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EGAN ASSOCIATES

DISCUSSION PAPER - PRODUCTIVITY

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eganassociates

Contents

1 Foreword

This discussion paper developed over several months by Egan Associates is intended to stimulate discussion on the nexus between pay and productivity across all tiers of Australia's workforce. This, our first discussion paper for a number of years, is intended to have a longer shelf life than our more regular KMP Reports which are both subject specific and time relevant. We do, however, trust that these observations are regarded as timely.

2 Acknowledgements

I would specifically wish to acknowledge the contribution of Indradeep Mazumdar in the compilation of research information and the analysis of various data, as well as the support provided by Virginie Maikim and the work completed by Suzanne Wohlthat in furthering our research enquiry, editing the document and verifying the accuracy of a myriad of footnotes.

In developing the framework for this report I benefitted from discussions with Professor John Buchanan, a colleague at the University of Sydney's Business School and Director of the Workplace Research Centre.

John Egan

3 Work Value

In recognition of workforce changes that have taken place incrementally over the last several decades and in particular had an impact on remote workforces, management and senior professionals in the private sector and in government, Egan Associates has developed a contemporary job evaluation model – eaIQ. The model recognises the changing knowledge requirements of workers in all phases of enterprise activity, also catering for the:

- Increasing requirement for innovation;
- Accelerating adoption of technology;
- Management of risk;
- Motivation of diverse workforces; and
- Working conditions as a work value differentiator for the less well paid.

The last element addresses work value premiums for hardship when compared to employees not exposed to remote working environments, long shifts and demanding physical working conditions or the requirement to spend extended periods away from a home base.

eaIQ offers an online tool with many additional features, including the ability to compile position descriptions using Egan Associates' library, drawn from more than three decades of consulting research and assignments.

4 Executive Summary

Egan Associates has closely followed the progressive enhancements in employment conditions negotiated over the last half century. While we acknowledge the many challenges associated in providing all working Australians and families with an appropriate standard of living, it is our view that payments to a proportion of the Australian workforce are currently out of step with the rest of the world.

Australia's preservation of penalty rates, overtime, and other cost-additive provisions has in some cases lost relevance in a world where access to information and assistance via the internet is 24/7 and goods and services are available for purchase online or through traditional channels seven days a week. Many of the current employment conditions and provisions were established before the advent of these factors and at a time when most families were supported by only one working adult.

We are not suggesting that some activities and working hours should not attract a premium. We clearly acknowledge that the changing nature of work in many occupations requires different skills from those relevant in the 50s, 60s and 70s and realise wages across all segments of the workforce will be influenced by the availability of suitably qualified and skilled employees. In this context, we strongly support government and employer commitment to continuing education and training.

Yet the fact remains that if Australian businesses are to grow, they need to be globally competitive or face further outsourcing of semi and highly skilled tasks to lower cost or more efficient workforces. Given this, businesses' deployment of capital and use of technology must reflect international best practice and their labour cost inputs need to be competitive.

In our judgement, put quite simply, productivity growth and global competitiveness will only arise when our units of output per unit of cost (including wages) meet and/or exceed world standards. Our analysis has revealed that this is not presently the case.

Similar lenses to those employed to explore productivity for workers covered by awards and/or enterprise agreements should be used to view pay for senior managers, executives, key management personnel (KMPs), and government employees.

We have observed that private sector employees exempt from enterprise agreements, including senior managers, executives and KMPs, have experienced one to two years of fixed remuneration freezes, while award or enterprise agreement covered employees have in accordance with established agreements steadily obtained remuneration increases in excess of the consumer price index.

Government employees have also gained fixed remuneration increases greater than award-exempt private sector employees, as their adjustments are in accordance with agreements, industrial provisions or a general expectation that there will be regular though modest increases to employees' fixed remuneration at all levels.

Some would argue that the recent restraint in the pay of award-exempt employees including KMPs is part of a necessary post GFC correction to match reward to outputs. We would note that the market is still in a period of transition, and that adjustments to remuneration settings are unlikely to have run their course.

