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Why productivity is not just for nerds

Revenge of the nerds

How is it that Australia's most important public policy issue is also its most boring?

Subjecting a normal, well-balanced audience like you here tonight to a speech about restarting productivity growth is surely a classic case of the revenge of the nerds.

In the small country town of Baradine where I grew up there were two groups of boys at school – the cool guys and the nerds. The Baradine girls liked the cool guys and barely tolerated the nerds.

I got appointed as leader of the nerds – mainly because no one else wanted the position. Leader of the nerds put you in the front line when the cool guys were looking for someone to humiliate.

My challenge tonight is to deliver a scintillating exposition of why productivity growth is important to everyday Australians – not just nerds.

Then, just when you're so excited you just can't hide it, I'll explain why, against the deep instincts of many everyday Australians, competition is essential to productivity growth in Australia.

The old productivity trick, eh?

Productivity is just a measure of what we produce each hour we work.

Well, that's labour productivity anyway.

If I were working in an icecream factory, my labour productivity would be the amount of icecream I produced each hour.

But I would probably eat half the icecream before I packaged it (especially if it was that Maggie Beer burnt fig stuff), so I wouldn't be very productive.

There's another notion of productivity – the old multifactor productivity trick, or MFP for short. MFP picks up the benefits of technological change from new ideas like shoe phones and now iPhones.

The old MFP is a very good measure of working smarter, through the creation and adoption of new technologies and the development and application of new skills and ways of organising business.

Productivity growth from working smarter makes for higher wages, bigger profits and lower prices and better quality for consumers.

Why productivity growth is important to cool people too

Productivity growth was responsible for 80 per cent of the increase in our incomes over the last 40 years – that's all of us: nerds, cool people, the lot.

Without productivity growth we would still be living in the seventies, watching horror movies right there on our TVs, as Skyhooks said.

As our population ages, productivity growth will again be called upon to do most of the heavy lifting in ensuring our future prosperity. Today there are five working-age Australians for every Australian over the age of 65; by 2050, the number is expected to fall to only a little more than 2½ workers for every older Australian.

Working smarter not harder is Australia's productivity challenge. That's why the Prime Minister put productivity growth on the national agenda in his series of speeches leading up to Australia Day.

Working smarter involves a more highly-trained and better-educated workforce working with better equipment and information technology and new technological advances coming our way or yet to be imagined.

Working smarter involves bringing the nerds in from the cold. Who knows, the next generation of Baradine girls might go for the nerds over the cool guys. It'll be too late for me, but for the grandsons of the nerds of the 1970s it could be the dawning of the Age of Aquarius – when the moon is in the seventh house and Jupiter aligns with Mars, when peace will guide the planets and nerds will rule the stars!

How are we going with productivity growth?

Are we up to the productivity challenge?

Judging by our miserable performance during the first decade of the 21st century the answer would be no.

But if we were able to repeat the sparkling performance of the 1990s the answer would be yes.

During the Nineties, labour productivity for the whole economy grew at an average 2.1 per cent a year.

But during the Noughties labour productivity grew at an average of 1.4 per cent a year.

What about the old MFP? Multifactor productivity grew at an average 2.3 per cent a year between 1994 and 1999 – an Australian record. Australia had the second-fastest growth rate among major OECD countries for this period.

But during the Noughties it fell away to a pathetic 0.2 per cent a year.

What's worse, productivity growth got slower as the Noughties wore on.

Between mid-2004 and mid-2008, the old MFP growth actually went backwards for the first time on record – we were less productive toward the end of the decade than five years earlier.

Productivity was like an engine all fired up from the roaring Nineties as we turned the bend into the Noughties. But it began losing momentum into the Noughties and almost ground to a halt in the last year of the previous Coalition government.

The problem we now have is getting the engine started again and the locomotive rolling along the tracks.

During the period from the start of the Noughties to the change of government in 2007, Coalition government ministers at first denied there was a problem of slowing productivity growth and then, when the train was parked at the siding, they blamed one-off factors.

