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# Treasury Says: Productivity Matters but Coalition Policy Doesn't

***"Productivity isn't everything, but, in the long run, it is almost everything. A country's ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker."***

***— Paul Krugman, Professor of Economics and International Affairs Emeritus at Princeton University***

**Matt Saunders**
**Richard Denniss**
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Level 1, Endeavour House, 1 Franklin St
Canberra, ACT 2601
Tel: (02) 61300530
Email: mail@australiainstitute.org.au
Website: www.australiainstitute.org.au
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# Introduction

Paul Krugman’s assertion that productivity is ‘nearly everything’ when it comes to driving economic growth neatly captures both the policy advice of the Australian Treasury and the stated rational for most major economic policies in Australia.[1]

Back in 2017, according to the then Treasurer, Scott Morrison[2]:

> If we only maintain the rate of labour productivity growth we have seen over the past five years of 1.5 per cent, it will not be enough to offset the slowdown in the growth of our workforce courtesy of our ageing population.
>
> We need labour productivity growth of around 2.5 per cent to maintain the growth in our living standards.
>
> This is why a year ago I tasked the Productivity Commission to undertake the first of what will be a series of five-yearly reviews into boosting Australia's productivity, as a sister publication to the Intergenerational Report.
>
> We must set a discipline for continually scrutinizing our productivity agenda.

At the time the speech was given, labour productivity was growing at around 0.3 per cent, a result that was well down on the average 1.3 per cent achieved under the Rudd/Gillard Governments and significantly lower still than the average through the 1990s of 2.4 per cent.

Despite low productivity growth being of sufficient concern to Mr Morrison in 2017 to warrant the creation of a new five yearly productivity review process to “set a discipline for continually scrutinizing” the Coalition’s “productivity agenda”, productivity growth continued to fall to a new low of zero in 2018/19 and is yet to rebound to the levels that first caused Mr Morrison to create his new review process “into boosting Australia’s productivity”.

Significantly, as discussed in detail below, the latest Intergenerational Report (IGR 2021) reveals that the Commonwealth Treasury is even more pessimistic about the medium term outlook for productivity growth than they were when they released the 2015 IGR. Further, and presumably of even greater concern to Mr Morrison, Treasury currently believes that

[1] Australian Treasury (2021), *2021 Intergenerational Report,* p. viii, https://treasury.gov.au/publication/2021-intergenerational-report

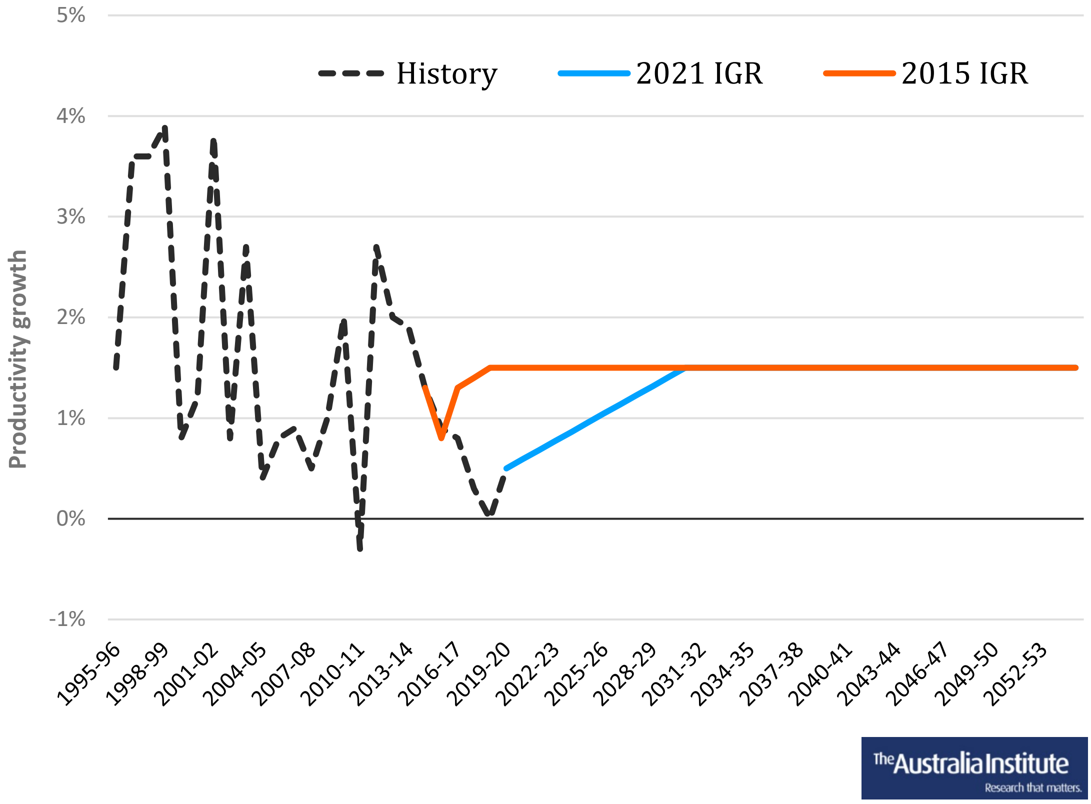
[2] Morrison (2017) *Address to CEDA 'Protecting our living standards'*, https://ministers.treasury.gov.au/ministers/scott-morrison-2015/speeches/address-ceda-canberra