Premiums in staff and executive reward should be based on the demands of the work, considering complexity, diversity, accountability and work conditions. The scope and complexity of many senior management roles within leading companies has increased significantly over the last twenty years as companies have become increasingly global and have grown significantly in terms of revenue, profit and market capitalisation.

Certain minimum remuneration must be provided independent of performance outcomes to match these varying workforce attributes, yet management and Boards of both public and

private organisations must ensure that they **do not allow reward adjustments to outstrip growth in outputs**. At the management level they must ensure there is a **relationship between bonuses awarded and organisation outputs**, which impact directly on shareholder and taxpayer welfare.

If productivity is not a driving factor at the top of the organisation, it will be difficult to implement it elsewhere.

4.1 A Viewpoint

After considering various stakeholder opinions on productivity, which we have summarised in section 9, we offer a viewing point on the focus necessary to improve Australia's productivity to the levels required to foster wage growth and improved living standards for all of the nation's workers.

Egan Associates is not in a position to offer all the answers but we have endeavoured to identify areas where further investigation may highlight regulatory or legislative impediments detrimental to the national interest as well as abuse and/or misuse of power or influence by business, governments, lobby groups, senior executives including the Board or workforce representatives.

Achieving a more productive economy clearly requires cooperative engagement from all stakeholders. This entails:

- Employers committing funds to research and development, innovation, and ongoing training and development of the workforce;
- Management recognising their role and accountability in elevating productivity;
- Governments continuing to contribute to the education of our youth and those seeking to change careers; and
- Employees engaging in the world of work under terms and conditions that have relevance on a global footing, contributing to the nations' competitive advantage.

In terms of reward, employers should:

- Align the value of the work people are asked to do and what they get paid;
- Acknowledge that if portions of the workforce take on complex and onerous tasks they should be paid a premium considering environmental hardship and physical risk;
- Ensure that the most effective and best trained people progress in terms of position importance and reward; and
- Avoid paying premiums to management or any worker (particularly incentive premiums) if their contributions do not improve long-term shareholder wealth.

Governments and their leadership play an essential role in establishing a framework both in terms of policy and regulation. Their decisions either foster or inhibit international engagement, productive work practices, workforce training and trading relationships. Ultimately governments can engender an environment which is pro development and advancement for the benefit of all in the community or they can be obstructive to prosperity. If the government does not act on productivity, any private sector action will be undermined. Therefore, the government should:

- Commit to further award simplification;
- Move away from the view of the world of work created in the 1950s and 1960s in terms of workers receiving premiums for varying shifts and certain days of the week;
- Remove legal provisions that are an impediment to employment because wages or work practices are out of step;
- Provide financial encouragement to increase growth, skills and innovation by way of further education, R&D grants and trade grants;

- Open employer access to sources of capital and skilled labour at internationally competitive pay rates to ensure planned and prospective development reflects 'best in class' outcomes;
- Ensure its own workforce is productive, its work practices contemporary and its conditions of employment reflective of the 21st century; and
- Investigate the merit of greater tenured exchange with the private sector at a leadership level while not unduly disturbing the core of expertise which ensures government and industry meet their stakeholder expectations.

We note that the recently elected Coalition Government in Australia has clearly stated that one of its key tasks is to implement policies targeted to make real improvements in productivity, competitiveness and growth, ensuring Australia becomes a stronger economy capable of delivering stronger real wage growth and job creation.

The government's agenda is comprehensive, representing a challenge on a scale and scope not addressed by any other single Australian headquartered entity. It will mean improving the nation's productivity performance, growth prospects and ability to compete globally while maintaining principles of balance and fairness. It will need to have regard to factors of jurisdictional risk, socio-political risk, currency risk, raw material and supply risk. It will also need to be accomplished while oversighting the day-to-day inputs and outputs of the National Government's $350 billion plus budget.

We also note that the Australian Governments at both Commonwealth and State level have been undertaking **reviews of their workforce** requirements, **performance management** systems **and outcomes** with a focus on improving productivity.

In government, executives' work has become increasingly complex, with a growing diversity of constituent needs and the increasing influence of our international engagement on the prosperity of both our state and national economies.