It was the drought.

It was the mining boom that involved a lot of investment but delayed increases in mine production.

It was declining oil reserves that were costing more to extract.

It was caused by low unemployment that brought less productive workers into jobs.

Comforted by these one-off factors, the Coalition never saw the need for and therefore never conceived of a comprehensive productivity-raising economic reform program.

Like many political ruses, there was an element of truth in these various one-off factors.

But they didn't explain all of the fall-off in Australia's productivity growth.

In fact, we now have estimates of how much they did and didn't explain.

The Productivity Commission estimates that one-off factors explain about 70 per cent of the decline in Australia's productivity growth in the productivity cycle that ended in mid-2008 compared with the previous cycle.

That might seem a pretty big part of the story of why the productivity engine stopped.

But consider this: Australia will experience droughts during the next 40 years; our oil fields will continue to decline; and at some stage, maybe sooner rather than later, we will have unemployment rates as low as those of the Noughties before the global recession struck.

In fact, the Bureau of Meteorology recently reported that much of Australia will be hotter and drier in the coming decades.

We will need to offset these one-off factors at times in the future because they are not necessarily one-off at all – just irregular.

And what about the remaining 30 per cent of Australia's productivity slump that is not explainable by one-off factors? Remember, small differences in productivity growth can make a big difference to national prosperity over long periods of time – especially in an ageing population.

The difference between Australia's average annual MFP growth during the 1998-99 to 2003-04 productivity cycle and the 2003-04 to 2007-08 productivity cycle was 1.3 percentage points.

If we take 30 per cent of that difference we get about 0.4 percentage points.

Now if we were to write off that difference of 0.4 percentage points into the future, we would be sacrificing income of around \$15,000 per Australian by 2050 in today's dollars – a total of \$530 billion in that year alone.

That's a lot of squandered opportunity. It's a lot of money that could have gone towards lifting underprivileged people out of disadvantage. It's a lot of investment we could have made in preserving our environment.

Speaking of squandered opportunity, the absence of a productivity-raising reform agenda during much of the Noughties directly contributed to a sharp decline in Australia's productivity compared with the effort of the productivity pace-setting United States.

Before Australia's productivity boom of the Nineties, our labour productivity was about 86 per cent of US productivity. By 1999 we had hit 94 per cent of US productivity. But by 2008, Australian productivity had slumped back to around 87 per cent of American productivity. We had squandered all the hard-won gains achieved during the Nineties productivity boom.

Australian labour productivity relative to US productivity



Australia probably can't fully bridge the productivity gap with the US in the foreseeable future for the simple reasons that the US has a much bigger home market enabling scale economies and America is geographically close to other high-tech economies enabling the old MFP growth. But the Productivity Commission suggests we might be able to close the gap to around 10 percentage points over the next two decades if we pull our fingers out (not a direct quote from the Productivity Commission).

Pulling our fingers out means achieving average annual labour productivity growth of 1.9 per cent per annum over the next 20 years (assuming US productivity growth remains at its 30-year average) – a repetition of our stellar effort of the Nineties.

Indeed, the Prime Minister flagged the benefits of 2 per cent annual productivity growth in his Australia Day speeches.

How did we pull the old Nineties productivity trick?

Some say orthodox economics is pie in the sky. Others say it's neo-liberalism gone mad. I say it works. In a classic economics textbook manoeuvre, the Hawke government began opening up the Australian economy to competition from abroad and at home. It floated the currency, deregulated the financial

system and began tearing down trade barriers that had protected business from competition for decades.

Then in the early 1990s the Keating government shifted decisively away from centralised wage-fixing by legislating for wage bargaining at the enterprise level. It followed up with national competition policy reforms to open up the economy even further.