none of the Coalition Government's major reforms introduced since 2015 have had any impact on the likely rate of long run productivity growth.

Figure 1 compares actual productivity growth in Australia with the projections from both the 2015 and 2021 IGRs. Three observations stand out:

1) The forecast bounce in the productivity growth rate for 2016 that was included in the 2015 IGR did not eventuate. Instead, productivity growth fell to zero by 2018/19 and is currently 0.5 per cent, one third of the rate of growth forecast in 2015 and one fifth of the 2.5 per cent goal that Scott Morrison set for himself in 2017.
2) The 1.5 percent medium and long term rate of productivity growth forecast by Treasury in 2015 is very low by modern standards.
3) None of the policy implemented since 2015 has persuaded Treasury to increase their long run forecast for productivity growth in the 2021 IGR. On the contrary, whereas Treasury believed in 2015 that the productivity growth rate could increase by around 0.5 per cent in 3 years they now believe it will take 11 years to grow by 1 per cent.

**Figure 1: Comparison of productivity growth projections, 2021 and 2015 IGR**




Source: Analysis of 2021 and 2015 IGRs and ABS System of National Accounts, June 2020

Despite changes to industrial relations, tax, infrastructure, education, trade and communications policy, to name just a few, not only do Treasury expect no long run increase in productivity growth as a result of the last six years of policy change, but they now expect improvement in productivity growth to be far slower in the coming 11 years than they did back in 2015.

In short, it is clear that Treasury do not believe that any of the Coalition Governments major economic policies announced in the last six years will deliver lasting benefits to the economy. Rather than helping to 'grow the pie', it is clear from Treasury's forecasts that they believe the only outcome of changes to tax, IR, trade and education policies have been to redistribute resources rather than produce more of them.

# Has there been a lack of focus on productivity?

One explanation for Mr Morrison's failure to boost productivity growth, both as Treasurer and Prime Minister, is that there may have been a failure to focus on either the goal of productivity growth or on policies to achieve that goal. However, as the following quotations show, the pursuit of productivity growth does seem to be central to the Coalition Government's rationale for most of its major, and minor, policy announcements.

**With regard to the creation of the Australian Building and Construction Commission** (ABCC) then Treasurer Scott Morrison stated, "This is an important economic reform ... that will drive productivity, that will support wages growth, that will support increases in profits of small businesses so they can grow and expand."[3]

A view shared by Christopher Pyne who said, "the last time the ABCC existed in Australia building and construction productivity increased by 16.8%".[4]

**With regard to trade policy** Mr Morrison stated, "Free trade agreements also increase Australia's productivity and contribute to higher growth by allowing domestic businesses access to cheaper inputs, introducing new technologies, and fostering competition and innovation."[5]

**With regard to infrastructure** Mr Morrison stated, "The Government is implementing a $50 billion national infrastructure plan to unlock our productive capacity, generate jobs, and expand business and labour market opportunities. To support this plan, the Government has reformed Infrastructure Australia to improve decision-making on infrastructure projects and ensure taxpayers' money is spent on projects that return the greatest productivity improvement."[6]

**With regard to privatisation** Mr Morrison stated, "The efficiency gains through privatisation of the New South Wales electricity network will place downward pressure on electricity prices, with the proceeds from the sale to fund new productivity-enhancing infrastructure."[7]

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[3] Karp (2016) *Scott Morrison's claim ABCC will boost wages shows it is fast becoming a magic pudding*, https://www.theguardian.com/australia-news/2016/oct/18/scott-morrisons-claim-abcc-will-boost-wages-shows-it-is-fast-becoming-a-magic-pudding

[4] Karp (2016) *Scott Morrison's claim ABCC will boost wages shows it is fast becoming a magic pudding*