Establishing and implementing common standards of pay and performance management across such a substantial workforce is a challenging task, requiring the development of formal protocols to ensure (to the extent practicable) that employees at all levels across government employ are treated similarly.

In the private sector there is a degree of variability in fixed and variable executive reward, reflecting variability in the level of expenditure, revenue and enterprise value resulting from the rigours of competition and vagaries of the market. In contrast, in government entities, remuneration at the leadership level normally increases on a steady annual basis, having regard to labour force movements, population growth, expenditure and inflation. Payments reflecting performance are modest when compared to the private sector and are increasingly managed conservatively.

The inner sector of both Commonwealth and State Governments (being the administrative and policy arms) have more restricted incentive programs than the outer sector engaged in the delivery of services and the management of businesses. Where government organisations are strongly exposed to the private sector, incentive rewards will be more prominent.

If the government is to increase its workforce productivity, it needs to:

- Control movement through the pay range, ensuring employees are paid for skill and contribution and not just for time served;
- Ensure clear lines of accountability exist;
- Invest in technology and shared services to improve workforce productivity and potentially reduce reliance on low skill roles;

- Investigate whether the current employment structure is the most efficient, or whether it makes more sense to have fewer employees with more paid in a higher pay bracket contributing to enhanced productivity; and
- Bring workforce entitlements (including special superannuation legislative provisions) into line with the private sector to increase mobility between the workforces, create a level playing field for Australian workers and improve the global attractiveness of the Australian workforce.

5 Background

Productivity is defined by the Australian Bureau of Statistics as the efficiency with which an economy or business transfers inputs, such as work (labour) and assets (capital) into outputs, such as goods and services.[1]

As the former Chairman of the Productivity Commission Gary Banks noted in a 2012 speech[2], productivity is not a policy objective in its own right. Instead, it is considered to be a key driver of the growth, competitiveness and living standards of a nation.

Normally, improvements in living standards would be enabled through productivity improvement and until recently this had been the case for Australia. However, in recent years it has been the record terms of trade reached during Australia's mining boom which improved wages and living standards rather than a productivity boost.

With investment in the resources industry under review and commodity prices in decline, both government and business have become increasingly mindful of the need to improve productivity in order to sustain current living standards. In the current economic climate improving the nation's productivity is vital.

Recent research by Price Waterhouse Coopers (PwC) has indicated that given Australia's current low productivity growth expectations, wages are expected to stagnate in relative terms, recording approximate growth in real wages of only 0.5% per year through to 2030.[3]

According to PwC estimates, Australia will move from having the highest average monthly real wages in the world to the fourth highest. The research highlights that **Australia's position can clearly only be maintained if we achieve world's best practice in managing productivity growth**.

[1] Australian Bureau of Statistics, *Measures of Australia's progress: Summary 2012*, cat no. 1370.0.55.001, ABS, Canberra, 2012
[2] G Banks, *Productivity: the To Do List*, Proceedings of the Economic and Social Outlook Conference 'Securing the Future', Melbourne, 1 November 2012, p.3
[3] D Hinwood, *Australian Standard of Living at Risk as Real Wages Stagnate*, PwC, media release, 2 October 2013

6 Productivity Performance

The overall measure of productivity (multifactor productivity) is a composite of labour productivity and capital productivity. Labour productivity is the output per unit of labour input, while capital productivity is the output per unit of capital input. Because output responds to market demand, which moves in cycles, productivity is also recorded in cycles. The latest productivity cycle was completed in 2007-2008. Figure 1 shows ABS data on compound average annual growth rates between productivity cycle peaks for selected industries.[4]

