

## **THE ROLE OF INSTITUTIONAL STRUCTURES IN CHANGE MANAGEMENT – THE AUSTRALIAN PRODUCTIVITY COMMISSION**

It isn't my usual practice to start out a discussion like this with a history lesson. I quite like economic histories, but I know they are considered pretty dull stuff by most people.

But I will start with history because it is a unique Australian story that the Australian Productivity Commission – the organisation I chaired until just a few weeks ago - can trace its lineage back more than ninety years. To a body that was established as part of the settlement of a great political and public conflict that emerged immediately after Australia became an independent nation, in 1901.

Like many countries over the past 100 years or so, as it became independent Australia sought to develop its manufacturing sector as a source of employment and national development by limiting competition from imports and establishing a culture of government support.

The tool of choice was often the application of a tariff or quota, applied to overcome a lack of scale and expertise presented to a newly independent but primarily agricultural nation.

The question of how much such assistance was enough was not a matter of science for our early leaders. It was more a matter of national pride.

But it was also divisive. As a newly independent federation of former colonies of England, our national government was not a solid political class. Possibly the most fundamental difference between the two largest colonies that joined together to create the Commonwealth of Australia in 1901 was a clash between free traders and protectionists.

The largest colony, New South Wales, was a free trade supporter. On the first occasion a vote for Federation was taken, it did not vote in favour. To gain its agreement, a commitment was made by the founding fathers to a number of concessions – one of which was specifically related to the use by the new national government of tariffs and the revenue they generated.

Despite this political compromise, in the early years after Federation, Parliamentary debates were dominated by heated arguments about how much assistance – if any – was just enough. For some, including of course the new

industries and the regions where they were located, any level of support was never likely to be too much.

Early Australian governments had actually collapsed over this conflict between free trade and protection, and instability was very damaging for a young nation in a world heading towards the conflict that became World War 1.

Immediately after World War 1, European nations erected new protectionist barriers in order to rebuild their fractured economies. The US responded (any similarities here...?) and the international acceptability of 'protection for all' became common political language on both sides of the Atlantic.

In this ugly environment, the Australian parliament did a remarkable thing: while it too adopted the view that protection in this environment was essential, it nevertheless also determined that some science must go into calculating how much assistance was necessary to encourage development without imposing too high a cost burden on the general population.

And that this science would be applied by an independent body, operating openly via public inquiry.

This new Tariff Board was created as long ago as 1921. It is the Australian Productivity Commission's original ancestor.

Because of the persisting strains between free traders and protectionists, its independent status was considered essential.

Being Chairman of the Tariff Board was accordingly a very big deal in Canberra in those days, more important than being Chairman of its successor the Productivity Commission is today.

The Board in the 1920s also provided a large part of the early Commonwealth Government's revenue, aside from the benefit that also was given to local manufacturers and distributors. So there was another reason why it was considered a very significant entity.

For most of its life, which in effect lasted until the late 1960s, the Tariff Board was a device for protecting an economy that focused on maintaining a trade policy set by its special relationship with its former colonial master in England.

But rapidly-growing economies - as many nations were by then with the productivity-enhancing innovations of air-conditioning, refrigeration, container shipping and transistor technology - do not cope with the restrictions and



impediments of quotas and high tariffs that had been built over those previous fifty years or so.

And the pressure those interferences in efficient resource allocation put on wage rates had caused serious inflation to emerge, along with a series of short boom and bust production cycles.

The Tariff Board, *as an independent entity*, decided in the late 1960s that it could no longer keep adding protection to an economy undergoing such structural challenge, and petitioned the government to allow it to shift its approach.

Eventually, it succeeded. It took seven or so years, and during this politicians from both sides ought to undermine its consistent but unwelcome message.

Even if it was independent in law, this was remarkably brave behaviour for appointees of any government.