[5] Morrison (2016) *Australia: A strong and transitioning economy,* p. 10, https://ministers.treasury.gov.au/sites/ministers.treasury.gov.au/files/2019-05/2016-012.pdf

[6] Morrison (2016) *Australia: A strong and transitioning economy,* p. 13

[7] Morrison (2016) *Australia: A strong and transitioning economy, p. 13*

**With regard to Competition Policy** Mr Morrison stated, “Competition policy is one of the surest ways to lift long-term productivity growth and generate economic benefits that can be shared by everyone. Increased productivity driven by a more efficient market will drive innovation, entrepreneurship and more productive investment. Previous National Competition Policy reforms in response to the Hilmer Review in the 1990s and early 2000s delivered efficiency improvements that boosted Australia’s GDP by 2.5 per cent. We will now build on this legacy as we seek to reboot competition reform policy. Reforming competition is one of the best options we have to boost growth and productivity in the years ahead, and this is why it’s at the heart of the Government’s economic plan.”[8]

**With regard to health policy** Mr Morrison stated, “Healthy and happy people are naturally more productive people. They are more likely to be out looking for a job, more likely to be free of dependency on welfare and more likely to be earning higher wages. Health is a genuine wealth enabler."[9]

**With regard to digital infrastructure** Josh Frydenberg stated, “The Governments’ Digital Business plan is targeted at building on this digital transformation of Australian businesses to drive productivity and income growth and create jobs. Our Digital Infrastructure package is estimated to increase Australia’s GDP by $6.4 billion a year by 2024 and around $1.5 billion of this additional economic activity is estimated to flow to regional Australia each year.”[10]

**With regard to Industrial Relations** Mr Porter stated, “The government's reforms aim to restore Keating's vision by making the bargaining system easier to engage with, faster, more efficient and, most importantly, capable of delivering those twin goals of productivity growth and higher wages."[11]

**With regard to the NBN** Minister Fletcher stated, “Today I want to talk about the NBN – and the way it can help boost productivity by giving businesses more bandwidth, more choice and lower prices. Already we are seeing significant evidence that the rollout of the NBN is stimulating the take up of efficient new cloud based ways of doing business – and in turn boosting economic activity and productivity growth. We want to drive this hard over coming

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[8] Morrison (2015) *Turnbull Government to promote more choice, better services, stronger growth,* https://ministers.treasury.gov.au/ministers/scott-morrison-2015/media-releases/turnbull-government-promote-more-choice-better

[9] Yaxley (2017) *Healthy Aussies could boost economy by $200b,* https://www.9news.com.au/national/productivity-commission-report-launch-treasurer-scott-morrison/a0f0be5e-9734-4eb4-aace-2ff5442ba3ef

[10] Morrison & Frydenberg (2020) *Digital business plan to drive Australia’s economic recovery,* https://www.pm.gov.au/media/digital-business-plan-drive-australias-economic-recovery

[11] Bonyhady (2020) 'Worst attack since WorkChoices': Key element of pay deals to be relaxed under IR reform, *https://www.smh.com.au/politics/federal/worst-attack-since-workchoices-key-element-of-pay-deals-to-be-relaxed-under-ir-reform-20201208-p56lmo.html*

years – because the NBN is an important part of our toolkit for improving our national productivity, and in turn our prosperity and quality of life."[12]

**With regard to infrastructure** Treasurer Frydenberg stated, "Our record infrastructure investment not only creates jobs now, it also sets Australia up for the future," the Treasurer said in a statement. A new intermodal terminal in Melbourne will help to boost the productivity of the nation by helping businesses get their products to domestic and international markets faster following the completion of inland rail."[13]

**With regard to suburban car parks** Minister Birmingham stated, "We are going to continue to deliver infrastructure projects for the nation because they lift our national productivity."[14]

**In summary, according to Scott Morrison** "As a government, the delicate rebalancing requires us to focus keenly on the policies that will boost investor confidence, drive productivity gains in our economy, particularly through innovation, and open up new markets through our successful and ambitious trade agenda and continue on our path of fiscal consolidation."[15]

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[12] Fletcher (2019) *Speech to CEDA's 40th State of the Nation - The NBN and Productivity,* https://www.paulfletcher.com.au/portfolio-speeches/speech-to-cedas-40th-state-of-the-nation-the-nbn-and-productivity

[13] Morrison et al. (2021) Federal budget supports Victoria's recovery plan, https://www.pm.gov.au/media/federal-budget-supports-victorias-recovery-plan

[14] Brinsden (2021) *Labor demands answers on $660m 'carpark rort' favouring Coalition seats,* https://thenewdaily.com.au/news/politics/australian-politics/2021/07/04/labor-carpark-rorts/

[15] Morrison (2016) *Australia: A strong and transitioning economy,* p. 2

# Have polices designed to boost productivity been poorly selected or poorly implemented?

Productivity refers to the amount of output that can be extracted from each unit of input. Labour productivity refers to the amount of output (usually measured in GDP) produced per unit of labour input (usually measured in terms of hours worked) although it is often described as GDP per person.

