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# Submission to the Productivity Commission 5 year productivity review: Increasing Australia's Fu- ture Prosperity

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## Submission to the 5 year Productivity Review

The Centre for Independent Studies (CIS) welcomes the opportunity to make a submission to this Inquiry.

As an initial observation, an excellent basis for a productivity boosting agenda is the extensive list of reforms stated by the former chair of the Productivity Commission, Gary Banks, in his outgoing speech "Productivity Policies: the 'to do' list" in 2012.<sup>1</sup>

The Productivity Commission has titled this as an Inquiry into "Increasing Australia's future prosperity." Improvements in productivity do not automatically result in improvements in prosperity, so it is commendable that the Commission has made this distinction. An excessive focus on productivity to the exclusion of all other measures might lead to the adoption of policies that increase *measured* productivity but are actually harmful to prosperity. The Commission should reject policies that have this effect.

Conversely, an excessive focus on measured productivity might mean worthwhile policies are rejected. This includes policies that encourage greater use of labour capital and resources, which can make Australia better off but might actually result in declines in measured productivity. The Discussion Paper mentions one example: policies that increase labour force participation (page 3). Some other examples are in Attachment 1.

The Discussion Paper also raises distributional issues (page 4). It would also be useful for the Commission to report on distributional issues on a regular basis, including the issue of the capital vs labour share of national income, following on from the earlier work done by Dean Parham on this issue.<sup>2</sup>

However there are complexities with inequality that are important. In particular, inequality can occur because of wealth obtained by innovation or just plain hard work. It is hard to see how this should have a detrimental effect on productivity. In addition, policy actions to suppress wealth could put a dampening effect on innovation which will likely harm

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<sup>1</sup> Gary Banks, 2012 "Productivity Policies: the 'to do' list", Address to Economic and Social Outlook Conference, 'Securing the Future' in Melbourne on 1 November 2012.

<sup>2</sup> Dean Parham, 2013, *Labour's Share of Growth in Income and Prosperity*, Visiting Researcher Paper, Productivity Commission.

productivity<sup>3</sup> and therefore lead to lower incomes and potentially increased poverty. Therefore, it is recommended that the Commission, if it examines the impact of distributional issues on productivity, should focus on the issues underlying inequality (including poverty and illegitimate wealth) rather than inequality itself.

### **CIS papers of relevance to Inquiry**

The CIS has produced several papers of relevance to this Inquiry, which are attached:

- **Sara Hudson (2016) *Mapping the Indigenous Program and Funding Maze***, Research Report 18. This paper found:
  - The vast majority of Indigenous programs (92%) have not been evaluated. Rigorous evaluation would enable replacement of ineffective programs to be replaced by effective (and productive) ones.
  - Several examples of inefficiencies (and therefore areas for productivity improvement) in Indigenous programs. This includes the Indigenous Business Australia (IBA) business loan program approving only 75 loans in a year — approximately one loan for every person employed to run the program.
  - Most programs are not targeted at need, and instead treat Indigenous people as homogeneous.
  - There are high degrees of overlap in the programs. Toomelah in New South Wales, with a population of only 300 people, has more than 70 service providers delivering programs. Roebourne in Western Australia, with a population of 1,150 has more than 400 programs.
  
- **Trisha Jha & Jennifer Buckingham (2016) *Productivity Commission Inquiry into Introducing Competition and Informed User Choice into Human Services: Submission in response to issues paper***, 1 July. This submission argued:
  - Expanding competition and contestability in school education has the potential to improve quality, equity and efficiency (and hence productivity).
  - One such policy is the establishment of charter schools or free schools — public schools that are managed by private organisations.
  - The CIS research Report 6 Free to Choose Charter Schools finds that charter schools produce strong positive impacts in almost all cases when the school has a focus on traditional instruction methods, frequent testing, and strict discipline and behaviour standards.
  - Charter schools provide particular benefits for low-achieving students and for students from disadvantaged backgrounds.

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<sup>3</sup> “high top statutory income taxes reduce the post-tax income of a successful entrepreneur relative to an unsuccessful one and can reduce entrepreneurial activity and TFP (total factor productivity) growth”: OECD 2010, [Tax Policy Reform and Economic Growth](#), OECD Tax Policy Studies No 20, November; Bronwyn Hall (2011) *Innovation and Productivity*, NBER Working Paper No. 17178, June; and Chiara Criscuolo (2009) “Innovation and Productivity: Estimating the Core Model Across 18 Countries”, Chapter 3 in OECD (2009) *Innovation in Firms: A Microeconomic Perspective*.

- Charter schools provide a high potential for significant gains in student learning, at the same per student cost as traditional public schools (ie increasing productivity).
  - Australia's long-standing governance and funding arrangements with non-government provide strong foundations for the establishment of charter schools.
  - There are barriers to entry and contestability in non-government schools that should be addressed.
- **Jeremy Sammut (2016) *MEDI-VALUE: Health Insurance and Service Innovation in Australia - Implications for the Future of Medicare***, Research Report 14, which argues:
    - The inefficiencies in the health system will not be addressed through centrally-planned programs.
    - Instead cost savings can come through managing utilisation and developing a real market for health services in Australia, such as through the 'Medicare Select' national health reform proposal where all Australians would receive taxpayer-funded, risk-adjusted health insurance vouchers to fund the purchase of private health plans.
- **Jeremy Sammut, Gerald Thomas, Peta Seaton (2016) *MEDI-VATION: 'Health Innovation Communities' for Medicare Payment and Service Reform***, Research Report 21, which argues:
    - Structural inefficiencies in the \$155 billion Australian health system cost the nation \$17 billion annually, or 11%.
    - The bulk of health funding is locked up in inflexible models of unintegrated care, which provide no incentive for individuals to take responsibilities for health risks.
    - The best way to allow for innovation in health to establish Silicon Valley-style 'Health Innovation Communities' that relax restrictive practices and laws, remove disincentives that prevent new ways of doing business.
    - Consumers would opt-in to a new Integrated Care Plan system where existing public and private health funds are pooled on a capitation basis.

