Menzies Research Centre National Productivity Roundtable

Edited by Stephanie Wawn

Presented on 13 and 14 April 2011 at NSW Parliament and Radisson Plaza Hotel, Sydney

Editor's Note

In April 2011, the Menzies Research Centre hosted the National Productivity Roundtable, drawing together academics, businesspeople and leaders from across industry and politics to discuss the productivity challenge facing Australia.

The following body of work is an edited collection of transcribed presentations by participants in the Roundtable. The presentations are organised according to the area of expertise and in the order in which they were presented, as some work refers to previous contributions on the day.

Not all presentations were available for publication; for clarity, the names of other participants are noted in the relevant sections. Biographies were current at time of Roundtable.

Stephanie Wawn
12 March 2013

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Hon Mike Baird MP was appointed Treasurer of NSW in 2011. He was elected as Member for Manly in 2007 and became Shadow Treasurer in 2008. He has more than 18 years' experience in corporate banking, securitisation, debt capital markets and project finance in Australia, London and Hong Kong. Career highlights include managing corporate finance transactions across a range of industries for Deutsche Bank and Head of Originations, debt capital markets in London for the NAB. Prior to his election, Mike was Head of Institutional Banking for HSBC in Australia and New Zealand.

It's a real privilege to be here - and I congratulate the Menzies Research Centre - because the agenda for tomorrow in particular is incredible.

I have also been asked to talk about, when I first opened my folder – (you know, when you get this blue folder as an incoming Treasurer) - what was there. You are always told that you can't share it, but I'm happy to share this with you. It said in the first line, "Congratulations, you are the Treasurer of New South Wales". It then said, "Commiserations, you are the Treasurer of New South Wales". And the next line was - and you get the rest.

Ladies and gentlemen we face a huge challenge. But I think that one thing that has garnished all is that we have this incredible opportunity. And it's almost a once-in-a-generation opportunity, and it is one that we are not going to let go. I can assure you that, in the role I have as Treasurer and as one of the players across this Cabinet, there is an opportunity to change the face of this State and, through that, change the face of the nation.

NSW used to be the Premier State; we used to be the leader of ideas; we used to be the leader in innovation; we used to be the leader in tourism; we used to be the leader in arts until Melbourne took that title. Over the last 15 years I'd say that our performance has languished, our economy has contracted, while other States have grown. While we are humbled by the opportunity that has been given to us a couple of weeks ago, there is a lot to do. There is a huge amount that we have to do.

Tonight I just want to say how do we start to improve productivity? I think it came back in my discussion with Ross Gittins - and for those of you who know Ross Gittins as a well-known economist, I did my HSC under Ross Gittins - well, not directly under Ross Gittins, but he was an economist icon. In my discussions with him, he said, "Listen, if you get the opportunity to govern this State, it's pretty simple," he said, "you just have to manage what you have better. That is the way you can improve productivity; that is the way you can make a contribution to the national economy. It's nothing more complex than that".

I have to believe him, because if you start to do that, if New South Wales starts to manage, the government starts to manage its services better, a huge portion of the overall State economy, which is a third of the national economy - so there are three things that we have thought about within that: benchmarking, culture and accountability. We think those three pillars are the way we can start to address the performance of the government and, through that link, productivity. The only way you can change the culture and change the performance is starting at the top and working your way down.

Now, over the last decade, New South Wales has stalled from an economic point of view. We have had the lowest growth - that is jobs growth - the lowest business confidence; we have had the highest interstate migration in the nation and we have also had the lowest jobs growth. All of those add together to an economy that is stalled.

Now, why has it happened? A big part was it was too hard to do business; too hard to do business in New South Wales. That stood as a millstone around the neck. You know, the high taxes. For the privilege of operating on the borders of New South Wales, we had the highest tax rates. Why should our businesses be punished for operating on our borders? Why aren't they getting a level playing field?

Heavy regulation. There were many broken promises. There was one example which, I think, gives a case study on how this manifests itself across the economy. The Northern Co-Op Meat Company, now they had a problem where they would import cattle from Queensland, and in New South Wales we allowed 48 cattle on the truck and in Queensland they allowed 60. Quite simple. They were 40 kilometres below the State boundary. So they went to the government and, for five years - this is a five-year process - they said, "Listen, can we just have 60 allowed?", because the trucks are coming from Queensland that would mean 567 less truck loads a year along the roads, and obviously at a cost. They estimate the cost at about $1 million for business. Now, the government did nothing about it.

Now, that is a very simple example on the sort of culture that has been approached. How does the government help productivity? How do we provide incentives to that business? I mean, that cost has gone against employment that could have come - that cost has gone again investment that could have come - capital investment, expansion and efficiency; and that cost has been opposed by no-one else than the State Government of New South Wales. So that sort of approach has to change. From our point of view, if we start to attack the productivity, we start to attack a culture that got in the way of business, good regulation, good taxes - if we start to attack them, we can start to turn the economy around.

Now, there are challenges to New South Wales' productivity, and they're common as they are federally. The ageing population over the next 30 years - the ageing population is expected to reduce the annual average GSP per capita growth by about 0.2%. Now, that equates to about 10% of the economy. That is a huge impost that is going to come.

There is declining literacy and numeracy levels, and there is obviously a need to improve the achievement levels at the bottom end of the scale which enables greater economic participation from some of our most vulnerable and most needing of support.

We do have ageing infrastructure. I mean, that is no surprise for those who live in New South Wales. That backlog of infrastructure, obviously, there's years of cost blow-outs and there's years of inaction. But at the same time it extends down to local councils. Local councils have billions of dollars in infrastructure backlogs that haven't been addressed. As councils, receiving cost shifting, have undertaken programs, they have cut back infrastructure spend and there are now many in a position that aren't sustainable in terms of their financial performance because they have not addressed the infrastructure backlog, so they need to be addressing those.

The population of New South Wales is expected to increase from 7 million in 2009 to about 7.8 million over the next decade. It's got the lowest business confidence in the country. The Sensis Business Confidence Index - I don't know whether anyone is here from the CBA, but that is a fantastic survey - and that's showing that our businesses over the last seven years, every single quarter except for one, New South Wales business had the lowest confidence of any in the nation. It is very hard to move your economy forward if your businesses do not have the confidence. So that is something we need to address straight away.

I would say it is one part of the puzzle. Obviously, COAG has a critical role to play, and that will be discussed in detail tomorrow.

Certainly, cross-sector reform is required. But I will just detail our program on the back of Ross Gittins' words, that if we manage the resources we have, if we could manage the services we deliver in a better, more fiscal prudent way, we can make a huge contribution to the growth of the national economy and the productivity of the economy through that process.

So, from the start, the three points I want to touch. The first one is benchmarking of government services. Now, that is not a unique nature or a unique concept to a business or a broad economy. I can tell you that it is something that hasn't been taken seriously by this particular State Government. We will be undertaking benchmarking, and we will be doing that through the Commission of Audit process. That will ensure that every service and every business within a State Government is actually benchmarked, benchmarked against its peer groups, other State Government services, benchmarked against the private sector, benchmarked against NGOs, benchmarked against global competitors. Then, you start to understand how that service operates. How does it operate in relation to customer service delivery? How does it operate in terms of its efficiency? As you start to unravel some of those, you can start to think of the absolute potential that rests in that approach. Because, if you have a benchmark of 30 competitors and you are sitting at number 28 or 29, what's the first thing you do? Like Jack Welch in GE, he has a very simple proposition that you need to be number one or two in your market or we start an exit strategy.

Now, from a government point of view, that is not necessarily the case. But what it does is say, "Listen, where do we sit on the process on that benchmark table, who is ahead of us and what can we learn from them?" So you start to foster a sense of innovation, you start to understand how someone delivers services more efficiently and you start to understand how customers are so much happier in the Perth rail system than they are in New South Wales. What are they doing better and how can we do it? I think that that has a huge upside for us.

At the same time we need to look at contestability of services. Now, I won't do a show of hands for who is from the Manly electorate. But I'm sure that there are some - yes, grandfather - but, yes, I'm sure there is some other class in the room. But it's a fantastic example. For those that went to Manly on the Jet Cat service, which was a State Government run entity, it was appalling. Now, why was it appalling? Because one in every 16 vessels broke down, the cost was astronomical, it cost the State $10 million a year to run, and their customer service, in terms of complaints, their satisfaction, was something like 15 or 20 per cent.

Now, they shut down that service, so they got $10 million back into the State

Government kitty to deliver better public transport elsewhere. The private sector has come in, and what's happened under that scenario? Well, patronage has gone up 42 per cent in the first year. It is cheaper. So they are actually tiering the fares to attract them outside of peak contraflows. They serve - for those on Eastern Hill they serve Earl Grey tea in the morning and they serve cappuccinos to the rest of us. They have papers, they have fruit, and they have customer service engagement. It is an incredible experience. I can tell you that the satisfaction level is through the roof.

Now, from a State Government point of view, that is exactly what we should be doing. How do we deliver this service in a better way? How do we improve that service for our communities? How can we be more efficient? With that $10 million we can deliver more services, additional services, and that provides a huge flexibility. I think the benchmarking will provide a huge opportunity for that.

The audit will also identify productivity enhancing measures within the public sector. Clearly, we also need to look at the skills needed. I know Fred is down here, but we need to understand where are the skill gaps in terms of the apprentices we need, where are the skill gaps that industry needs, how is that aligning with the education that we have providing it? How can universities - and I have to say this, that in terms of the future of this State, I have an unbelievable excitement about what the universities can do. I think that State governments have ignored universities. They have almost said, "Well, that is a Federal issue and that is not something we need to worry about". Well, I think there is a huge opportunity to engage in a very meaningful way with universities. Certainly we will be appointing a Parliamentary Secretary for the first time in this State that looks exclusively after tertiary education. That is a huge opportunity, I think, for this State government.

The last thing in that, in terms of benchmarking and thinking creatively, which I think is the way to do it, is also the balance sheet. We have looked where capital sits idle on the balance sheet and start to employ that and take that forward for other opportunities. So the desal plant is something that sat on the State Government's balance sheet. We have said we could sit there for 25 years, or that is something that we can do a long-term lease structure, we can grab that $1.5 million, and we can put it into the infrastructure that we desperately need. We think that will change.

The other thing we need to do, the second point, is culture. Now, I can't underestimate the importance of culture. All of those within the business context know the power of it. You know a company or a leader or an organisation that has actually got a culture that you are embracing and understand where you are going and how you are going about it.

How do you change that? Well, you start by clear targets. The State has a State plan. But the State plan almost means nothing – money's not allocated towards the outcomes of the State plan or, if they don't like how the plan is going – that is, the trains running late - they just change the definition. So in New South Wales we have got the capacity that trains, if they are five minutes late, are on time. In other words, whether it is a national first or a global first but you can be five minutes late and on time.

But things like patronage, you know, if you have measures and driving it, from a bus point of view, contracts should be awarded on the basis of improving patronage. Ferries should be; trains should be. So all of a sudden all these organisations - their focus is, "How do we get people onto them?" That means you improve customer service, you make it safer, you make it cleaner. That starts to drive the behaviours you are after.

At the same time, we think there should be incentives for public service - and this is something that Barry will take time to talk about in the next few months. You know, we think that we need to invest in people and at the same time hold them to account, give accountability, but also reward them. I mean, I had excellent scholarships, leadership programs. How do we actually invest and make the public service a place of employment, a place to be?

This afternoon I walked around some of the Treasury floors, and I don't think they had seen a Treasurer walk about before, so they were shocked. It was quite funny actually. But anyway, I'll just relate this story rather than another one. I met a graduate, and her name was Laura. The boss was telling me - she said Laura was one of 10. So there were 700 graduates that applied to come into New South Wales Treasury last year, and we only took 10. From my point of view, how do we make Laura - how do we make her Treasury, the New South Wales government, the public service, the sector of choice? How do we make the employer of choice for her together with everyone else who sits in the public service? How do we make the nurses in the hospitals? How do we make the teachers in our schools? How do we give them a sense that they are part of a broader program, a public service we can be incredibly proud of, and how do we invest in them and help them to deliver the services as well as help them to become managers and leaders of the future? I think that is a huge upside.

As I have interacted with the public service for two weeks - because they don't let you do it from Opposition - there is this appetite. There is this appetite to engage, there is this appetite to help deliver the efficiencies, the productivity. They just want to be part of that process, and I think that that change of culture is incredibly important.

The other thing we need to do as well is to make us the first place to do business - and I have spoken about this *ad nauseum* - and many in the room have probably heard this - but until you have that sort of vision, until you understand that that is what we want to be, well no-one really follows. Leadership, where you put up a bullseye on the wall and everyone knows where you are going and how you are going to get there, is going to be worked out. From our point of view, that is what we need to do.

We have announced things like the Small Business Commissioner. A Victorian idea. So it's not always the best things that come from New South Wales. But a Small Business Commissioner that advocates for small businesses across this State; a central point of contact, but also someone that goes across the whole of government to deliver better outcomes for small businesses in this State.

Red tape reduction. You know, we have said that if one piece of regulation comes in, two have to come off. Now, that is a difficult task, but it stops regulation coming in before you actually start ripping things off. And you need to stop that, because I think in Canberra what you see is taxes come in; in New South Wales regulation comes in. It comes in and comes in and comes in. It needs to go. Every single piece of regulation that comes into a New South Wales Cabinet is going to have a business impact statement. And that is every Minister needs to understand what's the cost to business, what's the time to business, you know, how this is helping business, and if it is coming in, what is coming off. I think that is a huge change to the way we go about it. (Applause). Thank you. I will tell Karen I got one clap in productivity.

The jobs action plan we've spoke about; again, it's part of this symbolism. And I hope you've sensed this. The way that you actually get business confidence back - you heard me talk about their business confidence being the lowest in the country for seven years, we say, "Listen, we are coming to help you. We understand what you need. We understand that, in order for you to be your best, you just need to be competitive; in order for you to take risks and to undertake all the activities in the day in and day out, you need to take the regulations off".

Our jobs action plan is about putting a rebate into the first 100,000 that come into this State. That is a clear signal to every business to get on with your jobs. “We are coming to help you. We are going to make your life easier. We are going to make New South Wales a place to do business”. That first investment through our jobs action plan is a clear symbol that we have a long-term vision on turning this State around, and we know that at the heart of it driving productivity across the broader economy we need to support our small, medium and large businesses”.

It's competitive tax, as I have spoken about, but we are also going to harmonise occupational, health and safety. That again is something - you know, we have a system in this State, which is the only place in the world, where someone is assumed to be guilty before you start. At the same time, the safety outcomes are at the lowest end in terms of the worst results across the country. So you have this incredibly onerous scheme that doesn't deliver safety outcomes and that needs to be fixed. We strongly support the harmonisation - which again is a signal that we are serious about creating this place as not only a safe workplace, but a place to do business, full stop. So all of those we think will help to start to change the culture.

The last one I want to talk about is accountability. You know, having spent time in working in many financial institutions when banking used to be a respectable career - I don't know if there's any bankers here, but I can say that now - but accountability was part of it. You know, for those that when your P&L would come in and you would understand that your revenue targets were low, your expense line was higher, you were going to have to explain to your regional boss - my boss was then in Hong Kong and I had a global boss in London - and I had to explain why my revenue was down, what plans we had in place to get the revenue up, why expenses might have been up or down and what we were doing to actually deal with it if it was up and had problems. That sort of accountability has been missing across this government for so long.

We took an approach in this campaign where we actually made some tough decisions. We said, "We can't build everything. You know, we can't actually do everything that everyone in the State wants us to do, but the things we do announce we will do". That is why we made some decisions in terms of infrastructure planning, which I will touch on in a second.

How do you actually start improving accountability? I think you just need to bring in a basis - and it comes a bit back to culture - that every dollar matters. You need to understand wherever you are in the public service that every single dollar you get is finite. There is finite recurrent dollars available; there is finite capital dollars available. If you actually have the responsibility of getting one or two of those, well, you need to apply them judiciously. We will be about fiscal discipline at every turn because, If you have fiscal discipline, well, that means you can improve services; that means you can build the infrastructure and, at the same time, you can deliver what I think is a better government overall.

Within it there are consultants. There's even this incredible situation where there are 2.6 - this is something I found out today, so this is a news flash - there are 2.6 million physical cheques issued by this State Government every year. Now, you don't have to do the maths, but it's estimated that costs between $40 and $50 a transaction for every one of those cheques.

There is almost $600 million in legal fees spent across this State Government. Now, I know that lawyers are incredibly important. But, you know, there is an incredible situation in this Government where the Transport Infrastructure Group would get legal advice and then Rail Corp would get legal advice on TIG's legal advice and around and around you would go. Now, that sort of process just has to end. We're going to be much simpler in the way we spend everything, and that is going to come under the absolute, immense focus of the incoming government.

But I think the biggest part of this accountability - and again it links into the overall infrastructure approach - how do you actually start to bring the best public outcomes to infrastructure? I have to say, when you go to what has happened in infrastructure in this State in the past 10 or 15 years, it's a big reason on why we find ourselves in the position we are in. We said, you know, "How do you actually deliver infrastructure?" We went around the world. The models that were determined by private sector and other governments which were delivering the best infrastructure were Victoria, the United Kingdom and British Columbia. Now, that model we have effectively introduced, or will be introducing in New South Wales - Infrastructure New South Wales.

Now, that will bring certain plans. We are going to do 20-year infrastructure plans. We are going to do the work properly. We are going to have an independent body that sits above the Minister straight into the Premier with a board that sits above that. That board is going to be charged with actually prioritising the infrastructure in this State. So for the first time you are going to have experts and not politicians who are going to be telling you what the priorities are across roads, across health and other infrastructure needs.

Now, it means for the people of New South Wales an incredible amount, because it means that every dollar that is available in the infrastructure goes into the projects of the most economic need. If you are not doing that, well, clearly the outcomes are there for all to see. How can you enhance productivity if the dollars you are spending on projects make no sense whatsoever?

We have seen that. I mean - I don't want to be political, but I will throw a bit in. The Parramatta-Epping railway is a good example. The CBD Metro is a good example. Now, the Parramatta-Epping railway was not on the 10-year infrastructure plan of the previous State Government. It was not even on the reserve list of Infrastructure Australia. Yet, in the middle of an election campaign, $2.6 billion was found to deliver a project that ran through four or five marginal seats.

Now, if we are going to enhance the productivity and the economic output and the life of the people of New South Wales, that sort of nonsense has to end. You need to be on the basis of economic need in the greatest interests of the State, not political outcomes or the postcode you are in.

I can tell you that the work that was done on that CBD Metro, when a press conference was held to announce it, the Premier at the time did not even know what the cost of that project was. I can tell you that the Parramatta-Epping railway, that was announced at $2.6 billion. Well, the expectation is that is going to cost much more than that. When you have those sort of decisions, it's clear that New South Wales is in the position it is today; that is, infrastructure became an election play thing and it wasn't about delivering the best possible outcomes for this State.

So, in conclusion, I just want to say that we need to reward, give direction and put customer service back in day-to-day government. I mean, certainly I'm incredibly excited by this challenge. I think for all of us in the New South Wales Government, as we have read our briefs and gone through all the scenarios, it's very clear that the roadmap is long, it is hard, but it's achievable. I think that for all of us in New South Wales, if we get to a decision where all of these items - whether it be the change of culture, whether it be the benchmarking we are producing or whether we are actually restoring accountability into government - I think that that is the greatest contribution that this New South Wales Government can make to enhancing the productivity of this economy and, thus, the broader national economy. Thanks very much.

Hon Tony Abbott MHR, Leader of the Opposition

Introductory Remarks

> *Hon Tony Abbott MHR has been Leader of the Opposition since December 2009. He was elected Member for Warringah in the Federal Parliament in 1994. He has served as Parliamentary Secretary to the Minister for Employment, Education, Training and Youth Affairs (1996-1998), Minister for Employment Services (1998-2001), Minister for Employment, Workplace Relations and Small Business and Minister Assisting the Prime Minister for the Public Service (2001-2003), Leader of the House (2001-2007) and Minister for Health and Ageing (2003-2007). Prior to entering Parliament Tony was a journalist with the Bulletin and The Australian, Executive Director of Australians for Constitutional Monarchy and Press Secretary to Opposition leader Dr John Hewson.*

In 2008 I wrote that the longer the Rudd Government lasts the better the Howard Government would look. I wrote that the Howard Government would soon seem like a golden age of prosperity that's been lost. Between 1996 and 2007 there were two million new jobs, real wages increased by over 20 per cent and net wealth per person more than doubled. This extraordinary economic performance was founded on a sustained improvement in our national productivity thanks to tax reform, welfare reform, institutional reform and workplace reform. Australian workers on average became substantially more productive.

