



# **Improving economic growth: the productivity agenda**

**14 October 2011**

**Enhancing regulatory quality: International  
experience and solutions for Vietnam**

**Sofitel Plaza Hotel, Hanoi**

**Dr Ben Jensen**

# Grattan Institute

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## **Grattan Institute is an Australian independent and evidence-based think-tank**

- Grattan Institute is truly non-aligned
- The independence of the Institute is underpinned by independent resourcing

### **Focus**

- Cities
- Energy choices
- Productivity growth
- School education
- Higher education

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- 1. Productivity and economic growth**
  - 2. Productivity-enhancing reform – examples from Australia**
  - 3. The social, economic and political conditions that impact productivity-enhancing reform**

## Productivity and economic growth

## 1. Population

## 2. Participation

- Labour force
- (Un)Employment rate
- Hours worked

## 3. (Labour) Productivity

- GDP/Hours worked

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1. Regulations/policies that interfere with managers' and owners' of capital decision-making
  2. Improve the quality and effectiveness of their factors of production
    - Physical capital
      - positive association between capital investment and productivity over time
      - Infrastructure
    - Human capital
      - Education and training
        - Positive association between education attainment and labour productivity
    - Innovation – research and development
      - Influenced by regulations – both for innovation and adoption
      - Endogenous or exogenous?
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- Public sector productivity
    - Substantial measurement issues
  - Tradeable and non-tradeable goods sectors
    - Exposure to competition
      - Need to consider managers in and outside of Vietnam

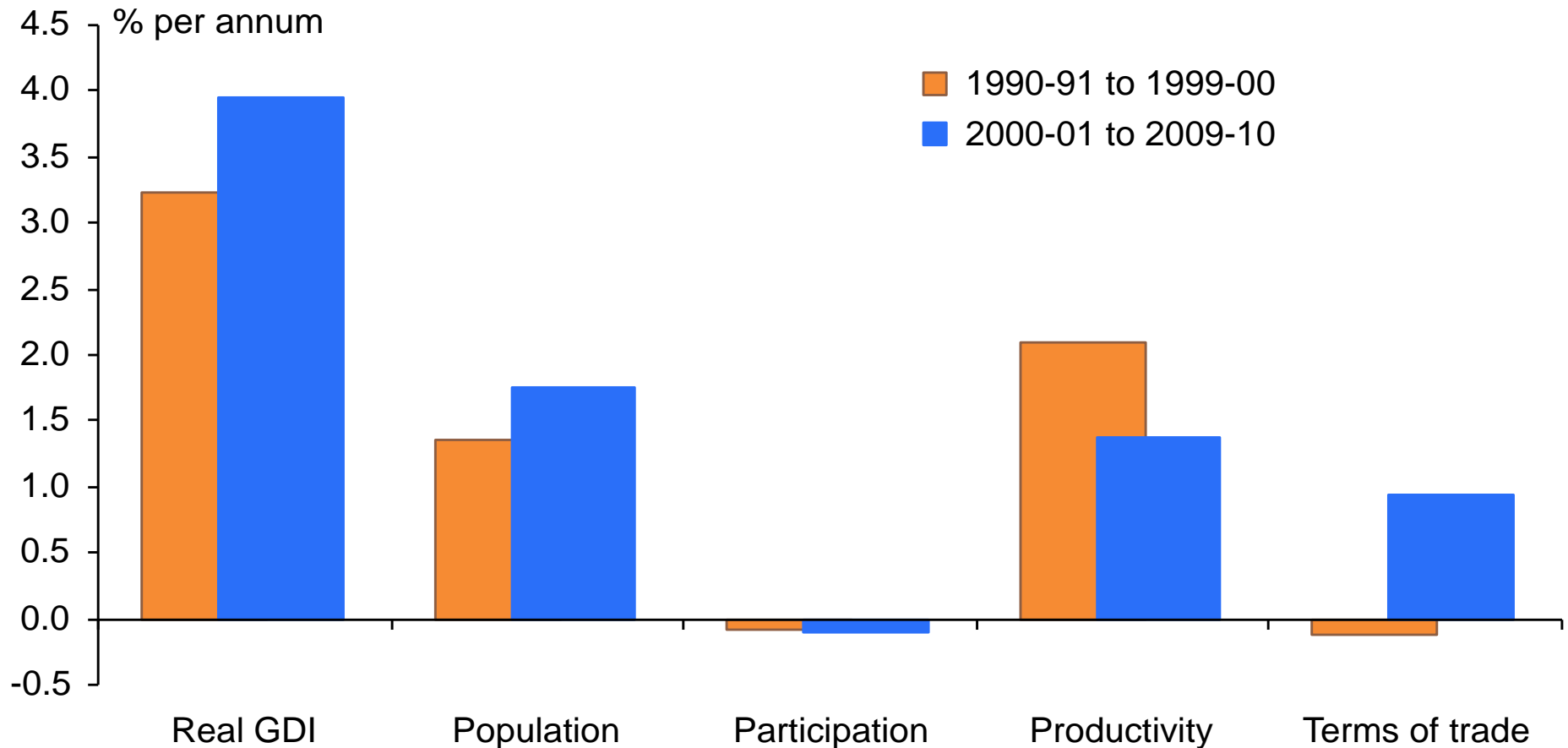
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- **Productivity of individual sectors matters more than ‘sector mix’**
    - **Maintaining strong growth over time is the the key**
  - **Service productivity and competitiveness is critical**
    - **Services sectors have accounted for almost all net jobs growth in nhigh-income countries over the past two decades**
  - **Government policies can strongly influence productivity and competitiveness in sectors not directly exposed to international trade or global competition**
    - **Business entry and exit is a signal of a dynamic economy**
      - **Regulation can promote or hinder this and can impact competition and productivity**
  - **New innovative sectors are not the big driver of economic growth**
    - **Too small – tax incentives and direct government involvement have not had a large impact**
    - **Improving capital and labour effectiveness has a much bigger impact**

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- **Regulatory and ‘productivity-enhancing reform can actually decrease measured labour productivity (at least in the short-term)**
    - **Reform aimed at increasing economic growth**
    - **Labour productivity = output per worker**
  - **For example**
    - **Reducing minimum wages**
    - **Reform to labour market regulations**
    - **Interaction with social security**



# The impact of slower productivity growth on living standards has been masked by population growth and the rise in the terms of trade

## Sources of growth in Australian real gross domestic income (GDI)

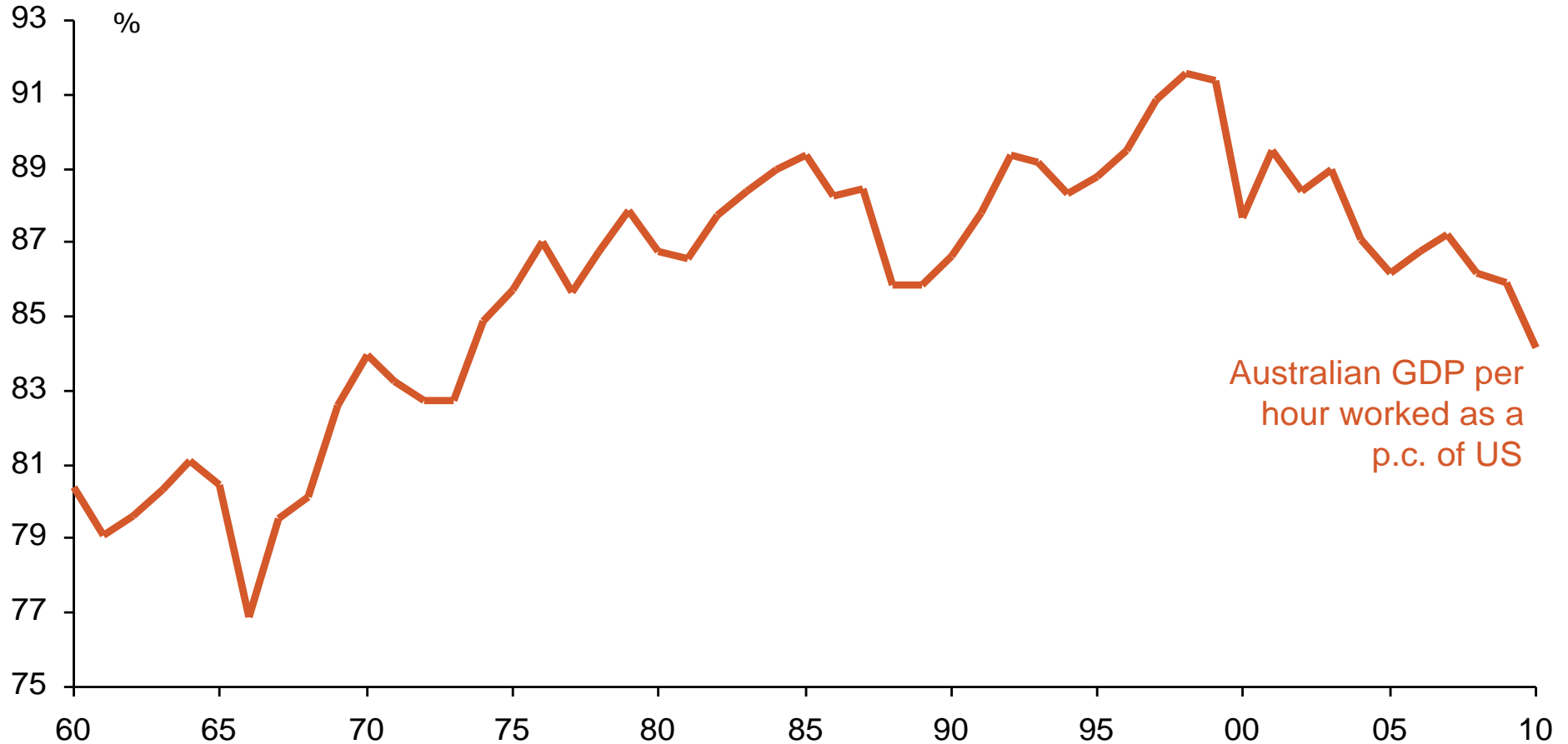


Note: Real gross domestic income (GDI) is real GDP adjusted for changes in the terms of trade.