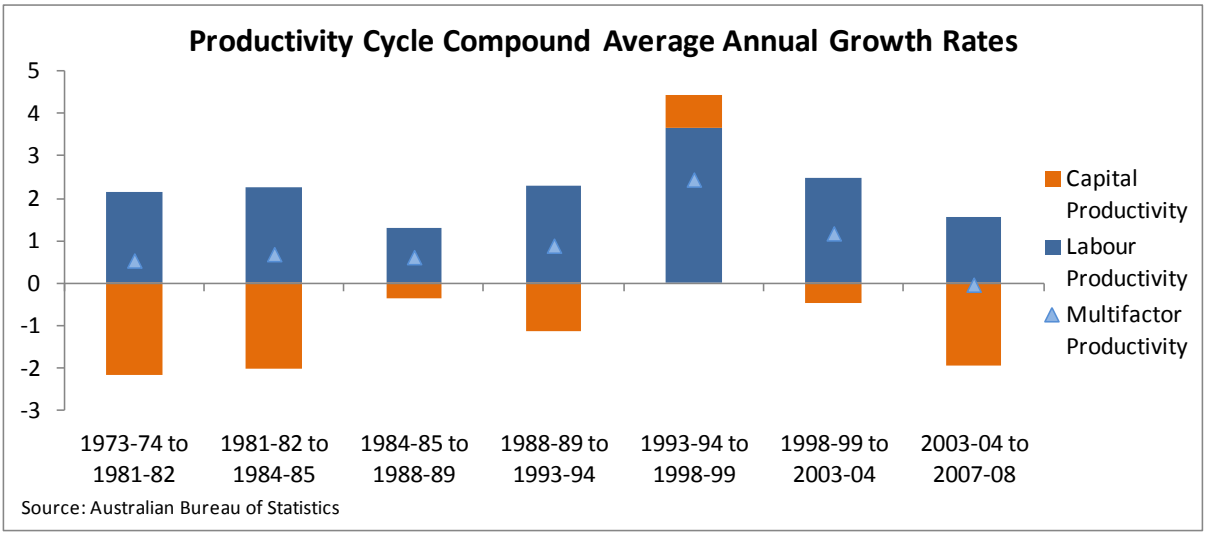

Figure 1: Annual Productivity Growth Rates for Historical Cycles

The largest increases in productivity occurred during the 90s, which experts attribute to technology advances and reforms introduced in the 80s by the then Labor Government, including cutting tariffs, deregulating labour, privatising government assets and floating the dollar.[5] These reforms were instrumental to opening Australia up to external and internal competition.

Australia's productivity appeared to pause at the end of the 20th century as evidenced by Figure 1 and Figure 2. **The last eight years have seen negative or negligible growth in multifactor productivity** in large part due to a lag in capital return.

The Reserve Bank's December quarter 2012 Bulletin highlighted evidence of a productivity upswing following the release of 2011-2012 productivity data, but added that it was too early to see a trend, as much longer runs of data are required in this field.[6]

It is worth noting that some sectors are not captured when measuring multifactor productivity. It is hard to quantify meaningful outputs in the service areas of health, education and training, public administration and security, contributing to a shortfall in data for calculating multifactor productivity. PwC estimates in its June 2013 productivity scorecard that these sector areas make up 26% of employment and 18% of output.[7] It further states that a significant proportion of these services are provided by government, indicating a need

[4] Australian Bureau of Statistics, *Estimates of Industry Multifactor Productivity 2011-2012*, cat. no. 5260.0.55.002, ABS, Canberra, 2012
[5] G Banks, Australian Government Productivity Commission, *The Drivers of Australia's Productivity Surge*, Proceedings of Outlook 2002 Conference, Canberra, 7 March.2002, p.1
[6] G Stevens, 'Producing Productivity', *Reserve Bank of Australia Bulletin December Quarter*, Address to the Committee for Economic Development of Australia (CEDA) Annual Dinner Melbourne, 20 November 2012, p.87
[7] J Thorpe, *PwC Productivity Scorecard*, Price Waterhouse Coopers, June 2013, p.4

for a specific focus on government productivity to make the most of taxpayer funds and the labour contribution of almost 2 million public sector employees.

