Australia's Productivity Malaise:
Reflections on the 'Debate'

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Introduction

It is a great honour to be giving the Shann Memorial Lecture for 2023; not only because of the eminence of Edward Shann and the significance of this Lecture, but also because of those who precede me in giving it. My thanks to Peter Robertson and John Roberts for the opportunity.

Professor Shann's philosophical and intellectual journey, during a life that was tragically cut short at the age of fifty-one, took him from Fabian Socialist to free-market champion. This evolution in thinking from 'left' to 'right' – which seems less common today than it once was -- can be seen as the result of a mind not only open to experience, but remarkably well equipped to draw lessons from his observations.

It also says much about the character of the man that his advocacy of free trade and liberal economics went very much against the grain of opinion in Australia at that time. Indeed, it appears to have provoked such hostility within the university and business communities, that one can't help but wonder whether this contributed to his untimely death.

In a short biography detailing the virulent opposition faced by Shann and how he dealt with it, Gregory Moore says '*he never lost his humanity and mission to raise the lot of common fellows, but that having witnessed some of the worst of state planning … he put his trust in private property, individual initiative and the allocative efficiency of the price mechanism.*' (Moore,

If we fast-forward to today, while few would disagree with the objective or raising the living standards of the populace, not only do differences persist about the respective roles of market and state in achieving this, such differences seem to have been getting greater. The Treasurer himself has penned an essay celebrating greater state intervention in the economy under a new 'values based' form of capitalism. (Chalmers 2023)

Moreover, as in Shann's time, positions taken on policy issues have often been as much about denigrating those expressing the 'wrong view' as countering their arguments.

Such trends are apparent in the so-called 'productivity debate' that has come to prominence again recently. Putting aside those who seem antagonistic to the very concept of economic growth, there are different views about what 'productivity' means, why it has stagnated and, especially, what policies help or hinder it.

While rarely achieving consensus, a well-informed debate can resolve differences and secure sufficient political support for governments to implement policies shown to be in the public interest. However, the way the productivity debate is currently being conducted is in my opinion not conducive to such an outcome. Indeed, it is resulting in a confused public, a poorly informed legislature and policy initiatives that are counterproductive.

This is occurring at a time when Australia has arguably never needed a lift in productivity more. Without it, both the shorter-term challenges of fiscal imbalance, debt and inflation, and the ongoing imperative to raise living standards will be put at risk.

Can things be turned around? It is becoming hard to be optimistic. If it is to happen, the starting point would be greater clarity and understanding about both the problems and the solutions.

The meaning of 'productivity'

.. *a word devoid of agreed meaning*. Paul Kelly, 2023

One basic area of contention is the extent to which achieving higher productivity growth is about working '*harder*' or working '*smarter*'.

Longstanding suspicions about productivity within the union movement are grounded in concerns that it will result in workers having to do more for the same or less pay. Echoing this, Treasurer Chalmers recently stated, following the release of the Productivity Commission's five-yearly productivity 'to do list', that he is opposed to anyone being required to "work longer for less". For its part, the Productivity Commission (PC) has shown this to be a straw man, affirming that "productivity is about working *smarter*, not harder". (PC 2023)

That is not to say that work intensity in our economy is never 'below par'. The Commission's report from last year detailing the productivity-sapping impacts of various work practices at Australia's ports, is a case in point. In the past, sizeable gains in productivity were achieved by eliminating chronic 'over-manning' in government utility services. Moreover, the recent moves in some jurisdictions to cut the working week of public servants without reducing their pay, are *predicated* on them currently spending more time on the job than necessary.

Slack work practices tend to be confined to where competition is lacking. While they can be remedied, unless the competitive environment improves, they can also reappear, as the waterfront case illustrates. Productivity gains over time can really only be achieved by mechanisms that enable continuous improvement: that is, by working 'smarter'.

That does not mean 'smarter' just in a literal sense of more advanced skills and technology, as is sometimes implied. Innovation in processes, products and marketing also play a crucial role. Moreover, all facets normally need to work together in dynamic market settings. This is why, when it comes to an organisation's productivity performance, 'flexibility' and 'adaptability' are central, even if not often recognised as such in government policy.

Productivity vs Participation

One source of confusion in public discussion is the relationship between productivity and participation. It is not unusual to see the two terms conflated or used interchangeably.