Sources: ABS; Grattan Institute.

# Relative to the US, Australian labour productivity is back to where it was in the mid-1970s

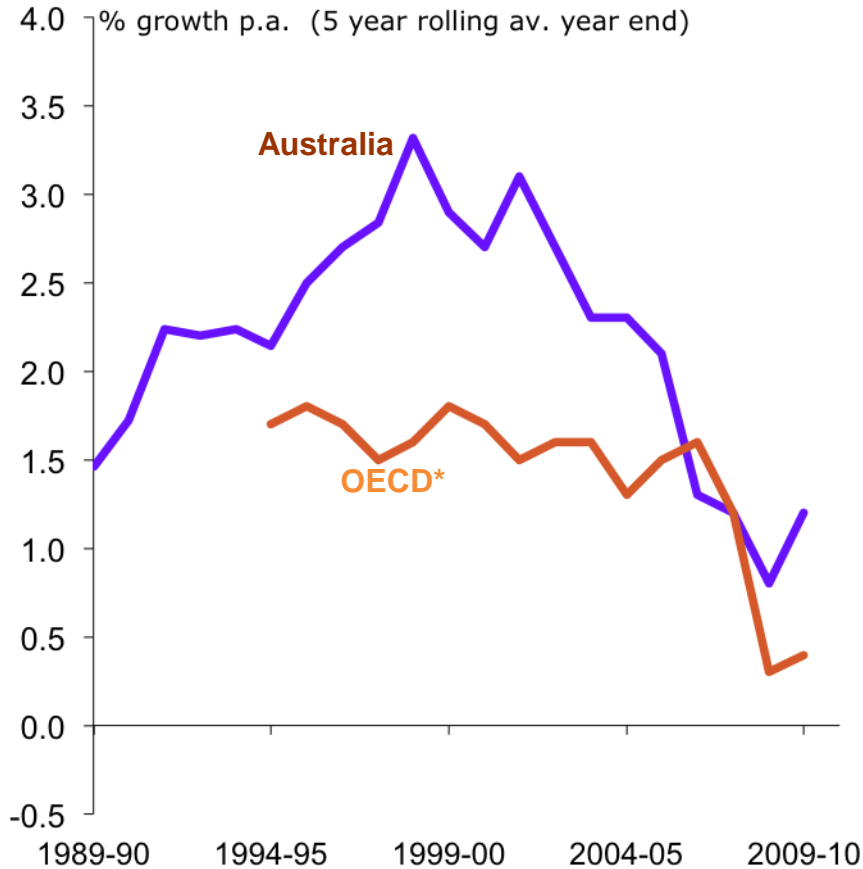
## Australian labour productivity as a percentage of the US



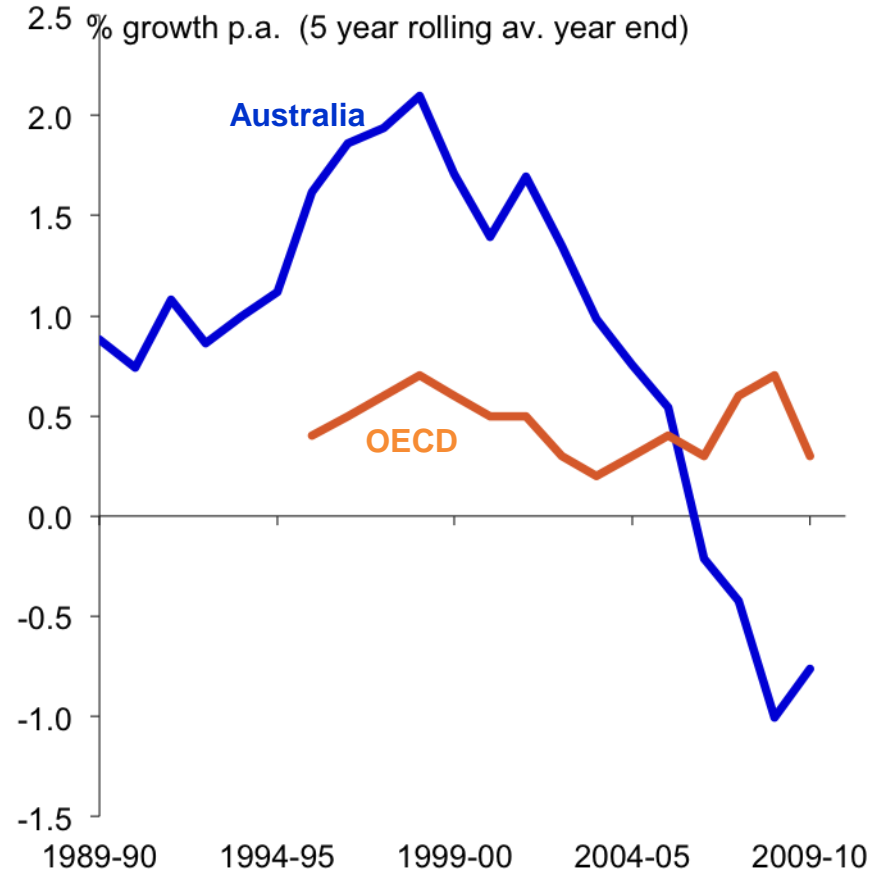
Note: Labour productivity here is real GDP (in 2010 US dollars) per hour worked.  
Source: The Conference Board, *Total Economy Database 2011*; Grattan Institute.

