



# Australia's productivity performance

## Call for submissions

The Commission has released this call for submissions paper and invites individuals and organisations to lodge submissions and comments to the Inquiry.

**The Productivity Commission acknowledges the Traditional Owners of Country throughout Australia and their continuing connection to land, waters and community. We pay our respects to their Cultures, Country and Elders past and present.**

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### **The Productivity Commission**

The Productivity Commission is the Australian Government's independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians. Its role, expressed most simply, is to help governments make better policies, in the long term interest of the Australian community.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

Further information on the Productivity Commission can be obtained from the Commission's website ([www.pc.gov.au](http://www.pc.gov.au)).

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### **Key inquiry dates**

Receipt of terms of reference	7 February 2022
Due date for initial submissions	23 March 2022
Release of draft consultation reports	To be advised
Public hearings	To be advised
Due date for final submissions	September 2022
Final report to Government	February 2023

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# Inquiry into Australia's productivity performance

The Australian Government has asked the Productivity Commission to undertake an inquiry into Australia's productivity performance and provide recommendations on productivity-enhancing reform (attachment A). This inquiry is the second in a series, undertaken at five-yearly intervals. It is intended to provide an overarching analysis of where Australia stands in terms of its productivity performance, and of what steps could be taken to improve productivity growth in the future, particularly in light of Australia's COVID-19 experiences.

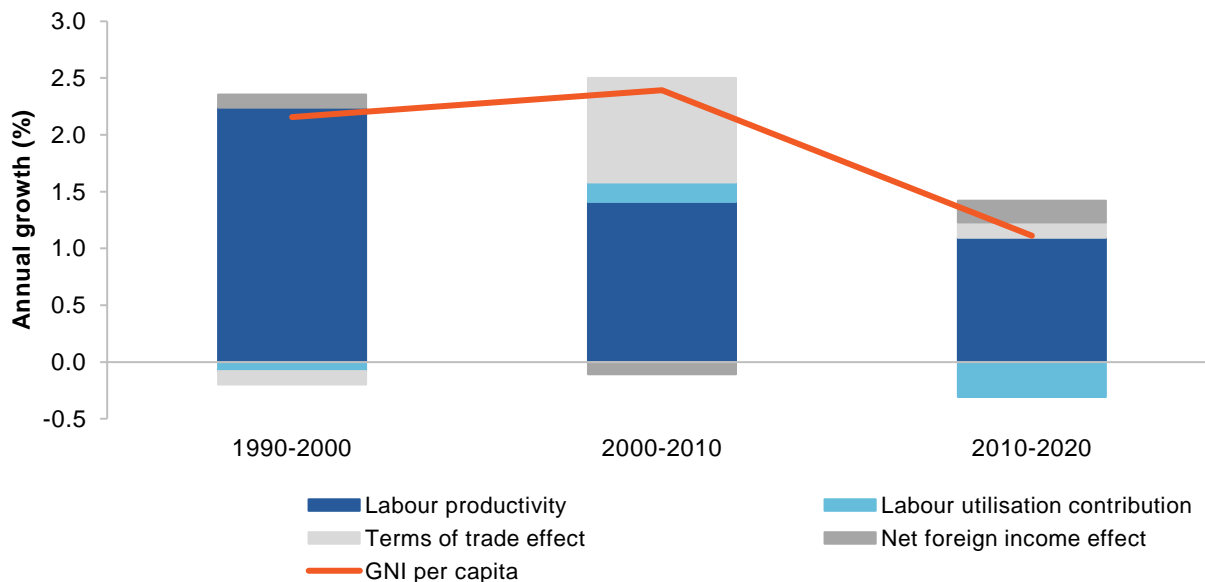
Productivity — the rate at which goods and services are produced from inputs (such as labour, machinery, raw materials) — is one of the most important drivers of Australia's living standards, including non-pecuniary aspects such as enhanced environmental and social outcomes, that improve wellbeing more broadly. Specifically, improved productivity, by reducing the resources required to generate the same outcomes for consumers (often by reducing the number of hours needed to produce goods and services):

- *expands people's work/leisure choices*: as labour productivity improves: workers can achieve the same income and standard of living by working fewer hours
- *gives people the means to consume more or improved quality* market goods and services
- *increases capacity to provide public goods and services*: the additional tax income available can be used to fund more and better hospitals, schools and emergency services.