Both are conduits to higher production and incomes. However, while raising the workforce participation rate can result in higher GDP per capita than otherwise, it need not result in increased *productivity* and may well achieve the opposite. After all, countries with the lowest productivity and lowest per capita *incomes* have among the highest participation rates.

To take a topical example, childcare subsidies are often said to be productivity enhancing, when their primary impact would be on participation. Even then, a labour supply response is more likely to involve lower paid, and thus lower productivity, females than those at the top end of the income scale.

The facts are that labour force participation in Australia is currently at an historic high, thanks to the rise in female entry to the (formal) workforce and the retention or re-entry of older employees. Any further scope to increase labour input is mainly through reducing the share of part-time relative to full-time work, which governments have been keen to promote. But studies show that many people *prefer* to work part-time, and many enterprises value the flexibility this provides.

In the longer term, participation rates will inevitably decline in response to the ageing of our population -- what a former Treasurer called our 'demographic destiny'.

Immigration is often seen as a way of staying 'forever young', but as analysis by the Productivity Commission has demonstrated, at best it defers the inevitable; that is, unless Australians want their country to become a population superpower of 100 million or more.

As for immigration's claimed productivity benefits, these need to be distinguished from mere increases in GDP. Any impact on productivity will depend not just on the level of migrants' skills, but also their complementarity with those of the existing workforce. In practice, empirical research by the e61 Institute using micro data finds that migrants have mainly gravitated to relatively low-productivity industries and firms. And economy-wide modelling by the PC and others, has typically found only small increases in per capita income from immigration, with the gains skewed to migrants themselves.

Macro vs Micro

With the RBA stressing the importance of productivity growth to its anti-inflation efforts, there has been a focus publicly on aggregate trends. This is understandable, but it can create the impression that productivity growth is an economy-wide phenomenon, influenced by generic forces.

In reality, the 'headline' productivity numbers for our economy represent little more than the accumulation of outcomes achieved by a myriad of individual firms and

organisations throughout the economy. These vary greatly, as they do at the industry level. For example, in the most recent ABS data labour productivity growth rates ranged from -5 per cent for the mining sector to +14 per cent for agriculture.

No two enterprises are completely alike. And managers generally need to respond in distinct ways to the particular challenges and opportunities of their particular markets and locations. Policies directed at raising productivity at the macro level need to be cognisant of the 'drivers and enablers' of productivity growth at the *micro* level, as well as the need for differentiated responses. That is not always apparent, particularly when it comes to workplace regulation, to which I will return.

What's been happening to productivity and why it matters

While productivity is a relatively simple concept, the statistics are neither simple to compile nor easy for the public to understand. The fact that there are a number of ways of measuring productivity, each with its own limitations, does not help.

The simplest measure relates production to hours worked. At a national level, which is the most commonly cited, this encompasses the 'non-market' services sector, where productivity tends to be poorly measured. This is becoming more of an issue as the public sector expands. Nevertheless, the consensus of statistical opinion is that on average labour productivity growth has been in decline for some time (as, to a lesser extent, has growth in multi-factor productivity).

A striking illustration of this can be found in the labour productivity growth assumptions adopted for the projections in Treasury's Inter-Generational Reports (IGRs). Based on the average for preceding years, these have declined from 1.75 per cent in the first IGR in 2002, to 1.6 per cent in 2010, 1.5 per cent in 2015 and just 1.2 per cent this year. Moreover, this number exceeds the rate actually achieved in the decade preceding the pandemic, which was the lowest for sixty years.

Seemingly small changes in productivity growth rates make a big difference to national output and incomes down the track. For example, the most recent adjustment, if realized, translates to GDP being 10 per cent lower by 2040 than it would have been. The Centre for International Economics has estimated that if Australia could repeat the peak productivity performance of the 1990s, within a decade average per capita income would be $10,000 greater in real terms than otherwise. (CIE 2021)

While such statistics may fail to impress 'de-growthers' and others professing a disregard for material progress, there is the obvious further point that higher rates of productivity growth nationally mean higher tax revenue and thus a greater capacity to provide services and address disadvantage. As has been said, a government cannot redistribute what its economy has not produced.

Properly conceived, productivity growth represents the ability to provide more of what matters to society without more labour or capital.

Productivity and inflation

The link between productivity growth and the ability of firms to increase wages without adding to inflationary pressures (and interest rates) has been stressed by the RBA over the past year and had much media coverage.