# Productivity growth has slowed in most OECD countries

## Labour productivity



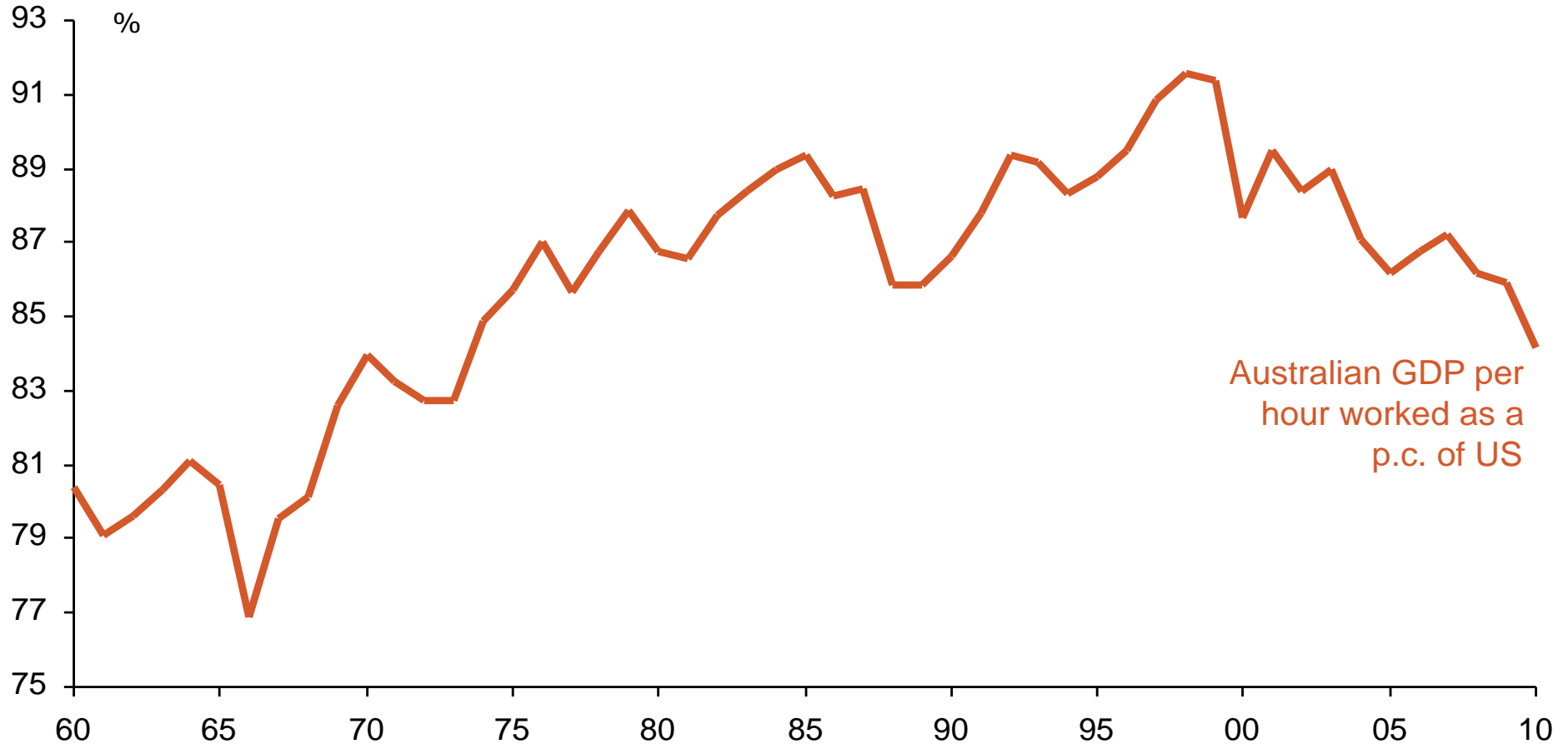
## Multi-factor productivity\*



Source: Australian Bureau of Statistics & Conference Board. Note: \*OECD uses Conference Board Data. Labour productivity is GDP per capita (rather than hours for Australia). MFP (% change in market GVA divided by market GVA) is Total Factor Productivity (defined as % change in total inputs divided by % change in output. It is not apparent whether output includes non-market sectors nor whether inputs other than capital and labour have been included.

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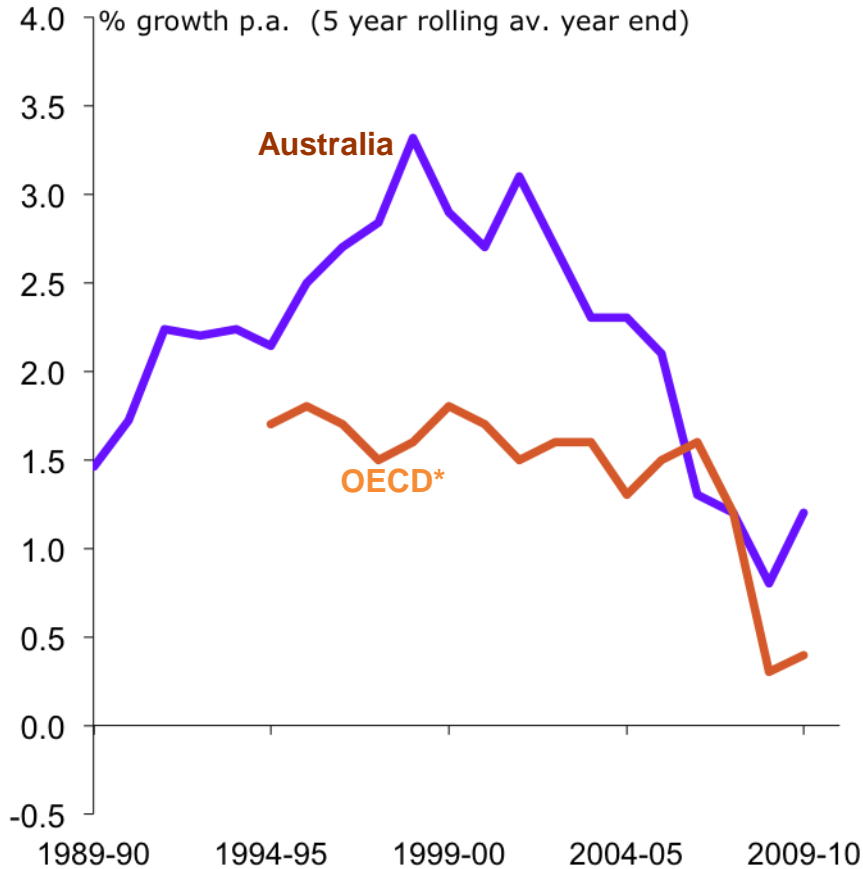
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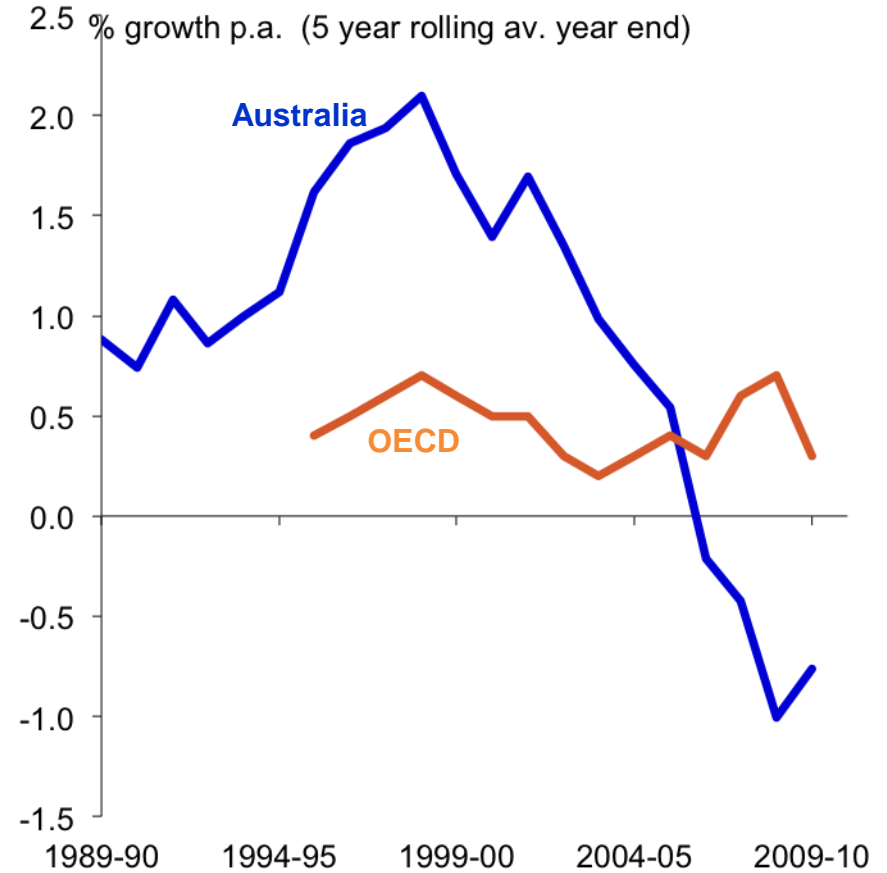
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# Productivity growth has slowed in most OECD countries

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**Productivity-enhancing reform – examples from Australia**

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- **Regulatory reform**
    - **Product markets**
      - **Reduced transaction costs**
    - **Labour markets**
      - **Deregulation and increased flexibility**
      - **1980s**
        - **Tri-partite agreement between government, unions and employers**
          - **Increased productivity in exchange for increased wages**
      - **1990s**
        - **Slowly a move to enterprise bargaining**
        - **Reduced union membership and power**
        - **Deregulation increased flexibility**
          - **Reduced costs of hiring and firing**
  - **Trade liberalisation**
    - **Substantial tariff reductions**
      - **Complete overhaul of many industries and eliminated some**
        - **Manufacturing, TCF, telecommunications**
    - **Deregulation of financial sector (foreign entrants)**
      - **Banking and financial sector**
        - **Natural high-productivity industry**
    - **Floating of the dollar**

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## ● Privatisation

- Time period varied between states
  - Some states still lagging behind (political reasons)
- State-owned government enterprises
  - Postal
  - Communications (phone, internet)
  - Utilities
  - Transport
  - Infrastructure
- Considerable use of public-private partnerships (PPPs)

## ● Competition-enhancing reforms

- Power and prominence given to
  - Australian Productivity Commission
  - Australian Competition and Consumer Commission

## ● Taxation reform

- Substantial reductions in individual marginal tax rates
- Substantial reductions in corporate tax rates
- Broadening of the tax base – move to a GST/consumption tax



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## Objectives of reform:

- **Facilitate the movement of factors of production from lower- to higher-productivity activities**
- **Increase competition in particular industries**
  - **Government-owned enterprises**
  - **Protected industries**
- **Increase the diffusion of new information and communications technologies**

**The social, economic and political conditions that impact productivity-enhancing reform**

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## Strategy means a long-run focus

- Good public policy needs to focus on the long-run
  - We are biologically hard-wired for the short-run.
    - A Stanford professor of Psychology investigated delayed gratification. He put four year old children in a room with a marshmallow. He told them he was going out of the room for 15 minutes. If they could wait until he got back, without eating the marshmallow, he would give them two.
  - Two thirds of the kids couldn't wait.
  - The third that waited not only got an extra marshmallow, they went on to earn SAT scores 210 points higher than the kids who only lasted thirty seconds.