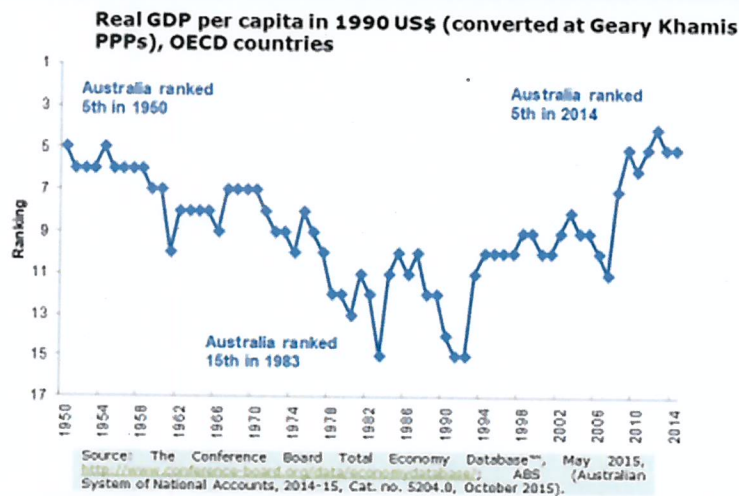
We live in civil societies where democratic principles ultimately prevail most of the time. Independent authorities are accordingly very useful for solving problems, but how and when they exercise their independence still requires great judgment. There is no doubt that this was a risky decision, but nevertheless history has proven a correct one.

The new bodies that succeeded the Tariff Board and eventually became the organisation I have headed since 2013 did not act alone.

But they were *the catalyst* for change away from the concept that had driven down national income growth in Australia, and opened up the case for a move towards greater efficiency and more concern for consumers.

The data I have included here shows how dramatically Australia declined as an economic entity from the 1950s, under a policy of protectionism. And how equally dramatically it rose again, from the 1980s, as that policy was replaced by a more open economy with a strong emphasis on growing those industries where we had natural advantages.

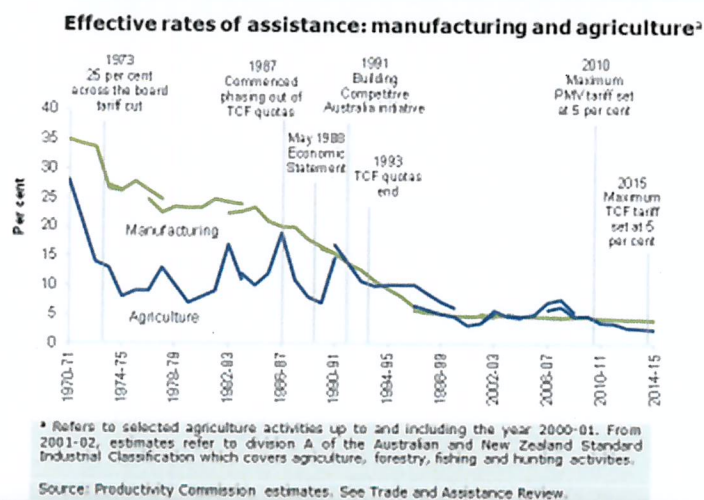
## Australia's OECD economic ranking



And this information maps the reforms of the Productivity Commission and its predecessors to the period of reform that coincides with Australia's return to strong and persistent economic growth.

Later, I will show you how this growth has been equitably distributed, as well.

## Effective rates of assistance: manufacturing and agriculture



Today, there is very little call for the Productivity Commission to use its independent and public process of review to investigate specific tariff levels or other barrier protection.

We still produce an annual analysis of how much each Australian industry sector is affected by Government intervention. Last year, the Australian Government still raised \$A5.9 billion through tariffs, almost none of which any longer serve any positive public policy purpose.

Manufacturing still receives almost all of that assistance. Mining and service industries (and their customers) still pay for it.

In my period as Chairman since 2013, we have only had one inquiry that was squarely focused on the kind of demand for increased tariff protection that the old Tariff Board would have faced. Yet it was every bit as ugly and angry as the debates between free traders and protectionist would have been ninety years ago. Data was manipulated, legal trickery was employed, politicians made increasingly hysterical claims and threats were made.

But our focus remained on obtaining independent confirmation of the applicant's data claims.

And we feel impervious to legal threat – as we must, if we are to be perceived as truly independent. The courts will do their work, and we will do our work.