Over the longer term, it is well established that labour productivity and real incomes move broadly in line with each other. Indeed, according to the Productivity Commission, almost the entire eight-fold increase in real wages since Federation is attributable to productivity growth. This is notwithstanding periods of 'decoupling', such as have occurred (in both directions) in response to shifts in the terms of trade.

Public understanding of this nexus has in the past proved important not only to securing wage restraint, but also public acceptance of pro-productivity structural reforms. It is therefore unfortunate that we have seen the link between productivity and wage growth 'declarified' in public debate recently.

The fact that the initial impetus for inflation was seemingly unrelated to wages has been used to justify regulated wage increases designed to keep up with inflation, with the RBA Governor's arguments against this receiving a hostile reception from the ACTU and in Senate hearings.

Even the established causal relationship between productivity and wages has been brought into question, with the PM asserting that the recent 15 per cent wage increase for aged-care workers, and by extension others in the 'care economy', would not be inflationary and would actually serve to increase productivity within the sector and more generally. It is notable, however, that the tab for the wage increase is to be picked up by taxpayers. And, given that the majority of workers to receive the wage rise are the existing ones, an overall increase in productivity is unlikely. Indeed, with the introduction of a new visa category for migrants committing to a union-linked stint in aged care, it may decrease.

Not just a long-run issue

Nobel Laureate Paul Krugman's statement that 'productivity isn't everything, but in the long run it is nearly everything' has been much quoted. It could be described as virtually a truism with respect to material living standards. However, it may have contributed to a commonly expressed view that productivity improvements are only achievable in the long run.

When it comes to policies directed at such areas as human capital, infrastructure and research, it is certainly the case that the impacts on productivity take some time to be realized. However, that need not be so for regulatory measures at the enterprise level, particularly those which constrain or distort decisions, or impose undue costs (of which there are many).

Reforms in such areas could be expected to yield more rapid improvements, while being no less lasting in their effects. However, they have proven more challenging to bring about.

The policy 'debate'

'The political class yammers on about productivity, sprinkling the term like magic dust over dodgy policy and wasteful spending.' Tom Dusevic, 2023

A number of features of the policy debate are hindering rather than helping public understanding of the productivity problem.

Not just us

For a start, it has been argued by some that since other OECD countries have latterly also experienced productivity slowdowns, this is not something that any one country can do much about on its own.

A more general slowdown is consistent with academic analysis that productivity growth tends to occur in successive waves of innovation stemming from the advent of new 'general purpose' technologies. That in turn has prompted speculation as to why, as Professor Solow famously put it, the IT revolution "can be seen everywhere but in the productivity statistics". Much research into the possible role of measurement failures has followed but seems not to have reached a definitive conclusion.

Such analysis does not, however, preclude a role for other contributory factors in common, particularly during a period marked by two global economic crises, with remarkably similar and synchronized policy responses internationally.

For example, notwithstanding historically low interest rates across OECD countries, private investment activity – a key source of the innovation and capital deepening behind productivity growth – has generally been muted. This reflects elevated uncertainty and higher risk margins, which in turn are likely to reflect, among other things, a less predictable policy environment, including for taxation and trade policy.

Moreover, in addition to the normal pro-cyclical variation in productivity growth rates, the massive government support for business during the downswing will have facilitated greater retention of less productive labour and fewer exits of less productive firms (the so-called 'zombies')

A more lasting legacy of the pandemic is the working-from-home phenomenon (which rapidly acquired its own acronym). The jury is still out on its impacts, but with employees pushing to extend WFH, issues that were hardly relevant during COVID are deservedly getting more attention. These include the difficulties posed for knowledge transmission, the training of new staff and for sustaining organizational culture, as well as the more prosaic matter of monitoring work effort.

At the same time, since the pandemic there has been a step-up in many OECD countries in the share of GDP and employment accounted for by government-funded services. This matters for productivity, due both to the lower measured productivity levels inherent to many public sector activities and the weaker incentives, compared to the for-profit sector, for innovations that reduce real costs.

If the global 'productivity frontier' is indeed destined to expand more slowly than before, it is even more important that a country like Australia that finds itself behind the frontier seizes every opportunity to narrow the gap. Recent research suggests that

instead of converging on the leaders, however, Australian firms have been falling further behind, especially in the dominant services sector.