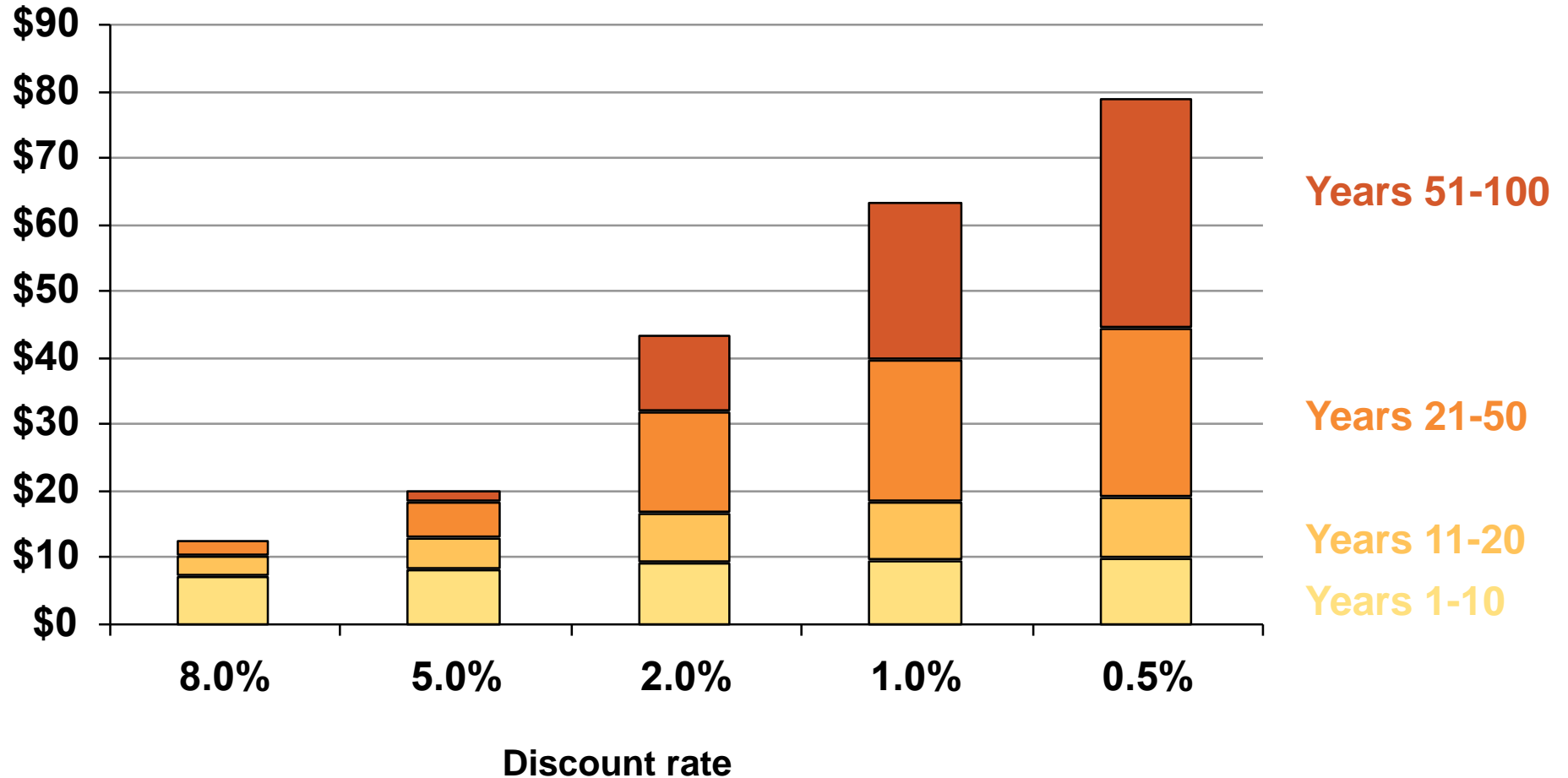
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## Strategy means a long-run focus

- Public finance theory can exacerbate short-termism and restrict productivity improvements
- One of the basic questions in cost-benefit analysis is how to value short term benefits relative to long-term benefits. In classic finance theory, this is calculated using a discount rate.
  - By applying a high discount rate, the benefits of the long term are small
  - Apply a low discount rate; the benefits of the long-term dominate
  - In choosing between a quick fix program and a long-term program, your decision will be driven by your discount rate

# Valuing the future

The value today of \$1 every year



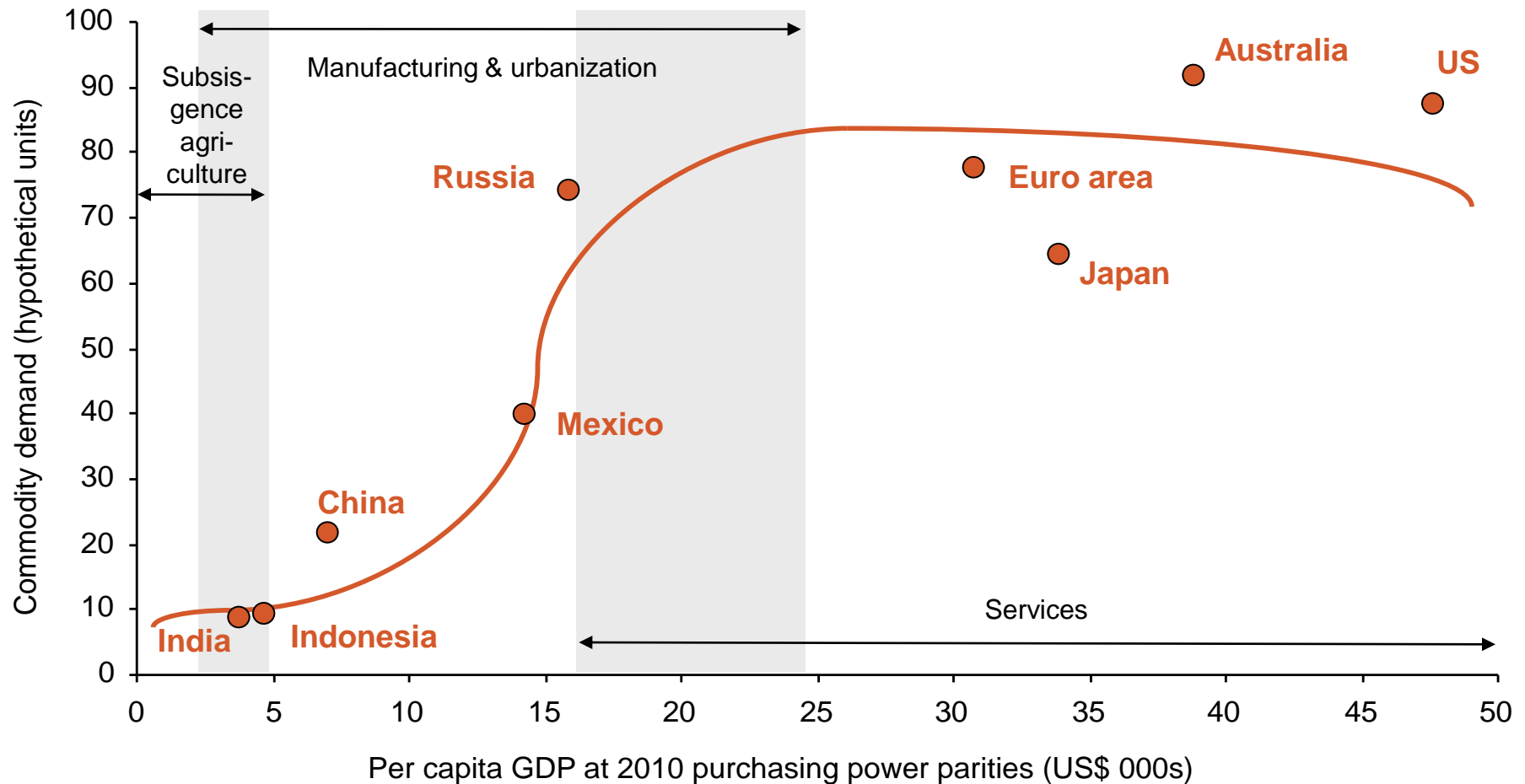
## Strategy means a long-run focus

- Regrettably, public finance often uses higher discount rates
- The analysis borrows from the private sector, but it does not always consider that governments are responsible for long-term economic growth and inter-generational equity

- **The need for increased productivity is constant but the 'push' for reform can have different origins**
  - **Stages of growth**
  - **Macroeconomic conditions**

# Economies typically pass through a stage of development during which the 'commodity intensity' of growth rises sharply before tailing off

