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Treasurer

Address to the Business Council of Australia

Making our own luck – Australia's productivity challenge

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As John Howard noted recently, many of us have "won the lottery of life being born in Australia". Others have chosen to make Australia their home because of the harmony, prosperity and quality of life here.

We are right to feel lucky, but today I want to talk to you about how we can continue to make our own luck – making the most of the opportunities we have so that we fulfil our extraordinary potential as a nation.

In particular, I want to talk about how we must increase productivity to secure a brighter future with even higher incomes.

This means creating the right incentives for workers and businesses through lower taxes, cutting red tape and flexible labour markets.

It means building the infrastructure needed to address congestion in our cities and better connect our regions.

It means having a health and education system that underpins the wellbeing of our community while equipping workers with the appropriate skills and training to maximise productivity.

All of this is necessary to boost our national productivity performance and to make our luck in the decades ahead.

There are no easy answers or silver bullets.

But there are a great number of things we can and we are doing to assure our standard of living continues to grow.

Our productivity performance

Enjoying our 28th consecutive year of economic growth, the Australian economy has grown on average by 3.1 per cent per year.

This compares to an OECD average of 2.2 per cent.

Behind this remarkable run is the story of the three P's – productivity, population and participation.

Productivity has contributed 1.7 percentage points or over half of the 3.1 per cent annual average growth, and population and participation growth delivering the other 1.4 percentage points.

The productivity boost was greatest in the 1990s, whereas changes in the labour force has been the more dominant driver since the 2000s.

The dividend for the Australian people from this record run of growth and higher terms of trade has been a lift in national income per person from around $40,000 to over $70,000 in real terms.

Over this period Australia has risen to have the 11th highest GDP per capita in the world.

The combination of Australians producing more as well as getting paid more for what they produce has delivered this rise in output and incomes.

This is the reason why living standards are rising.

But to guarantee that our living standards continue to rise and our children have even more opportunities in the future, we must tackle the productivity challenge.

Our productivity growth over the last decade has slowed and we cannot simply rely on high commodity prices to boost national income.

What is in our control is our ability to influence productivity with the right policy settings and business practises.

To put the challenge in perspective, labour productivity has increased over the last five years on average by 1.1 per cent and is even softer still in the last few years.

This is below our long run average of 1.5 per cent and where we want to be.

Should we get our average annual productivity growth from 1.1 per cent back to 1.5 per cent then annual national income per person will be over $3000 higher by the end of the decade.

The level of GDP and real wages will also be 4 per cent higher and the economy $70 billion bigger overall in real terms.

This is a lot to play for.

Defining labour productivity

To understand how we lift our productivity, we need to first understand why it has been slowing.

Labour productivity itself is made up of two things.

The amount of capital each worker has to use, known as capital deepening and how effectively the combination of labour and capital is deployed. This is known as multifactor productivity or some would say the magic sauce that differentiates the quality of managerial teams and companies.

Historically capital deepening in Australia has accounted for two thirds or 0.9 percentage points of the 1.5 per cent average growth in productivity with multifactor productivity contributing one third or 0.6 percentage points.

But more recently, it’s the capital deepening component which has been particularly soft averaging a third lower than the historical average contributing just 0.6 percentage points for the last five years.

Clearly the fall in capital growth in the mining sector following the transition from investment to the production phase has not been offset by a commensurate pickup in capital growth elsewhere.

In contrast, multifactor productivity growth has only fallen marginally from 0.5 per cent from its long run average of 0.6 per cent.

The Australian experience of slowing productivity growth is not an Australian phenomenon.

Across the OECD the five year average is 0.9 per cent per year.

With France, Germany, the UK, New Zealand and Japan having productivity growth at a level lower than Australia during the last five and ten year cycles.

Factors behind our productivity performance

So what is behind this slower productivity growth both at home and abroad?

It would seem three main factors are at play.

First, as the OECD has found while innovations are clearly occurring, giving benefit to some firms, they have not spread as widely to other firms across the economy as one would hope.

On this point, Treasury analysis shows that the top five per cent of firms in Australia, account for almost all of our productivity growth.

There is a clear gap between those at the frontier and the rest.