Mixed messages about what matters

Features of Australia's policy history, at least since the end of the 'reform era', can be seen as contributing to this and, in any case, present opportunities for improvement. Unfortunately, this is where the public debate has been least helpful.

Just as almost any policy or regulatory initiative in recent years has been labelled a 'reform' – regardless of whether it's likely to improve things – many are claimed to promote productivity, when in fact most may not and some will do the opposite.

To be worthy of the description 'productivity reform', policy initiatives need to promote the more productive allocation of resources across the economy or more productive behaviour within individual organisations.

Broadly speaking, this requires measures that improve incentives, enhance capabilities and/or enable greater flexibility and adaptability within firms and across industries.

Incentives to be more productive could be expected to come naturally where there is sufficient market competition, but can be dulled or distorted by government regulations, subsidies and taxes. *Capabilities* encompass not only workforce skills and managerial competence, but also access to infrastructure services like energy and transport. And the *flexibility* for enterprises and organisations to make changes that would increase their productivity can be affected by regulations that constrain choices, create risks or raise transaction costs.

This conceptual framework, developed and promoted by the Productivity Commission in earlier years, is no longer used as an expository device to the extent it was. In my view, this has made it harder to focus public debate on the policy areas that matter most and the need for interventions to be complementary in their effects. As has been said about macro policy responses to inflation, there is little sense in having one foot on the brake and the other on the accelerator.

'To do lists' in waiting

There is no shortage of well-researched and publicly tested policy options at governments' disposal from each of the 'incentives, capability and flexibility' streams. Many have come once again from the independent institution expressly designed for this purpose, the Productivity Commission. The problem, as the outgoing RBA Governor Phil Lowe observed recently while attending his final G20 meeting, is that very few of its proposed reforms have been getting implemented.

In addition to detailed inquiry reports on specific topics, the Commission prepares periodic stocktakes based on these and other research. The latest of these agenda-setting reports, titled *'Advancing Prosperity'*, was released earlier this year (PC 2023). It contains over 70 recommendations across five 'key themes'. These have to do with workforce and workplace issues, market competition and 'dynamism', more efficient

government services, reducing the cost of emissions reduction and better harnessing the ‘digital revolution’.

The Commission notes in its report that many items on previous to-do lists ‘remain relevant’ -- a euphemism for little having been done. As for what might be expected from this latest edition, the signs are not propitious.

For a start, the Treasurer sought to lower public expectations even before the report was released, indicating that there may be ‘some areas’ where the Commission’s recommendations aligned with Government thinking. On its release, he downplayed the role of the 1000-page report, characterising it merely as an *addition* to the debate.

Moreover, it appears that the Commission may not have had the traditional opportunity to brief departments and ministerial offices, including at the State level to which many of its recommendations apply.

Unfortunately, although yet to identify areas for follow-up, the Treasurer was quick to dismiss recommendations in two areas where reform is arguably *most needed* -- in terms of the depth, breadth and immediacy of the productivity gains on offer.

One is the *energy* sector, where successive governments have contrived to maximise the cost to the nation of reducing carbon dioxide emissions. The other is *workplace regulation*, which has been regressing towards the sort of centralised, prescriptive regime that preceded the Hawke/Keating reforms.

Historically, the abundance of low-cost energy in Australia has tended to offset the detrimental impact on industry competitiveness and growth of our rigid labour market. That this is ceasing to be the case does not augur well for our economic future.

The energy ‘transition’ debacle

In its report, the Commission observed of the so-called energy transformation that ‘the difference between doing it efficiently or poorly will be a major determinant of living standards in the future’. While not saying so explicitly, the report’s contents make it clear that Australia has in fact been doing it ‘poorly’.

Indeed, on the present trajectory, notwithstanding the escalation in electricity prices, it is becoming doubtful that supply can continue to be relied on to meet demand -- at least to the extent the population has come to expect.

That the public is only now becoming aware of the risks can be attributed in part to the complexity of the forces at work, but also to how governments past and present have gone about things. As a long-time observer of this evolving policy debacle, three aspects stand out.

The first and perhaps most damaging in my view has been the demonization of market pricing as an allocative mechanism. (Professor Shann would be rolling in his grave!) The federal Opposition’s slogan ‘a great big tax on everything’ may have been effective electorally in 2013, but intentionally or not it killed off any prospect of least-cost methods being used to reduce emissions. Instead, we have seen the emergence

of a variety of financial and regulatory measures to promote low abatement technologies and activities, interventions that have destabilized the grid and pushed up electricity prices.

