

On hobby-horses to corral productivity

Stephen Grenville

The Australian Financial Review

24 October 2011

P. 23

'Productivity isn't everything, but in the long run it is almost everything'. So says Nobel economist Paul Krugman. This sentiment has been recently echoed by both the RBA governor and the new head of Treasury, so it must be firmly on the policy agenda. Who can argue with the idea that it is better to have more goods and services and that we should have them with a minimum of effort?

If this is a policy issue, we want to know the mechanics of how to get more productivity and how to measure progress towards this goal.

Measuring productivity is daunting. The intuitively attractive simplest measure is to measure GDP per worker or perhaps, a little more precisely, per hour worked. But workers are helped by more and better capital equipment. This should be taken into account. This is addressed by looking at how labour and capital worked together in the past, with 'multifactor productivity' being the residual that can't be explained by the traditional relationship between extra capital and labour. Given the problems of valuing capital, the changing mix of output and changing production techniques, attributing this unexplained catch-all residual to 'productivity' is unenlightening, but it's hard to offer anything better.

If that gets us thinking about how things have changed over time, then we need to acknowledge that the goods and services produced now are quite different from those produced even a few decades ago. Today's standard car is far superior to a car produced twenty years ago, in terms of safety, comfort and reliability. As well, it is cheaper. How should we value it when calculating productivity?

More dramatic changes in quality abound. The statistician tries to take some account of the fact that today's computer is vastly more powerful than one produced even ten years ago. If it runs a hundred times faster, should we value it as one hundred times the computer of ten years ago? For most of us, using computers only for inter-net access and word processing, the extra power is nice but not really that much better.

What of the huge productivity gains we see in health services? An appendectomy now means a short stay in hospital, and many procedures are done in day surgery.

What did the ATM do for productivity? If this is simply measured in terms of teller-time saved, it misses the huge increase in convenience. What about extended shopping hours? This reduced measured productivity (much the same quantity of goods is now sold over a longer period where shop attendants have to be present). But what a convenience it is to shop on weekends!

Even where the fall in productivity is indisputable, the implication is not. The positive windfall of commodity prices has reduced productivity in mining. It now pays to exploit less-rich deposits, using more inputs. But is this a bad thing?

Measurement isn't the only issue. Are we producing the things that are best for society? Largely, we leave this up to the market to decide: productivity measures just accept that the price reflects the true societal value.

This might be as good as can be done, but it is subject to the well-known serious imperfections. Where goods are not marketed (for example, most of the things supplied by governments, such as defence), valuations are based on the cost of production.

Externalities are missed. Those who feel that sitting in a traffic-jam is not helping their productivity might wonder if we have the optimal resources in urban transport and infrastructure. Whatever your views on carbon and climate, you may be dissatisfied as to how this issue gets measured in productivity.

We have clearly shifted in the direction of private-sector provision of schooling: how do we judge whether this is good or bad for society? Should we produce submarines at home or buy more cheaply overseas? Shouldn't we be putting aside some of the current terms-of-trade windfall into a wealth fund, funded by a substantial resources super-tax?

Perhaps the market isn't always getting the right pricing. In recent decades, the financial sector has attracted our best and brightest, but it looks like a fair bit of their time has been spent doing socially useless activities.

Are we putting in place the right regulations to ensure safe workplaces, keeping passengers safe on planes and good governance for companies? Or have we gone over the top, putting resources into excessive airport security, nanny-state interference and useless governance box-ticking?

How is the country's income distributed? The shift of income to corporate executives is symptomatic of a general shift towards greater inequality. This matters too. Finding jobs for all those who want to work matters also: we should make allowance for the success in getting unemployment down over recent years.

All this said, the heart of the issue is not measurement, but what actions are taken when prompted by a call for better productivity. For some, the answer is deregulation of the labour market, to allow the bosses to deploy the workers more profitably. This surely is important, but both Qantas and Jetstar work within the same formal labour regulations, with very different outcomes.

For some, the answer is more competition. The lawyers and taxi-companies should compete more vigorously. Bring on the ambulance-chasers. For others, discussion of productivity prompts a doctrinal call to reduce taxes and get governments out of the way, privatising state-run enterprises so that the private sector can do the job.

Maybe *all* these things matter in the very long run: if we get any of these decisions seriously wrong, it will probably show up eventually in productivity, so maybe Krugman is right in the very long term. But if the productivity debate just provides the opportunity for the usual hobby-horses to be taken for a canter, then not much purpose will have been served.

Stephen Grenville is a visiting fellow at the Lowy Institute for International Policy.