It's true that measured productivity improvements declined in the Howard Government's final years. But this was largely due to other improvements, such as rapidly increasing employment and rapidly expanding investment. In any event, the productivity statistics have declined far further under the current government. Although under the current government economic growth has remained strong compared to other OECD countries, when you look behind the statistics, growth has been almost entirely due to increased population. Real wealth per person has hardly improved at all since 2007, which is why people don't feel richer, why indeed families feel under greater cost of living pressure now than at any time in the past two decades.

It's clear that Australia's relative economic strength owes far more to the reforms of previous governments than it does to the spending spree of the current one. As John Howard once said, today's reforms are the foundation of tomorrow's prosperity, and our challenge is to foster a new generation of reform that will create a new harvest of prosperity for our children and our grandchildren.

What Australia needs is more productive people, more productive enterprises and a more productive government, and to this end at the last election the Coalition promised amongst many other things a relocation allowance for young people on welfare who move to take a job, a commitment bonus for young people on welfare who took a job and kept it, an incentive for employers who took older people off welfare and back to work, a fair dinkum paid parental leave scheme so that the mothers of Australia had more choice to be economic participants as well as simply social ones. At the last election we promised a better deal for small business with a new ombudsman, access to unfair contract provisions and better access to capital. And we promised more productive public institutions through more people power in our public schools and public hospitals.

Since the last election we have maintained a strong positive agenda. Since Christmas, for instance, the Coalition has committed to better water management, including a plan for new dams. We've committed to a stronger anti-dumping regime. I've offered in a spirit of bipartisanship to work with the Prime Minister to get more people into jobs, to fund through savings rather than a new tax flood recovery payments, and to sponsor a new intervention in the towns like Alice which as we all know are subject to a developing social crisis.

And a fortnight ago I proposed new participation reforms, including continuous Work for the Dole for long-term unemployed people, mandatory income management for long-term unemployed beneficiaries right around Australia and not just those in the Northern Territory, and disability pension reforms to prevent the parking of people whose problems might not be permanent or fully incapacitating. I also proposed the suspension of unemployment benefit payments for young people in places where unskilled work was readily available. I note that last night the Prime Minister spoke of the importance of work, and good on her for speaking of the importance of work. The principal difference between her speech last night and my speech a fortnight ago was that her speech was entirely devoid of any hard policy content.

Today I propose measures to address what is perhaps the most abject problem of modern Australia; namely, infrastructure that is manifestly inadequate for a first world country. People who have sat in endless traffic jams on their way to work, who have waited on crowded platforms for trains that are regularly late, who have watched full buses crawl past their stop and who have seen long lines of ships waiting offshore to load our exports know there is a serious problem in this country.

And it's not that money is not being spent. The current Government as we know has spent $2.5 billion installing and removing combustible roof batts and $16 billion on over-priced school halls. It's now spending more than $50 billion running wire into most houses for faster movie downloads and more interactive gambling, as if this is our highest infrastructure spending priority. This is a part of a sustained spending spree the likes of which Australia has never seen, that's turned a $20 billion surplus into a $40 billion deficit and $60 billion in net assets into $100 billion in net debt in just a few short years. The current Government is also spending $26 billion under the AusLink program on a range of transport infrastructure projects, many of which are useful and important but none of which have had a full cost benefit analysis.

So the next Coalition government will revitalise Infrastructure Australia and will reappoint Sir Rod Eddington as its head. We'll keep it, we'll fund it and we'll listen to it because important infrastructure decisions should be made on the basis of rational planning and not short-term political pork barrelling. Infrastructure Australia will be tasked with preparing a detailed rolling 15-year infrastructure plan with clear published cost benefit analyses for each major project, and a priority list of projects based on these cost benefit analyses. While the government will make final decisions about which projects to fund, it will ordinarily give priority to those on Infrastructure Australia's list and won't fund projects over $100 million without a clear published cost benefit analysis.

In other words, we will accept as a government the public advice of people like Ken Henry and Gary Banks about the rational way to fund infrastructure and we will keep a commitment that the current government has made but never itself kept. The current government, I should add, is spending more on a feasibility study into high speed rail along the eastern seaboard than it is spending on Infrastructure Australia, and this is not a sign of the adult government that Australia surely now needs.

Paul Kelly, Editor-at-Large, The Australian
A History of Productivity in Australia

Paul Kelly is Editor-at-Large on The Australian. He was previously Editor-in-Chief of the paper (1991-96). Paul writes on Australian politics and history and international affairs and is a regular commentator on the Sky News program, Australian Agenda. He has covered Prime Ministers from Gough Whitlam to Julia Gillard. He is the author of seven books including The Hawke Ascendancy (1984), The End of Certainty (1992) and November 1975, published on the twentieth anniversary of the Whitlam dismissal. His most recent book, The March of Patriots (2009), offers a re-interpretation of Paul Keating and John Howard as Prime Ministers. Paul has been a Fellow at the Kennedy School at Harvard University and a Vice-Chancellor's Fellow at Melbourne University.

Well, thanks, Tony. After that introduction, I think one is doomed to disappoint. But I would like to acknowledge Opposition Leader Tony Abbott, Deputy Leader Julie Bishop, Tom Harley, many Liberal MPs and Senators - in fact, I'm inclined to think that I've never spoken to as many Liberal MPs and Senators ever at the one gathering - distinguished guests, ladies and gentlemen.

Well, if you're going to discuss productivity, then breakfast is surely the best time. Getting up at 5.30am, the only moral consolation is to think that you're being more productive. I mean, what could be more productive than discussing productivity at a Menzies Centre breakfast?

The productivity debate, as Tom said, always reminds one of Paul Keating's famous line that if you walked into a pet shop every galah was talking about microeconomic reform. And maybe we're a nation of smarter-than-realised galahs.

The point, however, is that at that time, when Paul Keating made that comment, a lot of people were discussing microeconomic reform and not just the galahs in the pet shop. And I think it is important here to distinguish between "discussion" and "action". I think one of the difficulties we face at the moment as a country is we're talking a lot about productivity, but we're not doing a lot when it comes to realising the rhetoric.

On the other hand, of course, there are some politicians who, understandably, treat productivity the way United States President Ronald Reagan treated his budget deficit - and I refer, of course, to Ronald Reagan's immortal quote to the effect: 'I'm not worried about the budget deficit, it's big enough to take care of itself'.

Under Kevin Rudd, no Australian Prime Minister ever spoke so much about productivity for such dismal results. And it's a reminder not to over-egg the cake.

Productivity is important, but it's also illusive. Cause and effect are often hard to judge. The gap between the policy and the result can be deceptive, and much of productivity gains come not from government but better management and innovation in the private sector.

The current definitive statement on Australian productivity comes from the Chairman of the Productivity Commission, Gary Banks, who, in a recent speech, warned that rising national income in Australia and weak productivity, and I quote: 'cannot go on indefinitely'. Banks' point is that Australia is engaged in a grand delusion. Its recent productivity performance is poor. Yet this has been concealed, first, by the housing boom in the previous decade and, then, in a more substantial way by the current resources boom. Banks has issued a warning: if productivity-enhancing reform is, indeed, becoming a no-goer, then Australia is in for a tough time. Banks said that productivity growth, by which we mean the ability to get more out of the country's resources - "resources" being used in its widest sense - is the mainstay of economic progress. Australia's productivity growth fell away in the early 2000s and has not recovered; indeed, it's headed south.

Banks put Australia's political system on notice by saying that both history and economic logic tells us that the terms of trade-driven income growth and weak productivity are on a collision course. At some point, probably sooner rather than later, our per capita income will move into line with our productivity performance. And unless at that point we have lifted our productivity performance, that adjustment will be an ugly political event.

Now, there are two broader points I want to make at this stage. First of all, I want to highlight the fact that the resources boom, despite its fantastic magnitude, can be a curse as much as a gift. History tells us that booms usually end in busts, particularly in this country. The current boom is delivering a high dollar; it renders less competitive large parts of the non-resources trade sector; it puts new pressures on manufacturing, tourism, services, tertiary education; it increases pricing pressures for households and for businesses. The proper response to the resources boom, in short, is to revive a productivity strategy. This is precisely the policy response we need during the resources boom.

The second point I want to make, however, goes to political culture. I think that Australia's long, unbroken growth cycle dating back to 1991 has induced a deep complacency and made economic reform a more difficult task. Now, I've written at length on this in recent times analysing why what I call the Hawke-Keating-Howard reform age, I think has largely terminated.

The word "reform" is still used very frequently, yet its meaning has been debased. What the word "reform" actually means is to improve the existing order; yet often it is attached to policies designed to diminish the existing order.

The rise of the 24-hour media cycle and short-term politics is fundamental to this problem. We now live in an age where politics is increasingly short-term, yet policy solutions demand long-run approaches. Consider the challenges based in demography, population ageing, climate change, tax and welfare reform and productivity enhancements. All these require policies to operate on a sustained basis over time, while the entire operation of daily politics works against this.

I think, in that sense, the conflict between policy and politics is substantial. And, of course, it's not just a feature of Australia; indeed, it's a feature, I think, of all western democracies at the moment and it may well inaugurate a crisis for western democracies in coming decades.

The long-run growth cycle has also engendered a political culture of winners all round. The first question a journalist asks a politician these days about reform or any new policy is whether anybody will be worse off. Both parties know that this has the potential to become a story. So the politicians offer bucket loads of compensation in recognition of the fact that they are not allowed to leave somebody worse off. Yet, this is contrary to the experience of life, to common sense and the reality of the marketplace, when people often lose out. The winners-all-round political culture has become a cargo cult, yet it is difficult to defy.

One of the challenges for politicians now is how to integrate a productivity strategy into an electorally appealing agenda. Now, I think we want to reflect a little bit on the last 20 years here. The OECD use the term "The Australian Model" for our economic reforms over the past generation. And the point I would make is that the history shows that reforms did actually help governments win elections. Hawke won a series of elections and, at a number of those elections, his commitment to economic reform was fundamental to his pitch.

And if we look back on the Hawke-Keating period and the way they sold financial deregulation, tariff abolition, national competition policy and enterprise bargaining, we can see that there is significant potential here to market national wellbeing and improvements.

And, again, look at the Howard and Costello period. A number of the decisions they took as individual decisions are exceedingly difficult, yet, they were able to abrogate those decisions into net political pluses. I'm referring here to the fiscal consolidation in the first term, to the gradual approach to labour market deregulation, particularly in the first term, the implementation of the GST-led tax reform on which the Howard won the 1998 election and the creation of an independent central bank.

So we need to be alert to the history, because the history tells us that there are a number of positive ways in terms of marketing productivity gains. Yet, there's no doubt that there are very big risks, and we should also reflect on the risks.

The story is mixed here, but the Howard Government, to a significant extent, lost the 2007 election on a very major reform - WorkChoices. And we saw the Rudd Government come to a point of absolute crisis over Rudd's major reform - the Carbon Pollution Reduction Scheme.

What this means, is that one has got to think very carefully, particularly when it comes to what I call "big bang reform" about the mechanics of the package to ensure that the package is sound as a reform policy itself and, secondly, to make a political assessment as to the viability of carrying the debate on that reform package.

I think the consequences of the defeat of WorkChoices at the 2007 election have been extremely detrimental in terms of the debate about labour market reform. I also think in relation to climate change that Australia is now stymied to a certain extent in terms of its debate about economic reform and productivity until it sorts out at some stage an entrenched position on how to manage climate change. And, clearly, it will take another election campaign to get to that stage.

If we look at the situation today, I think there are a number of morals and lessons we might draw in terms of the upcoming approach to productivity reform.

The first one I want to highlight is pretty obvious, and that is that reforms these days are based more and more on an integration of economic, social and environmental agendas. This makes them more complicated, but that is the way things are, and that requires a whole-of-government approach and a commitment at the leadership level to the reforms.

Secondly, productivity results in this country now depend very significantly on the performance of State Governments. Increasingly, it's State Governments and State Government capacity for reform in a whole range of areas - talking now about health, education, urban infrastructure - which will determine overall national success. And, once again, this puts a premium on the need to ensure that there is proper strategic co-ordination between the Commonwealth Government and the States.

The third point is that reforms these days do need a commitment to fiscal prudence; given where the budget is, off the back of the global financial crisis and the bipartisan commitment of both sides, to get the budget back to surplus. What this means is the capacity to buy reforms, to purchase reforms, is more limited than it's been in the past, particularly more limited than it was when the budget was in a strong surplus. So reforms that tend to be cost-free are at a premium.

This leads immediately to a few thoughts. One is the need for a comprehensive analysis of a government regulation affecting businesses in this country; the extent of creeping regulations, which are inhibiting business, are very significant; and, of course, to the extent that such regulations can be curtailed or abolished, then there will be double benefits - often benefits to the budget as well as benefits to productivity.

Gary Banks has stressed the enormous extent of industry assistance in this country, now running at about $17 billion. He's argued very strongly that scaling back this industry assistance again will have a double plus in terms of assisting the budget and assisting productivity.

An area that needs to be watched enormously is the entire area of green policy and green politics. We have seen a number of regressive and anti-productivity green initiatives introduced - whether one is talking about "cash for clunkers" or solar rebates and solar assistance - the Gillard Government itself has recognised mistakes in this area and, earlier on in the year, began to abolish some of these programs. However, these programs remain entrenched, to a certain extent, and they have political appeal. I think at this point in time with the priority given to green politics, it's enormously important to ensure that the climate change agenda is pursued with good policy, not bad policy.

I think, when it comes to the labour market, at some stage or other this debate has got to be re-opened. It would seem to me, however, that the way to approach the labour market, as in many other areas, is incrementally. I think one of the legacies of WorkChoices is that, in the labour market and in some other areas, big bang reform is not likely to work in the future and, therefore, a strategy should be gradual, incremental reform.

Another area to look at is the whole waterfront of defence procurement. Defence procurement is an area where a lot of difficulties are being stored up, tremendous inefficiencies and, in particular, we have to look very, very carefully at the whole strategy of the Australian defence industry rather than buying cheaper and more efficiently off-the-shelf overseas.

Tax reform must come back onto the agenda. Again, this may well be an incremental process rather than a big bang process.

I want to finish with a couple of observations.

The way a political party approaches productivity reform tells us about the fundamental values of that party. And I think that one of the features of the country in the last few years is there have been two productivity agendas. There's one productivity agenda which comes from the independent agencies, headed, if you like, by the Productivity Commission, and this productivity enhancing agenda is about market forces, sound pricing, structural adjustment in industry, prudent budgets and scepticism about government intervention and regulation. In a sense, that is a classical economic agenda of pursuing productivity reform.

There has, however, been another agenda, and the other agenda has been defined by the Rudd and Gillard Governments. And this is an agenda of productivity reform based on the concept of market failure. A lot of the big decisions coming from this Labor Government are based on the idea of market failure. This leads to a series of decisions based on government intervention, government ownership, more government spending - whether we are talking now about the approach to the National Broadband Network, the partial re-regulation of the labour market, the increase in industry assistance, particularly to the automotive sector, a number of green programs based on high degrees of government intervention and, to a certain extent, the education revolution itself, where the degree of regulation of the higher education sector has been very substantially increased. This is a philosophy of productivity, as I said, based on a bigger role for government, more government intervention and more government spending. And, in a sense, the way to understand the debate about productivity in this country over the last three to four years is that it's been a debate about these competing agendas. I think this is something that the Liberal Party needs to think about.

So, in conclusion, where do we go from here? Well, let's end on an optimistic note.

Political leadership is absolutely critical, and that means leaders must reclaim their historic mission from the apparatchiks of brokers and spin merchants who have been so persuasive in recent years.

I think it is encouraging that we have a bipartisan commitment across the political system to get the budget back to surplus, given the fiscal situation we see in both Europe and America.

I also think that while the debate has gone off the rails to a certain extent, it's also important to bear in mind that there is a wide-spread public recognition of the problems Australia faces and its challenges. I refer to the need for better planning and improved urban infrastructure, the need for more investment, better transparency and higher standards in education, the need to better address environmental, climate change and water issues, the need to manage population ageing and the need to tackle inter-generational welfare poverty and welfare dependency.

I think, to a considerable extent, the public is basically on side when it comes to a lot of these issues.

It's also important to reflect on the value of independent inquiries; whether one's talking about the Asprey Report many decades ago, the Hilmer Report into National Competition Policy, the recently released Henry Tax Review. Such independent inquiries have got the chance to shape public opinion and also have got the capacity to win support across both sides of politics.

Solutions, of course, will always have to be debated and canvassed at length for some time among policy makers in the political system and in the media. Consultation and dialogue with stakeholders is fundamental in reform. Consensus is not easily won and sometimes consensus cannot be won. The issue will have to be taken out to the public and resolved at elections.

Nobody asks any government to commit political suicide over reform, but reform does demand leadership, courage, communication and sometimes a willingness to risk a government. Thank you.

Part Two

Productivity and Business

Harry Triguboff AO
Chairman and Managing Director, Meriton Group

Christine Holgate
Chief Executive Officer, Blackmores

Peter Crone
Chief Economist and Director of Policy, Business Council of Australia

Questions and Discussion were led by Hon Joe Hockey MP

Harry Triguboff AO, Chairman and Managing Director, Meriton Group

Harry Triguboff AO is Chairman and Managing Director of the Meriton Group. He has overseen construction of almost 55,000 residential dwellings, and has won numerous awards for his contributions to the building, construction and housing industry. Born in Darien, China, he came to Australia in 1948 and was educated at Scots College in Sydney, before attending Leeds University in England. He graduated with a degree in textile engineering and began his working life in textile businesses in Israel and South Africa before returning to Australia in 1960. Mr Triguboff became an Australian citizen in 1961. He drove a taxi and owned a milk run before building his first block of units and establishing Meriton Apartments in 1963. Since then he has become one of Australia's most successful property developers and most generous philanthropists.

Today we are going to discuss productivity. When we talk about productivity we are really talking about how to increase wealth. I have a prepared speech which I will refer to in a minute but I wanted to make three preliminary comments about how Australia might increase its national productivity.

The first is to get more women into the workforce – as many women as possible. When I first came to Australia, women were not given jobs. Banks wouldn't lend them money. But now things have changed for the better. Women work and families save more. One of the benefits of women working is greater financial literacy. Working women know the value of money.

The second is a huge challenge. We need to learn how to make use of older workers. When people retire or downscale their jobs they find the adjustment hard. A working person with a very big job is suddenly told to take a smaller job. Older Australians are a growing asset of the country and need be regarded as an asset. If we look upon older Australians as a burden we will be missing an opportunity as a nation. At Meriton it is easier than elsewhere - people are used to working with me! Some people started their careers with me and I have grown old with some of them.

But for newer companies where people are not used to working with older people it is much harder.

The third idea is about higher education. When I started in the building business we used to have carpenters who would run the building sites. They knew how to build a cottage but they did not understand how to run a business. Today I have very well-educated young builders. They are very good young people, often university educated. The quality of their education is usually very good and we have to keep the standard high. But whether they are university educated or whether they go to TAFE or have other technical education, the educational institutions need to talk to the industry to see what it is that the industry wants and how we can help each other to produce a product that is good for both of us.

As universities go I think Bond University is a very good example of a highly productive institution. At Bond University students study accelerated courses. They have hardly any holidays so they finish quickly. This means students get into the workforce more quickly. I think this is a good thing. Students usually leave university with no money and big HECS debt so the sooner they are in the workforce the better.

These are three preliminary things Australia can do to try to increase productivity.

In my business I increase productivity by increasing the volume of my product. Even though we try to build as many buildings as we can, we can always try to build more. When we consider the business case for building something, we always examine three things. First, does the market want it? There is no point doing what you think the market wants, if the market does not want it. The market always knows best. Second, how much can the market absorb? It's no use building too many buildings. And, third, how much can the market pay per unit. That is the important part. Everybody loves beautiful things, but very few can afford to buy whatever they want. It's no use building castles if people can afford only cottages. It's no use building cottages if they can only afford huts. So we must produce what Australians want. This is the basis of our business productivity.