Many firms appear to be waiting for technologies like artificial intelligence, autonomous vehicles or the 'internet of things' to mature before they adopt them.

Sectors like mining where they have embraced cutting edge technology like driverless trucks and trains are seeing reduced costs, better metrics and increased output.

Second, even when technologies are both proven and in place for some technologies it takes time for the full benefits to be seen.

This was the case with electrification which came to the US in the 1890s, but it took 30 years for factories to reconfigure their process to enable them to take maximise the gains.

The same process played out with the integrated computer chip which was created in 1975 but took a couple of decades before computers were on every office desk and even longer still before the full potential of the technology was harnessed.

A corollary today is the effective use of machine learning which requires a new system wide approach with the right data sets, skilled technicians and analysts as well as a regulatory framework fit for purpose.

Third, there is a long run structural shift in the Australian economy towards services as incomes rise.

The services sector which makes up around 70 per cent of the Australian economy compared to around 60 per cent a bit more than three decades ago, tends to by its nature to have lower levels of productivity.

This is because services are more labour intensive and less likely to see capital substitution.

The hospitality, education and health sectors have been cases in point.

But looking forward, we can expect improvements in these and other services sectors as the application of new technologies revolutionises the way services are delivered and consumed.

The combination of these factors, the take up of technologies, the time it takes to realise their full benefits and the structural shifts towards services are all having an effect on our productivity performance.

As technology becomes more pervasive the impact of these factors should diminish over time and we will see productivity increase.

But how much and how quickly our productivity increases in the overall economy will depend on the actions of governments, employers and employees who all have a role to play.

Government as an enabler and business as the principle driver of economic activity.

Message to business: back yourself

My message today for business is to back yourself and use your balance sheet to invest and grow.

Nine out of every ten jobs in Australia are in the private sector.

If we are going to create new jobs and enable people to earn more for what they do, we need businesses to increase their capital expenditure and to adopt new technologies and business practises that effectively integrates capital with labour.

According to ABS data, the mining sector has on average 30 per cent higher management quality scores than those in the non-mining sector.

If the non-mining sectors were to match these scores, aggregate productivity could be 6 per cent higher across the economy.

With Australian corporates enjoying healthy balance sheets, record low borrowing costs and strong equity market conditions, the question is are corporates being aggressive enough in the pursuit of growth?

For example share buybacks and capital returns are becoming increasingly prominent and the default option for corporates but is a buyback always the best option for the future growth of the company and therefore the economy?

Over the last 12 months, approximately $29 billion has been returned to shareholders in the form of buybacks and special dividends compared to an average of $12 billion over the previous four years - a 140 per cent increase.

Understandably management and boards when they are in possession of excess capital either from asset sales or strong operating cash flows will want to be prudent around capital allocation.

But the lesson from companies like CSL and Cochlear is to take advantage of conditions, invest in research and development and back yourself to grow.

For these companies, the willingness to take appropriate risk is part of their long term growth strategy and success.

A more positive approach to investment and growth by Australian corporates would not only lead to a stronger economy but would contribute to the goal of capital deepening.

Government's role in meeting the productivity challenge

The Morrison Government's plan to turn the tide on productivity growth focuses on enabling productive businesses to invest in more and better quality tools to equip workers; creating opportunities to improve the skills and capabilities of our labour force and empowering businesses to put labour and capital to work.

In this year's Budget I announced the expansion of the instant asset write-off threshold to $30,000 and expanded it so an additional 22,000 businesses employing more than 1.7 million people would be eligible.

Combined with the reduction in the company tax rate for small and medium sized businesses with a turnover under $50 million, which has now been brought forward five years, and our new $2 billion Securitisation Fund which increases businesses access to capital, the costs for SME's to invest are being reduced.

I understand the frustration of the business sector around the company tax debate but that battle was had.

Our focus now needs to be on how we can more effectively encourage business investment.

This is not about providing tax breaks for companies to do what they will be doing anyway, but rather putting the right settings in place to enable them to go a step further and back themselves to grow.

It's a discussion which I am continuing to progress with the business community.

Public infrastructure investment

A key enabler of higher productivity is publicly provided infrastructure.