## Stylized depiction of the relationship between per capita GDP and commodity demand

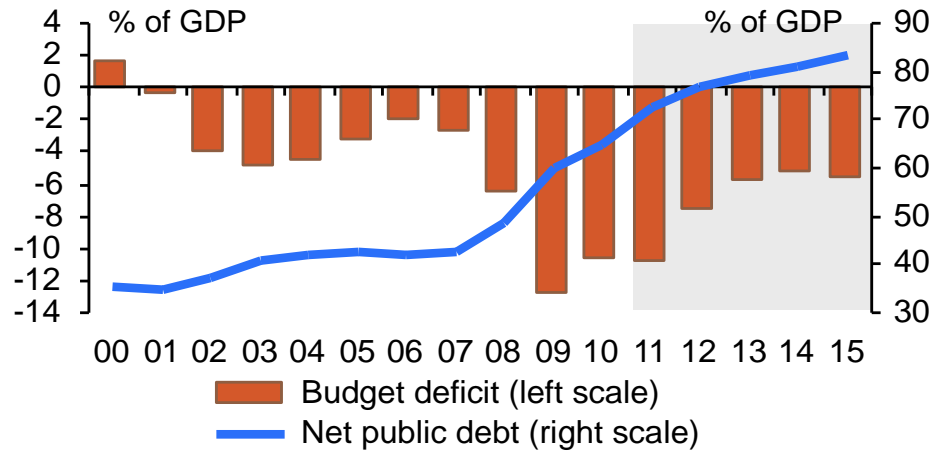


*Note:* Double-headed arrows denote the primary form of economic activity at different stages of economic development. The location of the countries shown on the vertical scale is intended only as a general illustration of the general level of commodity use and is not based on any specific units of measurement. *Source:* International Monetary Fund *World Economic Outlook* database (April 2011); author's estimates.

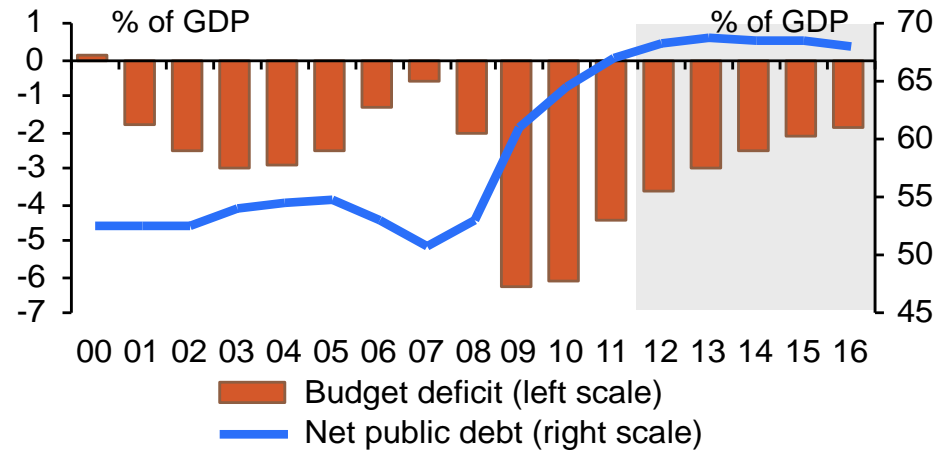


# On either side of the North Atlantic, governments and central banks don't have much 'ammunition' to fight a second recession

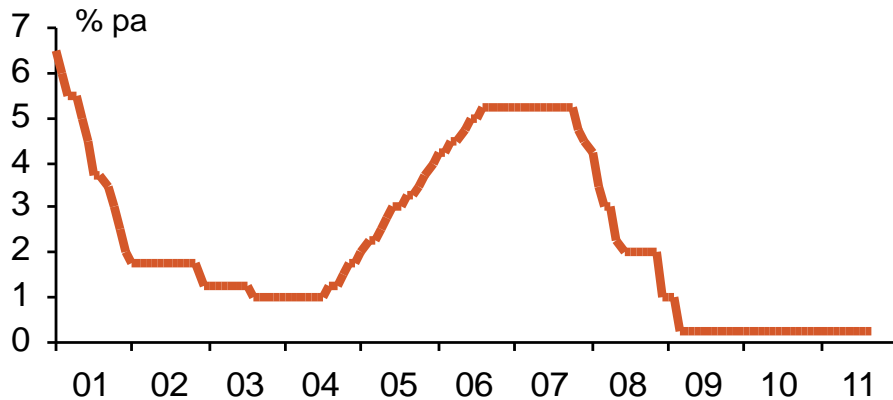
### US public finances



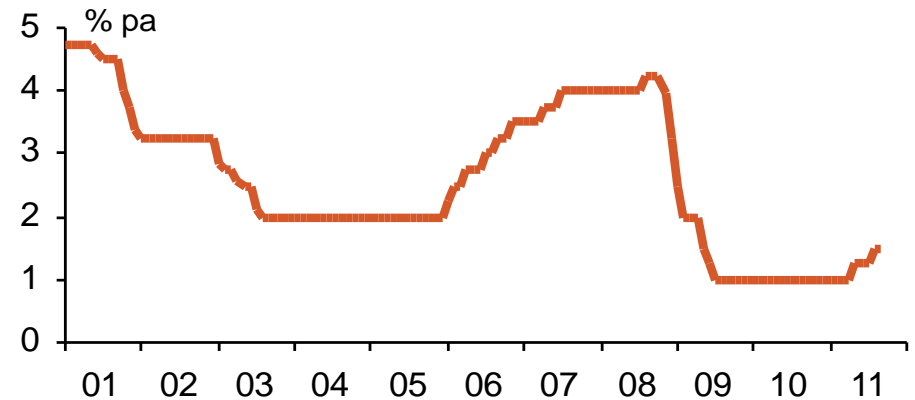
### Euro area public finances



### US policy interest rates



### Euro area policy interest rates



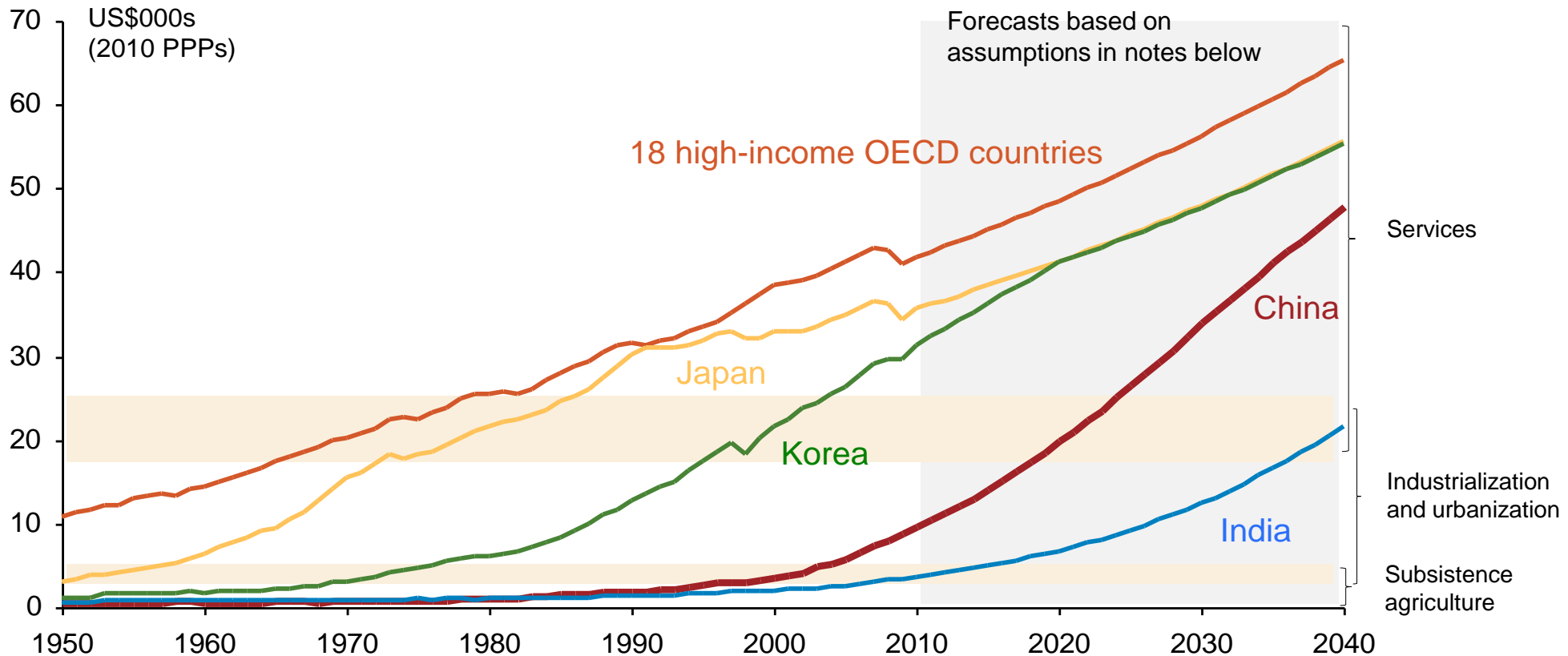
Sources: IMF World Economic Outlook (April 2011); US Federal Reserve; European Central Bank.