In our apartment building business, we are always dealing with two outside forces: the government and the banks. The government has to approve the project and the banks have to approve finance for the developer and for the purchaser. So it is a business therefore dependant on the inter-relationship of all three. Each must be better at working together. I believe that the banks should be involved with the council and the developer from the beginning. I believe in talking to banks and councils as much as possible so everyone knows what is happening. But one of my frustrations is the inability of banks and councils to approach matters together. If they worked together then councils would have a better sense of the importance of faster decisions.

Holding charges are another major issue. Holding charges are very great whatever the business. Holding charges must be covered by the amount of turnover and the speed with which that turnover is achieved. It's no good being able to make a lot of money in the distant future if you have to pay the outgoings today.

The next thing to increase my productivity was to utilise technology and in particular using mechanised production processes. I remember when I used to build in Penrith, 50 years ago, I used to run to the post office to telephone somebody in town. Today everybody has a mobile phone on the site they don't have to go anywhere to make a call. The increased speed of communications technology on all platforms including the internet is a great achievement.

As a business we have to constantly keep mechanising to improve productivity and drive costs down. Think about the advances better machines have given us in, say, the area of excavations. What used to take us a month, now can be done in a week.

But it is not just speed we have to always be conscious of we have to always improve the standard of our product. You are only as good as your last project. Everything you build must always be better than our previous work. That is important for our brand. It is important for our marketing prospects and it is important because the market always demands something fresh.

Now, the people are all the time more and more interested in position. You have to take that into account. Once upon a time, people didn't pay much for a view. So long as you lived in Bondi, you paid Bondi prices. Then views became important. Then people started having more cars so garages become important. Things change all the time. So we have to take into account all these things.

Once upon a time, people wouldn't go to live in Castle Hill. I remember one day I was selling out in Dover Heights and we were going to Castle Hill and they told me, “Well, there's a lot of space there and we're not crowded” and everything. Today, they prefer Dover Heights again because the people are conscious of time. Before, they didn't care about time. Time was very cheap somehow. Today, they are very conscious of time. They want to be close and they don't want to mow the grass all the time and they just want to use their time to be more with the children.

Productivity really dictates the progress of this country. And this is what applies to my business as well. How does it apply to government? I know my local government people, I know them, my councils, my State Government, but the culture is the same all over the government departments. It doesn't matter what you do. The first weakness in the councils and the State Government is we have many architects, we have many engineers, landscapers, librarians, but we do not have a person that understands business - to whom you can talk about business. Gradually, we are getting a few of them into the planning department in New South Wales - which is very, very good - so you can discuss with them the position and he can discuss it with his people. The people that are economic and in tune must be everywhere.

I have now a case with the council, a fight with the council, where their barrister is saying that viability of the project should not even be taken into account. Now, can you imagine that? I know they want to win the case, but still - I mean, enough is enough. If the viability doesn't matter, why bother? You know, I want to make the alderman stronger, not weaker. They make themselves weaker. I'll tell you why. If they approve nothing, then what's the point, they have nothing? I want them to approve more. I want to help them grow. They can't understand that. They want me to be forced to do things which they think should be done. They don't care what I can afford, they don't care what the market wants, but they think that they know. And when you tell them they don't know, they say, "Oh yeah, you want to make a buck today, but I know what will happen later". Well, if he knows what happens today he's really good, but nobody knows what will happen later. I promise you, nobody knows.

Now, I'm hardly an architect and I'm not even a bricklayer, but I do know that I have to find money to pay for what I do. And that is my job, you see. So they have to do the same. They have to know how to pay for things. But they really don't care, they just come and ask for more money from somewhere and they get it and so they go on.

Now, the next thing is communication, and this is very important. The way we do it now, is I talk to a town planner. The town planner doesn't talk to the alderman, and he and I spend half a year doing every possible detail on the plan. And eventually it goes to the council. And then the council may like it or may not like it and then we start again. We just hope that the alderman doesn't change and we hope that the planner doesn't change.

Now that's no good. When we want to have a plan, we should be able to draw a very simple picture, go with it to the town planner and then go to the council and then we will know what we're spending our time and effort and money on, okay?

I will give you a very good example. When I first started, I had a draughtsman and I told him I wanted to build a block of six flats and he drew me a plan. And I didn't like the plan, right, but I didn't know how to tell him how to do the plan properly. So I went to Botany Council and there was this young planner and I told him my problem. And so he drew it for me. In two minutes he drew for me what I wanted. Well, later on he went to the city council and we were still big mates. But as I grew, suddenly he was no longer my mate. I wish I could meet him and remind him of how he helped me when I was a small guy. That was the real spirit of the whole thing. He cut the whole process to a few minutes. Brilliant. That's what we want.

The next thing problematic thing is that we depend on China. We were up at Surfers Paradise and they say there is too much building happening there. There's not too much building there. The people left because there's no money there. Maybe the old people come in, but they don't create business.

Now, telling stories doesn't help. You see, we must always tell the truth, or try to tell the truth. We talk about the big prices in Sydney and Melbourne. That's true. But they are only caused by the Chinese who buy here. Our local people cannot buy them. They can't afford them.

When we talk about high prices, we must take into account the cost of the product. If the cost of the product is great, the price cannot be smaller than the cost. It must be greater. The cost of the product has got a lot to do with the charges the councils put on us, the time that we waste and the cost of doing it.

Now, the next problem is the Reserve Bank. Now that's my favourite story and I've been saying it for years. The bank never changes, I never change. Now, the high rates of interest, of course, cause the dollar to go up as well, which makes it harder for the importer and for the exporter. Anyway, this is a big problem because people can't afford to buy.

The beauty of this country has always been that people could either have a home if they want it or they could rent. But homes perhaps were too big. But anyway, they are definitely not big now. First, the land in subdivisions got smaller, each block became smaller, and then they started to build them very cheap, those houses. Terrible. And anyway now they are mostly townhouses. If you want to see how it works, you can go - I went over to Ipswich and saw how they build there. Ten years ago the blocks of land were big, the houses were brick. The blocks of land have become smaller, the quality is worse, and so it goes on. .

Now, the good story that I have asked the government and I have asked *The*

Economist and I have asked everybody in *The Economist* journal to do that and I told you that.

When the GST occurred and the global financial crisis, the Reserve Bank dropped their interest rates. Very good. And the government gave everybody $25,000. Even better. Marvellous. Now, the next thing, things settled down a bit, so they raised the interest rates and they dropped the $25,000. Now, that doesn't work that way. Everything has to be gradual. You can't suddenly give everything and then suddenly take everything away.

Now, this is what causes booms and busts. The boom is because the people want to buy. He is dying to buy something. So once you give him the opportunity, he buys it. Then you take away his ability to pay, and he goes broke. And that’s no good.

Then we come to migration. And this is very important for the way we run the place. Now, Australians are not prepared to do a lot of the work that has to be done. And Australia has an ageing population. The kids that were born between '45 and '65 are now retiring. There are now probably four people working per person who is retired, soon there will be three people who are working, before it was seven people. So we have to have more workers. The migrants, not only will they do the jobs that we don't want to do, but remember what used to be, remember that people have changed and circumstances have changed.

Now, I come to the subject of housing being a political football. That's very, very sad.

Every little alderman fights every other little alderman trying to say how he will not allow development because he thinks that's the way he will get elected. Unless of course the alderman is very far away somewhere where they will be happy for anything but nobody wants to live there. Now, that alderman wants development.

Everybody wants to go near the city because of the transport. And this is where Mr O'Farrell is right. So I hope he will have fast trains because I say the more the suburbs will grow, the more my central area will grow with it, so I'm very happy with it. We have to make the place more attractive by people living either close in or travelling quickly to their work. That is very important. Otherwise what is happening is that many are leaving the country because they can't have houses here, and they leave the country and the children then will grow up somewhere else and the old people will not keep running the country. We always need young people. We must keep them here and make it attractive.

Now, the next thing I will talk about the old people, which I mentioned before. It's very important that they do get work, otherwise we won't get far.

The other subject which is very interesting - and which we worked very hard with Chris Bowen, is super funds. We want to have self-managed super funds that can buy property, and where a person can live in the property he bought with the super fund, or he can rent it to his family. This we cannot do today.

Now, we find it very hard to change the policy of the country, because we are fighting the biggest companies in the world. They grab the money and they put it into shares. All right. Shares are very good. But then, unfortunately, today even our Australian companies are very often not owned by Australians; so really we are supporting someone else, and this has to stop. We have to be able to spend the money for housing in the super fund otherwise the people have no money, but the super fund in which they have the money they can't use. So, we have made some progress, but it is still slow. So we need to change. We are not poor; we are just cash poor.

Now, I want us to be not poor in any way. I want us to be rich in every way so we can have a house earlier. If we have the house earlier, we will have children earlier and we will grow quicker. Thank you very much.

Christine Holgate, Chief Executive Officer, Blackmores

Blackmore's Story: Increasing Productivity

Christine Holgate has been Chief Executive Officer of Blackmores since 2008. She has over 25 years of international sales and marketing experience in highly regulated industries, including telecommunications, finance, media and healthcare. She has held numerous board and senior management positions, working in Asia, the Americas and Australia. Christine's prime responsibilities have been leading teams through significant change, growth and start-up. Christine is also currently a board member of Ten Network Holdings Limited. Christine has just been awarded the 2011 (inaugural) International Executive Study Scholarship by Chief Executive Women and the Women's Leadership Institute Australia.

I'm going to tell you about the journey we have been on at Blackmores in the last two and a half years, and share some lessons that we have learnt. These lessons pertain to important things that can affect any business or person in government.

I joined Blackmores officially on 1 December 2008. We were still growing, but we were losing market share. Our apparent growth derived from there being a relatively soft Australian dollar, meaning that our Asian sale figures looked good. Competition was heating up and innovation was slowing. We had only launched two new products to market, despite being a business with over 300 products. Asia posed a huge financial stability risk. At the time, we also faced some major operational movements. We had five different sites in Balgowlah. We needed to move onto one site, and we had been delaying this. Moreover, for the first time in our corporate life of 80 years, we had taken on significant debt, while facing a volatile Aussie dollar. 98 per cent of ingredients for natural health products come from overseas, and we ship overseas, making this problematic for us. Finally, we faced a changing market. Everyone was worried about the GFC, and the period was very uncertain. Everybody that I spoke to in my first three months in the organisation said we have to change. This included investors because our share price was falling.

The first thing that we determined was necessary to increase productivity was a clear roadmap. Everywhere you walk when you walk around Blackmores you will see our strategic framework. I let everyone in the organisation know what our goals are. As a public company, people sometimes think that's risky. I disagree. If everybody in an organisation doesn't know where that organisation wants to head, how can they work towards the organisation's goals? Every month I stand in front of the staff and I tell them how we have performed. We share our profits with our staff, and I tell them whether the previous month has been good or bad for profit share, as well as how they have performed. As a result, even the little lady popping pills in a bottle on the production line feels a direct correlation to our performance as a public company, and understands its correlation to her taking home more money at Christmas.

I truly believe that you have to link business performance to individual success. You really need to align the goals of everyone in the organisation. We now have a strategy to do this.

Additionally, we recognised that even though we operate in nine different countries, our business was very "Sydney-centric". We developed a strategy known as "One Blackmores" to ensure that everyone felt part of our team, regardless of where they were situated, and that there were aligned visions, regardless of whether someone was employed to put boxes onto a truck, or as a senior executive. This sounds easier said than done, but it is achievable. I have said that our roadmap is found at our production facility, but that alone is not enough. We recognised that most of our staff, 60 per cent in fact, were not born with English as their first language, meaning that putting up a business roadmap map means nothing to them. So in addition, we created a picture. It is translated into the language of every nationality that we operate in. It effectively takes our strategic intent, makes it really simple and meaningful, to help unite our staff.

In addition to trying to listen to our staff and make them feel part of our strategy, we also make a concerted effort to listen to other stakeholders. This includes customers and others like government regulators. We want to hear the feedback of such people, and will invest time and resources to ensure that we are able to receive it. Our industry is good at telling government what we want. We were, in times past, not as good at listening and hearing their feedback about what they think about us as an industry. At Blackmores, we have set about changing this.

We have invested heavily in infrastructure. In addition to building a new state-of-the-art production facility at Warriewood, we also did a major supply chain review right throughout the business. This has helped us not just to maintain, but actually to improve our profit margins at a time when there's been much volatility in our ingredients. The move to Warriewood was very important for us. We moved in without glass in the front door, and I recall Tony Abbott coming to see us when there was still boarding up, but our facility, now complete is fantastic and assists our endeavours.

We have also really reinvigorated ourselves in the marketing approach. We are diversifying. We are launching into pet health and we just launched in Korea in December. I am pleased to say that both are going well.

We also know what we are as a Natural Health Company. We are not for example, prepared to sell products which don't have natural health ingredients in them. Often people come to me with great acquisitions for pharma companies. That's not for us. I think you really do need really strong rules and standards like this.

In terms of how far we have come, we set doubling the size of our company as a goal in my first few weeks of being there, but we actually doubled the market-cap pretty quickly. So we had to set a new goal, which was doubling the revenue and growing our profit faster, being number one with customers and number one with employees.

I'm pretty pleased to say that our share price closed last night at over $30. We have actually trebled the market cap of the organisation, which is no easy feat in two and a half years. And as an organisation last year, we closed the year with a 17 per cent profit growth rate, where I think most of my peer groups were actually experiencing profit declines. This year again, we have committed to the market that we will deliver profit growth, and we will.

We have a very high engagement with our staff. We have a 96 per cent return on our collective agreement. We score on average over 90 per cent on all our key measures with our own staff engagement. We are consistently ranked the most popular brand in Australia - not just by our customers but actually by end-user consumers. We have won awards in these respects consistently in recent years here in Australia and in Thailand as well.

In conclusion, I encourage you never to think that you can ever over communicate with the people that are your stakeholders. If you think you've communicated a lot, you have probably only covered half of what the stakeholders want to know. And I think you have to stop doing some things and prioritise. And you have to take risk which means empowering people, and thereby building a culture of trust.

I think that government can also help business by minimizing ineffective regulation. An example is vitamin K, which is not allowed to be manufactured in Australia despite being important for bone health, and it being able to be bought into the country. Technology is changing and so are consumers' habits changing. I think that government regulation also needs to keep up. Finally, I think that government needs to promote education and training in Australia. I visited Sydney University recently, and was amazed by what I saw there. I think that it is the responsibility of government to incentivise people into education and training, and to remain in Australia with the skills that they develop.

Peter Crone, Chief Economist and Director of Policy, Business Council of Australia

Peter Crone is Chief Economist and Director of Policy for the Business Council of Australia. Immediately prior to joining the BCA, Peter worked for Access Capital Advisers where he provided investment advice to a number of Australian superannuation funds. Before that, he worked as a senior adviser with Access Economics. Peter was Senior Economic Adviser to Prime Minister John Howard (1997-2005). He also served as an adviser to the Premier of Victoria, Jeff Kennett. Peter has held a number of company directorships and has previously worked in the Commonwealth Treasury.

I. Introduction

In this presentation, I will talk about productivity from a business perspective with regard to issues around business competitiveness. I want to draw on an important overseas example in the form of Wal-Mart, before considering the experience of Australian companies. Finally, I will flag a couple of important policy issues.

Recently, Henry Ergas addressed the Business Council on tax issues. He said that tax can be complex but also it can be quite simple. I think the same can be said of productivity. Productivity is essentially about producing more wealth with less expense. We know that anyone who has figured out a way to produce more with less has found a way to increase productivity. Some may have seen that a couple of weeks ago Clive Crook wrote a piece commenting on Barack Obama's State of the Union Address. In it Crook made some comments on productivity. He highlighted the fact that productivity gains for the most part come from cost savings. That being so, I believe that the goal is really to let businesses strive to lower their own costs in order to succeed. Additionally, productivity is about doing the boring things well, and about the adoption of better ways of doing business such as taking up new technology and better training the workforce. Most importantly however, I think the importance of competition and capitalism to improving productivity cannot be underestimated.

Last year, a piece was published with a good quote about our politicians' focus on fostering productivity via exciting high-tech breakthroughs (including green-schemes) misses a big part of what drives innovation, namely the diffusion of better business processes and management methods. This part of innovation is generally the result of competitive pressure.

II. An Overseas Example: Wal-Mart

Some may be aware that McKinsey and Company has done a number of studies on productivity, particularly focusing on the US. There's one study which I want to talk about despite it being a little bit dated. This is a report they did on US productivity growth over the period 1995 to 2000, when productivity was growing at about 2.5 per cent per year as opposed to about 1 per cent a year previously. What was found was that virtually all of the growth in US productivity had come from growth in just six sectors, and the retail sector was responsible for about a quarter of all the increase in productivity. McKinsey determined that productivity growth is actually explained by fundamental changes in the way that companies deliver their products and services. They also concluded that the bulk of the acceleration in productivity is traced to managerial and technological innovations that improve the basic operations of firms.

McKinsey noted the so-called Wal-Mart effect, whereby the history of Wal-Mart is actually a history of increases in productivity in the United States. I know people have different views about Wal-Mart and there are issues with it having a non-unionised workforce, as well as with the treatment of its suppliers. However, it has essentially made its goods cheap and available to vast numbers of American people, increasing their standard of living.

Wal-Mart has grown to be massive. It has approximately 4 000 stores and 1.3 million employees. Wal-Mart has been famous for its managerial innovations. It has been a leader, and a pioneer in IT use in its applications. In the late 60s into the 70s it was an early adaptor of computers to track inventory, made use of computer terminals in stores, introduced scanning and so-called universal product codes, and was a leader in electronic data interchange, satellite communications networks and supply chain technology. This has heavily influenced Wal-Mart's incredible growth.

Wal-Mart's success in a competitive market drove other companies to respond and follow what it was doing. As a consequence, other companies in the sector actually closed the productivity gap and halted the pace of increase in Wal-Mart's share of the market from 27 per cent per cent to just 30 per cent. That demonstrates the two points that I have made; new processes and innovation, as well as competitiveness are both productivity drivers.

III. The Australian Context

Australian retailers have tried to emulate the features of some of the global leaders, including Wal-Mart. Woolworths, for example, implemented their project "Refresh" from 1999, largely, but not entirely, about logistics and their supply chain. They reduced the number of their distribution centres by 50 per cent per cent, yet were able to handle 40 per cent more in terms of greater volume. A couple of the interesting features that have come out of the Woolworths material are that 80 per cent of their transport task is in metropolitan areas, so urban infrastructure is of critical importance to their logistics and efficiency, and notably there are regulations in existence that place curfews and delivery restrictions on about 45 per cent per cent of Woolworths stores in Sydney. So rather than get their trucks in at midnight, they have got to put their vehicles on the road in peak periods, which adds time, adds costs and congestion in traffic.

Coles has similarly has been investing significant amounts of capital in various productivity initiatives looking at improving their supply chain. There's even talk of so-called smart trolleys, including, I understand, radio frequency chips inside the packaging, which means when you put something in your trolley, you can get a running tally of how much you are spending on your groceries.

In 2003 the Productivity Commission produced some statistics on how various sectors compare. While economy wide, Australia's productivity was around 87 per cent of US productivity, in the retail sector it was something closer to 60 per cent. I spoke with one of the Business Council's CEOs yesterday about how that figure might have changed over time, given some of the things that companies like Coles and Woolies have been doing, and he indicated that the figure is still probably accurate. However, he explained that the larger scale of American retailers such as Wal-Mart make it easier for them to increase their productivity. He therefore believes that the fact that Australian productivity growth has kept up with US growth indicates that significant advances have been made in Australia.

IV. Government Policies

The Productivity Commission has suggested an approach with policies directed to three areas: incentives, which is about competition and tax; capabilities, which are skills, research and infrastructure; and flexibility, or the scope of firms to adapt, experiment, implement new business models and include such things as latent market flexibility. Professor Fred Hilmer has done likewise on an incentives and enablers approach, which he believes government should pursue.

I think that this, coupled with the wonderful thing that is the free market will continue to drive growth in productivity in Australia.

