

## Some Observations

27 November 2019

This note provides some observations on the report *Kickstarting the Productivity Conversation* (KPC) by the NSW Productivity Commission. These observations arise from a quick read of the report and reflections over a couple of days. They are a long way from a complete review.

The note starts with a few general observations. It then makes a few comments on the six policy categories in KPC. The third section adds a few further comments.

### 1 General Observations

Productivity is an important topic and the KPC report and ongoing conversation are helpful. However, it seems that there is some way to go in developing the most effective productivity policies.

KPC provides high level comments on the slow growth in *average* productivity in NSW. Importantly however, in developing policies, an essential first step is an analysis of the problem(s) and their causes(s). The report does not describe where and why average productivity is growing slowly

Averages can be misleading. It is possible for productivity (wages) to rise in all parts of the labour force but for average productivity to fall!<sup>1</sup>

Changes in average productivity reflect changes in economic structure and incomes in each sector. Across Australia in the six years to the third quarter 2019, employment in health care and education grew by around 28%, in construction by around 14%, in information and telecommunications by about 5%, while employment fell in manufacturing and mining.

Changes in average productivity also reflect changes in the nature of the labour force, demographics, participation rates, migrants and short-term visiting workers. For example, growth in female participation has led to a major growth in low paid child and aged care services, often serviced by short-term visiting workers.

KPC does not provide any data on the wages or productivity of different segments or features of the workforces. What was the growth in participation and the composition of workforce changes in NSW? Understanding these issues is important to understanding the real changes in productivity.

Labour productivity is a function of skills, motivation and opportunities. Thus, another important and major possibility is that productivity rises faster for skilled and motivated workers than for the less skilled and motivated. There is abundant evidence on the rising income gaps in developed economics including ours. The conjecture of this note is that skilled and motivated workers can and do raise their productivity

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<sup>1</sup> Illustrating the problem with averages – conversely as NZ Prime Minister Robert Muldoon once quipped: when a New Zealander moves to Australia, the average IQ in both countries rises!

and incomes in Australia. For various reasons, the less skilled and motivated workers may achieve much lower increases in productivity and incomes.

Numerous studies show a correlation between obesity and (low) incomes. Clearly factors that induce obesity are likely also to generate low productivity and incomes.

In the view of this note, to develop the most effective productivity policies, we must understand the major causes of low productivity and low productivity growth. *We need to know where productivity and incomes are rising and where they are not. And we need to know the reasons.*

Our (unproven) hypothesis is that productivity is highly correlated with inequality, poor health, social exclusion and low social capital. This would require analysis of relevant data to establish the relationships and conversations with those groups most affected to develop the most appropriate responses. KPC briefly notes the possible relationship between inequality and productivity on p.34. But overall, it appears to provide little discussion of these (in our view) fundamental issues.

## 2 Sectors and Policies Discussed in KPC

In the main, KPC raises issues and suggests some high-level policies but is light on detail. Clearly, more is needed to develop policies. The following are a few observations.

### Human Capital

Education is fundamental to productivity. Drawing on international tests, KPC notes that *average* student standards have fallen in reading, mathematics and scientific literature.

As John Hattie and others have shown, there is strong evidence that student outcomes reflect teacher quality.<sup>2</sup> And I understand that, in many schools, subjects such as maths and computing are taught by non-qualified teachers. Policies will need to be found to address these issues.

But, again, we need to understand the details. The writer's informal discussions with a few teachers suggest that the brighter and more motivated students from high functioning families are achieving as high, or higher, results than ever before. For them, productivity is not going to be a problem.

On the other hand, many problems arise with children from less secure families and with less motivated children generally. And I also understand from discussions with teachers that many more school children suffer today from significant anxiety than was traditionally the case.

Thus, we need to know more about the problems to be resolved. The response could then involve, for example, more investment in pre-school family assistance and in well-being assistance for students at primary and secondary schools, as well as improvements in teacher quality.

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<sup>2</sup> See <https://visible-learning.org/hattie-ranking-influences-effect-sizes-learning-achievement>. And other work by John Hattie.

## **Water and Energy**

The discussion of the water and energy sector is high level.