Australia's improvement in living standards since federation is largely explained by productivity growth — although that long run rise in productivity has come from a number of sources: technological change, capital accumulation, improvements in education and skills across the workforce, ongoing business innovation and a more efficient allocation of labour and capital across the economy. In practice, it is easier to identify sources of past productivity growth than it is to specify future drivers, such as new technological breakthroughs. There is a vigorous debate as to whether future productivity growth will match the experience of the past.

There is also a question as to why different economies achieve different levels and growth of productivity. Compared to other developed economies, Australia's productivity *levels* are now 'middling' and (as in a number of other countries) productivity *growth* has slowed over recent decades. That our incomes have continued to grow at a robust pace despite this, reflects, among other factors, favourable changes in Australia's terms of trade (figure 1), and significant investment during the 2000s mining boom, which helped support otherwise flagging growth in labour productivity. But these one-off factors are not reliable sources of income growth over the long-run. Lifting productivity growth rates is the only sustainable way to ensure Australians experience income growth similar to that of the past few decades.

**Figure 1 – Income growth has remained robust, despite falling productivity growth**  
**Contributions to growth in Gross National Income (GNI) per capita<sup>a</sup>**



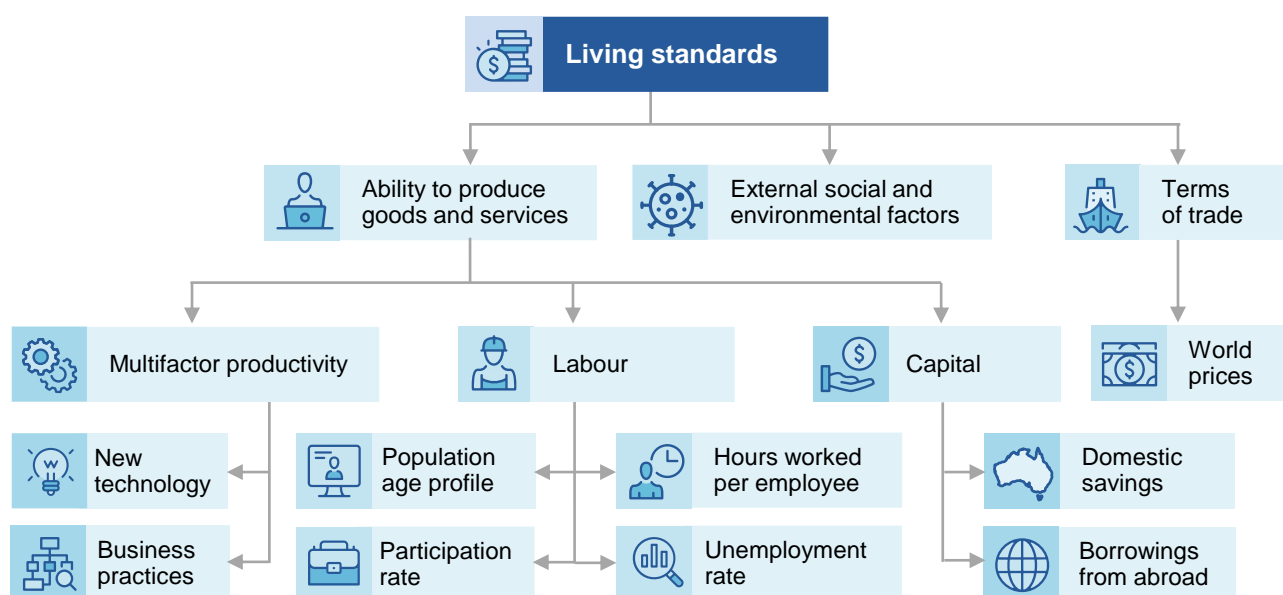
a. The labour utilisation contribution is the difference between growth in GDP per capita and labour productivity growth. Labour productivity growth, in turn, reflects investment in labour saving physical capital (known as capital deepening) and more efficient ways to use labour and capital in combination (known as multifactor productivity). The terms of trade effect is the difference between Gross Domestic Income (GDI) per capita growth and GDP per capita growth. The net foreign income effect is the difference between GNI per capita growth and GDI per capita growth.

Source: Productivity Commission estimates using ABS (*Australian System of National Accounts, 2020-21 financial year*, Cat. no. 5204.0., table 1).

While in general there are many factors that work together to contribute to our standards of living (figure 2), the Commission’s past work suggests that higher performing countries have strong productivity growth underpinned by enabling factors such as:

- an openness and access to leading technologies, business innovation and data use;
- the skills, capability and culture to take up new technology and data, and a workforce and businesses that explore, innovate and adapt;
- markets that facilitate resources (labour and capital) moving in a timely way to higher value uses; and
- institutions (public and private) and regulatory frameworks that support these features, and are efficient and effective in their contribution to improving Australians’ wellbeing.

