The desire to see commercial take-up of ideas appears to be at the centre of this thinking.

This move to consider culture and conditions that might foster investment in breakthroughs may be a positive sign.

It is certainly avoiding Einstein's definition of insanity: repeating the same tax policy shifts time and again, while expecting a different result.

If a culture of entrepreneurial activity is the target, how might policy discern effective actions?

Entrepreneurs are likely to benefit from lifting planning restrictions on investment; and also should gain from a positive operating environment if regulators are given permission to act with judgment towards new business models.

And, although I have made a number of references to digital disruptors, both these changes have the added advantage that they are generic.

That is, analogue disruptors are also welcome to try.

And thus these changes will be of benefit to the 95%, as well.

Beyond that, one factor stands out in relation to innovation and entrepreneurial ecosystems. I mentioned it earlier. These hot spots are just that – spots. They are local in nature.

In turn, this suggests more attention should be given to local factors rather than centrally-driven policies approaches.

Some of the favoured examples of entrepreneurial engagement with government (noting there are many successful examples that do not exhibit signs of any engagement with government, other than indirectly) appear to be vested with local characteristics and strong location-based networks: Silicon Valley, Cambridge, Singapore, Tel Aviv, etc.

Consistent with this, the OECD in its work on innovation leadership has noted:

‘Local governments...are often best-placed to identify the specific needs of potential entrepreneurs.’

This does not readily translate to the model of local government in Australia. Take it instead to mean local institutions.

Selected local institutions might thus be useful as preferred observers or advisers on the rise of networks or ecosystems, and act as the natural first place of contact.

The public policy needs of such networks, if any, may not involve money. I've already noted at length regulators and planning laws.

A highly centralised model is going to have difficulty identifying specific local needs and linking them to some form of public interest outcome.

And central models may also suffer the burden of the longstanding disposition in Australia to judge policy as serious only if it involves large amounts of funding.

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A final contribution that could be made by government to support innovators and innovation is release of data.

Governments in Australia are not naturally inclined to curate and release data on a basis that allows commercial reuse.

Once upon a time that might have been as safe, and costless. Today, it's not.

Analysis of data is not only the core force behind so much of digital disruption, but also the accepted method of developing a sound basis for public policy.

There are clear opportunities for big improvements in data curation, access protocols and wider release.

From recent Productivity Commission reports, known areas of high prospectivity include property sale and land tenure; health outcomes; infrastructure costing; and natural disaster risks.

Australia is not a leader in this effort, although it has aspirations and a few agencies are outstanding.

But it still seems as if the role of State governments is not being addressed. States are often active in releasing data where big development opportunities are obvious and capital is highly mobile. Resources and mining is a good example.

But in social policy areas, where the forces for reform are yet to be given the full reign – see the Harper Report, for example – the active release of big data would enable disruptors to play a role that governments are often loathe to play.

It is not without risk for agencies to do this. They need permission to be proactive.

But we can see if governments are ready to be innovators too.

Models to do this exist offshore and some are surely translatable to Australia.

Once again, what is needed most of all is permission to make a difference.