(p.14): “The right governance and regulatory frameworks will support appropriate future investments in these (water and energy) sector. Productivity payoffs will come from using water and generating energy as efficiently and effectively as possible”.

(p.15): “Reliability is important, but it is critical to avoid ad hoc policy making and inefficient expenditure”.

It is hard to disagree with such statements.

On the other hand, there appears to be little discussion in KPC of (i) the threat of climate change to productivity, including impacts on the productivity of natural resources and coastal erosion, or of (ii) related policy responses, notably more use of renewable sources of energy.

## **Infrastructure**

In KPC, the major infrastructure issues appear to be (i) the need for improved project selection and (ii) ways to deal with congestion including possible congestion charges.

On p. 78, KPC notes that “Another possible factor (for poor infrastructure projects) is the announcement of projects prior to completing detailed business cases”. This note would concur that this is a prime reason for poor projects and often expensive ones.

Desirably there would be more independent analysis to carefully scrutinise projected costs and benefits. In our experience, reports commissioned by government have a strong tendency to support these prior announcements. These analyses should also consider options, including project staging.

As numerous economists have argued for a long time, there are strong arguments for congestion charges, including for peak hour public transport.<sup>3</sup> Undoubtedly, congestion prices are complex in practice. But it is time to move beyond high level comments and to develop some practical options and move forward especially in Sydney.

## **Taxation**

Again, under taxation, KPC mentions problems (inefficiencies) with some state taxes but does not suggest significant detailed policies for discussion.

KPC discusses stamp duty on property transfers briefly but does not discuss any policy changes. Stamp duty is an inefficient tax that significantly deters housing exchange.<sup>4</sup> But there would be major complications in a complete swop of land (or property) taxation for stamp duty. Almost certainly, these make such a tax swop infeasible. However, stamp duty could be reduced by reducing land tax exemptions for property investors (the value base will be \$734,000 in 2020). And there is room for

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<sup>3</sup> For example, Hensher (2018) “Toll roads - a view after 25 years”, *Transport Reviews*, 38 (1), 1-5.

<sup>4</sup> Arguably, stamp duty has little effect on house prices (with housing stock highly inelastic the duty is borne mainly by house owners) or aggregate housing supply.

minor increments in other property taxes, including reductions in other tax exemptions or privileges. Thus, detail is required.

Another option not discussed by KPC would be an increase in the application and rate of GST more closely in line with most other countries that employ a GST (or equivalent VAT). These changes would need to be minor and, of course, would need national support. But it is a potentially important reform which would allow reductions in less efficient state taxes, which NSW could support.

Curiously, the section on taxation includes some high-level comments on the need for more performance monitoring of local government. Local councils typically provide over 100 different types of services including management of local public land and property, transport infrastructure, various social and cultural services, local planning, community health and recreation, environmental protection, waste removal and disposal, and in some case industry and tourism development. Accordingly, performance monitoring and benchmarks can at best be selective. However, this note strongly supports regular community satisfaction surveys of council services, as suggested by KPC.

But why does KPC suggest satisfaction surveys for local councils and not for (other) state government agencies?

### **Planning for Jobs and Housing**

The report is again somewhat high level and short on specifics on planning. Of course, planning needs to be efficient and to take account of all the relevant issues.

A problem is that no State Government agency, including the Department of Planning and the Greater Sydney Commission, has published an articulate and transparent guide on planning (zoning) principles and, more especially, of assessment of planning options.

In principle, the objective of planning is to maximise the social welfare of existing and future residents of NSW. Most people want, inter alia, both affordable housing and environmental quality. Essentially this means employing cost-benefit analysis of the benefits and costs of development strategies and major planning options. What is needed is a clear evaluation guideline to determine urban densities, open spaces, cultural opportunities and so on. But *there is no such public guideline*. In the absence of a well-defined and measurable evaluation method, there is a serious risk that development decisions will reflect special commercial interests rather than the public interest.