Given that the costs of attaining any given emissions target were always going to be greater for Australia, this is regrettable. That modest proposals by the Productivity Commission to enhance the scope for more efficient market signals were dismissed somewhat disingenuously as anti ‘clean energy’ is more regrettable still.

A second and related contribution has been the public demonization of energy sources other than renewables. I think it’s safe to say that no Treasurer will ever again display a nugget of black coal in the Parliament! Indeed, coal could not even be named in the Budget Speech as the export commodity responsible for an unexpectedly large surplus. And while it was once uncontested that gas would need to play a key role in the transition from coal, this crucial interim energy source too has come under attack from environmental groups and governments alike, with Victoria even vetoing its inclusion in the ‘National Security Mechanism’.

Meanwhile, nuclear energy, currently the only other feasible longer-term option for the ‘firming’ needed to accompany intermittent renewables, remains subject to a legislative ban-imposed decades ago under quite different technological and economic circumstances, with the Minister’s list of reasons for retaining a ‘no nuclear’ policy thin on evidence.

Thirdly, ‘ambitious’ targets for emissions reduction and renewable energy seem to have been set or agreed to by both sides of politics without a proper assessment in advance of the full costs of attaining them, including the transmission costs and environmental impacts. In this respect it has been largely a CBA-free zone, with the targets becoming an end in themselves. Meanwhile coal-fired generators are being driven out without a way to replicate the 24/7 service they provide.

Moreover, the price controls that have been introduced in an attempt to limit the affordability impacts for users, can only exacerbate existing supply and investment problems.

Then there are contingency measures to ‘keep the lights on’ pending a hoped-for breakthrough in storage or firming technologies. These include subsidies for intensive electricity users to ‘stand down’ at times of inadequate supply, and subsidies to enable remaining coal-fired power stations to remain on call.

The result of all this is an energy ‘system’ requiring far more *capital* (including prime farmland and natural habitat) to produce *less reliable* power -- the antithesis of a pro-productivity approach. In the process, real resources are bid away from more productive uses.

There is not even the consolation that we are at least ‘making a difference’ to the climate, as the public has increasingly been led to believe. Indeed, to the extent that production activity shifts offshore, global emissions are more likely to *rise*. The main impact on the environment of the poorly conceived energy ‘transformation’ will be local not global, and not in a good way.

Back to old-style labour regulation?

Industrial relations regulation has 'form' as an impediment to enterprise productivity growth. One might say that an anti-productivity bias was built into the system from its inception, given the centralised, highly prescriptive approach it embodied, and its deeply adversarial nature.

It was not until the Hawke/Keating era that the hitherto novel concept of enterprise bargaining began to offer scope for agreements that responded to circumstances 'on the ground'. As former Treasury Secretary Ted Evans stated in his own Shann Lecture '*the 90s growth in output, in productivity and in employment … owed much to labour market reform'* (Evans 2001). Research across OECD countries has found a strong connection between enterprise-based deals and productivity performance.

However, the Howard Government's rushed attempt in its 'WorkChoices' legislation to take those reforms to their logical conclusion gained little public traction, contributing to it losing the 2007 election. Things then went into reverse again in the Rudd/Gillard years, with new obstacles placed in the way of enterprise agreements. And, notwithstanding belated attempts at reform, they essentially remained in a holding pattern under the three Coalition Administrations that followed.

That changed with the election of the Albanese Government last year. Since then, successive waves of regulation have emerged with the ostensible purpose of 'getting wages moving' or achieving greater 'job security' or 'equality'. Looking beneath these aspirational headings, much of what is proposed appears more likely to *impede* than promote the enterprise 'dynamics' on which, as Treasury has stressed, productivity growth and well-paid jobs depend.

In the midst of the push to implement its agenda – which aligns closely with the ACTU's own wish list -- came two discordant reports from the Productivity Commission. That they were commissioned by the previous Government probably did not help their reception. With the Treasurer implicitly accusing the Commission of a 'scorched earth' approach and the Commission not defending itself publicly, the recommendations appear to have sunk without trace.

A 'scorched earth' characterisation is hard to reconcile, however, with the content of the reports themselves, which for the most part merely seek to restore flexibilities consistent with the Hawke/Keating/Kelty reforms.