Bigwigs such as the OECD, the IMF, the Productivity Commission and the Commonwealth Treasury have recognised that this pro-competitive reform program, extended in parts by the Howard government, was overwhelmingly responsible for the 1990s productivity boom. The other major source of productivity growth was the revolution in information and communications technology beginning in the early 1990s when someone other than Al Gore came up with the internet.

Getting the productivity engine moving again

As a result of the reforms of the final two decades of the 20th century which opened Australia's product markets to greater competition, Australia was ranked as the most open economy in the OECD in 2003. But having fashioned Australia's open, competitive economy, it's hard to do the same trick twice.

In the recent OECD regulatory review of Australia, the OECD noted that Australia has been one of the best-performing economies in the OECD over the past two decades, with 17 years of unbroken economic growth and an increase in its GDP per capita ranking from 16th place in 1992 to 8th place in 2007.

However, the OECD also noted that Australia's productivity growth had slowed markedly in recent years and urged Australia to renew its reform efforts.

There is unfinished business in deregulation and competition policy. And the pressure is always on to protect parts of the economy from competition, pressure that must be resisted if we are to achieve our ambitious productivity growth goals.

The formula for restarting productivity growth and getting it motoring again contains two elements: supporting new 21st century sources of productivity growth while further increasing the exposure of the Australian economy to competition.

Supporting 21st century sources of productivity growth

International research shows that the most powerful sources of modern productivity growth in open, market economies are education, innovation and infrastructure. The Rudd government's productivity-raising reform program therefore includes:

1. Investing in and reforming the nation's education and training system through the Education Revolution – resulting in a smarter workforce better able to create and innovate;
2. Supporting innovation – enabling businesses to lower their costs while at the same time selling better products and services; and
3. Investing in productivity-raising infrastructure – better road, rail, port and broadband networks enabling the delivery of goods and services quicker and cheaper.

By supporting education, innovation and infrastructure investment the Government is seeking to improve the capacity of Australian businesses to compete internationally and at home against imports.

1. Reforming Australia's education and training system

The Government's education revolution is bringing in more market disciplines and transparency, better enabling poor performance to be identified and remedied.

For the first time in more than a century Australia will have a national curriculum, removing the absurdity of a single nation having eight different curricula.

A light is being shone on poor school performance by the revolutionary My School website, not to punish under-performing schools but to identify them enabling remedial support to be put in place. That support includes extra funding for literacy and numeracy in struggling schools and extra pay for teachers in disadvantaged communities.

Early childhood development services are being expanded so that all children, regardless of the incomes of their parents, are offered the same start in life.

At the other end, Commonwealth-supported university education places are being uncapped to allow institutions to vary their course offerings in response to the needs of students, and 711,000 training places are being provided under the Government's productivity places program.

2. Investing in innovation

Competition acts as a spur to productivity growth by forcing management to search for cheaper and quicker ways of producing goods and services in the quest for market share and profitability. Business managers who feel the heat of competition are far keener to adopt new technologies to ward off their rivals or take market share from them.

Managers who know they will be protected from competition by a complicit government usually become fat and lazy and see little need to innovate. As

their costs go through the roof from poor business practices they simply go back to the well of government largesse, seeking and finding extra protection from competition. The poor old consumers, of course, are the losers, and quite often taxpayers too.

Investing in innovation can be a vital source of productivity growth – but only in an open, competitive economy. Handing innovation funding to protected businesses is like supplying free cocaine to addicts – the more you give them the more they need.

Since the late 1980s successive governments have progressively reduced import barriers for the automotive industry. All quantitative restrictions are now gone and tariffs are at either zero (for imports from countries with which we have free trade agreements) or just 5 per cent.

The Rudd government is replacing an inefficient R&D tax concession that rewarded lots of innovation which would have happened anyway. The new R&D tax incentive will provide increased financial support through more generous base rates. And unlike the existing scheme of deductions, the new refundable tax offset will allow small start-up businesses to get an immediate contribution towards their R&D.