And we accept that we work in a democracy where our politicians can play to the emotions of the public audience. This is the nature of a democracy, much as it can cause confusion and ultimately undermine the very credibility that political leaders so desire.

We know we must disregard the emotional nature of what is said, if we are to see our data and our analysis accepted in the public arena as the product of minds not influenced by political preference or ideology.

We are helped a little in this by recalling the brave independence shown by our predecessors back in the 1970s. But almost no one in Australia recalls this today, of course. Just us.

So while it is helpful, a little, when we come under pressure, history isn't what ensures we are respected as a source of truly independent quality advice.



That comes instead from creating and maintaining high standards of work, open to the comment and criticism of all, and actively demonstrating <sup>the</sup> in report after report published over twenty years now.

It is very valuable that the public and the news media that reports on politics and economics can see a public policy analysis slowly constructed through

- formal submissions from any interested party; and
- then the publication of a draft report; and
- then public hearings to critique that draft; and
- then a final report

This public audience may not always like **what** we propose to solve the problem, but they are always today likely to accord us the respect reserved for the truly independent about **why** this problem is as bad as it is.

In Chile, you are developing this kind of credibility with your own equivalent to my organisation, adapted to your local requirements. You are persisting through the political cycles and with constant commitment to truly independent analysis.

Political leaders generally value credibility – even as they may also be unhappy with its outcomes at times - and they want to be associated with it. So there should usually be a good reason for them to give you more work, if you are seen as this true source of credible analysis.

We have of course had our share of personal criticism. This too must be accepted as a badge of honour, if you are truly acting independently.

There have been periods in our twenty years as the Productivity Commission where our senior appointments were not renewed; where requests for new Inquiry work were ignored; where confrontations with Ministers ended up on the front page of newspapers.

But please note that this too now adds to our reputation. Because of this history, our independence is today unchallenged in the minds of all the industry and social policy groups, as well as our media commentators.

We of course also have our critics amongst affected industries or the beneficiaries of poor policy who claim we are wrong or foolish. And at times governments will prefer their view to ours. This too is democracy at work.

But we have taken away one advantage that such self-interested often have when shouting down good advice in many other countries. It is this: our critics gain no sympathy or support if they attempt to cast their criticism as suggesting that we have favoured one party or another.

Our critics have to be careful.

We are the genuine article.

Claims of conspiracy don't work here.

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Today, we don't spend much of our analytical time and policy design effort on tariffs and protectionism.

Our work is most often now directed to complicated questions of how to:

- remove impediments to competition; or
- encourage innovation and adaptation to new technology; or
- frame social policy – health, education, public services in cities - to enable and indirect lift in productivity, income and social welfare.

There is no simple yes/no answer to these kinds of issues, as politicians once thought there was with the application of a tariff or quota.

That complexity gives us a natural advantage over groups who claim to be able to solve a problem by simply spending more money or restricting competitors' behaviour.

Our advice is still developed in the same way we did when first investigating questions about who benefits from tariff assistance and whether that is in the national interest.

We still look first to what the data can tell us, and we seek to confirm it from independent sources. Social policy data in Australia is large in quantity but poor in quality.

Where it is contradictory, we publish that and try to force a debate between the claimants so that the bright light of public exposure limits parties from misleading or manipulative behaviour.

We are helped because our data analytics are still second to none. There are private sector advisers who are often employed to create favourable presentations for Parliamentary or even legal inquiries. They tend not to



bother us. We can if necessary expose their deception. Presentations that rely on public relations techniques to make their point generally cannot provide the genuine analysis that is essential when politicians finally decide that the problem must be solved.

By comparison with private advisory efforts, a Productivity Commission-style body can create the solutions that come from impartial analysis and so offer governments a reliable foundation for change.

Every judgment we make in our written reports has a line of evidence attached to it. Every piece of data in that line is weighed and analysed. And then it is all published.

There is no doubt that the data we have discovered and the way it is publicly presented means everyone – not just a few firms or a few bureaucrats – then knows the facts of the debate.

A wise government recognises that this is helpful for them, if they too are unsure of which argument is right.