Part Three

Productivity: Education, Labor market and Skills

Professor Fred Hilmer AO
President and Vice-Chancellor, University of NSW

Peter Anderson
Chief Executive Officer, Australian Chamber of Commerce and Industry

Alan Manly
Managing Director, Group Colleges Australia

Nicholas Wyman
Chief Executive Officer, WPC Group

Questions and Discussion were led by Senator the Hon Eric Abetz

Professor Fred Hilmer AO, President and Vice-Chancellor, University of NSW
Productivity, Education, Labor Market and Skills

Professor Fred Hilmer AO has been President and Vice-Chancellor of the University of New South Wales since 2006. He was Chief Executive Officer, John Fairfax Holdings Limited (1998–2005). He was previously Dean and Director of the Australian Graduate School of Management (AGSM) and a Director of Port Jackson Partners Limited. Prior to joining the AGSM, Professor Hilmer was a director of McKinsey & Company. He served on the Committee of Inquiry into Management Education (1981-1982). He was a member of the Commonwealth Higher Education Council and Chairman of the Business Council of Australia's Employee Relations Study Group. He chaired the National Competition Policy Review Committee (1992-1993). He is a Director of Westfield Holdings Limited. He previously served as Chairman of Pacific Power, Deputy Chairman of Foster's Brewing Group Limited and as a Director of a number of other Australian companies.

I. Introduction

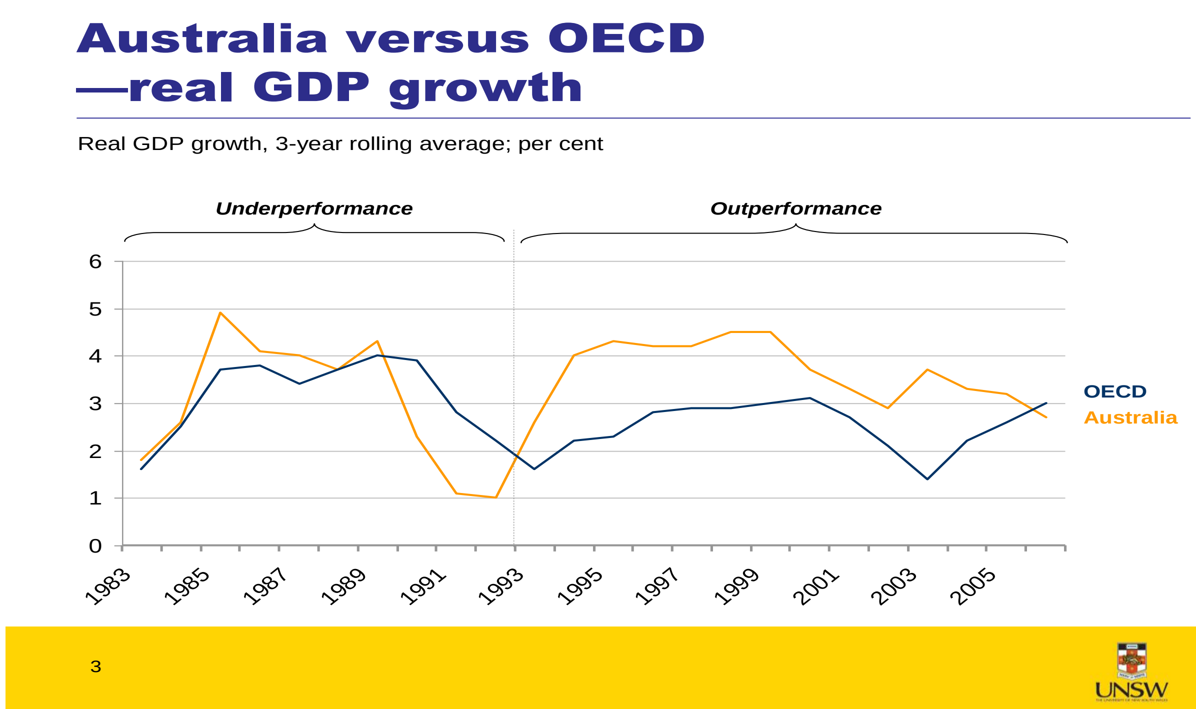
The central topic that I'm going to talk about is productivity and how it can be enhanced. I will do this in three parts. First, by looking at what's happening in terms of productivity. The great American football coach, Vince Lombardi coined the saying, "Winning isn't everything; it's the only thing". In economics, productivity isn't everything; it's the only thing. There are other things you can do; you can increase participation in the labour force; you can have an immigration policy that brings more people in the country, but if you don't improve the output of each unit of production, you don't get rising living standards. So, productivity is truly critical.

Having looked at productivity in general, I want to progress to examine the policy framework that drove our good years in productivity. I will conclude by relating that to the topics of education and training, and thus try to put everything into perspective. I think setting the parameters of the debate is important, because in the past we have often looked at the wrong things in the productivity debate, which leads nowhere.

II. Australia's Productivity Outlook

If you look at multi-factor productivity levels in Australia, you will see that, in the late 80s, there was no improvement. I think that our average improvement was 0.2 of a per cent. We then had a sustained period of around 2 per cent productivity growth from the 90s through to the early 2000s. Unfortunately productivity growth has since stalled again, and we are back where we once were.

The graph below shows how that is reflected in our performance relative to other OECD nations. The blue line is the OECD real GDP growth and the yellow line is Australia's. You can see that when we had no productivity growth, we tracked the OECD. When we had above-average productivity growth, we outperformed the OECD. Those were the years when we were considered the miracle economy; those were the years when we ran the surpluses that have now been largely dissipated, and they were the years that I think really made Australia textbook case of how to run an economy properly.



Then you ask the question, "why is that the case?" And before I jump into education, I think you need to understand why productivity growth has slowed in Australia.

There are many explanations. Infrastructure and skills are now inadequate. People say, “We're bottle-necked; you can't get the coal out of the port; you can't get the rail working; the retail productivity is low because our traffic is congested; the trains don't work”. So, we've got a whole lot of infrastructure and skills inadequacies. Wal King would often harangue me at university, "We need more engineers; we need more engineers". And there's no doubt that we need more engineers and we can use more engineers but, to produce an engineer you almost have to start in Grade 7 and you won't see them doing anything for 10 or 15 years.

The second explanation is a lack of R&D and innovation. Apple is probably the majority factor at the moment in the US resurgence, and we don't have an Apple, and we don't have a Google, and we don't have an Amazon and we have low R&D and innovation. That's not quite fair when you actually look at the numbers. We are by no means a disaster, but more innovation would enhance productivity.

A third reason is that we’ve got mining expanding and investing, and we're not yet getting the results. Conversely, we’ve got agriculture, which has had a drought, and we have utilities which have been doing badly because of poor regulatory performance. There are other sectors not doing that well (e.g. Retail), and the public sector certainly is not doing well. What is most compelling, and which explains part of this at least, is that we've lost our way in terms of microeconomic reform. We've started to go backwards.

What should be Australia’s micro-economic strategy? The focus should be on infrastructure, education and skills, and cutting red tape. A government can do two things to promote productivity. It can either create incentives or enablers; productivity doesn't occur by passing legislation; productivity doesn't occur by actions of government; productivity occurs when private firms find ways to increase output relative to inputs.

Of those two, incentives are far more important. The three main incentives are competition, tax and governance. The competition agenda has been eroded, particularly through the introduction of regulation in almost every sector, making it harder to compete. With regard to taxation, we were at one point increasing productivity by decreasing taxation. Now however there is talk of only minor tax cuts, and in real terms, taxation is likely to increase as new taxes are added. Corporate governance is significant in this country, because increased regulation forces boards of directors to spend time ticking boxes rather than addressing performance issues.

Enablers include infrastructure, skills, labour market flexibility, and technological advance. Infrastructure, in my opinion is not as crucial as some believe, and is too often used as an excuse to justify failures to increase productivity. Skills are important, but the skills to which we refer are labour market skills dependent on significant education, and, as in the case of engineers, must be a long-term focus. I believe that labour market flexibility and technological progress are the most important of the enablers.

Why are incentives the key? I think that they are, because without significant incentives, there is no reason for people to use the skills that they acquire to work hard. Without incentives, it is likely more desirable for them to choose an easier path that gives them more time away from work. The question of what incentives encourage people to strive for excellence and drive productivity is complex. The real breakthroughs in this area have largely been about understanding how complex and at times perverse incentives can be. Some of the incentives around pay systems have been perverse and have led to perverse effects. That doesn't mean we should not have incentives; it means that we should give a lot of thought to the notion that the principal tool of policy is incentives.

The Japanese economy provides a good example as to why incentives rather than enablers are key. In Japan there are globally competitive industries like the automobile and electronics industries, and some very uncompetitive industries like the chemical and retail industries. What must be remembered is that they have the same enablers. They have the same infrastructure. They have a wonderfully skilled workforce. The difference is competition. Intervention in the form of regulation in the industries that are successful is also low.

Countries seeking high productivity must focus on incentives. This does not mean that enablers should be ignored, however they generally improve slowly and affect productivity in the long term.

This conceptual framework explains the trends that we have seen in productivity in Australia in recent decades. During the 90s we increased competition and we decreased product market regulation. In the 2000s regulation increased, particularly relative to other OECD nations. Taxation also decreased in the 90s, a trend that has stopped. Finally, governance focus in the '90s was all about performance. When I was on the Fosters' Board at that time, our concerns included where to expand and whether to diversify, and we considered cost structures. We didn't worry much compliance, especially compared to directors now. This is obvious to me from the committee that I chair at Westfield. In the 1990s we also focused on one enabler in the form of labour market flexibility, but did little for infrastructure and education.

The current government has at least indicated a desire to address these two areas, but will probably not address the incentive side of the equation, which is not a good approach.

III. Conclusion

Several conclusions arise from the analysis above. Firstly, it's absolutely desirable to improve enablers. I am not opposed to better infrastructure or a more educated workforce. However, such things impact productivity long-term, and do not generate an immediate bounce.

Education is actually important from another perspective. In recent decades, Australia has become an exporter of education. Education is a great success story as an industry. In fact it is Australia's third most successful export.

Finally, I feel compelled to argue that productivity is not anti-worker, as it is often perceived. It is perceived this way because productivity is often talked about as if it is only based on cutting costs. The most productive countries in the world however, are productive because they invent new things. Look at the United States as a case in point.

In summary, productivity is about incentives. Education is important; it's important as an industry; it's important as an enabler, but by no means the whole game if we're serious about reversing the productivity decline.

Peter Anderson, Chief Executive Officer, Australian Chamber of Commerce and Industry

Influences on Labor Market Productivity

Peter Anderson has been Chief Executive of the Australian Chamber of Commerce and Industry since January 2008. He is an elected member of the International Labour Organisation (ILO), a delegate to the International Chamber of Commerce, the Organisation for Economic Cooperation and Development (OECD) and regional business forums. He was recently appointed a member of the Government's Business Roundtable on Climate Change. He also serves as Chair of the International Chamber of Commerce (Australian Branch), Chair of the National Business Action Fund, Vice President of the Confederation of Asia Pacific Employers, Board Member of the Australian Made Australian Grown Campaign, Member of the National Workplace Relations Consultative Council and Delegate to the Confederation of Asian Chambers of Commerce.

I. Introduction

There are three drivers that can be put on the table that interrelate productivity with our labour market. Firstly, our participation levels; secondly, our skills; and, thirdly, the way we organise our work. If we were able to improve our performance in each of those areas, our country would be such a strong economy that we would be providing leadership globally, and our resources sector and Indian and Chinese demand would not be masking a multitude of sins in our failure to really undertake micro-economic reform in this early decade of the 21st century. They are the areas which have the capacity to make a very real difference beyond the cycle of our resources boom, and what I will focus on in this presentation.

II. Participation Levels

The goal of increasing workforce participation certainly can have a productivity output. When people talk about workforce participation, the immediate attention goes to more people being employed in the workforce. I believe that that is too narrow. In the labour market we have thousands of entrepreneurs (small business, contractors, self-employed-own-account people etc.). Increasing workforce participation is therefore not just about employers employing more people; it's about more people believing that they can become entrepreneurs; about more people believing that they can participate in their own right and both be rewarded and contribute. There's very little attention given to policy development that will help drive people into entrepreneurship; into believing that doing something for themselves and through that for the community good is as desirable and capable of being rewarded and valued as being an employee in a direct sense. That side of increase in workforce participation needs to be the subject of some creative ideas and thinking.

When it comes to direct employment, there are some really important drivers that can affect the way in which we either increase our overall employment levels or see them fall. There are winners and losers when you take these decisions. Obviously, the relationship between the welfare system and people who are in the workforce is an important policy area. It's a difficult policy area for governments; it's been difficult for governments of both major political persuasions because there are winners and losers when you are trying to transition people from the welfare system into the workforce, but it is a critical element that contributes to increasing our workforce participation. I believe that we need some changes and new policies that establish greater incentives for people to move from welfare into work.

The demographics of our population are also an obvious area regarding participation levels because of the ageing population. I believe that the challenge before us is to ensure that people who want to remain in the workforce don't just move straight into retirement, that there are transitions capable of keeping them in the labour force for as long as they want to be.

We also want to make sure that we don't have gaps between people who are ceasing their education and entering employment. As a nation we’ve done some good things to try and deal with those gaps through the education and training system over the last 20 years, but again it's an important area where new ideas and incentives are required.

Government policy needs to be coherent in all of these areas. Government needs to talk with, generally speaking, a common message in terms of policy direction. The Prime Minister said at the start of this year in an address to CEDA that the workforce participation goals were part of the government’s agenda. And yet a few weeks later we saw a range of measures being taken inside regulators to force industry to justify again the right to use contractors and the status of contractors. These are steps taken that work against the stated objective. A few years ago both sides of politics were falling over each other to laud contracting as the new aspirational component of the labour force. And yet here in 2011 we are having to reargue some of those propositions. This appears to be a step backwards.

III. Skills

We have a skills shortage that has been recognised, and part of that is driven by the way in which the resource industry is taking labour supply out of other parts of the economy. We just concluded a survey and some research work of industry, including small and medium businesses, and what that showed is that we've also got a skills deficit. About 80 per cent of people's skills are productive skills. There's about a 20 per cent deficit between what businesses see as the necessary skills to do the job and the skills that actually exist amongst the workers.

The projection forward was that, in five years' time, the skills deficit will increase to 25 per cent. That's a real challenge. Money can't just be thrown at the problem. We saw the Keating government throw a huge amount of money at this in the early '90s, and a lot of it just churned people through training. You need, firstly, the creation of real jobs; and, secondly, a capacity for business to have an education and training system that builds skills which are industry relevant.

We also need to make sure that we're not just pumping those resources into some of the traditional trades. In particular we need to address the demands of the growing services industry.

IV. Labour Market Organisation

Inefficient work practices are the subject of rule-making by industrial tribunals. The failure of productivity-based wage bargaining is not, as the Minister has said in the last couple of days, a failure of industry; it is a failure of the structure that's been put in place that allows economic coercion on industry to concede claims which would not otherwise be conceded. The idea of productivity bargaining as an equal benefit is as completely foreign as the practice in the first two years of the current industrial relations system.

My final point on that is that most of industry does not organise themselves through collective structures. We know that the private sector is overwhelmingly non-unionised. How on earth can an industrial system have as its main rule of productivity, a rule based on collective bargaining to produce productivity when most employees are non-unionised? That is simply not logical, and it is a major thorn in the side of those hoping to see productivity rise within industry which needs to change as soon as possible.

Alan Manly, Managing Director, Group Colleges Australia

Alan Manly is the Managing Director of Group Colleges Australia. As Managing Director he is responsible for the corporate planning and governance of the group of companies. Alan has over thirty years' experience in business management in industries including, technology and education. He has twenty years' experience as a Company Director with private and public companies. He is a former Director of the Australian Council of Private Education and Training (ACPET) and is a current member of the ACPET NSW State Committee. Alan is a Justice of the Peace, a member of the Australian Computer Society and a Fellow of the Australian Institute of Company Directors.

My name is Alan Manly; I'm the Managing Director of Group Colleges Australia (GCA), a private Higher Education Institution. Higher education being:

- under-graduate degrees;
- post-graduate studies;
- masters' degrees and
- doctorates.

In Australia most people assume a degree is from a university. It was not always the case. It used to be:

- universities;
- Colleges of Advanced Education (CAEs) and
- non-government institutions.

Today the higher education system comprises:

- 39 universities, 37 of which are public and 2 are private;
- 1 Australian branch of an overseas university;
- 3 other self-accrediting higher education institutions and
- 150 non-self-accrediting higher education providers.

They were formerly accredited by the States and Territories, but are now being accredited by the Federal government.

The non-self-accrediting higher education institutions are now accredited by TEQSA (Tertiary Education Quality and Standards Agency). These number, as I said, more than 150. They offer a diverse range of courses to the public.

Universities and higher education institutions now have the same government auditor for academic quality.

80 of the 150 higher education institutions have been approved for *Fee Help*. They've become known as Higher Education Providers (HEPs).

There's a list of the Higher Education Providers on the government website.

All Australian students receive government funding:

- Universities - *HECs Help*;
- Higher Education Providers - *Fee Help*.

It depends on the student's choice.

The Australian higher education system, where students have government support for fees:

- 39 universities;
- 1 branch of an overseas university;
- 3 self-accrediting higher education institutions and
- 80 approved Higher Education Providers.

Who chooses what?

- 39 universities attract approximately 814,000 students each year.
- The 80 approved HEPs (Higher Education Providers) attract approximately 100,000 students each year.

The cost to the student for the degree - they go to one of the 39 universities (makes up 814,000 of them); they pay a half; that is half the tuition fees as a loan back to the government – *HECs Help*.

The cost to the student of a degree if they should be attending one of the 80 approved HEPs - accredited by the same Commonwealth government department for academic quality - their fee is 100 per cent. They pay the full tuition fee as a loan, plus they pay a 25 per cent administration fee.

The 80 approved HEPs are equivalent to three large metropolitan universities.

That's approximately $2 billion in capital investment saved by students choosing HEPs; by students choosing a non-government-built education facility.

My suggestion is all students should have freedom of choice and be treated equally.

Further, students should not be discriminated against based on their chosen education institution.

To end this discrimination, the funding should be the same for all students; not to mention the obvious productivity gains to be made within the education sector by allowing the private education sector to build facilities and have students choose them of the own free will.

Nicholas Wyman, Chief Executive Officer, WPC Group

Utilising Young Workers

Nicholas Wyman has been Chief Executive of WPC Group since 2006. Previously he was Group General Manager for Workplace Connect. He has also worked in Employment and Training at BHP Billiton for eight years. He started his career winning the Australian Apprentice Chef of the Year. He quickly progressed through a range of positions in the hospitality and catering industry, both in Australia and overseas. In 1988, Nick was Captain of the Australian Olympic Culinary Youth Team. The Team won Gold for Australia and was also awarded the Luxembourg Trophy for their achievement. Between 2008 and 2011 Nick participated in Leadership Development and other global executive education , including Corporate Social Entrepreneurship (a process enabling business to develop more advanced and powerful forms of Corporate Social Responsibility), at Harvard Business School.

In Germany, 80 per cent of apprentices complete their apprenticeships. Youth employment is below that country's natural unemployment rate. It would startle people in to know that in Australia only 50 per cent of our apprentices complete their apprenticeships and that in several Australian locations youth unemployment is now running at five times the national average.

I'm the CEO of a company called WPC Group and we're a leading apprentice organisation working across 11 industry sectors. My company directly employs 500 apprentices and trainees. We work with a network of 220 employers. I'm proud to say that my organisation has a workforce development program that has completion rates in excess of the German model running at 84 per cent. In this presentation I will share my experience of workforce programs from the front line.

I have been in a unique position to see, hear, learn and do something in the ever-changing world of work and its impact on today and tomorrow's workforce. My presentation is around skills and the power of both employee and employer engagement. The focus is on apprenticeships and traineeships, which is where my background is.

As many of you may have heard or have seen in the media in the last week, youth unemployment was reported as being at 54 per cent in the 15-19 year old age bracket in the north-west of Melbourne. WPC Group, my organisation, has 150 apprenticeships on offer, and many of them are actually in that region. Our young people won't take these jobs. My question today is why? The workforce participation gap is widening. On one side, we have employers concerned that younger "job seekers" as they are called by DEERWR (the responsible Department of Education, Employment and Workplace Relations ((including the long-term unemployed)) do not have the capacity nor the entry level skills to do the jobs. On the other side, we have many young Australians disengaged, some believing that they are destined to a life on welfare.