- Low economic growth can be a spur for productivity-enhancing reform
  - Australia in 1980s
  - Europe and USA current day
  - “Never allow a crisis to go to waste”
    - *White House Chief of Staff Rahm Emanuel*
- Labour productivity can increase during an economic downturn
  - Organisations shed workers
  - Cyclical unemployment
- Australian business is now less likely to shed workers
  - General belief that costs of re-hiring and training workers after 1991 recession was great
  - Prefer to ‘ride-out’ economic downturn and avoid costs of re-hiring and training new workers

- **High economic growth can also be a motive**

# China and India still have a very long way to go before they reach the range of per capita incomes where 'commodity intensity' starts to decline

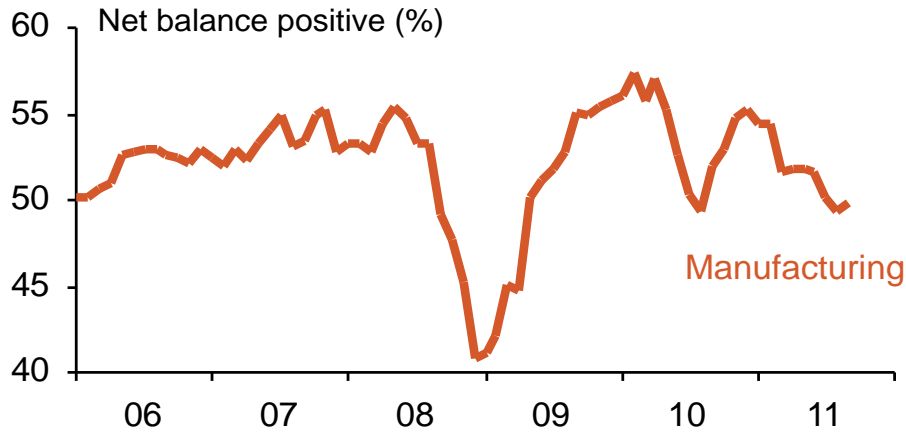
## Per capita GDP in 2010 US dollars, 1950-2040



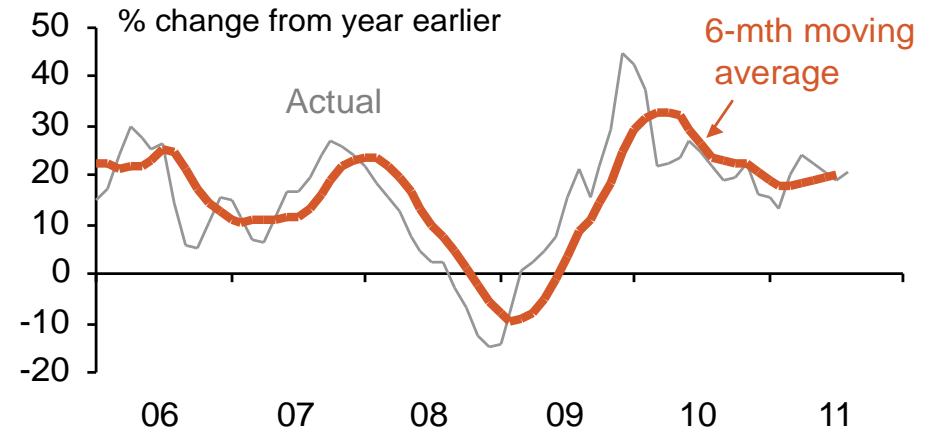
*Note:* GDP is in 2010 US\$, at purchasing power parities. The 18 high-income OECD countries are Austria, Australia, Belgium, Canada, Denmark, Finland, France, Germany, Iceland, Italy, Luxembourg, Netherlands, New Zealand, Norway, Sweden, Switzerland, the UK and the USA. Per capita income in these countries and Japan *assumed* to increase at 1½% pa from 2010 onwards. Per capita income in Korea assumed to rise at 3% pa 2011-2015, 2½% pa 2016-20, and 1½% pa thereafter. Per capita income in China assumed to rise at 8% pa 2011-2015, 7% pa 2016-2020, 6% pa 2021-2025, 5% pa 2026-2030, 4%pa 2031-35, and 3% pa 2036-40. Per capita income in India assumed to rise at 6½% pa 2011-2025, 6% pa 2026-2035, and 5½% pa 2036-2040. Sources: The Conference Board, *Total Economy Database*, January 2011 and author's calculations.

# China's economy is slowing a bit – as the authorities try to quell inflation pressures – but there's no suggestion it's on the cusp of recession