The inquiry process allows our governments to say

‘The Productivity Commission is an independent body. Let us see what they find, and only then do we need to decide if it is important to do something’

To sum up at this point, three things matter, if structural reform issues are to be better addressed as societies become more complex and community expectations of what government can do for people naturally increase:

first, independence by the inquiry body is a unique asset that should be both protected and promoted by being constantly observable on every occasion. This is a matter of principle, and is unchanging.

second, independence is not exercised in a vacuum. It is not enough just to be independent. It must be accompanied by recognising, after completing all the analytical and design work, that there is a social context in which the work is occurring. The public will need to see that the inquiry body is aware of the impact that the community feels. This is about behaviour, and may change over the years.

third, conducting these processes as openly as the context allows is deeply desirable. Not only will future debates be better informed but in

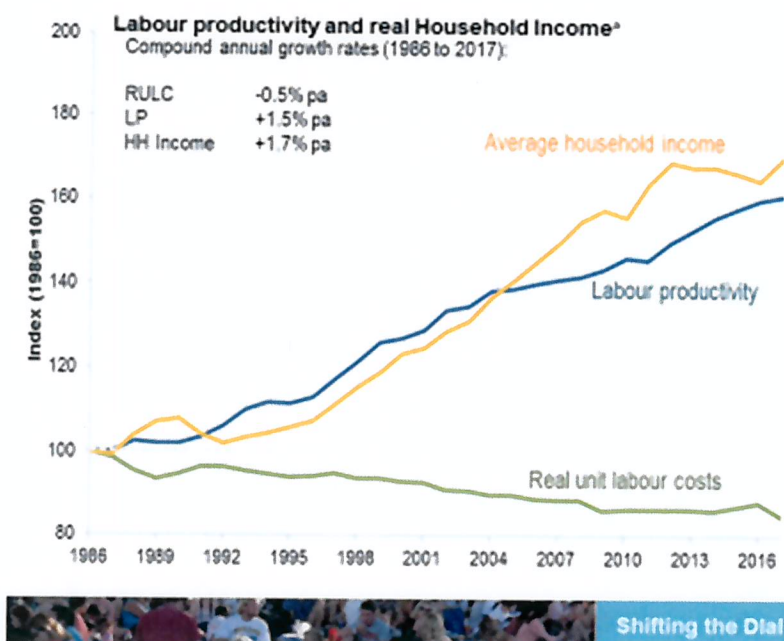


an age where politicians and media are claiming to meet a standard based on something as laughable as “alternative facts”, truth must be **seen to** develop, through debate.

In Australia, the Productivity Commission inquiry process, along with the efforts of other Australian agencies, has given us an economy that often exceeds expectations for a middle-sized nation a long way from the major centres of the world.

We have managed through a period of continuous change to grow productivity sufficiently to keep both labour costs manageable while family incomes persistently increase in real terms.

### ➤ Income growth out-performance



I'd like to finish today by showing our most recent effort at adding an independent policy voice to a growing public debate.

Possibly the most controversial topic in public policy amongst developed nations and developing nations alike is the question of inequality in the distribution of wealth and income.

We undertook a research program on this issue in 2018 because we can see in the political and policy shifts that have emerged in the past three or four years in Europe and the US a clear danger to an open economy like ours from ignoring a rising public perception of inequality.

All of us of course believe in greater equality.

But there is no easy way to identify when inequality is sufficiently serious to warrant public policy intervention.

Some much-admired nations with quite low inequality in the distribution of income have quite high inequality in the distribution of wealth. Which is the priority – wealth or income?

And what about opportunity? Should we redistribute more income through taxation and welfare spending, or should we try directly to address the causes of generation after generation being unable to break out of a cycle of disadvantage?

Perhaps we can try to do **all** of these things.

But first, we need to know all about the actual circumstances, not just the perceptions and alternative facts.

Because inequality is as much a feeling, as any single data point.

Australia now holds the record for the longest period of unbroken economic expansion since records of macro-economic growth started being kept around the world last century.

The slide I have included below shows the distribution of income growth across all deciles over this period of expansion.





