

# HOW USEFUL IS THE PRODUCTIVITY COMMISSION?

The Productivity Commission doesn't always get it right, but it has made a major contribution to policy, writes **Judith Sloan**

While the Productivity Commission may not quite be a household name, there is little doubt that many Australians are aware of its work. The media regularly outline the contents of the commission's steady stream of publications on a broad range of topics, and use material sourced from them to inform other stories. Moreover, speeches given by its long-standing Chairman, Gary Banks, are widely reported.

The commission has made major contributions to the public policy debate in Australia. It has dealt with core economic issues and important social policy topics. It has produced innovative work on the environment. Its regular reporting of the provision of government services across the states and territories continues to provide useful information. The data it produces in relation to Indigenous disadvantage add value to policymaking in that area. Working from the premise that regulation should be light-handed, effective and efficient, the commission has recommended many changes along these lines in its reports. As an independent advisory body, and spared the requirement of servicing any government minister on a routine basis, the commission has made substantial contributions to the quality of policy outcomes.

It is easy to take this state of affairs for granted. After all, the commission, in various forms and with various names, has been around for many, many years. But the reality is that as

an independent statutory body advising the federal government on microeconomic and social policy matters, the commission is a rare beast in an international context. More latterly, other governments—the Victorian and New Zealand governments, for instance—have copied the experiment by setting up similar bodies. But for a long time, the commission was a unique organisation, providing well-researched and frank advice to the federal government.

## A potted history

A remarkable feature of the commission's history is its strange lineage—its great-grandfather was the Tariff Board, an organisation set up in the 1920s to confer the benefits of tailor-made tariff protection on rent-seeking organisations. After the Tariff Board came the Industries Assistance Commission (IAC), set up by the Whitlam government in 1974, which was a marked improvement on the Tariff Board.<sup>1</sup> The IAC morphed into the Industries Commission (IC) in 1990, which was a further improvement, dropping the word 'assistance.' In 1998, the Productivity Commission was established, taking on board the IC, the Bureau of Industry Economics (BIE), and the Economic Planning Advisory Council (EPAC). This transformation

Professor **Judith Sloan** was a Commissioner of the Productivity Commission from 1998 to 2010.

paralleled the change in approach to economic policymaking taking place at the time: from 'all-round protection' to the promotion of an open and competitive economy.

Other research and advisory bodies have also operated within the federal sphere. The Bureau of Labour Market Research, for instance, produced some valuable research in the 1980s, but the release of a controversial report on youth wages saw its functions absorbed into the department. Similarly, the Bureau of Immigration Research undertook and commissioned a large volume of work related to immigration, and was renamed the Bureau of Immigration, Multicultural and Population Research, but was abolished in the late 1990s. In this sense, the sheer longevity of the commission is in contrast with the fate of other government research bodies.

It does need to be pointed out that the commission, and its antecedent bodies, have all been statutory agencies; a government decision to abolish the commission would require

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rescinding an Act of Parliament. This said, any government has the option of starving such a body of funds as well as undermining its functioning by providing few and/or insignificant references.

Needless to say, there have been some dark moments for the commission, in all of its forms. For a variety of reasons, from time to time, the organisation was not viewed with enthusiasm by the government of the day and references were few and insubstantial. For instance, in the Annual Report of the IAC for 1988–89, frank language was used to point out that:

The past year has not been an easy one for the IAC. The absence of a forward inquiry program, the referral of industry policy questions to department research bureaus and

*ad hoc* bodies and delays in making appointments ... all fuelled uncertainty as to the IAC's future role and its contribution to the microeconomic reform program.<sup>2</sup>

The transition period during which the IC absorbed the BIE and EPAC (1996–98) were also gloomy days for the organisation. A report on the passenger motor vehicle industry was found to contain some empirical errors, and the associate commissioner assigned to the inquiry produced a dissenting minority report. It would be fair to say that when the *Productivity Commission Act* finally received Royal Assent in 1998, the organisation was not riding the crest of a wave.

Two political names stand out as particularly important to the history of the organisation: John Howard, who successfully resisted attempts to significantly slash the IC's funding in the late 1970s, and Paul Keating, who transferred the responsibility for the organisation from the industry portfolio to Treasury.

### Productivity Commission legislation

*The Productivity Commission Act 1998* is relatively brief. It contains a number of strange provisions negotiated with the Australian Democrats to allow passage of the bill through the Senate. However, the core features of the statute remained intact. Section 8(1) of the Act deals with the general policy guidelines for the commission and include:

- (a) to improve the overall economic performance of the economy through higher productivity in the public and private sectors in order to achieve higher living standards for all members of the Australian community; and
- (b) to reduce regulation of industry (including regulation by the States, Territories and local government) where this is consistent with the social and economic goals of the Commonwealth Government; and

- (c) to encourage the development and growth of Australian industries that are efficient in their use of resources, enterprising, innovative and internationally competitive.