We welcome people’s views on extent to which these factors are relevant and what else we should consider.

**Figure 2 – Contributors to Australia's living standards<sup>a</sup>**

a. Material living standards are measured by Gross Domestic Production. Alternative measures, such as Net National Income or Gross National Income would require consideration of net foreign borrowing and depreciation of assets.

Ultimately, decisions affecting productivity are made by individuals and businesses in the market and non-market sectors, but government has a key role to play. Policy settings can either aid or hinder the achievement of productivity growth. For example, government influences the ability of households and businesses to innovate and adapt to changes in the economic environment through establishing and enforcing regulatory arrangements, providing infrastructure, building skills and offering a safety net for the most vulnerable in society.

Past microeconomic reforms (with the aid of beneficial macroeconomic reform) have laid the foundations for the past 30 years of economic prosperity in Australia and helped partially reverse some of the decline in productivity evident during the high inflation and unemployment period of the 1970s. Part of the success of these policies has been to move the economy away from one where narrow interests distorted the flow of resources to one where competition plays a much greater role.

Today, Australia's product and input markets are flexible by world standards. So too is Australia's 'openness' to the world. But COVID has highlighted areas in which progress is readily possible and areas where there are barriers/challenges to be addressed. Over the past couple of years we have experienced widespread changes in the ways people work, shop, undertake study and access a range of services, such as health care. There has been a burgeoning collection and use of data across the economy, a rapid diffusion of digital technologies, and some upskilling in their use throughout the population.

We know there are further challenges ahead for the economy — adjusting to changes in the international movement of people, risk inclinations and priorities as we adapt to life after what have been unprecedented social upheaval and lifestyle restrictions. Added to these are longer term issues — evident before COVID-19 — associated, for example, with our ageing population, climate change challenges, and geopolitical realignments, that will continue to both attract policy attention in their own right and add to the context of future productivity.

This inquiry will consider a wide range of reform areas to enhance Australia's productivity. We will focus on economic reforms rather than on social and other reforms that may be desirable but not impact productivity directly. While there is often overlap — such as may be the case with measures that improve social inclusion

and can have real economic consequences — the focus of this Inquiry is on productivity. We will be prioritising reforms in areas that could have the biggest impacts on productivity growth. We are also intending to draw on other concurrent and recent work, to avoid re-prosecuting areas where comprehensive reform is already underway or where a comprehensive review has been completed.

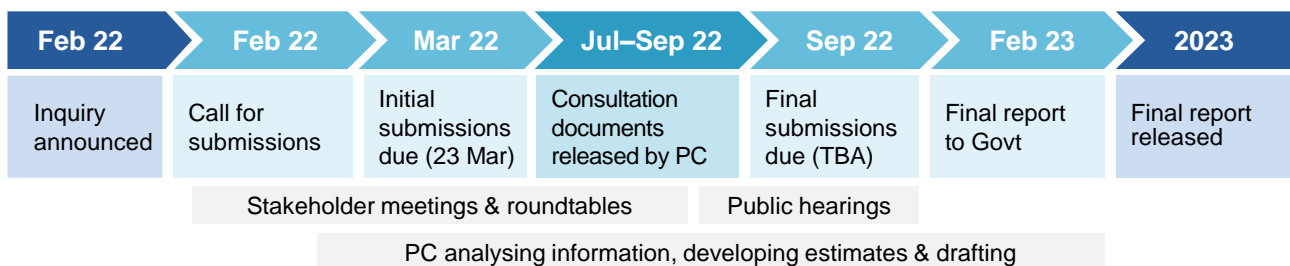
In responding to this call for submissions, interested parties should consider issues and reform areas that would, in their view, be most likely to enhance productivity growth with a view to improving the living standards and wellbeing of Australians. For example, the Commission is interested in views on:

- What are the key drivers of productivity growth that governments should be influencing?
- Which reform(s) should governments prioritise to improve productivity in the next couple of years and in the longer term?
- Have other countries implemented leading practice productivity-enhancing reforms that could be relevant for the Australian context?

We welcome examples from within Australia or from overseas of where government action or reform is necessary for individuals or business to get benefits from productivity improvements. Provision of data and other evidence to support participant views is particularly useful.