For example, the Commission proposes a pragmatic and fair way of securing workplace agreements shown to yield net benefits to an enterprise's workforce as a whole, including more widely through amendments to 'awards'. The report also seeks to amend regulations that effectively give unions veto power over innovations that would enhance productivity.

The Commission further notes some obvious downsides for productivity growth in a number of the Government's latest initiatives. These include the potential for 'industry' deals being forced on individual firms that were not party to them, and the undercutting of flexibility-enhancing (but non-unionised) segments of the labour market such as casuals and the gig economy.

Wider implications

The experience in these two key policy areas indicates that the productivity challenge has become as much about averting *new* anti-productivity policies as reforming those in place. As the Chief Executive of Australia's largest company recently remarked: "What can we do to enhance productivity? *Stop doing more harm*!" (England, 2023)

The potential for 'doing more harm' is in my view as great as it's ever been and maybe greater.

For one thing, the combination of anti-productivity interventions in the vital energy and labour markets would seem to have further to run.

In the case of energy, the determination to meet overly ambitious emission targets while suppressing our only base-load energy sources will inevitably mean further price increases and less reliability, which (unless there's a change of mindset) could in turn see a further resort to price controls and other regulatory interventions that can only exacerbate supply-side problems.

Moreover, the series of costly missteps leading to the present state of affairs for energy, may well presage what to expect in the further quest to reduce emissions from agriculture. The recent overturning of the previous Government's decision not to accede to the 'Global Methane Pledge', means that emissions from livestock will need to be reduced by at least 30 per cent by 2030.

In the case of IR, to the extent that the current Government's policies continue to be influenced by union concerns, we could expect to see further measures to increase union coverage and 'say' and limit the ability of management to secure productivity-enhancing changes within workplaces.

The latest 'new' industry policy

Of further concern is the Government's seeming ambition for Australia not just to meet arbitrary emission targets, but to become a renewable energy superpower. This has been conflated with the perceived need, post-COVID, for us to develop a 'sovereign' manufacturing capability in order to reduce supply-chain risks.

Though portrayed as a new, forward-looking approach to industry policy, there is much that is 'old-think' about it. For example, a '*local content'* scheme -- a form of non-tariff protection long discredited for lack of transparency and high costs -- is being contemplated to promote battery manufacturing. Ironically, this activity has recently been migrating from Europe to China, to avail itself of that country's cheap power fired by Australian coal.

At the same time, there are signs that the Government may have ambitions beyond providing subsidies for the *purchase* of electric vehicles – equating to abatement costs per tonne around 20 times larger than for most other measures -- to bring about the 'resurrection' of local car *manufacturing*.

Meanwhile, with Labour's National Conference coming up, unions have been pushing the Government to take a new approach to trade agreements in order to achieve a 'more level playing field' for local manufacturing. And the Minister has signalled that 'green tariffs' may be imposed on imports from selected countries judged to have weaker 'decarbonisation' policies than ours.

To someone whose career commenced at the Tariff Board and IAC, the sense of *déjà vu* is palpable!

A second feature of recent policy practice is a lack of consistency across different policy interventions. For example, measures that raise the cost of energy can only hasten the decline of the relatively energy-intensive manufacturing sector. And measures that serve to inhibit enterprise flexibility and adaptability are at odds with government efforts to promote technological 'transformation'.

More spending vs better regulation

In terms of the three-way productivity policy framework noted previously, the reform narrative has focussed mainly on promoting 'capability'. Policies impacting on 'incentives' or 'flexibility' have received much less attention or have operated in the wrong direction. This could be expressed as a revealed preference for *spending more overregulating better*.

Many of the spending initiatives in the preferred areas of skills, industrial technology and human services, will take a considerable time to yield productivity gains. Even then, the size of any payoff from these so-called 'investments' will depend on how well the programs have been designed and managed. The experience with many existing ones has not been encouraging -- the NDIS and 'Gonski' being two well-documented examples.

By contrast, regulatory changes, whether for good or ill, tend to have effects that are more immediate and predictable. The deleterious effects of price controls on the availability of rental housing provide another well-documented example; a mistake we nevertheless nearly saw repeated.

The demise of good policy process

That an anti-productivity bias in policy has emerged, despite the avowed pro-productivity ambitions of current and previous governments, reflects in part the way policies are being made, which in turn is reflective of trends in politics and perhaps society itself.