I meet many of these young people, and it may be a revelation to know that many long-term unemployed young people do actually have skills. Unfortunately, they're misguided skills. They're skills passed through intergenerational reliance on welfare versus work. Tangible and intangible skills, like multi-tasking and researching. Skills often developed spending their day manipulating the system of Youth Allowances, NewStart and other Benefits. These skills can and must be redirected.

If we look at the grand prix of welfare, Australia is racing through the field. We've passed the US, and now we've passed Ireland in public expenditure. The Prime Minister's focus on the three-quarters of a million people with disabilities in isolation is complex and misses the much larger welfare pool twice that size.

We have a situation in this country where youth welfare allowances are greater than entry level wages. Many young people my company meets describe their allowance as "their pay". And I know people have heard that, but it is actually quite concerning when a young person on benefits comes to you and says, "I've just been paid". Welfare should be transitional; not a way of life. Over the next two decades, the aged population will grow and, the tax-paying workforce will enter into relative decline. The number of dependents on welfare is increasing.

One of the concerns in this area is that many apprentices are failing because they don't realise the majority of apprenticeships require good literacy and good numeracy skills. I call them "career-readiness skills". Our schools do not offer a curriculum that's relevant to the majority of school leavers. The curriculum is not engaging, and as we all know, if something isn't engaging, students switch off. So, by the time many young people get to our jobs, they've actually switched off; they've switched off further education, they've switched off life-long learning.

There is an increasing demand for skills in Australia, yet there are also increasing barriers. We have over 2.3 million unemployed or under-employed Australians. Over one million of them have the capacity to be in productive employment if we are innovative in how we address the barriers. These barriers exist on both the demand and the supply side.

On the demand side, for example, businesses at all levels are becoming increasingly frustrated with poor turnout at job interviews. Of the 150 apprenticeships my company has on offer, only 25 per cent of candidates referred to us by the Job Services Australia network have actually showed up for the interviews. This leads to barriers building with employers about working with this group. On the supply side, "over-complicated", "over-crowded" and "over-regulated" are words that describe the skills marketplace in Australia. After a $4 billion overhaul, the government's Jobs Services Australia contracts with DEEWR are set up to fail. Perhaps the best example of this is the fact that operators are paid regardless of whether they actually produce an employment outcome.

Real reform will be incremental, and a sensible place to start is in our schools to remove the barriers for our next generation of skilled workers, people who are currently at school. We need to create stronger academic pathways into apprenticeships as well as traditional university pathways to break cycles before they form. We need to raise expectations. We need to renew and review careers advice and make the curriculum relevant in a real-world environment.

For the lost generation (as I call them) of disengaged unemployed Australians between the ages of 15-24 we need to promote the idea of hand-up, not hand-out as the only way to go. We must no longer hand out money. We must, rather, reach out in creating innovative workplace development initiatives towards self-sufficiency. We need to let them gain knowledge of real work.

My company has run some very successful programs, which are four-week programs and which are around attendance (the person gets to wear a uniform, gets to really try what a trade is like, and, most importantly, gets a week in a real work setting). Participants mix with a different type of person. The most important part of that program is the mentoring aspect. This is happening at the workplace level, which is absolutely critical.

We can't blame these people; we can't put them down; we've created the system. We need to decrease the over-regulated and duplicated Job Services that offer poor back office efficiencies. We need to make youth income support directly linked to workforce participation, with ramifications for those who don't show up and don't attend.

We need to look at sensible government contracting. I estimate, of the seven contracts awarded in New South Wales alone under the Global Financial Crisis building stimulus, had the COAG-endorsed stipulation of 10 per cent of each contractors' workforce been followed, that would have just created 3,500 apprenticeships alone in one state.

In summing up, today's youth is tomorrow's future. It is my belief and experience that apprentice training and employment opportunities empower and engage individuals to want to reach their full potential. These people will then go on to pass these hand-up skills to the next generation of 15-24-year-olds.

Part Four

Productivity and Infrastructure

Scott Lennon

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Questions and Discussion were led by Hon Joe Hockey MP

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Scott Lennon is the PwC NSW Government Leader and Senior Partner in its Economics & Policy Group. He is a Transport Economist by training with over 15 years' experience specialising in infrastructure feasibility studies, business cases and economic appraisals. Scott joined PwC in 1999, following roles at the NSW Independent Pricing & Regulatory Tribunal and within NSW Government Transport Agencies. He has been working on a variety of business case, economic appraisal and feasibility studies on a range of projects including: a new Inland Railway from Melbourne-to Brisbane, new heavy railway lines to South West & North West Sydney, new railway and port infrastructure in the Pilbara, potential metro railway lines in Sydney and container port expansions in Sydney, Melbourne, Newcastle and Brisbane.

I. Introduction

In this presentation I plan to focus on five key themes in relation to the topic of productivity and infrastructure: why productivity growth is critical; how infrastructure can contribute to productivity growth; what infrastructure Australia should be prioritizing in order to improve national productivity and which types of projects are most likely to yield highest productivity gains; what the optimal process is for prioritising investments in infrastructure which provide the largest gains in productivity; and potential labour market reforms and better approaches to regulation to deliver more efficient infrastructure.

II. Why Productivity Growth is Critical

Let's begin with a definition: "Productivity refers to the change in the ratio of service outputs per unit of input (inputs are labour, capital, raw materials, etc.)". It can be measured at a facility, entity, industry, state or national level. Improving productivity often involves innovations or capturing technical improvements to generate more outputs or new, higher-value products with the same inputs. Productivity growth (more output per hour worked) is essential to improve living standards in the community and is critical to generating greater economic growth by better harnessing our labour and physical resources. Generating sustained improvements in productivity is vital to improving the standard of living of our nation and it is the key economic challenge for Australian governments.

Considering that real GDP growth only occurs three ways - through increasing population, participation or productivity - the importance of the latter is exemplified when examining the economic landscape in Australia. Population growth has ranged between 1-1.5 per cent in recent years, and now looks to be constrained by the unfortunate 'big Australia' debate. Furthermore, participation rates have also remained fairly stable or slightly falling. Neither of these indicators are likely to change substantially in the near future. Hence the onus to generate strong GDP growth rests mainly with lifting productivity.

Productivity growth can also be separated into different results for the government sector (including all three levels of government) and the private sector. The OECD in 2008 estimated that public spending as a percentage of GDP is 35 per cent for Australia compared to 39 per cent for the USA and an EU average of 47 per cent. Hence governments need to play a key role in improving their in-house productivity as well as providing 'business friendly' and 'innovation friendly' economic environments for the private sector to also drive productivity. Reporting on productivity performance by the government sector has substantial scope for improvement. But most economists believe the government sector continues to have the largest room for productivity improvement, with most studies concluding gains of 10-20 per cent are achievable. By contrast gains in private sector productivity are likely to be much more modest.

To retain the national focus on this important productivity debate, PwC will shortly be releasing a quarterly "PwC Productivity Scorecard" which will provide labour productivity results by state and territory and across 16 key sectors.

Productivity is not about making people work harder. I agree with the Fire Brigade Employees Union when during wage rise negotiations where the government was seeking productivity improvements they stated that 'they could not climb their ladders any faster'. Rather, productivity-induced efficiencies can potentially be obtained from labour mix roster optimisation, upgrading road network pinch points, smarter fleet allocation, use of predictive analytics to better match resource quantities and locations to the risks etc.

Productivity is best achieved in an environment which combines: incentives and commercial certainty to encourage business and government investment (such as in higher capacity equipment) in the participation of the provision of infrastructure; effective quality infrastructure with adequate capacity and speed to meet peak demand; real government policy reforms (like cutting taxes, exposing state business to more competition, and real reductions in red tape etc.); and more sophisticated business management and better use of ICT to achieve better resource allocation, as well as greater economies of scale and scope. Productivity growth is also stronger where there is a commitment to targeted R&D as well as tertiary education to drive innovation and smarter ways to add value to services. The globalisation of markets for some goods, capital and technology creates opportunities to access new suppliers and improve scales.

All government agencies and even leading private sector operators should view improving productivity as a dynamic, ongoing and routine part of management during all periods. We need to adhere to a notion that all operations, even the most efficient, need to retain an ongoing focus on identifying smarter operating practices or the better use of ICT to continue to generate productivity gains each and every year.

State and Commonwealth government budgets build-in assumptions that productivity growth will continue at long term average rates to assist in meeting target fiscal results over the forward estimate period. Productivity growth across the economy can contain cost growth or lift state revenues facilitating opportunities for debt repayments, tax cuts and/or increase spending on priority programs.

Real pay rises can only be afforded in the medium to long term where productivity growth covers the component above inflation and this principal is reflected in state treasury policies that wage rises above CPI need to be linked to realisable plans to make productivity gains.

Driving productivity improvements is a vital part of the state government strategies to retain their AAA grade credit rating by returning to a surplus position and then using surpluses to repaying debt. During 2010/11 the NSW Government is fast approaching the S&P liabilities trigger band of 120 per cent to 130 per cent[1] where NSW would be likely to be downgraded to AA. Hence the new Government needs to extract productivity gains quickly to improve the NSW budget position.

Additionally most treasuries impose modest generic efficiency dividends often requiring cost reductions of CPI minus 1-2 per cent, with the agency needing to self-identify and pursue the savings without cutting front line staff or making savings in

[1] S&P formula is: (Non-financial public sector net debt plus net unfunded superannuation liabilities) / public sector revenues

other areas which may create industrial issues or significant community complaints. But with all these constraints the realisation of productivity gains by governments using this approach has been mixed.

Most international and local research identified strong productivity growth through the 1990s. Multifactor productivity growth in Australia's market sector accelerated from an average 0.6 per cent per annum in the 1980s to 1.3 per cent in the 1990s, including an average 1.8 per cent in the five years to June 2000[2] which was an internationally respectable outcome with large gains in utilities, communications, mining and wholesale trade. Over the 1990s NSW aggregate productivity growth was usually at or just under the national average with the gains attributed mainly to structural reform and uptake of ICT. However, more recently productivity growth rates in Australia and in NSW have slowed, and even declined which creates a stronger case for more focus on making productivity gains and for better infrastructure to reduce congestion.

The focus on improving productivity is not only for raising profits but can improve society as a whole. Michael E Porter noted that:

> 'Productivity is the prime determinant in the long run of a nation's standard of living, for it is the root cause of per capita national income. High productivity not only supports high levels of income but allows citizens the option of choosing more leisure instead of longer working hours. It also creates the national income that is taxed to pay for public services which again boosts the standard of living. The capacity to be highly productive also allows a nation's firms to meet stringent social standards which improve the standard of living, such as in health and safety, equal opportunity and environmental impact'.[3]

Over the past decade, the expenditure growth rate for many governments has been sizably above revenue growth rates and population growth rates. Additionally the cost per unit of output has been rising in real terms indicating reducing productivity.

Measuring productivity improvements is a challenging analytical exercise requiring robust data analysis requiring input from econometricians, outsourcing specialists and benchmarking experts. Correct calculation of productivity growth requires consistency in definitions and calculations in areas such as the capital, the

[2] NSW Treasury PRODUCTIVITY TRENDS - Implications for the NSW Economy and Budget (2005) available at: http://www.treasury.nsw.gov.au/__data/assets/pdf_file/0019/5392/trp02-5.pdf

[3] Porter, Michael E (1991), The Competitive Advantage of Nations, The Free Press, New York.

depreciation rate, quality adjustments for both capital and labour, and the choice of time periods. Results can be influenced by a range of factors including cyclical effects, by understating labour inputs, and by sampling bias from not assessing sectors with archaic practices.

Productivity benchmarking enables comparisons of KPIs such as unit cost, cycle time and quality difference between facilities and against best practice. The key part of this process is for facility managers to try to understand why their result level is where it is, compared to averages and best practice. This reconciliation process can help build a case for change and adoption of smarter processes.

Benchmarking should also evaluate demographic trends (population growth, workforce participation, retirement ages, hours worked per week, tertiary education participation/skills formation, birth rates, immigration etc.) and business investment trends (factors in locating new operations, equipment replacement cycles, which tax reductions provide the largest boost to GSP and productivity) as these can drive productivity growth.

Australia has a great need to increase productivity to counteract the ageing population, the ongoing threat of climate change and the eventual end to the resources boom. This point is reinstated by Glenn Stevens, the Governor of the Reserve Bank of Australia who declared that productivity was 'the only real basis for optimism about future income'.[4] What Mr Stevens is arguably saying is that without productivity growth our standard of living will go backwards! The Commonwealth Treasury has estimated that the ageing population will detract from labour utilisation and reduce GDP by 0.5 per cent to 1.5 per cent per annum over the next 40 years hence a tripling of direct efforts to boost productivity is required.

III. How can infrastructure contribute to productivity growth?

Investment in infrastructure is important for productivity as it does not only add to Australia's physical capital stock but also facilitates improved efficiency in private sector production. A key turning point in recognising the need to fix our infrastructure was in 1989, when David Aschauer of Bates College in New York attributed the decline in productivity in the USA in the 1970s to a lack of infrastructure investment. The argument Aschauer put forward was that public investment in infrastructure can increase the efficiency of private investments in labour and capital stock.[5] Additionally The Global Competitiveness Report of 2009-

[4] Stevens, Glen (2009), 'Challenges For Economic Policy', Address to the Anika Foundation, 27 July.
[5] Aschauer, David (1989), 'Is Public Infrastructure Productive? Journal of Monetary Economics, 23, pp. 177-200.

10 from the World Economic Forum stated that an inadequate supply of infrastructure is one of the 'problematic' factors in doing business.

The OECD realises the importance of infrastructure to the economy stating that:

> 'Adequate and well-functioning infrastructure is a key ingredient to growth and well-being. The benefits to activity of efficient spending in energy, water, transport and communication sectors go well beyond their contribution to capital accumulation. Good infrastructure facilitates trade, bolsters market integration and competition, fosters the dissemination of ideas and innovations and enhances access to resources and public services. These benefits are particularly important for Australia because of its size, the geographical dispersion of its population and production centres, and its remoteness from other markets.'[6]

Studies from the OECD show that investment in infrastructure is more effective in boosting long term economic output than other types of investment.[7] Moreover estimates from the International Monetary Fund suggest that a 1 per cent increase public infrastructure stock leads to an average increase in output of approximately 0.2 per cent.[8]

The US Treasury also highlights the significance of infrastructure declaring that:

> 'Research has shown that well designed infrastructure investments can raise economic growth, productivity and land values, while also providing significant positive spillovers to areas such as economic development, energy efficiency, public health and manufacturing.'[9]

Two key examples of sectors where investment in infrastructure can boost productivity are transport and the internet: Regarding transport, issues such as population growth and ageing mean that we must revisit our urban infrastructure requirements. Australia is highly urbanised with over 75 per cent of the population living in major cities. A projected population of 36 million by 2050 is forecast to feature further urbanisation. If not managed properly, current and emerging problems will be exacerbated by congestion, resource consumption, environmental degradation and a higher cost of living. The NSW RTA peak hour travel speed survey

[6] OECD Economic Surveys – Australia, (2010), OECD, Paris, November.

[7] OECD 2009, *Economic Policy Reforms: Going for Growth, 2009*, OECD, Paris.

[8] Kamps Christophe (2006), *New estimates of government net capital stocks for 22 OECD countries 1960-2001*, in IMF Staff Papers, Vol. 53, No. 1, Washington DC.

[9] US Treasury (2010), 'An Economic Analysis of Infrastructure Investment', 11 October

on key corridors in Sydney suggests speeds have remained stable at 25-35 kph. But these results don't feel right to many drivers who report longer journey times and rising congestion. In the large metropolitan areas, BITRE estimates congestion costs total $13 billion (1.5 per cent of GDP) in 2010 and could exceed $20 billion in base year prices by 2020 with unchanged policies or about 5 per cent growth per annum.[10] Furthermore the resource boom in Australia has put considerable strain on the existing port and rail infrastructure, and as highlighted by BITRE, the demand for freight is expected to double between 2000 and 2020.[11] This needs to be addressed or Australia faces the risk of losing exports if shipments experience significant delays in transport.

Regarding the internet, the OECD Economic Survey of Australia indicated that high speed broadband internet services in Australia have gaps in distribution, high prices and relatively slow connection speeds. Slower broadband speeds result in lost time for employees and therefore this is a key area of investment as it is vital to respond to changes in technology to remain competitive on a world scale. Internet services that are faster and have greater coverage will offer substantial productivity gains. Although a costly project, recent OECD research shows that a new broadband internet network can offer benefits of 0.5–1.5 per cent of GDP over a 10 year period in the areas of healthcare, education, transport and electricity.[12] However the business case for almost universal high speed broadband coverage requires a cost benefit analysis given low population densities and high capital costs to connect a range of rural and remote areas.

It is worth mentioning cost benefit analysis (CBA) does focus on matching the investment to the size of the problem. Critics say a CBA of the Harbour Bridge would have seen it built as only a one two lane structure in the same way our M2 and M5 were built at four lanes and now need extensive widening to six. Overall the notion of future proofing needs to be better incorporated into design so that items such as overbridges are built with spans wider than initial lanes so future widening costs are reduced.

[10] BTRE (Bureau of Transport and Regional Economics) (2006), "Freight Measurement and Modelling in Australia", *Report*, No. 112, Canberra.

[11] BTRE (Bureau of Transport and Regional Economics) (2006), "Freight Measurement and Modelling in Australia", *Report*, No. 112, Canberra.

[12] OECD (2009), "Network Developments in Support of Innovation and User Needs", Working Party on Communication Infrastructure and Service Policy, DSTI/ICCP/CISP (2009)2/Final.

IV. What infrastructure Australia should be prioritizing in order to improve national productivity? The types of projects most likely to yield highest productivity gains.

Australia has a substantial infrastructure deficit, which is in part due to underinvestment in the 1980s and 1990s, and as a result the Federal Government has put infrastructure at the top of their agenda. Analysis by Citi Group suggests the deficit is $770 billion. Whilst debate persists on this estimate, the backlog is substantial and there is a clear need to increase infrastructure expenditure as well as deliver structural reforms to optimise public and private investment choices and boost the use of existing facilities with better regulation.[13]

To tackle this challenge the government set up Infrastructure Australia, who conducted an assessment of the priority needs to steer public and private infrastructure investment to the areas which give the best to national productivity. The six key areas highlighted by Infrastructure Australia as providing the best boost to national productivity are:[14]

A. A national broadband network: developing a more extensive, but not necessarily universal, globally competitive broadband system;

B. Creation of a true national energy market: more extensive national energy grids to enable greater flexibility and competition in the nation's electricity and gas systems, whilst creating opportunities for the development of renewable energy sources; The Mid-West Energy Solar Plant (WA, $795 million) is a project of this ilk which has been recognised by Infrastructure Australia.

C. Competitive international gateways: developing more effective ports and associated land transport systems to more efficiently cope with imports and exports as an example of this type of project; Road Freight Access to Port Botany and Kingsford Smith Airport – M5 East (NSW, $4,000 million)

D. A national rail freight network: development of our rail networks so that more freight can be moved by rail as an example of this type of project ; Adelaide Rail Freight – Goodwood and Torrents Junction (SA, $418 million) and the Melbourne-Brisbane Inland Railway Study is an example of a national rail network investment - the 2010 PwC study for ARTC found the project to be viable by 2035 but recommended reservation of the corridor to

[13] OECD Economic Surveys – Australia, (2010), OECD, Paris, November.

[14] Infrastructure Australia, (2008), A Report to the Council of Australian Governments

prevent residential encroachment and subsequent cost escalation or rise in residential encroachment issues.

E. Adaptable and secure water supplies: more adaptable and resilient water systems to cope with climate change as an example of this type of project; Tasmanian Water and Sewerage Reform (TAS, $1000 million)

F. Transforming our cities: increasing public transport capacity in our cities and making better use of existing transport infrastructure as an example of this type of project; Melbourne Metro New Rail Tunnel Stage 1 (VIC, $4900 million)

Also important to note is what is not on Infrastructure Australia's list. Absent are school halls, hospitals, regional highways, sport or tourist facilities, cycle ways, universities and ferry wharfs.