3. Investing in infrastructure

Australia endured an infrastructure investment drought, especially from the Commonwealth, through much of the Nineties and Noughties. A 2009 OECD report shows that Australia's investment in transport, storage and communications infrastructure as a percentage of GDP fell between the Eighties and Nineties, and fell again in the Noughties.

National investment in economic infrastructure averaged less than 4 per cent of GDP between 1990 and 2007, only rising to 5 per cent of GDP in 2008.

Even if we were to assume that 5 per cent is adequate – and that is unlikely – then the underinvestment in infrastructure over the last decade and a half has been \$8 billion a year.

The Rudd government's \$22.5 billion Nation Building Plan for the Future announced in the 2009-10 Budget involves a major new investment in the nation's infrastructure, including an investment of \$8.5 billion in expanding Australia's transport networks – essential road, rail and port infrastructure.

But governments will not be able to finance all of the extra infrastructure needs of a growing population – not anywhere near it.

That's why the Government has put in place the institutional arrangements needed for a nationally-coordinated approach to the future planning and development of Australia's critical infrastructure.

Infrastructure Australia is an independent, statutory advisory council driving the development of a long-term, coordinated national approach to infrastructure planning and investment.

Modern communications infrastructure is essential to productivity growth in the 21st century. The National Broadband Network will be an enormously powerful enabling technology for Australian business, especially small business, offering the prospect of lower costs and extended market reach.

Pushing the door to competition wide open

Although the Australian economy is now among the most open in the world, our businesses are still shackled by lots of productivity-sapping regulations. These overlapping and inconsistent regulations applied by different states and different levels of government are forcing businesses to operate not in one national market but in eight state and territory markets.

In many areas, Australia's 22 million people face more internal regulatory obstacles than Europe's 500 million people. Australia's geography is too large and its population too small to be divided into eight markets, each with its own business regulations.

The Rudd government is working with the states and territories on a regulatory reform program to move Australia to a single national market.

Of the 27 areas of business regulation being reformed, we expect to have finished at least nine of them by 1 July 2010. That's one-third of the program done just 1½ years into a five-year agreement with the states and territories.

By the time we are finished, we will have replaced more than 160 pieces of Commonwealth, state and territory legislation with just 10 modern laws.

Our Liberal opponents have claimed that by getting rid of their beloved Work Choices we have returned Australia to the centralised wage-fixing system that existed in the 1970s before the Hawke and Keating reforms. In fact, enterprise-level bargaining remains the central organising principle of the new system. And, for the first time since Federation, Rudd Labor has delivered a single national industrial relations system for the private sector with the one exception of Western Australia.

Competing in a small, open economy

Businesses tend to prefer less competition to more – life is easier and more predictable when there are no competitive threats.

Consumers should prefer more competition over less – since competition restrains prices and improves the quality of goods and services available to them.

In a democracy, governments are elected to represent the interests of the people, not business interests or other sectional interest groups.

Big corporations in Australia often claim they need to become even bigger through mergers and takeovers to enable them to achieve the economies of scale needed to become national champions in tough, competitive global markets.

But is bigger necessarily better?

It is true that cost-reducing efficiencies may be achieved through greater size. That's why our competition regulators often approve proposed mergers and takeovers.

But if in the process of becoming big the competition is obliterated, the incentive to be efficient falls away.

Costs then are not contained and consumers are ripped off through higher prices.

National champions turn into national gluttons.

Australia's big four banks have long wanted to merge into just two megabanks, they say to enable them to be national champions in the world arena. Thank goodness successive governments have ignored their protestations.

Of the world's 100 largest banking groups, after the global financial crisis, only 10 are AA-rated or above, which includes Australia's big-four banks. A combination of bigness and poor regulation allowed global foreign megabanks to hide their shonky, anti-competitive practices from an unsuspecting public.

No Australian consumer wants less competition in the Australian banking system; they want more. Only the banks themselves want less competition through the dismantling of the Four Pillars policy that has served Australian consumers well.