KPC also raises the issue of approval times for development applications. The writer is aware of some cases of very lengthy approval times. However, the concern about development approval (DA) times is largely misplaced. Most developments take a year or two to plan, may be an average of 60 to 70 days in DA process, and a year or two in delivery. In this 3 or 4-year development timescale, saving 20-30 days in the DA process is a very small saving. What many developers want is to minimise community involvement in the decision process. But their building will be standing there for 50 or more years. Local residents have every right to be properly consulted and not ignored and over-ridden by exempt and complying regulations.

Much more could be written on planning. For example, KPC does not discuss how safe and quality construction standards should be achieved. There is no discussion of the major conflict of interest in allowing private certifiers to certify developments by their paymasters.

Turning to affordable housing, an analysis of the real issues is needed. The writer's analysis shows that there are major housing affordability problems for low income households. On the other hand, as a proportion of income, neither rents nor mortgage repayments have risen for median income households (renters or buyers respectively) over the last 15 years.<sup>5</sup>

Housing stress may affect not just the welfare of households, but also their productivity. If that view is confirmed, there would be two grounds (welfare and productivity) for providing more social support for housing for low income households.<sup>6</sup>

## Regulation

KPC notes that regulations may have to change to allow the emergence of new technologies and that the government (p.130) is "currently establishing a process to assure regulatory quality".

However, on my quick reading, KPC does not discuss explicitly the drivers of innovation or the role of government in innovation.<sup>7</sup> These seem important omissions.

## Some Other Issues for Consideration

In concluding, we briefly make a few more observations.

It might be helpful to provide social context for the discussion. The ultimate social (policy) objective is generally social welfare. Productivity is a means to welfare, but not more important than welfare.

Secondly, the report appears to focus on the private sector. On p.2, the Commissioner states that "The private sector is the central driver of productivity". This creates two possible limitations. (i) It underplays the possible role of the public sector in innovation.

(ii) KPC largely ignores the potential to improve productivity in the public sector. For example, in the writer's view, the introduction of Executive Directors (EDs) into the management structure in state government departments a few years ago produced both an excessive layer of management and an excessive number of managers into the departments and has been messy and inefficient.<sup>8</sup> This is but one example. The more important point here is the general omission of any discussion of public sector productivity.<sup>9</sup>

There are two other areas where the KPC makes limited references. One is health which is fundamental to productivity. And poor mental health is a major driver of low productivity. Often this is a consequence

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<sup>5</sup> Abelson, *House Prices, Rents, Home Ownership and Affordability: The Facts and a Mainstream Economics Explanation*, July 2018, Australian Conference of Economists, Canberra.

[http://www.appliedeconomics.com.au/publications/papers/housing/references-housing.htm#P2\\_23](http://www.appliedeconomics.com.au/publications/papers/housing/references-housing.htm#P2_23)

<sup>6</sup> It may be argued that subsidising rent for low income households reduces the incentive to work. However, this note conjectures that there is a significantly positive relationship between housing security and productivity.

<sup>7</sup> See Gans and Leigh, 2018, *Inequality + Innovation*, MIT Press on the government role in innovation.

<sup>8</sup> It should be noted that this is a criticism of the management system, not of individual EDs.

<sup>9</sup> It should also be noted that public sector productivity is not always raised by public/private partnerships, as the experience with the Northern Beaches Hospital has shown.

of small or broken families and isolation. Inclusion and socialisation via local council / community services is a major policy option response.

Second, KPC seems to have an urban focus. There is relatively little attention to raising rural productivity including maintaining natural resources.

This takes us back to the start of the note. To develop policies for productivity, we need more analysis and information on what is happening to productivity and to the drivers of low and high productivity. Our expectation is that productivity is highly correlated positively with household inclusiveness and negatively with exclusion. Productivity depends both on releasing the free spirit of capitalism but also on building social capital. We look forward to more such analysis.<sup>10</sup>

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<sup>10</sup> In 2010, Andrew Leigh published *Disconnected*, a book exploring the decline in community in Australia. Leigh found that, between the 1980s and the 2000s, Australians had fewer friends they could drop in on uninvited and fewer friends they could call on for a favour. In his recent book, *The Art of Belonging*, a leading Australian social analyst, Hugh Mackay (2014, p.1), wrote: “We rely on communities to support and sustain us and, if those communities are to survive and prosper we must engage with them and nurture them”. Indeed.