It is about getting goods to market more efficiently and effectively and people to work and home sooner and safer.

Governments need to address the rising cost of congestion in our cities which as the HILDA survey has found is seeing commuters spend 60 per cent more time in traffic per day than they were 15 years ago.

Infrastructure Australia warn that the cost of congestion will double to nearly $40 billion a year by 2031.

This is a key focus of our ten year $100 billion pipeline of federally funded transport projects with 160 major projects currently under construction and 120 in the planning phase.

We are considering what projects can be potentially brought forward keeping in mind capacity constraints and the need for coordination with the States.

But let's not forget about the significance of what we have already committed to.

For example, the Coalition has moved after half a century of Commonwealth and State indecision, to create a second airport in Western Sydney and an airport rail link in Melbourne.

And the Inland Rail is a massive $9.3 billion commitment that will create 16,000 jobs and build a 1700 kilometre transport freight link between Melbourne and Brisbane.

It will double volumes, slash costs, see 200,000 fewer truck movements per year, better enable better access of our regions to key global markets and add $16 billion to the economy over 50 years.

It is one of a number of Commonwealth funded projects that will change the nation's infrastructure landscape.

A skilled workforce

Skills and education is another area of focus for the Government.

We recognise that there is more that we can do in this area and that increased funding is not the only answer.

The nature of work is changing.

Services and digital technologies are more prominent and employers require different skillsets from their workers than even a decade ago.

Our vocational training system needs to reflect that its role in educating the workers of the future is just as valuable as our leading universities.

This is why we are setting up in response to the Joyce review a National Skills Commission and a National Careers Institute.

These bodies will ensure that funding goes to the right courses at the right time and that students know what jobs they can get from what courses.

In other words it is tackling the challenge at both the front and back end with incentives for VET providers and authoritative information for students.

These initiatives build on the 80,000 apprentices we announced funding for in this year's Budget with a doubling of the financial incentives for both employers and apprentices and the establishment of ten training hubs in regional areas.

A healthy workforce

It is not just the skills of our workers but also their health which is important for the quality of our labour force.

People are living longer and at nearly 83 years, our life expectancy is the third highest in the OECD.

But as the Productivity Commission states in its *Shifting the Dial* report, Australians spend nearly 11 years in ill health, the highest in the OECD.

If we were are to move those from poor health to fair health we could increase workforce participation buy around a third.

Not to mention the reduced health costs, the improvement to peoples' wellbeing and the overall boost to the economy which the Productivity Commission estimates could be worth up to $200 billion over the next 20 years.

It is with these goals in mind, the Government is implementing a National Health Plan with record funding on Medicare, medical research, the Pharmaceutical Benefits Scheme and a focus on a more integrated patient centred health care system.

Mental health and suicide are also key priorities for the Government with mental health the single largest contributor to the number of years Australians are living in ill-health.

The Business Council of Australia estimate that 6 million work days are lost each year to mental health related issues.

It is in this context, I have asked the Productivity Commission to undertake an inquiry into the economic impacts of mental illnesses and to make recommendations to boost productivity and social and economic participation.

It is simply unacceptable that 65,000 Australians attempt suicide every year and eight families lose a loved one every day.

Better support for prevention, treatment and recovery is required and it was one of the key areas of focus in the Budget and is a real passion and priority for the Prime Minister and I.

Industrial relation and regulatory reform

Industrial relations reform and deregulation are two areas which directly impact on the productivity agenda.

Flexibility in the work place is important but so too are the rights and entitlements of workers.

It is about getting the balance right and taking the workforce with you recognising that as a company gains so does the employee.

We have important bills before the Parliament namely the *Ensuring Integrity Bill* and the *Proper Use of Workers Benefits Bill* both of which will help ensure a law abiding work place and by definition a more productive one.

We are interested in further workplace relations reform that is evidence based, pragmatic, protects workers entitlements and produces clear gains to the economy and working Australians.

These are the guard rails that the Prime Minister set and these are the ones we will stick to.

Deregulation too requires a balance to be struck. It is not about removing necessary consumer or environmental protections but rather ensuring our regulations are effective, efficient and fit for purpose.

Better regulation not more regulation is the goal.

