

# Productivity Review

## Suggest a reform

The Australian Government has asked the Commission to look at policy options to improve productivity and prosperity - how Australia can better use its people, capital, and knowledge to improve the wellbeing of Australians.

This extends beyond commercial activities to include government funded services (like health care and education), factors that limit how people can use their time (such as congestion), and that restrict people's capacity to contribute to overall output in the economy (such as barriers to labour market involvement).

## What reform would you like to suggest?

### Please provide a short description of your reform idea \*

Systematic reform and investment based on a new reform process will rescue Australian growth and productivity. This can be termed "Walking on Two Legs".

This new reform process requires two key components: ongoing structural reform, and new investment for the future.

Structural or institutional reform is well known and well advocated, but can be revitalised. Discussion of the need for a further complementary strategy that involves renewed and reinvigorated investment in the nation's future is less well developed and much more piecemeal, but becoming increasingly recognised as essential too.

The pursuit of both institutional and investment approaches together would be the most beneficial path to securing Australia's future.

For the complete analysis and more information, please see The Securing Australia's Future report – Australia's Comparative Advantage that can be found at <http://www.acola.org.au/PDF/SAF01/SAF01%20full%20lo%20res.pdf>

### Which level of government does this reform relate to? \*

## Details about the reform

### What is the objective of this reform?

The reform package objective for Walking on Two legs is to provide a vision of a comprehensive package of reform that brings large benefits for Australian living standards. Productivity is the core benefit, but assisted by increased population and participation reform pay-offs.

The reform package will build Australia's future comparative advantage to bring these higher living standards, and can assist with increased equity and greater sustainability often directly

and also, where needed, with complementary equity and environmental policies. Evidence on the environmental and equity trends is offered.

Economic modelling for the Australia's Comparative Advantage report suggests that a new reform package across institutional change and future investment could add more than 17% to GDP per capita and, better still, more than 20% to living standards by 2030 over and above trends that would be based on current policy settings only (base 2015).

## **Why is this reform worth pursuing?**

Modelling for the ACA project found that addressing reform in a broad way would have valuable and sustained benefits for the Australian economy and its people. This would mean both:

- institutional reforms in political, legal and market institutions ranging from federalism, through intellectual property to trade, taxation, workplace relations and competition policy, and also
- investments in infrastructure, education, research and development, innovation, labour participation and immigration.

The modelling analysis is from well-attested techniques also used by the Parliamentary Budget Office, the PC itself and others.

While either of the two paths, institutions or investment, would be valuable, the power of the two together, creating comparative advantage by 'walking on two legs' is especially impressive. There is the potential for increases in living standards of 22% within 15 years, over baseline trend.

Under the combined scenarios, manufacturing would get the greatest benefit with agriculture also predicted to grow strongly. Demand for manufactured goods is boosted by the high rate of infrastructure investment required to support a higher rate of economic growth and agriculture benefits from the boost from free trade agreements. In this latter respect Brexit may offset TPP effects, but these recent developments are not modelled.

While the policy and reform process is never without challenges, a survey of public attitudes conducted for this project shows there is an appetite for at least some level of policy change. This includes a desire for more spending on core drivers of comparative advantage such as education at the school and tertiary level, and transport and communications infrastructure. While there was less support for taxation structural change, there was very clearly a willingness on the part of those members of the public surveyed to contribute to the wider cost of institutional reform through a higher level of taxation.

## **What is the evidence to support this reform?**

As an ACOLA project, the ACA report is principally based upon well-documented evidence. As well as drawing on the general body of knowledge and other ACOLA reports, the project itself commissioned a series of studies that are at the core of the deliberations and findings.

The project takes the view that evidence-based policy helps reduce the differences between contending views and puts future action on a surer footing. It does not resolve all issues. Interpretations of evidence can differ and values will often contend in assessing the significance of findings. But to enter the market place of ideas armed with systematic knowledge is to provide a surer foundation for informed discussion.

The project itself wrote or commissioned seventeen reports as resources for the Final Report from the project. This is important as the project covers a huge canvas but needs to be sure on detail as well as big picture issues.

Of help here has been the ongoing work and final reports of the other Securing Australia's Future projects. But the ACA project did develop its own detailed documentation, so that propositions and evidence provided can be interrogated further as required. These reports can be found at:

<http://www.acola.org.au/index.php/australia-s-comparative-advantage-contributing-reports>

The evidence in these studies and gathered together in the project's Final Full Report and in an Extract Report covers a full portfolio of benchmarking, scenario analysis, opinion surveys of business, government officials, and the public plus time series analysis and economic general equilibrium modelling including with a semi-endogenous Australian model.

## **Who would benefit most from this reform?**

The modelling undertaken for the Australia's Comparative Advantage project shows that broad based changes to both institutional reform and increases in investment for the future could have sustained benefits for the broad economy and society as a whole in the medium and longer term. They could however stimulate the private sector and underpin all of the industry sectors that are crucial to Australia's future, including in the shorter-term for the more flexible, agile and innovative elements of business and the community sector too.

Society would benefit too through higher levels of employment and education shown in the policy paths that were modelled, with a much enhanced standard of living with a higher after tax wage. Fiscal consolidation would also be feasible and facilitated.

## **Are there likely to be any losers from this reform, and who are they?**

Relatively speaking the lower paid workers are advantaged relative to the more highly paid, under the reform packages proposed.

The modelling postulates double-digit rises in employment and there are gains in after-tax wages of an average of 21.5% by 2050. The biggest gains are for low-skilled workers with a predicted increase in after-tax wages of 38.1% compared to increases for mid-skilled workers of 20.9% and high-skilled workers of 13.1%.