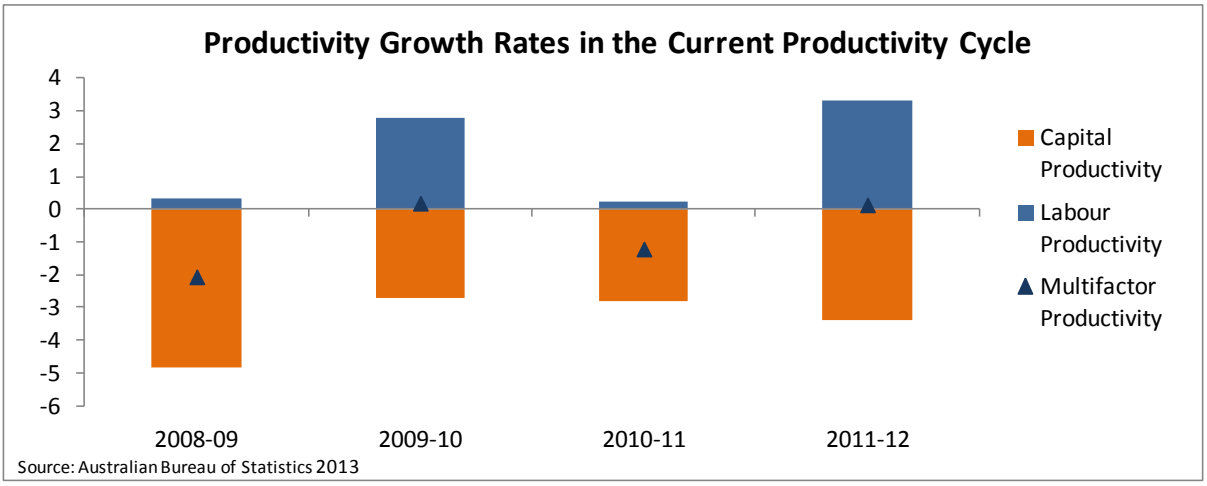

Figure 2: Annual Productivity Growth in the Latest Productivity Cycle

Australia's productivity decline has been broad based, with falls across most industries, as highlighted by economist Saul Eslake in a 2011 Reserve Bank of Australia conference. Figure 3 displays the relative labour productivity performance of selected industries for 2000-2007 compared to the 90s.[8] Mining and utilities experienced particularly large declines.