Again the Productivity Commission is being put to work tasked to streamline regulations in the resources sector currently underway.

A regulatory process which required 4000 approvals and took ten years to complete for a single iron ore project in Western Australia is not just too long and too costly but a significant disincentive to investment.

Working with Assistant Minister to the Prime Minister Ben Morton, I am again focused on tackling the deadweight cost of red tape and putting in place practises and processes that reduces the burden for businesses and consumers.

It is also important for government to deliver its services as efficiently and effectively as possible with the Prime Minister pointing out in his recent speech to the public service that the Commonwealth employs over 240,000 people.

How they perform their roles is critically important to the productive capacity of the economy and now with the establishment of Services Australia and the implementation of the Digital Transformation Strategy the Government is renewing its efforts to improve service delivery.

Competition

Competition is another area where we can level the playing field for good firms and good ideas no matter their size.

Tackling barriers to entry and misuse of market power will help ensure the most efficient allocation of resources and most productive outcomes.

Digital disruption is the by-word for established sectors like energy, banking and telecommunications and we need to ensure that our competition framework and our regulators are equal to the task.

We are positioning Australia to be a world leader in the highly innovative FinTech sector making it easier for newcomers to start up and allowing fintechs to be able to access a sandbox to test their solutions.

Together with our Consumer Data Right which recently passed the Parliament, these initiatives will be a game changer, encouraging more competition to the benefit of consumers.

So too the landmark ACCC Digital Platforms report which proposes a series of legislative changes aimed at boosting productivity, competition and consumer outcomes.

Reforms to our tax, workplace, regulatory, competition, education and health systems enhance our ability to produce more with what we have.

But we also need to keep expanding the markets for our goods which is part of the demand side of the equation.

Trade

This is where the Government's focus on free trade agreements is really producing dividends for the country.

Free Trade Agreements covered 26 per cent of our two way trade when we first came to government but now extends to over 70 per cent today.

The Coalition has opened up new opportunities for our exporters in the rapidly growing middle class markets on our doorsteps as well creating new investment opportunities in Australia.

Despite the uncertainty in the global economic outlook sparked by increasing trade tensions between the US and China there are still plenty of new opportunities for Australia to take advantage of.

The 16 nation Regional Comprehensive Economic Partnership is a case in point.

Involving China and the ASEAN countries, it will also be the first time India is part of a major regional agreement.

Concluding this agreement will be good news for Australia.

Putting productivity on the Commonwealth, State and Territories agenda

Today I have outlined not just where the Commonwealth is focusing its energies on the productivity agenda but also how I believe business should be rethinking its approach to investment and capital growth.

I want to finish with a word about the States and Territories.

They are our partner in addressing the productivity challenge as a great number of initiatives can be taken at their level.

States are after all primarily responsible for service delivery and of the 28 policy recommendations in the Productivity Commission's *Shifting the Dial* report, 22 of them are either the sole or joint responsibility of States and Territories.

Zoning laws, occupational licensing and stamp duty to name just a few.

Productivity is a national task requiring a national conversation.

I have therefore written to the States and Territories and will be placing productivity as a standalone agenda item at the next meeting in October of Treasurers known as the Council on Federal Financial Relations.

This will enable Commonwealth, State and Territory Treasurers to outline their priorities and policy positions with a view to building a shared commitment to lifting Australia's productivity performance.

Conclusion

The fundamentals of the Australian economy are strong.

We continue to grow.

More than 1.4 million new jobs have been created since we came to office and our employment growth today is more than three times the rate we inherited.

Over $300 billion of tax cuts set out in the last two budgets have passed the Parliament enabling Australians to earn more and keep more of what they earn.

Our AAA credit rating has been maintained and the Budget is coming back to surplus for the first time in more than a decade.

We are as well placed as any other country to navigate the choppy seas ahead but we are not complacent.

To continue along our path of economic growth and rising living standards we need to work together - governments, employers and employees to boost our productivity performance.

Productivity as US Nobel prize winning economist Paul Krugman has said “isn’t everything but in the long run it’s almost everything”.

Simply put, lifting our productivity will see Australians earn more for what they do and this will be to everyone’s benefit.

End.