These areas have been highlighted by Infrastructure Australia to meet the gaps, deficiencies and bottlenecks in our nation's infrastructure. As noted by the OECD, infrastructure investment must be effectively targeted to ensure overall economic benefits are maximized.[15] Simply spending money does not ensure gains in productivity. The Economic Stimulus Package released by the Government, necessarily preferenced projects which were 'shovel ready' rather than projects with the largest national productivity gains. Adding more schools halls, social housing and community infrastructure sustained the trades sector but with the benefit of 20:20 hindsight, as it became clearer Australia would avoid the recession, perhaps parts of the tail end of the package could have been reallocated to the areas nominated by Infrastructure Australia. Under the BER $16.2 billion was spread across over 9000 schools over four years and given a recession in Australia was avoided the potential to reallocate part of this funding to infrastructure which delivers sizable productivity gains was not grasped.

With the establishment of Infrastructure Australia and its demands for integrated planning we have seen a greater awareness about the substitutability and merit of some different infrastructure investments within a geographic catchment. For example some motorway widening announcements result in uninformed calls that the motorway will be congested again as soon as the extra lanes are opened so the funding would be better used in rail upgrades. The reality is railways also experience crowding which can in peak periods mean passenger cannot squeeze on and need to await the next service, but we hear few commentators suggest there is no point upgrading train capacity as it will only fill up quickly. Furthermore for

[15] OECD (2009), *Economic Policy Reforms: Going for Growth, 2009*, OECD, Paris.

many journeys, switching to train is not a feasible alternative as many are multi-stop cross regional journeys between home-childcare-schools-work-sport-retail etc. Overall, as our cities get larger we need to lift the sophistication of debate - rail is not the sole answer for passenger transport infrastructure upgrades in large cities and we need to select the most appropriate mode to service the most pressing demand hotspots.

V. What is the optimal process for prioritising investments in infrastructure which provide the largest gains in productivity?

Infrastructure investments generally require a large capital outlay, and often take between three to 10 years to construct. But once commissioned they then deliver benefits for decades to come and when targeted towards Infrastructure Australia's six priority areas, can provide long lasting productivity benefits for the economy. This requires government infrastructure spending and economic growth plans to take a 10-20 plus year time horizon and to feature a disciplined commitment to delivering the projects which were selected based on robust and modally agnostic evaluation using economic CBA. Therefore a comprehensive analysis of each project is needed to ensure the most economically viable option is chosen. If projects are not prioritised so as to deliver those with the greatest net benefits, scarce capital will be inefficiently allocated and productivity growth could stall or turn negative. Spending programs should not only examine the benefits of each stand-alone project, but also how the project affects productivity in the economy as a whole.[16] The importance of a strong decision making framework is highlighted by a report from the Productivity Commission that estimated improving productivity and efficiency in energy, transport and infrastructure could increase GDP by almost 2 per cent as part of their National Reform Agenda work.[17]

Infrastructure Australia was established to improve how infrastructure investment decisions are undertaken, by the assessment of projects, and to have a coordinated, long term approach to national planning.[18] NSW has announced it will replicate this concept but at a state level with Infrastructure NSW. Infrastructure NSW will also be identifying where weaknesses and bottlenecks constrain productivity and using a comprehensive cost benefit analysis to identify the most productive project.

[16] Eslake, Saul (2010), Infrastructure Investment and Productivity

[17] Productivity Commission (2006), *Potential benefits of the National Reform Agenda*, Report to the Council of Australian Governments, Canberra.

[18] Australian Treasury (2009). 'Raising the Level of Productivity Growth in the Australian Economy', Submission to the House of Representatives Standing Committee on Economics, published in Round-Up, August, pp. 47-66.

An economic cost benefit analysis is used to assess the full range of economic, environmental and social impacts, both positive and negative, incorporated within a project from a national prospective. Measures of productivity within infrastructure can include: reduced travel time, reduced vehicle operating costs and less use of labour. The use of a cost benefit analysis allows for projects to be ranked by their 'benefit/cost ratio', and therefore offers a method of comparison. By selecting projects with the strongest 'benefit/cost ratio' (of which Infrastructure Australia prefers projects to be above 1.5), the infrastructure supported has greater potential to increase productivity. It is also vital that consistency is upheld within how cost benefits analyses are undertaken, particularly that the same discount rate and residual values are used throughout. This process is key to ending a marginal seat bias to selecting infrastructure projects which has unfortunately featured albeit less often in recent years, over many decades.

Whilst a robust cost benefit analysis is crucial, the projects which are selected need to be well planned and form part of a coherent integrated long term strategy. The former NSW Government has received much criticism over the last few years with regards to their inadequate submissions to Infrastructure Australia. Submissions prior to 2009 have reportedly not been adequately focused on inter-relationships between proposed projects or how the proposed projects fit into an integrated 20 year plan.[19] This has potentially cost Sydney commuters billions in funding for road and rail projects. Infrastructure Australia has rejected projects for the funding M4 and M5 due to inadequate planning details.[20]

VI. Potential labour market reforms and better approaches to regulation to deliver more efficient infrastructure

The creation of a Commonwealth Employment Participation Minister is a smart concept. For too long the Employment Minister focused mainly on cutting unemployment but when it is around 5 per cent (or near the natural rate of unemployment), the better opportunity is to entice re-participation by the one third of skilled people who have stepped back from the workforce and not actively looking.

The introduction of paid maternity leave should also provide a boost to population and encourage more workforce participation. The scheme encourages women to maintain their connection with the workforce. It has outcomes such as incentivising

[19] Smith, Alexandra (2009), 'Inadequate' submission puts NSW down the list, Sydney Morning Herald http://www.smh.com.au/news/national/inadequate-submission-puts-nsw-down-the-list/2009/02/05/1233423405333.html

[20] Saulwick et. al, (2011) Transport stuff-ups cost state billions, Sydney Morning Herald http://www.smh.com.au/news/national/inadequate-submission-puts-nsw-down-the-list/2009/02/05/1233423405333.html

resuming careers between children and the scheme will play a role in preparing Australia for the challenges of an ageing population.

Although a challenging subject, Gary Banks, Chair of the Productivity Commission emphasises the importance of examining industrial relations in Australia, suggesting that reforms 'that deserve some priority now are those that can reduce business costs and enhance the economy's supply-side responsiveness, while being fiscally parsimonious'. Banks goes on to say that regulations designed to promote fairness in the workforce must not detract from productivity, and that 'labour markets cannot remain a no-go area for evidence-based policy making'.[21]

Labour skills shortages have increased the cost of infrastructure projects and decreased the number of projects that Australia can deliver. In recent years Australia has addressed this issue by the use of immigration; in fact, Australia has one of the highest rates of immigration in the OECD. [22] However in the lead up to the 2010 election there has been a shift in community sentiment towards lower rates of immigration. It should be noted that extended durations of skills shortages can have significant negative effects on productive capacity and result in blowouts to infrastructure capital costs.[23] We need to continue a reasonable intake of people on 457 visas (or similar) to ensure adequate supply of a range of skill sets. This further highlights the importance of expanding education and training systems and/or liberalising the visa requirements for skilled workers. Of particular concern is the need to increase the number of students undertaking engineering and science degrees (of which Australia has relatively low levels) and addressing the skilled trade shortage.[24] Increasing employment in these areas will assist with the delivery of more infrastructure for the same budget.

Regulatory reforms are needed in the management of transport, as there are high levels of congestion in the large metropolitan areas. This results in lower productivity from: delays to deliveries, longer travel times reducing the working day, and additional costs for vehicle maintenance. The use of congestion charges, also known as 'peak period pricing' while politically difficult to sell without being branded as a big new tax, can result in a more efficient use of roads, as it applies an explicit cost to the user. This has been the case for the Sydney Harbour Bridge toll and tunnel, with pricing ranging from 25-37.5 per cent higher in peak hours, there has been a 3.1 per cent increase in off-peak traffic and a 3.5 per cent reduction in

[21] Banks, Gary (2010), 'Successful Reform: Past Lessons, Future Challenges', Address to the Annual Forecasting Conference of Australian Business Economists, Sydney, 8 December;
[22] OECD Economic Surveys – Australia, (2010), OECD, Paris, November.
[23] Budget Papers 2008
[24] Eslake, Saul (2011) Riding the Boom: How Will Australia Cope?,

peak traffic[25]. Although this may seem like revenue raising by the government, the purpose is to correct the market failures and the revenue raising argument falls away if all proceeds are transparently re-invested in full (or hypothecated) in improving public transport.[26] This approach could also be applied to truck pricing as a strategy to pursue the NSW Government's commitment to move more container freight from Port Botany by rail.

A clear and efficient regulatory framework is needed to allow the private sector to make investments effectively and in a timely manner. The importance of such a framework was highlighted by Jerry Hausman in 1997 who established that the technology for mobile phones was available in the 1970s, but was not made publicly available until 1983 due to a lengthy regulatory decision making process.[27] This undoubtedly cost society millions of dollars in lost productivity. However Australia has been moving in the wrong direction in the last decade, with 'productivity-stifling' legislation such as some national security measures and some new regulations relating to corporate governance.[28] The new NSW Government anti-red tape policy of 'one on, two off' for regulation, with matching of the regulatory burdens whereby the two regulations being deleted, offers hope to make life more productive for businesses and consumers.

It is also vital that the regulation of infrastructure is light handed and encourages asset sharing, where spare capacity exists, for a fair price and does not delay investment in capacity upgrades it is particularly important to ensure all out exports have good supply chain access to reach foreign markets. Regular reviews of regulatory regimes are important to meet this delicate balance of objectives.

The taxation system must also be assessed as it can provide support in Australia's strive for productivity growth. Taxing businesses and individuals particularly when done via a multitude of smaller state and federal taxes gives rise to dead weight efficiency loses that need to be minimised. The Henry Tax Review suggested that 'Australia should configure its tax and transfer architecture to promote stronger economic growth through participation and productivity'. The review indicated that by; reducing company income tax, improving the taxation of non-renewable resources and land, replacing a range of narrow product taxes with a broad-based cash flow tax, and improving the structure of other taxes aimed at improving social

[25] RTA Data
[26] OECD Economic Surveys – Australia, Volume 2010/21, OECD, Paris, November.
[27] Hausman, Jerry A (1997), 'Valuing the Effect of Regulation on New Services in Telecommunications', Brookings Papers on Economic Activity: Microeconomics, pp. 1-54.
[28] Grattan Institute (2011), Australia's Productivity Challenge

outcomes could lift output by two-three percentage points, or $25-40 billion in 2010-11 prices.[29]

Finally, without reverting to the notorious area of infrastructure bonds, some reforms to the tax system could boost private sector infrastructure investment incentives particularly around depreciation and deductibility of infrastructure related R&D.

Improving Australia's education and training systems has the ability to increase productivity across the whole economy. Reports from the Treasury show that, 'a more highly educated workforce is likely to be more productive and better able to adapt to changing circumstances', something which 'requires not only increasing the number of people with higher level qualifications but also ensuring that all Australians have strong foundation skills'.

To create a smarter workforce in the long term, we need to consider options such as phasing out the Year 10 school certificate to change views that ending school education at that juncture is a sound decision. Also due to the high correlation between performance at end of the very first year at school and in HSC we need to consider incentives of regulations to make at least one year of preschool before school (i.e. kindergarten) to lay the platform the norm or mandatory.

Most studies on improving education outcomes show that improving teacher quality by lifelong training and recognition of better skilled teachers is far more important to creating a smarter workforce than cutting class sizes from say 24 to 22 or providing schools with a second school hall. A study from the 'Journal of Economic Perspectives' shows that it is actually more beneficial to increase class sizes by 10 per cent, as the funds could then be used to train better teachers to boost their ability to engage and develop students.[30]

Additionally Ben Jensen of the Grattan Institute showed that improving teacher effectiveness by 10 per cent would boost real GDP growth by 0.2 per cent, resulting in a $90 billion increase by 2050.[31]

These statistics show the better way to obtain productivity and educational improvements is to invest in teacher quality or better training and performance pay rather than extra halls or classrooms.

[29] Henry, Ken (chair) (2009), Australia's Future Tax System – Report to the Treasurer, Commonwealth of Australia, Canberra, December.
[30] Peltzman, Sam (1997) *Class sizes and earnings*, Journal of economic perspective, 11(4): 225-226

[31] Jensen, Ben (2010), Investing in Our Teachers, Investing in Our Economy, Grattan Institute, Melbourne.

The new Commonwealth policies like providing employers with 5000 dollars to train workers over 50 years to reduce unemployment in this older demographic may have potential to be a smarter targeted way of boosting national labour output. Additionally, the Federal Opposition's proposals to expand the work for dole program could provide a boost to supply options for low skilled labour and ease cost pressures. We still need some smarter incentives to get workers to delay retirement and to create more jobs closer to home to reduce road and rail congestion to boost productivity.

In closing, I hope it is now somewhat clearer that boosting productivity is a national imperative to protect and enhance our quality of life and standard of living.

More investment into the six types of infrastructure identified by Infrastructure Australia can play a major role in boosting productivity. And finally reform of education, training, taxation and regulation can play a key role in delivering more infrastructure for the same constrained funding envelope.

Part Five

Productivity and the Ageing Population

Professor Henry Ergas
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Professor Ian Wronski
Pro-Vice Chancellor, James Cook University

Questions and Discussion were led by Senator Concetta Fierraventi-Wells

Also presenting: Jill Pretty, Associate Professor Hazel Bateman

Professor Henry Ergas
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Henry Ergas is a Columnist for The Australian, Professor of Infrastructure Economics, SMART Infrastructure Facility, University of Wollongong, and Senior Economics Adviser at Deloitte. He was a microeconomist at the OECD where he headed the Secretary-General's Task Force on Structural Adjustment. He has since served as visiting economic adviser to the Australian Trade Practices Commission and chaired the Australian Intellectual Property and Competition Review Committee in 1999. He is a member of the Menzies Research Centre's Academic Advisory Council.

I believe that it is nonsense to talk of population aging as a problem. Rather, its main and most enduring cause—the sustained rise in human life expectancy—is one of society's greatest achievements. But that is not to say it is without challenges, and I want to briefly deal with some of those. In doing so, I will first review the demographic trends, look at where those trends might go and finally turn to consider their economic implications.

Let me start at the beginning. For most of human history, birth rates and death rates were in the order of 5 per cent or more of the population per annum, and human life expectancy, even in early adulthood, was constant and relatively low. Moreover, body size was about 50 per cent lower than today, reducing resistance to disease and ensuring most of the population was ill much of the time, with a high incidence of degenerative conditions. In short, mortality and morbidity were both extremely high and life was truly "poor, nasty, brutish, and short".

Over the course of the last 300 years, that situation has changed dramatically. As improvements in agricultural productivity allowed the elimination of chronic malnutrition in the West, human body weight rose by over a third and human height increased by 15 to 20 centimetres. Greater body mass reduced vulnerability to disease while better nutrition increased human energy levels. The result was a wave of increases in human longevity that began in the mid to late 18th century.

It is impossible to do justice in a few minutes to the magnitude and significance of that transformation, which is commonly referred to as the demographic transition. But four points are worth noting.

First, initially, death rates declined far more rapidly than birth rates. The result was to increase family size relative to desired levels, which then led to an equilibrating fall in birth rates. This fall itself allowed further reductions in death rates, as it increased the spacing between births, diminishing mortality risks both for mother and child. As this process played itself out, birth rates declined until they came to be very close to, and in some advanced economies below, death rates. As a result, birth rates were about equal to death rates both before and after the demographic transition, but the difference in the rates at which they fell during the transition caused an unprecedented, and likely never to be repeated, surge in world population.

Second, the initial increase in longevity was largely due to reductions in infant mortality, and this remained the case for much of the 19th and early 20th centuries. Indeed, even taking a period as late as that from 1921 to 1971, nearly 60 per cent of the substantial increase in Australian male life expectancy that occurred over those years was due to reductions in death rates under the age of 5. In contrast, beginning in the late 1970s, the developed economies, including Australia, witnessed a process in which death at ages below 30 virtually disappeared, with much of the rise in life expectancy coming from reduced mortality at higher ages.

Third, initial increases in life expectancy were significantly greater for women than for men, reflecting factors that include the reduction and then virtual elimination of death in childbirth and the lower female loss of life from violence, workplace accidents and work-related diseases. The result was the development of a serious problem of old-age poverty and isolation, as expected years of widowhood increased as rapidly as longevity.

In the advanced economies, however, that trend to a widening gap in gender life expectancy reversed in the early 1980s, implying, among other things, that expected years of widowhood for members of couples have declined both absolutely and relative to expected years of life in old age.

Fourth, while the gender gap in longevity has diminished, differences in longevity associated with socio-economic status have, on balance, increased in most of the advanced economies. In Australia, while life expectancy has increased dramatically for both manual and non-manual workers, the gains for non-manual workers have exceeded those for manual workers. Indeed, for each of the main causes of death, mortality rates are now higher for manual than non-manual workers, which previously was not the case.

Given those four aspects of the demographic transformation, what of the future? I want to say a few words about birth rates, death rates and longevity.

On birth rates, perhaps the simplest point is that both total fertility rates and the distribution of fertility over time are not easy to predict, at least for economists. We do not have a good predictive model of desired family size, nor do I think we really fully understand the behavioural determinants of birth timing. The result is that we are not well-placed to do much more than projections, i.e. to assume some range of variation around current behaviour and that is what most of the models do.

Death rates and longevity, however, are far better understood, if nothing else than because they are less directly dependent on human choice than say, the timing and number of births. Here four points can be made.

First, there must be a very high likelihood that death rates will continue to decline at high ages. For Australia, over the period from 1971 to 2002, we have seen a 50 per cent decrease in the probability of death for every age from 42 to 77 years for both genders. A continuation of this trend obviously implies a high death rate at some very old age, but quite what that very old age is, is controversial. That said, the oldest recorded age at death has risen in every decade since 1900.

This leads to my second point which is that diminishing death rates at higher ages will lead to further increases in life expectancy. The extent of that rise, and for low long life expectancy can continue rising, is however, extremely controversial. What is clear is that globally, maximum national life expectancy has been increasing along a straight line. But excluding only a few observations significantly affects the pattern, and suggests a slight slowing in the rate of increase in the period from 1960 on.

That said, there are many uncertainties, associated with factors such as the rate of progress in molecular medicine. But what does seem clear is that if there are physical limits to human life expectancy, as one assumes there are, they are still some way off.

As far as Australia is concerned, the rate of increase in life expectancy in recent years has been strikingly rapid. Over the period from 1983 to 2007, male life expectancy increased by about 3 months every year to reach 78.7 years, while female life expectancy increased by over 2 months a year to 83.5 years. Moreover, while life expectancy rose for all ages during that period, the greatest increase in life expectancy has occurred for the elderly. For example, male life expectancy at age 80 went up by 31 per cent to 8.22 years, while male life expectancy at birth only increased by 9.2 per cent.

Projections by the Productivity Commission provide age and sex-specific mortality rates from 2007 to 2050 under three survival scenarios – low, medium and high. Under all three scenarios, mortality rates are assumed to decline in the future, implying higher life expectancies. Under the medium mortality scenario, life-expectancy at birth is projected to increase to 88.2 for males and to 90.8 years for females by 2053. The high survival scenario (i.e. the scenario with the lowest mortality rates) generates a life expectancy at birth of 93.8 years for males and 95.8 years for females in 2053. These life expectancies imply a more than doubling of the duration of human life compared to Australian levels in the 1850s.

Third, while life expectancy will continue to rise, much less can be said with any confidence about whether mortality will be dispersed or compressed. Broadly, a population life expectancy of (say) 80 requires that some 56 to 57 per cent of the population live to be older than 80, so as to compensate for mortality in the 30 to 80 age bracket. However, the distribution of individual death rates consistent with a given life expectancy can be more or less wide and more or less skewed. There are some compelling reasons to expect the dispersion to narrow, for instance as durations of life hit a biological wall; but there is not yet compelling evidence that such a decline in dispersion is occurring to anywhere near the extent the best known model of mortality compression, which predicts the spread in mortality shrinking to a normal distribution with a small variance around the modal age at death. As a result, individual longevity risk seems likely to remain high and could even increase.