The overarching framework that drives the commission's work is the promotion of community well-being. In assessing the impact of existing policies and proposed changes, the commission takes the perspective of the entire economy and community, rather than analysing only the immediate sectoral effects. In doing so, it accepts that changes to economic (and social) policies create both winners and losers, and makes suggestions on managing the transition.

In response to a controversy about economic modelling that existed at the time of the bill's passage, section 8(3) calls upon the commission either to use two different models or appoint a reference panel to comment on any modelling undertaken. By and large, the second approach has been used by the commission.

### **What does the Productivity Commission actually do?**

The core functions of the commission are undertaking inquiries and commissioned research. These activities arise from references sent by the federal government, with commissioned research more likely to cover matters of interest to state governments (and which sign off on these terms of reference). In addition, the commission undertakes a stream of independent research; produces annual reports on Government Service Provision (the *Blue Book*) and Overcoming Indigenous Disadvantage; and reports on assistance and regulations affecting industry (reported in the Annual Report and separately).

The commission's Annual Report contains a theme chapter each year covering a different topic in some detail, picking up on relevant research and material produced by the commission and elsewhere. Some of the themes covered include: productivity trends and explanations; evidence-based policy; labour force participation; reforms beyond the global financial crisis; and social policies.

The policy areas described and analysed by the commission are partly dictated by the references given by the government. This is an iterative arrangement, with the commission involved in the process that determines which references are sent. Of course, government makes the ultimate decision and there have been some disappointments. For example,

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the newly elected Rudd government selected Steve Bracks to head an *ad hoc* inquiry into the passenger motor vehicle industry, explicitly circumventing the commission. Other examples in which the commission has been excluded relate to textiles, clothing and footwear and the National Broadband Network. Managing the forward work of the commission is a constant challenge that requires patience, diplomacy and perseverance.

Having said that, there have been some coups, starting with the inquiry into gambling, which established the commission's reputation in social policy analysis. With the winding back of tariffs and many of the traditional competition issues being progressed, in part through the National Competition Policy, the commission needed an additional niche to demonstrate the value of its research capability and processes. Other topics the commission has dealt with include: broadcasting; private health insurance; national occupational health and safety framework; paid parental leave; caring for older Australians; and disability care and support. In the field of the environment, the commission has made important contributions with a number of studies applying a market-based perspective to achieving the least-cost outcomes.

### **The Productivity Commission processes**

One of the distinctive features of the commission is the open and transparent manner in which it conducts its inquiries and commissioned

research. For inquiries, the commission is generally required by the Act to conduct public hearings. This requirement is also met in respect of many commissioned research projects, although smaller roundtable discussions are sometimes used instead, depending on the topic. In addition to public hearings, the commission calls for public submissions upon releasing an issues paper. Then these submissions are posted on its website, save for submissions that contain confidential material, which are relatively rare. Consultations with interested parties and visits to particular locales are a regular part of the process.

Typically, a draft report is released for public comment, further submissions are called for, and further hearings are undertaken before the final report is either handed to the government, in the case of inquiries, or released, in the case of commissioned research. Under the Act, the government must release an inquiry

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report within 25 sitting days after delivery. A pattern has developed in which the government formally responds to the recommendations of both inquiries and commissioned research. It is easy to dismiss the importance of these processes, which are open to everyone to contribute their 'two bobs' worth.' The reality is that these processes add significantly to the credibility of the commission's output, while also providing valuable information not available to staff members by simply sitting at their desks in Melbourne or Canberra. While *ad hoc* committees established by the government can, and do, imitate these processes, the fact that the commission has a long and consistent record of consulting, listening and receiving submissions means that it is the preferred organisation to consider contentious policy topics.

### Does the commission always get it right?

Given the many publications that the commission has produced, it should not come as a surprise that it does not always get it right. A common criticism is that the reports are too lengthy and detailed, giving rise to less interest than might otherwise be the case. The reports however do contain both a short list of key points and an executive summary that allow readers to ascertain the main features of the topic and key recommendations. The counterargument is that the commission is required to undertake thorough and comprehensive analysis and to record the results, both for the time at which the report is released and to stand as a record for the future. The use of technology, however, should allow the commission to solve this problem by referring readers to the more detailed material posted on its website and to publish shorter and pithier reports.

A second general criticism is the commission's ongoing failure to understand the workings of the federation and the benefits of competitive federalism. Ironically, the *Blue Book* has been a boon to the workings of 'yardstick competition' as states have been able to compare the efficiency of the provision of various government services in the various jurisdictions. But a number of commission reports have recommended national solutions, national agencies, and the removal of state government authority over particular areas, even where the Australian Constitution is quite specific about state government sovereignty. Federalism seems untidy but very little attention has been given either to the required transition—often justifiably resisted by state governments—or to the possibility of regulatory failure on the part of the federal government.