In petrol retailing, Caltex wants to buy Mobil's service stations, arguing that Australian motorists would be better served by a more efficient system. What they really mean is that the resulting business would be more profitable. Making bigger profits is fine, but not if it is at the expense of motorists. The ACCC has sensibly knocked back the application on the basis that it would be anti-competitive and could lead to higher petrol prices through further market concentration.

In Australia's relatively small, remote and geographically dispersed market there is a persistent tendency towards oligopoly or even duopoly.

Until the Hawke government undid it, two airlines had a legislated agreement to carve up Australia's skies.

Two banks remains the banker's dream.

In the past, two big supermarket chains have benefited from barriers to entry, including restrictions on the entry of foreign rivals. The Rudd government is tearing down those barriers, enabling rivals like Aldi and Costco to expand their presence in Australia.

Removing restrictions on the entry of foreign supermarket chains is right up the alley of the open, competitive model.

But while all that good work is going on, another set of government regulations is throttling competition, having created not eight markets but thousands of little, protected markets.

I'm talking about planning and zoning laws.

Planning and zoning laws might be shaping up as Australia's 21st century protection racket.

They limit the number of competitors in a local market. Some even provide for objections by existing businesses against the proposed entry of rivals on the basis that the new competitor might damage the profitability of the privileged incumbent.

So-called centres policies limit the location of retail outlets to a small number of precincts, usually including a major shopping centre, ostensibly on the basis of managing traffic and general environmental amenity.

If one supermarket chain gets the gig for operating in a designated shopping centre, rivals are excluded from setting up nearby. And until recently, the major supermarket chains entered into restrictive agreements with shopping centre owners effectively to keep rivals out.

Not any more. With the encouragement of the Rudd government, the ACCC has prevailed upon the supermarket chains to remove those anti-competitive provisions in their lease agreements with shopping centres – more than 700 of them are gone.

Through the Council of Australian Governments, we are looking at the anti-competitive effects of planning and zoning laws. In fact, the New South Wales government is taking the lead, recognising that its laws have anti-competitive features and doing something about it.

Is bigger necessarily badder?

While bigger is not necessarily better, bigger is also not necessarily bad.

When Tony Abbott announced his Great Big New Tax on Everything to fund his paid parental leave idea – a 1.7 percentage point lift in the company tax

rate for bigger corporations – his shadow ministers formed a procession to bag out on ‘the big end of town’.

The Rudd government has no difficulty working with Australia’s bigger companies in the quest for greater productivity through a seamless national economy as the foundation for more jobs for working Australians and greater prosperity for all.

Bigness can, indeed, bring with it economies of scale.

Bigness can be a virtue when the industry produces traded goods, because the big companies are unlikely to be able to set the world price and competition from imports can restrain prices at home.

But where the stuff being sold on the home market by a handful of big companies can’t readily be imported and where there are high barriers to entry into that industry, the tendency to anti-competitive behaviour will be strong.

Having just a couple of businesses in an industry isn’t the end of the world – if they are competing against each other ferociously. But if they and governments can keep rivals out, look out for the great big consumer rip-off!

Productivity growth is not just for nerds; it’s for everyone

As a nerd from Baradine, tonight I hope I have demonstrated that productivity growth is not just for nerds; it’s vital to the wellbeing of all Australians. Today’s productivity growth is tomorrow’s prosperity. And today’s productivity growth is poor – it has been for a decade.

Productivity growth is about working smarter, not harder.

The Rudd government is investing in the modern sources of productivity growth: the talents of our young people; nation-building infrastructure; and new ideas.

But for that investment to pay maximum dividends in terms of productivity growth it must be made in an open, competitive economy.

That’s why we moving to a seamless national economy, tearing down silly state regulations that divide our nation into eight markets.

Successive Australian governments have for three decades opened up the national economy to competition in the quest for a single national market.

Competition is good; more competition is better.