Fourth, the mechanical effect of low birth rates and rising life expectancy is an aging population. This is especially pronounced in countries such as Australia where there was a post-war baby boom, as the legacy of that boom is a very large cohort that will arrive to age 70 beginning around 2017-2020. Thus, the Productivity Commission's projections of the Australian population have the share of people aged 65 and over rising from about 15 per cent in 2007 to 30 per cent in 2050, with the share aged 85 and over rising from 1.6 per cent to somewhere between 5.5 and 6.5 per cent.

It is this last fact that naturally excites the most attention, as it implies a marked increase in the dependency ratio, i.e. in the ratio of the number of people not of working age to the number who are of working age. For instance, in the Productivity Commission's low population scenario, the aged dependency ratio (the ratio of those 65 and over to those aged 15 to 64) rises from around 22 per cent in 2007 to over 41 per cent in 2050.

In considering the effects of this, it is useful to note that in many countries, overall dependency ratios will not be much higher in the coming decades than they were a century or more ago. But there are two differences. First, a century ago, the bulk of the dependents were children, not the elderly; second and even more important, our expectations of consumption as dependents (i.e. the public and private resources we expect to consume in old age compared to those we expect to consume during working life) are far greater than they were in the past.

The consequent concern, highlighted in the data presented in the latest Intergenerational Report is that the growth in the number of older people will place rising demands (notably in the form of expenditure on health care, aged care and public pensions) on society's resources, both absolutely and relative to total output. If current policies remain in place, meeting those demands could require sharply increased taxes on the working population, not merely in absolute terms but as a share of incomes. Those higher tax rates would reduce savings which, in turn, would lower capital accumulation and hence productivity, and ultimately reduce living standards when compared to some counterfactual evolution of the population.

In assessing this scenario, it is useful to distinguish three elements: the certain, the uncertain and the analytically complex.

The certainty is that at some point older people leave the labour force but continue to consume. To do so, they must have claims on output at that time. Some part of those claims will take the form of goods purchased during working life that continue to provide services into older age: housing is the most important example. But the largest share of those claims will be in financial form, some privately accumulated (such as superannuation savings and other assets) and others involving entitlements to public spending.

It follows that if an increase in life expectancy translates into a rise in the number of years spent out of the labour force, and if consumption by those who are out of the life force is to remain roughly in line with levels of consumption during working life, then there must be an increase in the quantum of claims owned by those out of the labour force on the output of those who are in the labour force.

Even assuming those 'ifs', what remains uncertain is how great that rise needs to be. This is for example the case for health care, where levels of expenditure depend on health status, health technologies, health unit costs and population access to health care.

Thus, some analysts believe we are experiencing a compression of morbidity, in which the incidence, severity and duration of illness will rise much less rapidly than life expectancy, or perhaps even fall. Others, however, stress that ageing will continue to bring with it molecular and cellular pathogenesis that degrades the functional integrity and homeostasis of the body. These normal processes of pathogenesis, along with the rising population incidence of neurodegenerative diseases and of chronic conditions such as obesity, will translate into a requirement for substantial and ongoing medical services, as well as for aged care. As the cost of these will continue to rise relative to the cost of other goods and services, expenditure will increase even more rapidly than the growth in the volume of care.

Both views have significant elements of truth; what is uncertain is the balance between them. But even if expenditures on care and other services did rise substantially, the economic consequences are still far from obvious—which brings me to the analytically complex.

Underlying this complexity is the fact that to at least some extent, individuals anticipate the need to finance consumption during retirement, and hence, faced with an increase in life expectancy, will invest more in human capital, work for longer and increase their savings. The greater the degree to which they do so, the less of a problem is population aging, since its effects are offset as the rise in savings permits an increase in society's capital stock, lifting productivity and increasing wages and hence labour supply, all leading to greater output.

In other words, in the absence of market distortions, outcomes would to at least some extent adjust to population aging through offsetting increases in total work hours, savings and human and physical capital accumulation.

In practice, however, individuals' incentives to increase work effort and savings are significantly affected by the degree to which they can rely on public pensions and on public services. For many reasons, it is eminently desirable for society to ensure a dignified old age to all older Australians. But it needs to be recognised that the price we pay for this is that individuals, left to their own devices, may not work as long and save as much as would be socially desirable.

Thus, although there has been a marked increase in the labour force participation of older people, it remains the case that individual's human capital appears to depreciate relatively quickly as they age, driving post-tax market earnings below the point where they are attractive compared to the pension. The recent increase in the ratio of the pension to average weekly earnings, though doubtless justified, underscores this issue.

There is, to that extent, a difficult trade-off between ensuring a socially desirable level of income support in retirement and encouraging those choices to work and save that will facilitate adjustment to demographic change.

We have sought to deal with this in Australia mainly by a mix of compulsion and tax incentives for retirement savings. This strategy has many merits but it is far from clear that it offers the complete answer. It will take many years before private retirement savings reduce the share of full or part pensioners in the older population. Moreover, the defined contribution nature of our superannuation schemes exposes individual to a high degree of individual longevity risk, only partly alleviated by the aged pension. And those savings do not cover, and are not intended to cover, a very substantial share of health and aged care costs, which are currently paid for out of taxes.

It is, in my view, important to begin a serious consideration of these issues. It is an obvious consequence of our demographic evolution that both the age and the remaining life expectancy of the median voter are rising. Indeed, last year marked the first time since the qualification age for voting was reduced forty years ago that the age of the median voter returned to its levels at the time of federation. The risk is that the electoral weight of older voters will translate into policies that impose disproportionate burdens on the working age population, reducing productivity and incomes.

Avoiding this outcome requires an integrated consideration of at least three elements:

- First, how to remove or at least reduce artificial disincentives for labour force participation of older workers, including those associated with the taxation of labour income, recognising that achieving a longer working life is not an end in itself: rather, the goal is to minimise the economic cost of distortions to lifetime decisions about working and saving;

- Second, how to place retirement savings, including not only superannuation but also the aged pension, on a financially sustainable basis, including in terms of being able to respond to demographic uncertainties, without exposing older Australians to undue levels of financial risk; and

- Third, how to ensure the adequate and efficient long term financing of health and aged care.

None of this is to suggest the sky is about to cave in. The demographic transition that began 250 or more years ago was an immense economic boon, not a curse; equally, our economy has the flexibility to benefit from an aging population. But that will require some adaptation in a broad range of institutions. Demographic trends play themselves out over extended periods of time. That gives us the luxury of being forewarned; up to us to show that we can be forearmed.

Professor Ian Wronski, Pro-Vice Chancellor, James Cook University

Professor Ian Wronski has been Pro-Vice Chancellor and Executive Dean of Faculty of Medicine, Health and Molecular Sciences at James Cook University, Townsville since 1997. He has been Chair of the Australian Council of Pro-Vice Chancellors and Deans of Health Sciences since 2005. He was previously Head of the School of Public Health and Tropical Medicine, James Cook University. He was President of the Australian College of Rural and Remote Medicine (2000-2003). He was the Foundation Health Services Director of the Kimberley Aboriginal Medical services Council in 1991. He has 25 years' experience as a clinician and health service planner.

(NB – The slides referred to in this presentation were not available for publication. The issues under discussion are however, easily understood).

Thank you for this opportunity. It's always great to come here. I really liked the choice of wine last time.

This is around ageing health and productivity, so I have a short presentation about that.

Firstly, the first slide shows the population structure in Australia from 1945-2045, in that 100 years. This comes from the Australian Institute of Health and Welfare from 2010. The structure itself, to people who are connoisseurs of this, says lots of things. What's usually termed a "beehive" structure from 1945 shows that there's a bulge in younger age groups. You can see that over 100 years in 2045, it becomes a pyramid - not the beehive, the pyramid - the population pyramid becomes much more like a beehive without the large base. And Australia's life expectancy has risen to about 84 for females and about 79 for males - which is amongst the world's highest. Death rates have been falling for many major health problems - cancers, cardiovascular disease, obstructive pulmonary disease, asthma and injuries.

So the population pyramids were named because, just at the shape and they mean things to people who are interested in demography and epidemiology.

There are some important things about it. The top of the pyramid fills out as society ages and the bottom tails in as birth rates decline.

Now, currently that's true in nearly all societies, even developing countries so, naturally, the issues are somewhat different for developing countries. What's often said behind the scenes is, "Will developing countries become wealthy before they get old", or "old before they get wealthy?" That is deeply important for how societies are evolving economically, globally. The point being that societies who get old before they get wealthy will be struggling to provide the materials required for an aged population.

Overall, the graph highlights the key issues around tax bases, services and productivity all in one snapshot.

The second slide is somewhat tongue-in-cheek, but the point of this slide is that ageing does have an impact. So this slide looks at marathon records for men as they age. So, as you can see, it's almost a linear decline from about 30-70 years of age. So, reduction of vitality seems real. As a well-known molecular biologist I knew told me that your cells' power plant, the minor chondria, becomes 1 per cent less efficient every year after about 40, which is why many of us go to the gym to try to generate new cells and make up for it.

But what we also see is decreasing senescence, the process of deterioration with age and infirmity in old age. There are a lot more active 60 and 70-year-olds than previously. And my guess is soon they will be 80 and 90-year-olds.

So, the next slide is looking at the issue of ageing health and productivity. It isn't news that the pressure on health services is increasing. People are living longer, surviving and being productive, and many of them are doing so with multiple conditions, or what is known as comorbidities. This requires a more complex health workforce, and it isn't enough to have first-rate diagnostic services based on medical practitioners and treatment regimes that are basically "set and forget", to borrow a phrase from the investment industry.

Paraphrasing a work colleague of mine, if you lose your arm and you want to stay productive, replacing your arm with a hook is no longer a viable alternative for a developed society.

So, just when analysts were getting comfortable with the notion of chronic disease; namely, diabetes, cardiovascular disease and hypertension, et cetera - the whole nature of disease processes in modern societies seem to be evolving. Infectious disease has made a spectacular comeback. HIV in the 1980s started it. Since then, we have seen the re-emergence of old and new infectious organisms - to be fair - partly due to molecular biology's capacity to detect them, but including the resurgence of tropical infectious diseases, say, in northern Australia, such as dengue, tuberculosis, et cetera.

So, this resurgence in outbreaks and the organisational structures around them has largely fallen into disrepair in Australia and in most other developed countries in the last 40 years. Our lack of capacity to deal with the re-emergence of infectious disease - tropical infectious disease in this instance - has the capacity to severely impact on resources and the productivity of the entire system.

What is more, the general population recognised, after the Second World War, that access to health care made a difference. Before then, it wasn't absolutely clear how much that was the case, so all developed countries pretty much developed insurance systems that provided access to health care, whether it was the United Kingdom's National Health System, the Earle Page Scheme in Australia in the 1950s, or the Kaiser Permanente employment-backed schemes of the United States.

The next slide looks at the burden of disease. This slide, again from the Institute Of Health and Welfare from 2006, is a league table of the major category of conditions, and includes both the impact of death - such as years of life lost; which is the dark blue - and years of life disabled, which is the light blue. Together, this is known as DALYS, or Disability Adjusted Life Years, or burden of disease is another way of talking about it.

The top half pretty much line up with the national health priority areas - cancers, cardiovascular disease and mental disorders; neurological and sense disorders. But what's worth noting is how important mental health, neurological disorders and injuries, chronic respiratory and musculo-conditions have become, largely because of the impact and disability in adjusted life years. And, quite rightly so, given the impact that they have on a nation in an individual's productivity because, increasingly, in developed societies, certainly, and many others, the capacity to work while you are somewhat disabled is already a critical issue and will become more so. So the coming of age of disease burden rather than just deaths has a significant resource allocation implication, particularly considering research demonstrating that early intervention in some mental health conditions significantly changes the outcomes.

So, overall, we're learning about how to intervene earlier in many of these areas and what the consequence for wellness is, and that will affect policy.

The next slide looks at the percentage of disease burden attributed to selected determinants of health. Down the left you can see behaviours and things people do that have a substantial impact on health. So, you are probably familiar with this type of list. It analyses the percentage of disease burden that can be attributed mostly to social and behavioural origins of illness.

It does demonstrate the massive impact of health-related behaviours on health status and, therefore, important considerations for health and social policy.

The top few are being overweight, smoking, high blood pressure, physical inactivity, high blood cholesterol.

It's not that the impact of behaviour on health is new; much of the social and health gained in the past related to housing policy, sewerage, behaviours associated with disposal of refuse. I guess older people might remember the campaigns in the 1920s and 1930s about the L1 *One-a-Day Girl* campaign, meaning to go change your underpants daily. I mean, there were social campaigns around that that were necessary then.

So, health behaviours were codified in the Old Testament. There are prayers around washing of hands, for instance; avoidance of certain foods.

So, there are important challenges relating to the skilful use of policy and social marketing relating to current behaviours as well.

The next slide looks at a change in obesity. This is about the share of obese Australians as a percentage. The left slide is for men; the right side is for women. It looks at across the ages the percentage of adults who were obese between 1995 and 2005. So, you can see from both men and women the growth of obesity in Australia has been unequivocal. I mean, it's obvious, and it has its inevitable consequences.

In many ways, my guess is in social policy obesity will be the new smoking in terms of how we approach this. It's a hard thing for people who do policy to come to terms with – and, in many ways, so was smoking back in the 1950s and 1960s, but we will have to have approaches to obesity that use all the mechanisms of government available, as well as social marketing.

The next slide is around ageing health and productivity. What is really important is that - it tended to be neglected in the 1970s - is that there is an obvious increasing impact by molecular and technology. So, the impact of medical sciences has been extremely significant in the last 30 years; but considerable since the Second World War, and the pace is increasing.

So, this is really different to the pre-Second World War years, where most of the gains related to public health interventions. They were really around housing and growing wealth. The manipulations of the human genome and understanding about how environment and family conditions and birth-related activities relate to how the human genome - or what is now called the epigenome - is impacted on or will be one of the major improvements in understanding and how it will have dramatic impact on how we do health policy.

The next slide looks at cancer survival, really, just to make this point, between 1982 and 2004. This comes from banks, health costs and policy in ageing Australia from the Productivity Commission in 2008. It just looks at cancer survival, which has been increasing dramatically in the last 25 years, and continues to do so.

You could have similar graphs for heart attacks, cardiovascular disease, respiratory disease, and they would all look similar to this.

The next slide is about life and disability-free life expectancy. This comes from a strategic review of health and equalities in England post-2010 by a famous person called Marmot. This is data from the strategic review of health and equalities that was published - it says last year, so I think it's published in 2010 - probably 2011. It must have been 2011.

The vertical axis is age. The horizontal axis is neighbourhood wealth. So what Marmot and his team did was look at distribution of neighbourhood wealth across shires, across England.

Now, the curves showing life expectancy at birth is the top curve. The bottom curve is disability-free life expectancy.

So, I doubt that Australia is much different. But it's quite a nice way of looking at the area between those two curves; because the area between the top and bottom curves more or less reflect the potential for increasing productivity due to ill-health. That's the first time I've really seen a slide with this sort of data in it. Really, it's a measure of the disease over the years of life lost due to disability.

So, from the policy perspective, it gives us an indicator, or a proxy variable for potentially what could be increasing productivity from addressing some of the disability issues.

What is also interesting is that it shows that the strategy to decrease the impact of disability needs to target all sections of society, not only the poorest. So, neighbourhood income deprivation is most obvious in the poorer neighbourhoods.

But both life expectancy and disability adjusted life-years is lower there. But, as you move to the higher income areas or the top half of the curve, the gap between life expectancy and disability-free life here is also very substantial.

So, from a policy perspective, and an increasing productivity perspective, a strategy that targets society overall is actually going to be really important.

That's probably a little bit different from our traditional ways of looking at these things. So, naturally, in an intuitively equity basis society like Australia and how we, in policy terms, deal with this in a proportionate way - and what some writers have called proportionate universalism - is going to be very difficult at the policy level, because there are moral and ethical reasons for targeting the most deprived at the same time. So, how we balance those things out will be pretty important.

The next slide deals with health costs that apparently rise with age. But I do have to say that the interpretation is disputed. Again, this comes from the Productivity Commission's report in 2008. So, there are cross-sectional studies that show that health costs rise with age. And cross-sectional studies really mean that they are studies taken at a point in time looking at the proportion of people who do things. But the study design isn't the most suitable. We really need a cohort study to show that this is really what happens with a given population and it's not just axis shift; its people living longer. I think that is going to be really important, and very important in understanding what the real health costs are.

Now, these are costs, not gains and, naturally, this is one side of the equation. Increasing productivity is the other side of the equation. So, how we deal with this is going to be important.

For instance, some commentators have said that throughout history whatever the last 10 or 20 years of life that people have lived, regardless of the age, have always been the most expensive. If we live longer, that curve will move - there will be axis shift there to. So, we're always going to be spending a lot of the money on the last 10 or 20 years of life, even if we live to 120. So, that's important.

In the "So what?" area, I guess, health policy around promotion and prevention is going to be important. So, along with the gains in bio-medicine, the targeting of upstream determinants of ill-health will have to be a major focus of activity. Currently, this accounts for just 2 per cent of expenditure on health.

The war on the metabolic syndrome – that's diabetes, hypertension, cardiovascular disease, et cetera, and obesity - will need to be huge. Obesity will become the new smoking. There may need to be some areas of policy dealt with in a similar way to seat belt legislation is my speculation.

Clusters of medical disorders that increase one's risk of cardiovascular disease, such as stroke and diabetes, will need to be thought of as a group. These days, they come under various names, such as metabolic syndrome. They used to be called syndrome X. There was a while there they were called insulin resistance. But I think these days they are commonly thought of increasingly as vascular inflammation. But there are a cluster of conditions that we will have to deal with as a group.

The next slide is on rising costs. So, my guess is that rising costs in the aged years are mostly real and not just axis shift. We will need to have a much more systematic way of dealing with them. There is much to be gained from reorganisation, integration of the nation's various health systems. Some of the current government's broad policy directions are the correct ones, in my view. However, the reality is the implementation of policy has often been remarkably poor.

Our clinical training systems will need integration across jurisdictions, including the private for-profit and the non-government organisation sectors. Implementation here has also been woeful. There are forces that have been released that will change the nature of our clinical training systems forever, including the critical university teaching health system relationships. There seems to be little insight into this in my view.

It may be that fund holding at a local level will also needs to be a policy option.

The next slide is education, training, research and workforce. I have already talked about the first two dot points, and age-related disincentives are a major barrier to workforce participation. It won't be possible to provide a health workforce that makes up around 20 per cent of the total workforce, which is the OECD prediction, without ongoing participation of older professionals - who, more often than not, want to stay in the workforce. Our current systems increasingly seem to be disincentives for that.

The next "So what?" is health security and bio-security. So, finally, disease patterns in all societies continue to evolve. Comorbidity - that means multiple illnesses all at the same time between infectious disease and chronic disease, such as diabetes - were well known 60 years ago, but we've forgotten the relationship between TB and diabetes, for instance.

Since I gave this talk actually, there's a lot more data around how TB and diabetes are emerging together in many places in the world. So, we're in a period where we are seeing the re-emergence of infectious disease, not only internationally travelling flu viruses, but also dengue fever and TB in tropical Australia. International travel and wetter tropical areas are enabling vectors and viruses to spread and re-establish. These could have a profound impact on the health of the nation. Outbreaks and shocks seem to becoming a greater feature of the health care landscape, and these events will test the limits of any system.

Part Six

Productivity and Federalism

Professor Kenneth Wiltshire AO
J D Story Professor of Public Administration, University of Queensland

Dr Dan Norton
Chairman of Tasmanian Ports Corporation Pty Ltd and Menzies Research Institute Tasmania

Professor Peter Shergold AC
Chancellor, University of Western Sydney

Questions and Discussion led by Senator Marise Payne

Hon Tony Abbott, MHR and Hon Andrew Robb AO, MP concluded the Roundtable

Professor Kenneth Wiltshire AO, J D Story Professor of Public Administration, University of Queensland

Making Federalism More Productive

Professor Kenneth Wiltshire AO is the J.D. Story Professor of Public Administration at The University of Queensland Business School. He served as a Commissioner on the Commonwealth Grants Commission for nine years, was a founding board member of the Constitutional Centenary Foundation, and consultant for the New Federalism (1989-1994). He also was consultant to the Australian Advisory Council on Intergovernmental Relations Inquiry into Metropolitan Governance, and a member of the Council for the ANU Centre for Federal Financial Relations. He served as Special Adviser to the Australian National Training Authority for three years. He is a National Fellow of the Institute of Public Administration Australia, is a Trustee for the Committee for Economic Development of Australia and a member of the CEDA Research Advisory Council, Board member of The Smith Family.