To give one example, the commission's report on Australia's health workforce recommended the creation of single national health practitioners' registration authority.<sup>3</sup> This recommendation was always a solution in search of a problem: registration of health practitioners had always been handled on a state-by-state basis, with separate registration for

the various health practitioner groups. Interstate movement of health practitioners was handled through the mechanism of mutual recognition. The subsequent creation of the Australian Health Practitioners' Registration Agency has in fact turned out to be a dismal failure, with the sheer scale of activity being beyond the bureaucratic capacity of any one agency. The information required of health practitioners is excessive and onerous to provide, and any benefits flowing from the creation of this single agency are extremely unclear at this stage.

The commission also got it wrong in its report on executive remuneration.<sup>4</sup> The report is in two parts. The first part examines executive remuneration trends in Australia. This analysis demonstrates that executive remuneration in Australia is lower on average than in the United States and the United Kingdom, and that the growth of executive remuneration in Australia can be explained by the growth and performance of companies. The second part of the report is completely at odds with the first. Here there are a series of bizarre and burdensome recommendations actually related to executive remuneration, including the so-called 'two strikes' policy<sup>5</sup> and the abolition of the 'no vacancy' rule (which is unrelated to remuneration).<sup>6</sup> These extremely interfering and poorly targeted suggestions are particularly strange given the general policy guidelines as specified in the Act 'to reduce regulation of industry where this is consistent with the social and economic goals of the Commonwealth government.' Given that the report was unable to establish anything out of the ordinary in respect of executive remuneration in Australia—indeed, the good corporate governance practices of Australian listed companies are noted in the report—these recommendations should be a constant source of embarrassment to the commission.

The commission generally takes great care to ensure the empirical and factual accuracy of its output. Mistakes on this score are relatively few. Occasionally misleading estimates are nonetheless produced as a result of faulty direction from the government. The clearest example of this relates to the report that

estimated the potential benefits of the National Reform Agenda.<sup>7</sup> Because program implementation costs were specifically excluded from the exercise, the benefits of the 'human capital' reforms (health promotion and prevention, education and training, and work incentives) were deemed to be very large and exceeded those from improving productivity and efficiency in energy, transport and related

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infrastructure, and reducing the regulatory burden on business. However, the exercise made no sense unless *net* benefits (benefits less costs) were the focus of the modelling.

### Conclusion

There is little doubt that, on balance, the commission has been, and continues to be, a useful and influential institution. By setting out the key criteria that should drive effective and efficient policymaking—in economic, social and environmental areas—the commission has made major contributions to improving community well-being in Australia. Of course, both federal and state governments have not always been keen to embrace all the recommendations of all the reports—some are ignored to be picked up later, some are rejected out of hand, and some are implemented, although not always all the recommendations in any one report. But these outcomes should not be seen as a sign of failure on the part of the commission—the mere release of a well-argued and rational response to a policy problem can have an impact and stands as permanent record of the preferred policy position.

That the commission is not always right is also not a damning criticism. A vast amount of material is released by the commission, and innovation and experimentation will necessarily involve mistakes. The fact that the commissioners undertake a checking process before major reports are released ensures a degree of risk management. Moreover, the courage of some of the chairman's speeches suggests that the

commission is an organisation that is not for turning. In 2010, Gary Banks publicly said:<sup>8</sup>

Industrial relations regulation is arguably the most crucial to get right ... Getting the balance right is challenging ... This is particularly important in the context of the structural pressures ... given the premium they place on flexible, adaptable labour markets. However, regulatory changes (in both directions) have generally been exempt from even the cursory obligations of regulation impact statements. If we are to secure Australia's productivity potential into the future, the regulation of labour markets cannot remain a no-go area for evidence-based policy making.

Frank and fearless are apt descriptors of this excerpt from the chairman's speech.

Over the years, politicians and bureaucrats from a number of countries have consulted with the chairman and other commission staff about setting up a similar organisation in their own countries. Apart from New Zealand, which did set up its own Productivity Commission in 2010, all other inquiries have resulted in no action. The major sticking point is the sheer independence of the organisation and

the inability of politicians to control outcomes once a reference has been sent. While this may seem scary and unconstrained, the independence and commitment to open and transparent processes underscore the commission's strength as a force for good in policymaking.

### Endnotes

- 1 See Productivity Commission, *From Industry Assistance to Productivity: 30 Years of 'The Commission,'* (Canberra: 2003).
- 2 As above, 63
- 3 *Australia's Health Workforce*, Productivity Commission Research Report (January 2006).
- 4 *Executive Remuneration in Australia*, Productivity Commission Inquiry Report (January 2010).
- 5 The 'two strikes' policy involves a complete spill of the company board in the event of a 'no' vote against the remuneration report of the company greater than 25% in two successive years.
- 6 The 'no vacancy' rule allows companies to adjust the size of their boards during the course of the financial year. Abolition of this rule means that any vacancy that arises must be filled.
- 7 *Potential Benefits of the National Reform Agenda*, Productivity Commission Supporting Research Report (2007).
- 8 Gary Banks, 'Successful Reform: Past Lessons, Future Challenges,' Keynote Address to the Annual Forecasting Conference of the Australian Business Economists (Sydney: December 2010).