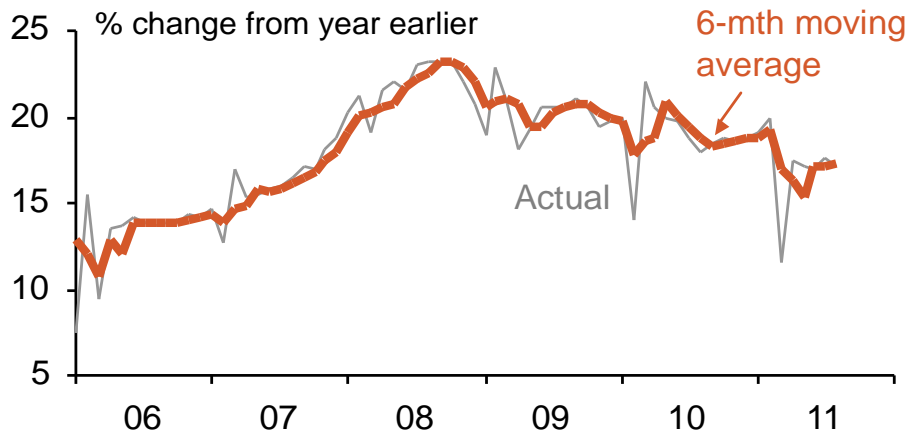
### China purchasing managers' index



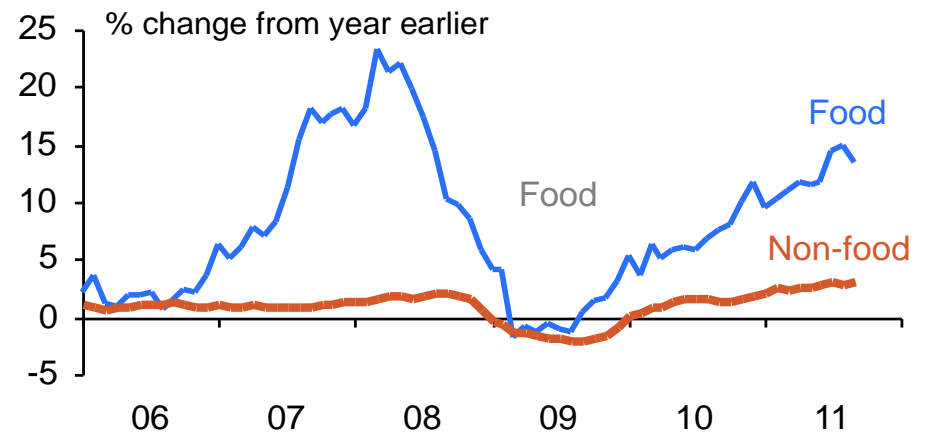
### China construction index



### China retail sales



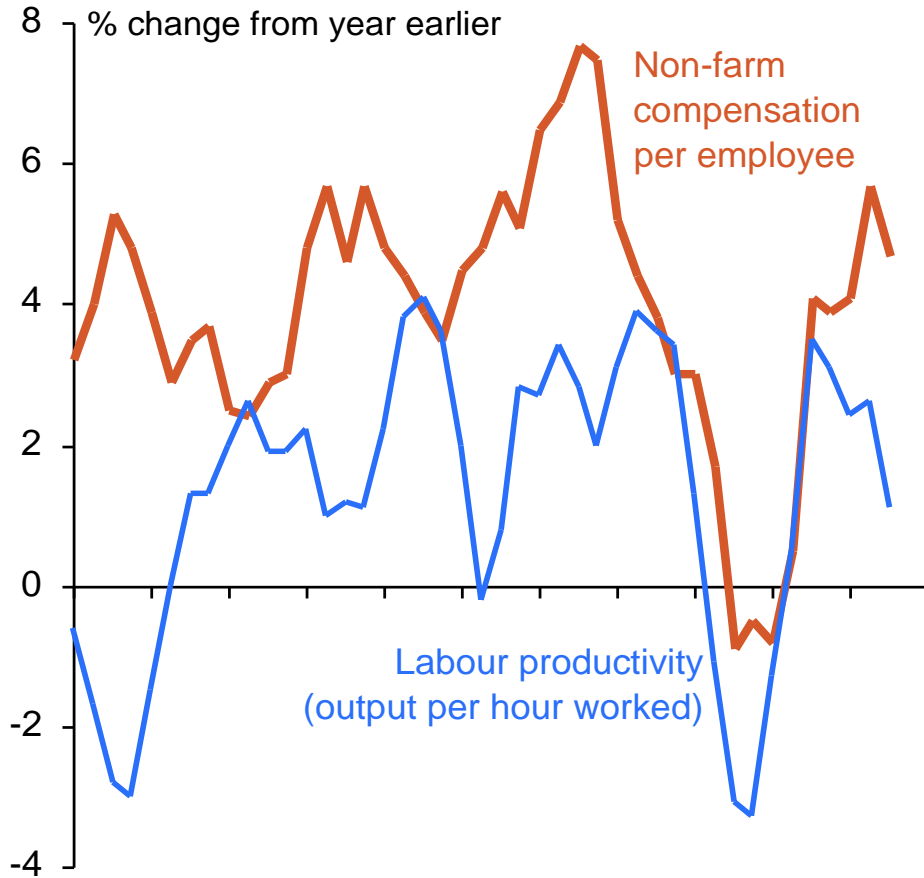
### China consumer prices



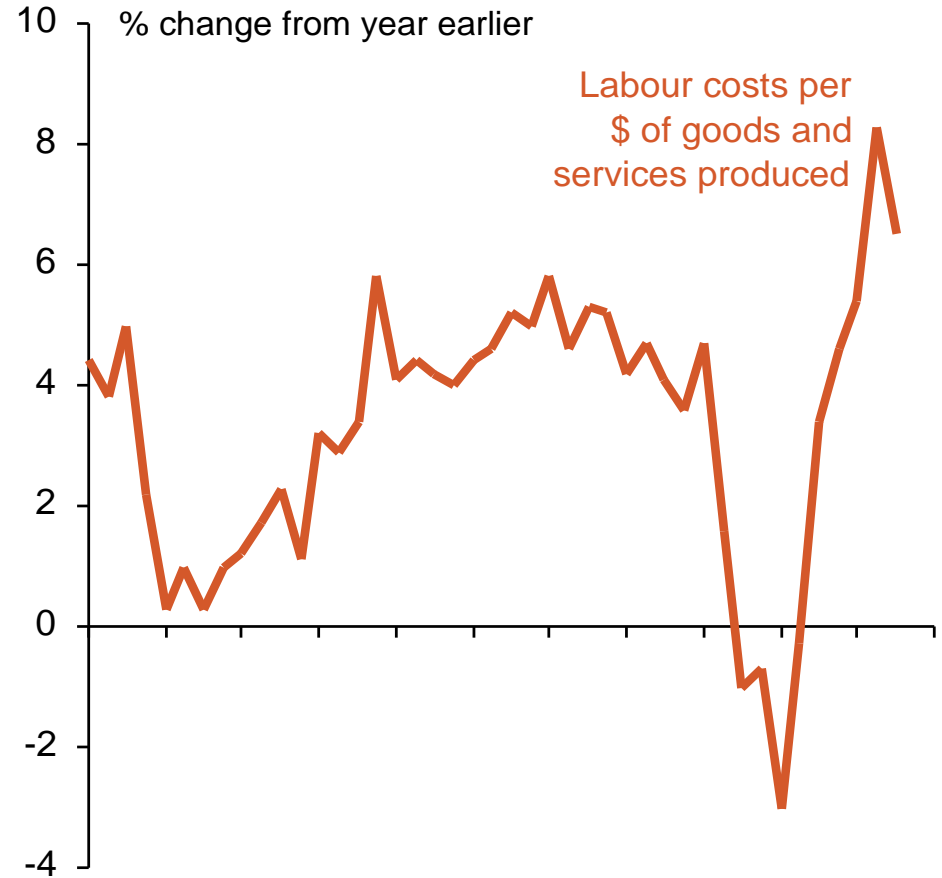
Sources: HSBC; China National Statistics Bureau; UBS Asia.

# Poor productivity growth means that even modest (by historical standards) wages growth can generate unacceptable inflation in Australia

## Labour cost growth and productivity



## Unit labour costs



Source: ABS.

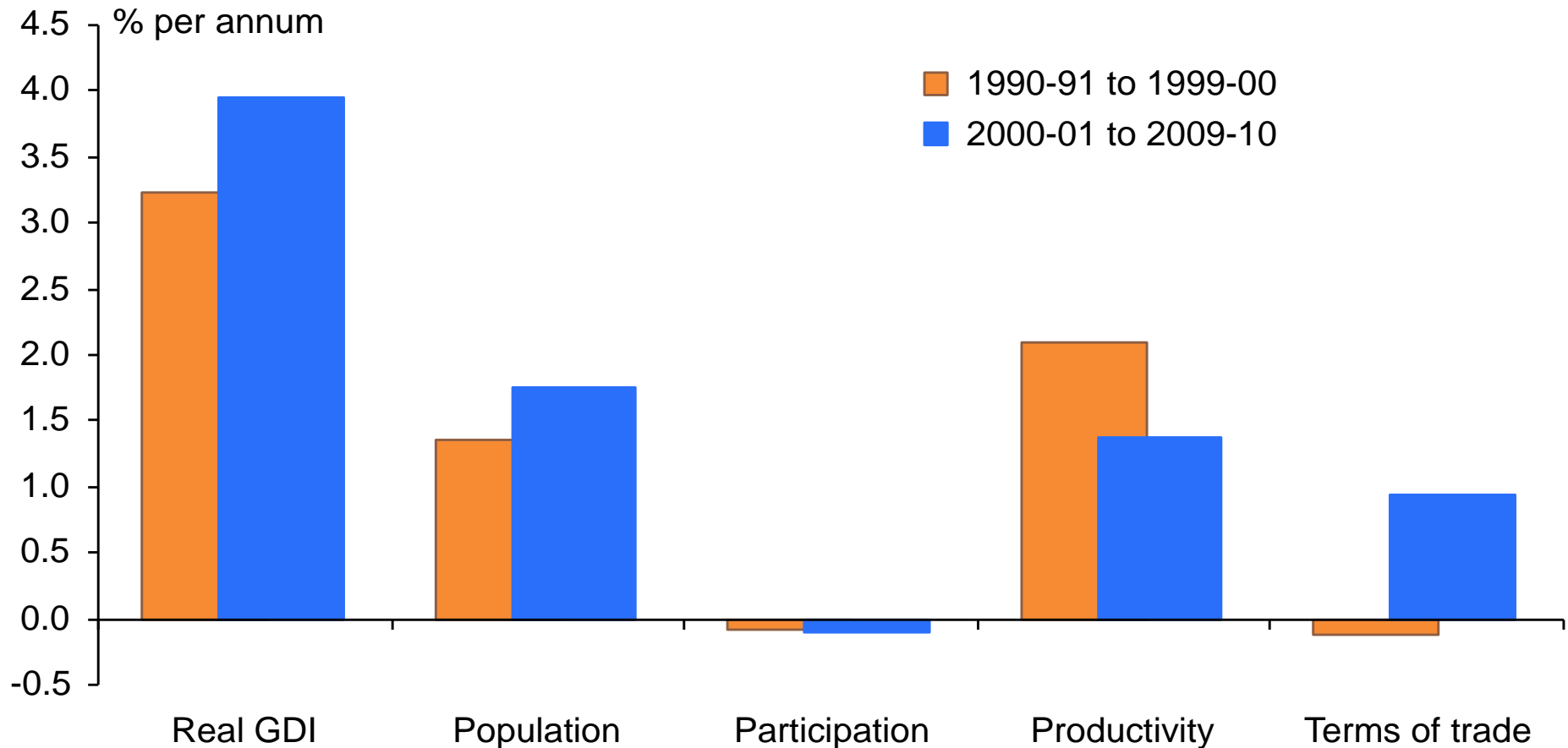
# BUT a warning from Australia

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- Do **NOT** enjoy your economic growth
  - We fear that complacency has set-in

# The impact of slower productivity growth on living standards has been masked by population growth and the rise in the terms of trade