Some additional thoughts of relevance to this Inquiry are at Attachment 1.

We trust that these papers are of assistance to the Commission. The authors of each of these submissions can discuss the individual submissions with you, or you may contact me at [mpotter@cis.org.au](mailto:mpotter@cis.org.au) or on the office number 02 9438 4377.

## Reform processes and institutions

The Commission has requested ideas for improving reform processes and institutions (see Discussion Paper at page 17). The following ideas are worthy of further consideration:

- Reinstating payments to jurisdictions that undertake reform, based on the previous National Competition Policy payments system,<sup>4</sup> and expanding these payments to cover reform by local governments. In theory, States should have intrinsic incentives for reform, but too often States think reform is too hard and give up. Additional financial incentives are worthwhile to lower these barriers to reform, as the Commission has itself noted.<sup>5</sup>
- Reforming the GST distribution system to remove disincentives to reforms by States (and local governments). This distribution system generally operates to penalise States that reform their economies and tax systems to encourage growth, while subsidising States that postpone or veto reform.<sup>6</sup> As a result, the GST distribution acts like a *negative* reform payment.
- Substantially expand the independent evaluation of existing programs, such as through a broader remit for the Commission or the Audit Office, or the establishment of a new evaluator-general.<sup>7</sup>
- Require Regulation Impact Statements to be prepared independently of government, especially where the regulatory burden is above a threshold. This could be through a new independent agency, or through existing independent agencies such as the Productivity Commission.<sup>8</sup>

### Non-market activity

One area where prosperity goes beyond the ‘headline’ measures of productivity relates to non-market activity. Measured productivity counts only activities that are in the scope of the national accounts (GDP). So this means the “productivity” of non-market activities such as family and leisure time are excluded, or only indirectly included. Changes that affect our non-work lives are not measured in productivity statistics.

For example, moving a child from parental care to child care increases both GDP (the numerator in productivity equations) and the inputs (the denominator). However, the

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<sup>6</sup> See for example Robert Carling (2008) “Fixing Australian Federalism”, *Policy* 24(1) and Robert Carling (ed) (2008) *Where to for Australian Federalism*, Centre for Independent Studies Policy Forum 15. The harmful effects of the distribution formula on efficiency were acknowledged (but downplayed) in a report to the Federal Government in 2012: John Brumby, Bruce Carter & Nick Greiner (2012) *GST Distribution Review Final Report*, at Chapter 9.

<sup>7</sup> As proposed by Nicholas Gruen (2016) “Why Australia needs an evaluator-general”, *The Mandarin*, 9 May.

<sup>8</sup> The CIS has previously recommended that Regulatory Impact Statements should be reviewed independently, see Simon Cowan (2014) *Submission to the National Commission of Audit*, TARGET 30 paper 8.

'productivity' of the previous parental care is not included in this calculation as it is outside the scope of the market.

Urban amenity, travel times (as mentioned in the Discussion Paper on page 3) and pollution all affect both market and non-market lives, but an examination of productivity alone omits the non-market aspect. This means that a focus on productivity alone may not put sufficient weight on the importance of reforms in this area.

Therefore, the Commission should develop comprehensive measures of productivity in the non-market sector (including government, health and education), to be updated yearly, preferably at a State level. This will build on the work the Commission already has underway (see Discussion Paper on page 15). In addition, when examining policies in this Inquiry that impact on non-market activity, the Commission should evaluate the policies based on their impact on prosperity/wellbeing rather than productivity alone.

### **Policies to increase use of labour, capital and resources**

There can be substantial benefits to Australia from policies that encourage the increased use of labour, capital and resources. However, these policies can often result in declines in *measured* productivity, because the new labour or resources brought into production are often less productive than the average. But these policies should not be rejected solely because of their effect on measured productivity.

Examples of these policies include:

- Welfare reforms that increase activity tests on people who can and should work
- Similarly, welfare and tax reforms that reduce disincentives to work
- Reduced regulations of employment standards, particularly for low-skilled workers
- Reduced stringency of unfair dismissal rules (elsewhere known as employment protection legislation)
- Reduction in planning rules for less productive agricultural land and mineral resources.
- Deregulation permitting the hiring of unused properties (eg AirBnB) or cars (Uber).<sup>9</sup>
- Changes in employment regulations to allow assets to be used more intensively, such as reduction in penalty rate regulations and regulations of working hours, and limits on protected industrial action (strikes). These changes can all reduce the time that assets are left idle.
- Increased use of peak load pricing for utilities, which can result in usage shifting to off peak times.

# The Centre for Independent Studies (CIS)

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- an economy based on free markets
- democratic government under the rule of law
- an autonomous and free civil society

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