All income deciles have grown in rough balance in Australia, unlike the growth in the same period in the UK or the US.

Not only that, but we have grown faster.

You might think that, with such a record, questions of inequality would be far from the public mind.

But higher growth almost inevitably means higher expectations.

Thus a reliable survey this year suggests 44% of Australians believe they have ***not personally gained*** from this record expansion phase.

Income deciles are good data but they aren't really a good response to this sort of perception.

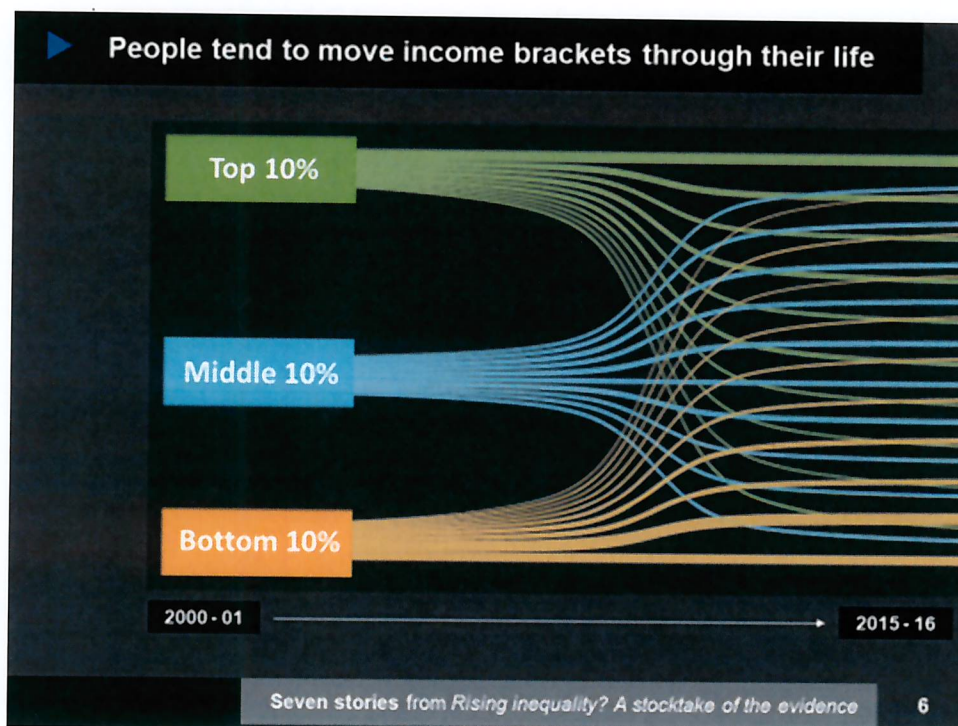
What might be better is to study opportunity.

Education, preventative health care and progressive redistribution of income are major factors in allowing *all* citizens an opportunity to lift their incomes and those of their family members beyond the income cohort of their parents.

So we did this analysis too, for all Australians.

And we found that people in Australia have an exceptionally good chance of moving out of the income cohort where they were born into another cohort.

We found that over 15 years, only a quarter of the highest income earners remained in the highest income earning cohort. And almost all middle income earners rose or fell in equal measure across the income cohorts as they aged. And only a similar quarter or so of the lowest income earners remained in that category for 15 years.



This relatively healthy distribution of opportunity is better than income deciles in triggering a public debate.

But it is nevertheless hard to use to communicate with the public. And we know that communication is very important for institutions like ours.

The voice of the independent adviser must be heard in a way that shows we are aware of the perception held in the public environment and respectful of it. I mentioned earlier, as one of my three key points, it is not enough to be independent and have the best analysis. Adapting what we say to the environment in which we say it, *without altering our conclusions*, is an art – but a very important one.

This work on inequality was only released a few weeks ago, just before I retired.

I would say it has proved to be effective with many political leaders.

But it remains a work in progress, in the public environment.



The Australian Productivity Commission hopes to be able to do more with this work, and contribute to offsetting in our nation the dangers that developments in the North Atlantic show us could occur if public disquiet is not addressed.

That's what independent agencies with strong credibility can do for governments.