While the term productivity is widely discussed, the concept is not widely understood by the public or policy makers alike, with many using it seemingly interchangeably with terms like profit, competitiveness and effort.

While cutting the wages of a worker may lead to an increase in profit, and potentially improve the competitiveness of one firm compared to another, wage reductions do not result in an increase in productivity. Indeed, lowering wages may lead to a reduction in productivity if they dissuade firms from investing in labour saving technology.

It is often suggested that education and training boost labour productivity, either by equipping workers with more of the 'specific skills' that employer require or by ensuring that students are better able to learn new skills on the job and retrain themselves over the course of a long and carriable career. But while few argue that more education and training are beneficial for labour productivity, measuring the amount of education and training that is imparted, and measuring the increased output that results is far more difficult. For example, in Australia a large amount of money is spent by private schools on indoor swimming pools, rifle ranges and concert halls.[16] While all of this expenditure is classified as an investment in 'education', it is not clear how, if at all, expenditure on such amenities will boost productivity growth in the decade after students complete their schooling.

Similarly, it is often suggested that when firms invest in new plant and equipment, or governments invest in infrastructure, that it will lead to an increase in productivity. While it is possible that new investments in equipment or infrastructure means that workers can produce more output per hour, the relationship is in no way direct, stable, or easy to measure. For example, while a new coffee machine may allow a barista to make more

[16] Bagshaw (2016) *Taxpayers fund private school orchestra pits and swimming pools,* https://www.smh.com.au/education/taxpayers-fund-private-school-orchestra-pits-and-swimming-pools-20160411-go37i9.html

coffees per hour, it is not clear how the record sales of utes will lead to a reduction in travel time for Australian tradies.[17]

While the theory of what should boost productivity is clear, and the mathematics of measuring productivity are straight forward, in reality it takes judgement, skill and time to identify and measure policies that genuinely drive productivity growth. Just as new CEOs often waste a lot of time and money ‘restructuring’ and ‘rebranding’ their new organisations, new governments can waste enormous amounts of other people’s time and money ‘restructuring’ and ‘reforming’ both the public sector and the economy as whole.

While the quotations above make clear that the Coalition Government believes it has been focusing on driving productivity growth, both the recent results, and Treasury’s belief that the long run rate of productivity growth is unchanged, suggest that the Government’s efforts have been poorly targeted.

[17] Dowling (2021) *VFACTS May 2021: Toyota HiLux, Ford Ranger and Isuzu D-Max take out the Top Four, drive record ute sales,* https://www.caradvice.com.au/957832/vfacts-may2021-toyota-hilux-ford-ranger-and-isuzu-d-max-take-out-the-top-four-drive-record-ute

# Conclusion

Scott Morrison declared in 2017 that "We must set a discipline for continually scrutinizing our productivity agenda." And for years after making that claim it is obvious, from both the recent data and from Treasury's forecasts, that the current agenda is not working.

Changes to the industrial relations system have weakened workers bargaining power but done nothing to boost productivity growth.

Changes to the tax system have redistributed income in Australia, but done nothing to boost productivity growth.

And likewise the deregulation of vocational education, changes in higher education, changes in schools funding have done nothing to boost productivity growth.

But all of these changes have had a significant impact on the distribution of income, opportunities, and wealth in Australia. The idea that good policy often requires sacrifice today to deliver benefits in the future is built into the democratic debate about 'policy reform' in Australia, but the last 6 years of data, and the next 40 years of projections, suggest that there is no long community gain for the short term pain borne by large segments of the Australian community.

It is of course possible that the reform agenda of the last six years will significantly increase productivity growth in the coming decades and that the 'problem' is that Treasury either don't believe that or don't want to reveal that. But if productivity growth is any higher than the 1.5 per cent forecast by Treasury then the long run impacts on GDP will be enormous, the future deficits forecast in the IGR will vanish, and Australia has no long run economic problems associated with its existing tax and spending settings.

In short, the latest Intergenerational Report makes clear that either we need to abandon the current obsession with tax cuts, IR reform and privatisation of services or we need to stop worrying about future deficits.