I. Introduction

I would love this presentation to be about the contribution of Australia's federalism to productivity. Unfortunately the presentation would be too short, so I will consider the impact of federalism on productivity, and how the federal system could contribute better to productivity instead.

The word "federalism" comes from an ancient word "federal" which most likely has its origins as a Jewish word meaning a covenant or a compact. The concept of a federal system is indeed one where a group of communities enter into a compact or a covenant. I think this is very, very important, because the idea of a contract between regions to form a nation lies at the heart of this whole exercise, and perhaps we have lost sight of that.

The most distinguishing feature of a federal system that makes it totally different from a unitary system is the concept of divided sovereignty. In a federal system, sovereignty is actually divided between the national government and the sub-national governments. In a unitary system, you may well have regions, but you don't have that divided sovereignty between two levels of government, if you would like to put it that way. And the uniqueness, of course, of federalism, including Australian federalism, is that it creates unity in diversity.

Most federal countries in the world are very large countries, and people in large countries take on board federalism not because they want to, but because the country is too large to be governed from one point, and because they also want to preserve the regional identities of the places where they live. This was true in Australia's case, even though here we had a small population in a large country.

Australia is less "culturally dense" (as I like to put it) than other federations, where you have many cultures in one country, as in, say, Switzerland, and federalism is a very good way not only to create a nation, but also to preserve the cultural identity of people in the different regions. Quebec in Canada is much the same. I think that this is worth remembering as we examine Australia's federal system.

II. Changing Powers

The founders of Australia designed the Australian federal system largely modelled on the American federal system particularly with regard to the way the powers are divided. There is also however, a little dollop of Swiss cream, namely the referendum provision provided for in section 128 of the Constitution.

The American founders had studied ancient history, ancient regimes, as well as modern regimes; they really did spend a lot of time thinking about the principles and the philosophy behind what they were doing. They came to the conclusion that the reason most empires and nations had fallen was because power was too concentrated. The Americans decided that the one thing you wanted in a democracy was fragmented power. And so, in the American Constitution, power is fragmented in two ways: it's fragmented horizontally by the separation of powers, and it's fragmented vertically between the Federal government and the state governments, and to some extent the city and local governments. The American founders' desire to fragment power to such an extent ensured that no one place in the political system would become dominant and overly powerful. This gives rise to a lot of headaches such as the current battle over the budget, but checks and balances like this are undoubtedly healthy for a democracy.

Reading the Australian Constitution would lead one to the conclusion that the state governments are all-powerful. This is also true of the American Constitution. On the face of it, the founders tried to design a system where the states would run the whole nation. The federal government would remain very small. The key ingredient to that is the division of powers and the boundaries put around federal powers. There was also hope that the senate would be the states' house, and that it would end up acting as a watchdog over the federal government.

Things have obviously changed. Australia has become an incredibly centralised nation. In fact, you could almost argue that Australia is no longer a federal system. The Federal government is so dominant in the political system now that some people would question the sovereignty of the states.

Our Constitution can only be changed through referendums. Three of the eight that have been passed have shifted power to the Federal government. In 1927 on loans and borrowing; in 1946 on social security powers; and in 1967 on indigenous powers.

From time to time both state and federal governments have done things that are actually unconstitutional, which have not been challenged. This is not a very litigious area generally. High Court interpretations are however, very significant within our system. If you look at the whole history of our federation, the High Court, on balance, has produced decisions that have significantly centralised and given more and more power to the federal government. Sometimes this was due to the political bias of the judges. Sometimes however, the court has simply acknowledged that Australia had become a nation. When we were founded, we were six nations, or six identities. The court has also simply responded to the fact of globalisation. The main impact of globalisation, of course, is that it creates a kind of centrifugal force so that the federal government has to speak on behalf of the nation.

High Court decisions which have centralised power have covered a range of areas including tax in particular. But the most important area is federal finance. Australia is now the most centralised fiscal federal system in the world. The vertical financial imbalance is higher than any other federal system. The federal government collects more than three-quarters of all the taxes in Australia's. The states are dependent for more than half the revenue on federal government transfers and half of those transfers have conditions attached.

Executive federalism has become a big feature in the last 10-15 years. Australia is now the most centralised fiscal federal system in the world, and federal finance is crucial to the states. The centralisation trend took off heavily with Premiers' conferences. (Premiers' conferences began as Premiers' conferences with the

Commonwealth as an observer only).The Premiers' conference has now morphed into COAG, but nothing like COAG is mentioned in the Constitution. COAG has done some very good work on productivity but has also become an incredibly bogged down, as reflected in the fact that there are over 350 intergovernmental agreements in Australia which cover 40-45 per cent of the whole of the public sector; the main problem, of course, is it gets things done, but at the price of accountability because, as a result of all of these intergovernmental agreements, the average Australian citizen does not really know who's accountable and who's responsible for specific things. We see this where there is duplication between the Commonwealth and states, like in health and education.

The other big trend of centralism is the political parties. As someone who believes in some state sovereignty, I'm incredibly disappointed at the Liberal Party's centralist position under Howard. As a result, I no longer think any party is that believes strongly in real state sovereignty.

III. Questions Relating to the Future of Australian Federalism

The one question that always comes up in debate is do we need to be a federal country, or should we become a regional country? Should we create regions? I believe that if we want a region like system we need to create more states, although people often dismiss this idea because of the horror notion of there being 20 premiers around a table. Constitutionally it's much easier to create a new state than it is to abolish old states. I believe that the Northern Territory, New England, Far North Queensland, North West Australia, and possibly North and South Tasmania could become new states. I believe that this could occur with minimal fuss.

The second fundamental question often asked relates to whether states should be policy partners, or simply service deliverers. This also needs to be resolved. The division of powers in Australia is complex in its mix, with a lot of interaction between areas of federal and state responsibility. An example is the way in which federal immigration policy can affect housing needs, a state responsibility. One way to simplify matters could be through the subsidiarity principle in use in the European Union, whereby powers are devolved to the lowest possible level of government for the actual administration of policy although this is unlikely to be adopted here in the near future.

IV. Increasing Productivity in the Australian Federal System

The first thing that needs to be addressed to increase productivity in the federal system is overlap and duplication. The German Constitution in particular provides an impressive model in this regard. Rather than trying to neatly divide areas of responsibility, the Germans recognised that multiple levels of government would address the same policy area, and instead sought to define what the role of each level of government would be in the design and implementation of public policy within these areas.

Vertical financial imbalance is at the heart of many problems in the Australian system. As long as the Federal government holds all of the strings and finances in our system, we will not get anywhere. I thought the Fraser government was on the right track with tax sharing. To preserve the unity of the tax system, I believe it is necessary to allow states to set their own levels of taxes. This will create competition, a benefit for productivity. Of course, it would be necessary to ensure that multiple systems did not create far greater complexity.

In terms of executive federalism, I would like to see the senate go back to its role as the states' house to some degree, in particular by scrutinising some of the inter-state agreements. I think that this would force productivity in cooperation to a greater extent than currently occurs. I would also like to see the senate examine treaties, particularly as they affect federal-state relations.

I would also like to see more of a focus on how local government can contribute to the smooth administration and delivery of policy outcomes together with the other levels of government. Local government was the first form of government in most places in the world, and is in my opinion a level of government that is under-utilised at present. I think we should remember that it is to local government that we turn when we want urgent capital infrastructure fast. I would like to see local government formally recognised through a referendum in Australia, after serious consideration about the proper role that it should play, where it fits into the system, and how it can contribute to productivity arrangements.

Deregulation is always important in promoting productivity. Why then, not deregulate the States? Why are they so heavily controlled? Wouldn't we get a healthier system and a competitive system going if we allowed the States to be more deregulated? I believe that amongst the benefits we would receive would be lower taxes bought about by free choice between states, and true competition for investment and human resources. Of course, this would require information to be freely available regarding state performance.

Finally, I think that skills are crucial to promoting productivity in federalism. The national curriculum is an absolute mishmash, and states will soon be able to opt out of some elements of it. I believe that this must be stopped. I also believe that the government should consult with the Australian people regarding the curriculum, which must be based on promoting enterprise and giving students the skills that business needs. If you are ever in need of inspiration, turn to the Australian people; they won't let you down.

Dr Dan Norton, Chairman of Tasmanian Ports Corporation Pty Ltd and Menzies Research Institute Tasmania

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I. The Issue

I've been asked to briefly comment on ways to get around the inbuilt inefficiencies of the federal system, specifically in relation to productivity. My approach is not to argue for radical change to federalism – this is unlikely even in the medium term unless there is a national crisis. Rather I want to suggest several practical ways that the operation of this imperfect system might be improved. I acknowledge that in Australia, as well as internationally, it is very evident that reducing the relative size of the government sector is a key priority, and should increase national productivity. However, I don't propose pursuing this further here as it is outside my remit. In the context of federalism, I intend to argue that improving productivity requires a greater focus on public sector activities that promote:

- competition
- innovation and entrepreneurship
- smarter investment, and
- accountability.

But first a few words on centralism and subsidiarity.

II. Centralism and Subsidiarity

Centralism is a very strong force. In recent times it has been supported by both major parties when in government nationally, as well as by leaders in the business community. In this context it is pertinent to remember the importance of one of the underpinning principles of our federal system; subsidiarity, or the idea that:

> a central authority should have a subsidiary function, performing only those tasks which can't be performed effectively at a more immediate or local level.

The reasons for applying the subsidiarity principle are multifaceted. A prime reason is that it best aligns local activity with local interests. It also limits central power and mitigates the impact of bad government. We should also recognize subsidiarity as a mechanism to drive improved productivity, especially in public sector service delivery. It has strong links to both competition and the notion of local experimentation and innovation, as opposed to conformity to one approach, which is a consequence of centralism.

However, it must be acknowledged that serious tensions arise when a structure based on subsidiarity faces changed circumstances that increase the effectiveness of a central approach. The most obvious example is the national nature of much economic and social activity today, which means greater national regulatory coordination and consistency is required than was necessary at the time of federation. Gaining agreement on where the balance should lie as circumstances change is a major challenge in a federal system. COAG provides a mechanism for trying to resolve such matters.

Ken Wiltshire has addressed the COAG process and I don't intend commenting further, other than to say that it is important to ensure that achieving national co-ordination and consistency doesn't inadvertently limit competition or hinder innovation and entrepreneurship by mandating a lowest common denominator approach. Importantly, the pursuit of regulatory consistency does not necessarily require either a Commonwealth takeover or the adoption of uniformity.

III. Competition

A defining feature of competition is that efficiency and effectiveness generally should win out. Exploiting competitive federalism in the area of public sector service provision should increase productivity.

Competitive federalism acknowledges that no-one has a monopoly on the best approach in all situations. Better outcomes result from the greater policy innovation and experimentation that flow from competition between governments in a federation. Very importantly, it rewards success and penalises failure! It is important that horizontal fiscal equalisation doesn't interfere with this! Less Commonwealth intervention in state service delivery areas should facilitate more competition in establishing better approaches. This probably requires initiatives to address vertical fiscal imbalance, which I'll briefly return to later.

However, there are broader possibilities. The Howard Government pursued competitive private sector service delivery in a number of areas. There is great scope to harness this approach further across areas including health, education, social services and public housing. Incentives to promote this through the COAG process would be worth considering. One example would be to apply the Department of Veterans Affairs' approach to purchasing competitive health services to the delivery of public hospital services. Accompanying this would be the need to establish regional public hospitals as separate entities.

IV. Innovation and Entrepreneurship

Linked to competition is the need to foster innovation in service delivery, which in turn requires risk taking and entrepreneurship. This raises tensions with bureaucratic approaches to administration and accountability. The beauty of applying innovation in local service delivery is that you don't need to rush in with a comprehensive solution. You can trial alternative options and exploit competition between them. It is likely that no one option will come out in front in all situations – solutions usually need to match local needs and resources. However, governments need to take a different approach to risk management than traditionally applied. Risk adverse mechanisms with large reporting and other administrative overheads need to be replaced by smarter mechanisms where risk is managed appropriately, not eliminated.

Effective accountability arrangements are also a key. An example of this approach is the opening up of vocational education and training to competition between TAFE Institutes and private sector registered training organisations. In this case, it is important that national regulation of the sector doesn't thwart innovation by imposing a lowest common denominator approach.

V. Investment in New Technology and Infrastructure

New technology in the public sector should be a driver for improved productivity rather than a driver of additional costs. To do this it must focus on labour savings not just improved functionality. Governments at all levels are often poor at successfully investing in new technology. A number of problems are common, but I want to highlight one: projects are often made too big and complex, trying to do 'all things for all people'. Usually, the bigger and more complex the system is, the lower the chance that it will come in on time and on budget and deliver what is expected.

Reaping the benefits from sound investment in technology is generally easier in a devolved structure with appropriate accountability. An example of this working is the initiative whereby state, territory and federal governments have established a jointly owned company (Transport Certification Australia) to utilise intelligent transport systems, and in particular vehicle telematic services provided by the private sector to deliver improved regulatory outcomes including new productivity opportunities for road transport operators.

In the area of infrastructure investment, State Governments have not performed well. By and large they squandered the 'windfall' increases in GST revenue that they enjoyed before 2008, on additional public servants and wage increases. Infrastructure investment was neglected. There are two issues I want to mention here: planning and funding.

On planning: the Infrastructure Australia model has contributed to a better understanding of infrastructure bottlenecks at a national level. The application of the model at the State level is to be commended, and it is encouraging to see the incoming NSW government move in this direction.

On funding: in the current review of the distribution of GST, it may be worthwhile considering mechanisms whereby states/territories agree to quarantine some GST revenue in an infrastructure account as a qualification for receiving Commonwealth infrastructure funds.

VI. Accountability

Poor accountability is the enemy of productive efficiency. It thwarts initiatives to increase productivity. In terms of federalism, vertical fiscal imbalance is a major limiting factor –a much recognised problem with only one major positive reform since federation: the Howard Government's decision to provide the states and territories with a growing revenue base in terms of the proceeds from the GST.

Further initiatives to redress VFI, such as by mandating tax sharing between levels of government, as Ken has argued elsewhere should be pursued. Perhaps at a more mundane level, improved accountability arrangements within the system we have are an essential requirement for improving productivity. But to have accountability the first thing that you need is meaningful comparative data on activity based costs and performance.

This is an area that the public sector continues to struggle with. National Partnership Agreements attempt to implement the measurement of performance against specified targets, but they seem to create a new level of bureaucracy to do so. Collecting and reporting on performance should be a standard, embedded part of public sector management. The Productivity Commission has a role to play here, providing comparisons of relative efficiency across all public sector agencies along the lines of the reports it provides on the performance of government trading enterprises. Greater accountability is also achievable with public sector entities that have a clear service delivery mandate by establishing them as companies under corporations law. Well-established governance arrangements can be applied and the legal requirements on Directors and Officers of companies should strongly focus them on operating in an accountable way.

Commercial accounting also improves transparency, especially regarding the maintenance of depreciating assets, an area usually buried and ignored by governments intent on focusing on the short run. Also, companies are generally much better at cost reduction! This has been successfully applied in a number of Commonwealth/State joint initiatives. However, it has been under-utilised within jurisdictions – often because of fears of 'loss of control' by Ministers. This is perplexing because it actually gives them more effective control than they have over departments with diffuse accountability.

VII. In conclusion:

We have to make the best of the system we have. And, we need to be mindful of its advantages. The best way to improve productivity in this context is to promote:

- competition
- innovation and entrepreneurship
- smarter investment, and
- greater accountability.

Professor Peter Shergold AC
Chancellor, University of Western Sydney
Current Trends in the Federation

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Let me start by saying there are two antithetical views of the relationship between federalism and productivity. The first view is that federalism helps to enable and inspire different ways of doing things, whether it's setting policy or delivering services. In other words, you get jurisdictional competition and it leads to innovation, whether it's in energy distribution, school curriculum, building public transport or providing aged care. My successor at the Department of Prime Minister & Cabinet, Terry Moran who, when I knew him headed up the Victorian Public Service, once did something truly remarkable; he presented this case with a completely straight face.

The opposite view is that federalism undermines productivity to the extent that it results in unnecessary duplication and greater regulation, more political intervention in the market and cost shifting. In other words, that it has very significant dead-weight costs which lead to risk aversion and stifle innovation, weighing down enterprise. In my work, I saw many examples of this, particularly regarding duplicate and non-uniform regulation. Currently, we are slouching towards a genuinely national system of industrial relations. We keep approaching but then retreating from having a national system of occupational health and safety, and we haven't even got to the starting gate on having a national system of workers' compensation. Any employer will say that the costs that are imposed upon them by federalism are great, and these are three areas where non-uniformity and complexity are particularly onerous.

Clearly, I incline towards the latter view regarding federalism. Having said that, I am a political realist. I see for the foreseeable future we will have three tiers of government. We have to make it work, even though I believe that the challenge is becoming greater.

One reason that the challenge is becoming greater, although it may provide an opportunity, is that, both at state and federal level, human services, which are often the area in which administrative and financial responsibility overlaps, are increasingly being delivered through third party not-for-profit organisations under contract. In other words, the federalism we have today is significantly different from a generation ago because it is federalism outsourced. $26 billion of federal and state government services now are outsourced to not-for-profit organisations to deliver services in this, the most tricky interstices, I think, between tiers of responsibility. I spent five years working through the COAG framework to try to create a whole-of-government approach. I think my colleagues in the states did the same. We talked about "joined-up government" endlessly. It is clear to me now that "joined-up government" depends on organisations like Mission Australia and the Salvation Army. It is the organisations at the end of the outsource chain who have to bring together programs from different tiers of government, from different agencies, and actually deliver them to the citizen that needs them.

I think that there is now a greater sense of national identity, driven in part, of course, by increased geographical mobility of Australians between states. That is reflected in the trend towards centralisation of power in the hands of the Commonwealth.

The point I want to make is that centralisation has actually made things more difficult rather than easier because nearly always, the areas into which the Commonwealth moves like for example health, education, or disability or aged care support, are not areas from which the states then abdicate responsibility. What you end up with is both those tiers of government arguing about the administrative and financial responsibility. So, the increased dominance, the increased centralisation has, in fact, introduced greater complexity. The powers are shared and wielded concurrently, and that makes it more complex and, in many instances, more burdensome. The key, as we've seen, has been COAG and the ministerial councils underneath. I am delighted that the number of ministerial councils has been reduced.

But, of course, what happens beyond those quite irregular half-day meetings is public servants negotiate compromises endlessly at the level below. In reality, they muddle through. Hopefully in 10-20 years this might change, although it must be said that if you read the business literature, that's perfectly fine and a perfectly rational administrative response to these wickedly complex problems.

But there are costs. The first cost is the speed of change. Everybody knows that following often bold announcements at COAG, the implementation of those announcements is often glacial. Because when federal and state ministers sign off in principle, it is then often left to bureaucrats to pursue policies. This is usually a tortuous process.

The second cost is that you get inevitably a softening of the agreements. So you will hear announced, "we have come to a national agreement" in parenthesis “in principle". What that usually means is that once it leaves COAG or the ministerial council, it starts to get watered down. In fact, we have a word for it; it's called “harmonisation”. So, instead of having a national system, you have endless disputes about, “well, what the ministers really meant by that is having our systems harmonised”, and then you endlessly discuss and debate how far away you are going to be from a national system and still have harmonisation.

The third problem is you get opacity of reporting. It's very difficult to see what progress is being made. So, in spite of the Commonwealth's desire to make transparent how Commonwealth funds are being spent by the states, you have a perfectly understandable view from the states that they want to have maximum flexibility from the Commonwealth funds that they are receiving. And, therefore, you have this debate that goes on endlessly about how to measure against what and what to report.

Often, public documents are delayed for six or nine months because of claims that, "that criteria doesn't reflect very well on us, we would prefer a different criteria". And that's why, I think, the COAG Reform Council actually does have a really important role.

I believe that ultimately to overcome the problems of speed, softening and transparency, the COAG Reform Council has to be significantly empowered so that we may be able to restore a greater degree of cooperative federalism.