The Commission invites interested individuals and organisations to make a written submission or comment addressing the issues raised in the inquiry terms of reference, including items 1 to 7 (attachment A). Submissions are requested by **23 March 2022** (figure 3). Further information on the inquiry and how to provide a submission or comment is available at [www.pc.gov.au/inquiries/current/productivity](http://www.pc.gov.au/inquiries/current/productivity) or by contacting Tracey Horsfall on 02 6240 3261.

**Figure 3 – Key steps in the inquiry**



## A. Terms of reference

### Periodic inquiry of Australia's productivity performance

I, Josh Frydenberg, Treasurer, pursuant to Parts 2 and 3 of the *Productivity Commission Act 1998*, hereby request that the Productivity Commission (the Commission) undertake an inquiry into Australia's productivity performance and provide recommendations on productivity-enhancing reform. This inquiry is the second of a regular series, undertaken at five-yearly intervals, to provide an overarching analysis of where Australia stands in terms of its productivity performance. The first report, *Shifting the Dial* was completed in 2017.

### Background

Australia's economy has performed strongly in recent decades enjoying robust growth in incomes and living standards following 28 years of consecutive economic growth interrupted by the COVID-19 pandemic. Australia's economic recovery from the pandemic has been world leading however to ensure Australians continue to enjoy higher living standards, we need to continue to focus on the task of lifting productivity.

Productivity growth is vital for Australia's future, particularly as the Australian and global economies emerge and begin to recover from the economic impacts of COVID-19. The 2021 Intergenerational Report makes it clear that future growth in income and living standards will be driven from productivity growth as the participation effects of young migration are offset by an ageing population. Global and domestic productivity growth in recent decades however has slowed. Changes brought about by the COVID-19 pandemic and the global and domestic policy responses will also provide a unique historical context for this Review.

Given the scale and nature of the economic shock caused by the COVID-19 pandemic, it is expected to have an enduring impact on Australia's productivity challenge. The acceleration in the uptake of technology by business and individuals has stimulated growth in remote work, online commerce, businesses' digital presence and innovative delivery of public services like health and education. The pandemic has affected business models in some key sectors and underscored the need for labour mobility across the economy.

In this environment, Australia needs policy settings that foster a flexible and dynamic economy, that is able to adapt in the face of economic challenges and opportunities. Policy settings should encourage the economy to adapt to the growing importance of digital technologies, including through developing a skilled labour force. They must also be forward looking and support an environment that promotes economic dynamism, entrepreneurship and appropriate risk-taking, and innovation and technological adoption.

Against this background, the Review can play a critical role in making high-value and implementable recommendations to support Australia's productivity growth. Lifting Australia's productivity growth will involve a combination of economy-wide and structural reforms, in addition to targeted policies in particular sectors to push Australian industries closer to the global frontier.

### Scope of the inquiry

The Commission is to review Australia's productivity performance and recommend an actionable roadmap to assist governments to make productivity-enhancing reforms. Each recommendation should qualitatively and



quantitatively estimate the benefit of making the reform and identify an owner for the action and a timetable in which it might occur.

Without limiting related matters on which the Commission may report, its report to the Government should:

1. Analyse Australia's productivity performance in both the market and non-market sectors, including an assessment of the settings for productive investment in human and physical capital and how they can be improved to lift productivity.
2. Identify forces shaping Australia's productivity challenge as a result of the COVID-19 pandemic and policy response.
3. Consider the opportunities created for improvements in productivity as a result of Australia's COVID-19 experience, especially through changes in Australia's labour markets, delivery of services (including retail, health and education) and digital adoption.
4. Identify priority sectors for reform (including but not limited to data and digital innovation and workforce skills) and benchmark Australian priority sectors against international comparators to quantify the required improvement.
5. Examine the factors that may have affected productivity growth, including domestic and global factors and an assessment of the impact of major policy changes, if relevant.
6. Prioritise and quantify the benefit of potential policy changes to improve Australian economic performance and the wellbeing of Australians by supporting greater productivity growth to set out a roadmap for reform.
7. Revisit key recommendations and themes from the previous five yearly review in light of the above, where relevant.

The Commission should have regard to other current or recent reviews commissioned by Australian governments relating to Australia's productivity performance and include comparisons of Australia's productivity performance with other comparable countries. The Commission should support analysis with modelling where possible and qualitative analysis where data is not available, and this is appropriate.

## **Process**

The Commission should consult widely and undertake appropriate public consultation processes, inviting public submissions. The Commission should actively engage with Commonwealth, and state and territory governments. The final report should be provided to the Government within 12 months of receipt of these terms of reference.

**JOSH FRYDENBERG**

**Treasurer**

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