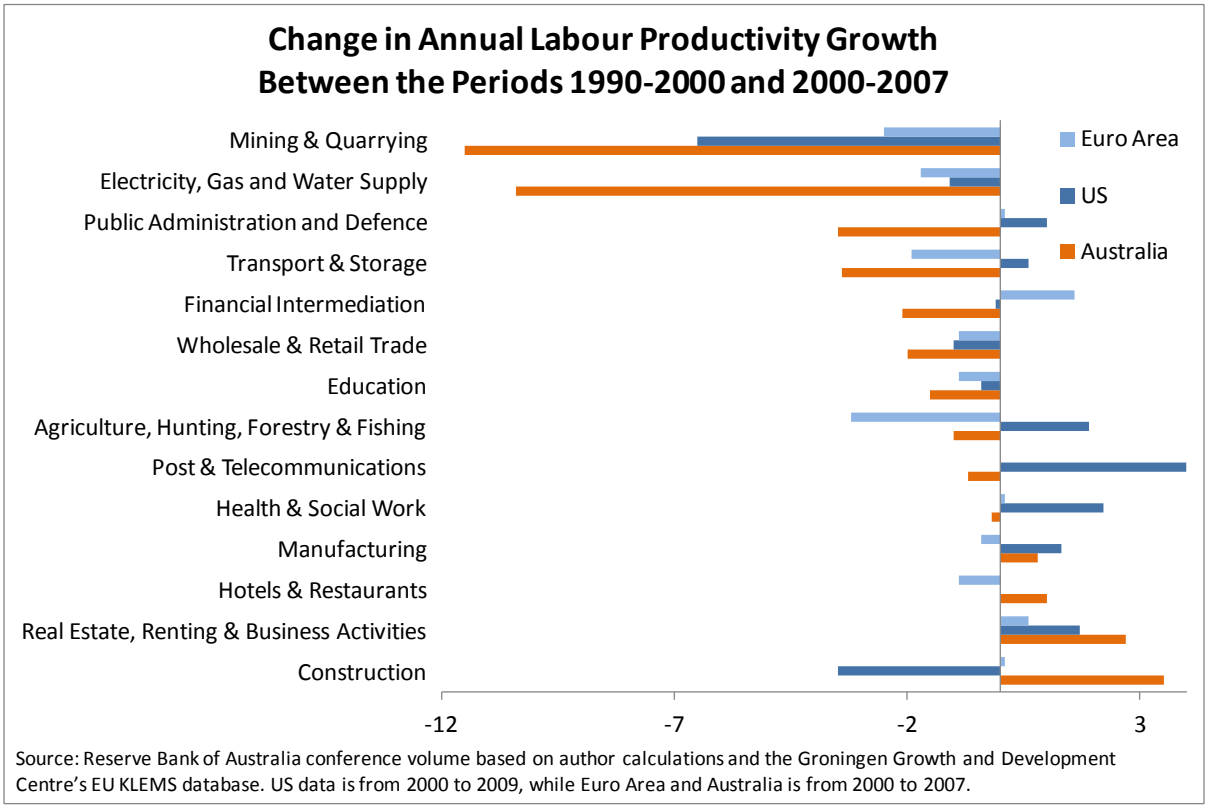

Figure 3: Change in Labour Productivity Growth between the Periods 1990-2000 and 2000-2007

In its 2013 Productivity Update[9], the Productivity Commission attributed mining's decline to

[8] Saul Eslake, *Productivity: the Lost Decade*, Proceedings of the Reserve Bank of Australia the Australian Economy in the 2000s Conference, 15-16 August 2011 ,Sydney, p.236

[9] Productivity Commission, *2013 PC Productivity Update*, Productivity Commission, May 2013, p.21

falling resource quality, poor cost control, and a surge of investment that is yet to generate outputs. The utilities industry declines are thought to be due to drought and spending more on power networks for better environmental, aesthetic and safety outcomes.

The reduction in productivity is by no means an Australian phenomenon. Most countries experienced lower slower growth in the 2000s than the 1990s, as can be seen in Figure 4 and Figure 5, showing the absolute per annum growth in multifactor and labour productivity for the two periods.[10]

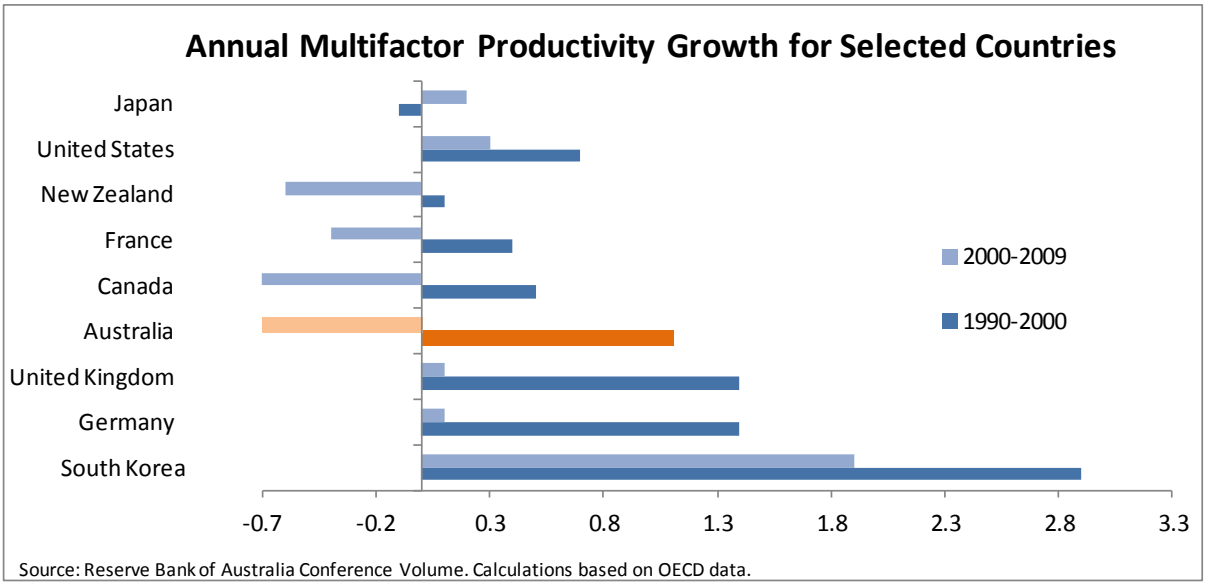

Figure 4: Absolute Annual Multifactor Productivity Growth in Selected OECD countries