The past decade or so has seen a further shift away from 'evidence-based policy making' to policies based on what I'd characterise as *aspirations, interests and 'light bulb moments'.* Key elements in decision-making such as problem clarification and options assessment are increasingly honoured more in the breach.

Consultation processes, which are integral to good policy and played an important role during the high period of structural reform, have been a particular casualty. Indeed, in the form upheld by earlier governments as 'best practice' they seem to have lapsed

almost entirely. Instead, we increasingly hear about something called a policy 'conversation'.

Unlike public consultations, which are based on well-established principles, a 'conversation' is a more malleable concept. The term suggests an active dialogue to inform government decisions, but the recent policy experience -- in energy and IR, but also immigration and taxation -- has been more akin to promotional statements after a decision has been made. Although 'conversation' sounds both friendly and inclusive, in practice the meetings that do take place have tended to be selective and behind closed doors.

Such an approach, which is bipartisan, provides limited scope for governments to receive proper input or feedback from those potentially affected by a policy initiative. As a result, policies have often required repeated revision 'on the run' to remove glitches apparent at the legislative stage and, after implementation, the consequences can remain uncertain and contentious.

Moreover, far from being informed about what is at stake in policy decisions, the public, when not kept in the dark entirely, is often misinformed or even misled. Problems allegedly justifying policy action are rarely well defined or documented, and often exaggerated. Energy policy and IR once again provide prime examples.

The associated political rhetoric has become increasingly hyperbolic and disconnected from economic reality. Thus, we have the PM lauding his Government's "smarter, more strategic approach" to the productivity challenge and the Treasurer saying the energy 'transformation' is a boon for productivity, when evidence and logic indicate otherwise. Infrastructure schemes that would fail any reasonable cost-benefit test are depicted as 'nation building'.

Unfortunately, this rhetorical approach to policymaking seems to have enabled anti-productivity provisions in legislation to get a far easier ride through our parliaments than warranted, based on a combination of sympathy for the slogans and lack of time to absorb the detail.

Countering lack of 'political will'

So, is there any hope of restoring a *real* pro-productivity orientation to policy conduct?

Based on experience to date it is hard to see this happening under either major party. An excess of 'pragmatism' (read political expedience), combined with a more 'progressive' and assertive crossbench, stymied progress at the federal level under the Coalition. Devotion to big government, a suspicion of market forces and strong union influence are proving even more challenging under Labour. When in Opposition, including at State level, parties have tended to be half-hearted opponents of bad policy and in some cases supporters of it.

If there is to be reform of a kind that would make a difference to Australia's productivity performance, it will require a change in the politics. Governments follow or anticipate public opinion more than leading it. How the public reacts to the stagnation or decline in living standards (including added tax imposts and other unpleasant 'surprises') that

an ongoing productivity malaise implies, remains to be seen. But an electoral backlash cannot be ruled out – as we have just seen in WA against the ill-conceived 'heritage' legislation.

As in that case, electoral pressure is more effective politically when informed by a clear understanding of the link between bad outcomes and the policies responsible for them. Such an understanding is unlikely to be fostered by the political interests implicated in those policies. The major structural reforms of the past were driven more by the advocacy of industry bodies, notably the NFF, AMC and BCA, often drawing on evidence produced by the Productivity Commission and its predecessors. This saw in turn the emergence of political leaders who were more receptive to reform and more capable of advancing it.

In recent years, industry bodies in my view have been less engaged in resisting anti-productivity policies and less effective in pressing the case for reform. By contrast, despite dwindling membership, unions have become increasingly influential.

With the consequences of complacency becoming increasingly manifest, especially in the crucial areas of energy and Industrial Relations, I sense that things are beginning to change. Importantly, we are starting to hear from senior business figures themselves, who can speak with authority about the impacts of policy at the enterprise level. And with many Productivity Commission reports still on hold, there is no shortage of reform ideas to take forward.

There may also be potential for the Commission itself, consistent with its legislative remit, to do more publicly to advance meaningful reform. Whether the institution will still be in a position to discharge this essential public education role in future, given the Treasurer's intention to '*revitalise, renew and refocus'* it, remains to be seen.

Finally, recalling the contribution to public policy of the man we honour in this Lecture, it would be great to see more academic economists making a contribution to the debate. After all, to borrow from Edward Shann's biographer, it's hard to think of a mission for economists more worthy than *raising the common lot* of Australians.

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