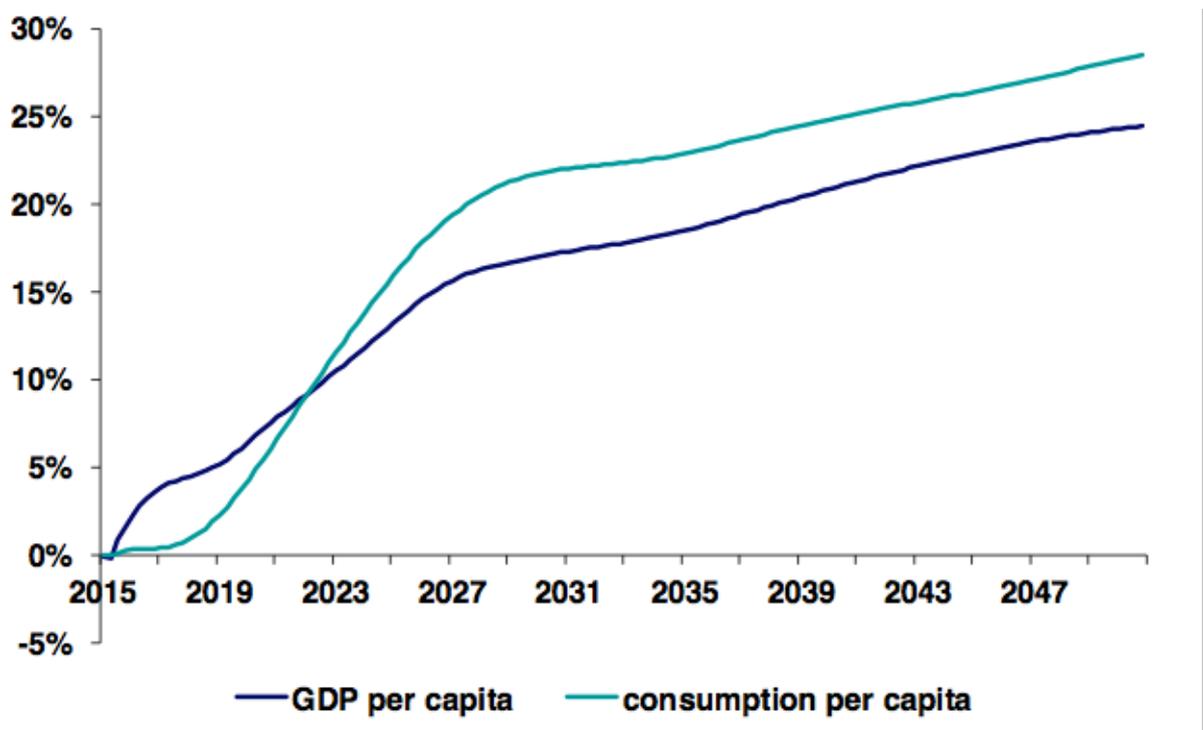
The effects of the two reform components do differ in distributional impact, according to the modelling. The Advancing Competition Scenario reforms have broadly neutral distributional impacts. By contrast, the gains from the Investing in the Future Scenario reforms are slanted heavily in favour of low wage earners. This latter is because the migration and education reforms both increase

the supply of high skilled workers relative to low skilled workers, leading to some narrowing of wage differentials.

This is a striking outcome for the objective of the pursuit of growth with equity, and arises in the modelling from the shift in demand matching the growth in supply, but it is a phenomenon well-attested by the migration and education literatures using historical and comparative data.

### Over what timeframe do you believe this reform could be implemented?

Based on the Microeconomic Reform process (see The Productivity Commission, Stocktake of Progress on Microeconomic Reform, 1996) and lessons therefrom, the major implementation phase could be largely completed in a five year period, with rapid benefit accruing over the next ten years and further steady benefit growth continuing at lower rates thereafter. This is reflected in the phasing in the model for this ACOLA project that emerges from realistic implementation paths for each of the components of the reform package, as provided in detail in <https://www.acola.org.au/PDF/SAF01/8.%20Economics%20Scenarios.pdf>



Source: Independent Extended CGE model

### What implementation costs do you think this reform might involve?

The report suggests that it may be easier to achieve implementation of reform if it is pursued across the board, covering most if not all of the key areas examined in the comprehensive policy package scenarios. Others may also be possible, but the included policy changes cover a representative set of the reform areas under most informed public discussion: a representative national “to do” list that transcends narrow partisanship to embrace the broad set of requirements for a better future.

A comprehensive package of reforms across both institutional change and investing for the future allows for a coherent narrative for change and benefit, which would assist in the partnership and leadership identified in the report as essential for successful reform.

Also, because the benefits may appear more modest and the barriers large for one area of reform in isolation, while taken as a whole the areas where there are losers from change could be more than offset from the gains made in other areas. Australia's tax-transfer system could be fine-tuned to ensure that this happens. The nation as a whole gains from pursuit of comparative advantage through rebuilding the foundation of that advantage.

### **Are there any obstacles or impediments that may prevent this reform from being implemented?**

Having defined the pathway to building Australia's comparative advantage, securing that future remains a challenge. It involves making clear the benefits that can be gained, and the modelling approach adopted for this purpose validates the worth of that.

Likewise, the Public Preference Study commissioned for this project has made clear that the wider Australian electorate is likely to be supportive of and responsive to these possibilities.

The big task that remains, also analysed in the report as indicated, is ensuring that the leadership and partnership that is also needed for this change can be forthcoming.

According to Boulding's Law "If it Exists, It is Possible". Australia's reform era across the Hawke-Keating and Howard-Costello governments did achieve this in the past.

### **About you**

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