## Sources of growth in Australian real gross domestic income (GDI)



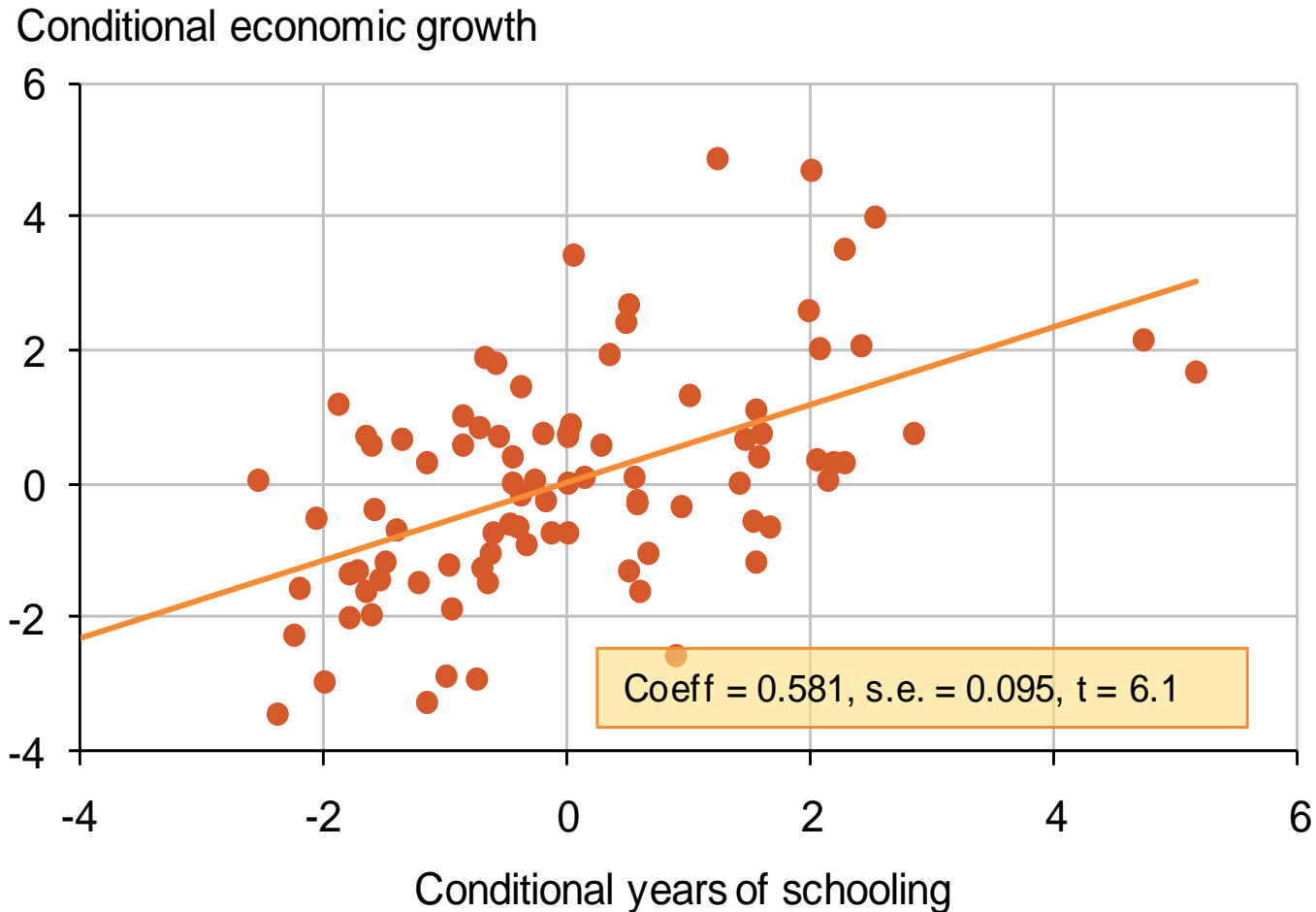
*Note:* Real gross domestic income (GDI) is real GDP adjusted for changes in the terms of trade.

*Sources:* ABS; Grattan Institute.



- **Still much work to do**
  - **Taxation reform**
  - **Removal of unjustified government assistance**
    - **Has increased in the guise of environmental reform**
  - **Some industries still protected from new entrants**
  - **Targeted infrastructure projects**
    - **Most infrastructure projects merely divert economic activity**
  - **Further deregulation and increased flexibility in product and labour markets**
- **Public sector productivity – school education**

## Economic growth and years of schooling

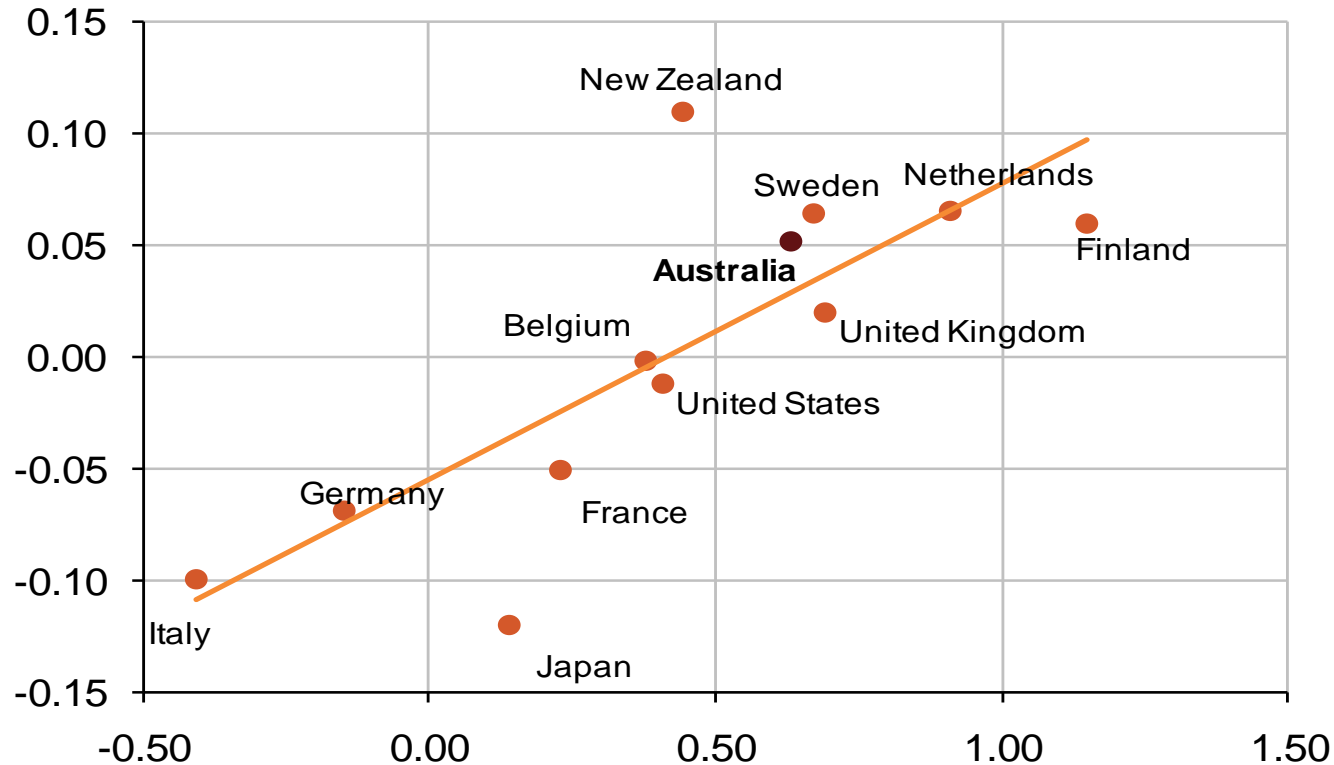


Note: These results are from a regression of the average annual rate of growth (in percent) of real GDP per capita in 1960–2000 on average years of schooling in 1960 and the initial level of real GDP per capita in 1960.

Source: Reproduced from Hanusheck and Wößmann (2007)

## Student performance and economic growth

Trend in growth rate



Trend in test scores

Note: Only 12 countries have participated in international tests over a sufficiently long period to look at trends over a 30 year period. In the chart, the 'trend in growth rate' is simply a bivariate regression of test scores on time. Trends in test scores are similarly derived. The plot provides the pattern of slopes from the test regressions.

Source: OECD (2010), originally presented in Hanushek & Wössmann (2009)

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- **OECD Program for International Student Assessment (PISA)**
    - **First results for Vietnam will be published in December 2011**

## PISA 2009 – Australia’s performance – regional comparison

### Reading literacy

Country/Economy	Below minimum	Minimum	Average	High performers
Shanghai-China	4.1	13.3	63.2	19.4
New Zealand	14.3	19.3	50.6	15.8
Singapore	12.4	18.5	53.3	15.7
Japan	13.6	18	55	13.4
Korea	5.8	15.4	65.9	12.9
Australia	13.4	20.4	52.6	12.8
Hong Kong-China	8.3	16.1	63.2	12.4
Chinese Taipei	15.6	24.6	54.5	5.2
Macao-China	14.9	30.6	51.7	2.9
Thailand	42.8	36.8	20	0.3
Indonesia	53.4	34.3	12.2	0
OECD average	18.8	24	49.6	7.6

## Impact on long-run economic growth

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- What is the relationship between student performance and economic growth?
  - Hanushek and Wößmann
    - One-standard deviation in test scores associated with
      - 1.74% increase in GDP growth rates
      - 1.47% increase in GDP growth rates for OECD countries
      - 1.26% increase in GDP growth rates (including institutional variables)
  - A more conservative estimate shows that a 5% increase in PISA scores in Australia associated with
    - Add over \$100bn to Australia's GDP by 2050, per annum
    - Make Australians 12% richer by the end of the century



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