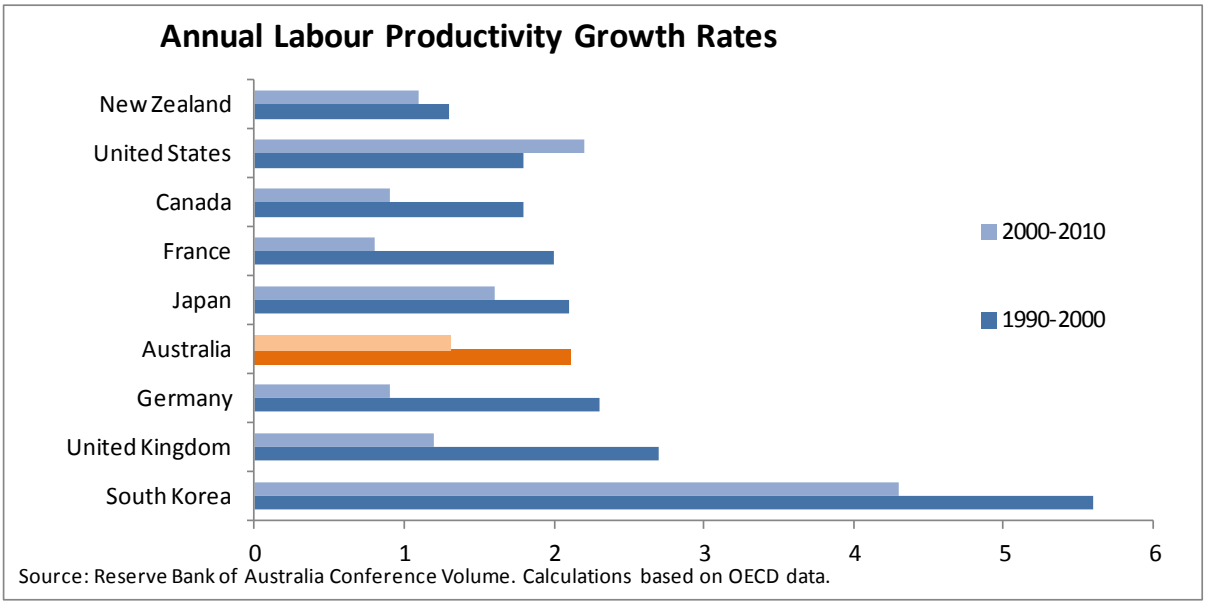

Figure 5: Absolute Annual Labour Productivity Growth in Selected OECD Countries

Eslake noted that while Australia's decline in labour productivity from the 1990s to 2000s was broadly in line with the decline in other countries **its decline in multifactor productivity was more than double the unweighted average decline for the other countries**. Contributors to productivity and possible causes for Australia's fall in productivity are discussed in the following section.

[10] Eslake, p.228

7 Contributors to Productivity Performance

Recent reports both international and domestic in scope offer a number of explanations for the possible deterioration of Australia's productivity. We provide an outline of issues that need to be carefully considered.

7.1 Competitiveness of the Nation

Australia scores highly in various measures of competitiveness, but certain changes have begun to detract from our standing.

Australia achieved the third highest ranking in the Wall Street Journal and The Heritage Foundation's *2013 Economic Freedom Index*[11], which ranked 184 countries on individuals' (and by extension businesses') ability to control labour and capital. The index was based on 10 indicators divided into four pillars:

1. Rule of law (property rights, freedom from corruption)
2. Limited Government (fiscal freedom, government spending)
3. Regulatory Efficiency (business freedom, labour freedom, monetary freedom)
4. Open Markets (trade freedom, investment freedom, financial freedom)

Although Australia's overall score of 82.6/100 is above regional and global averages, it is lower than last year by 0.5 points. Corruption and business freedom gains were offset by declines in labour freedom and the management of government spending as seen in Figure 6, which shows indices for which Australia's performance changed over the last three years.

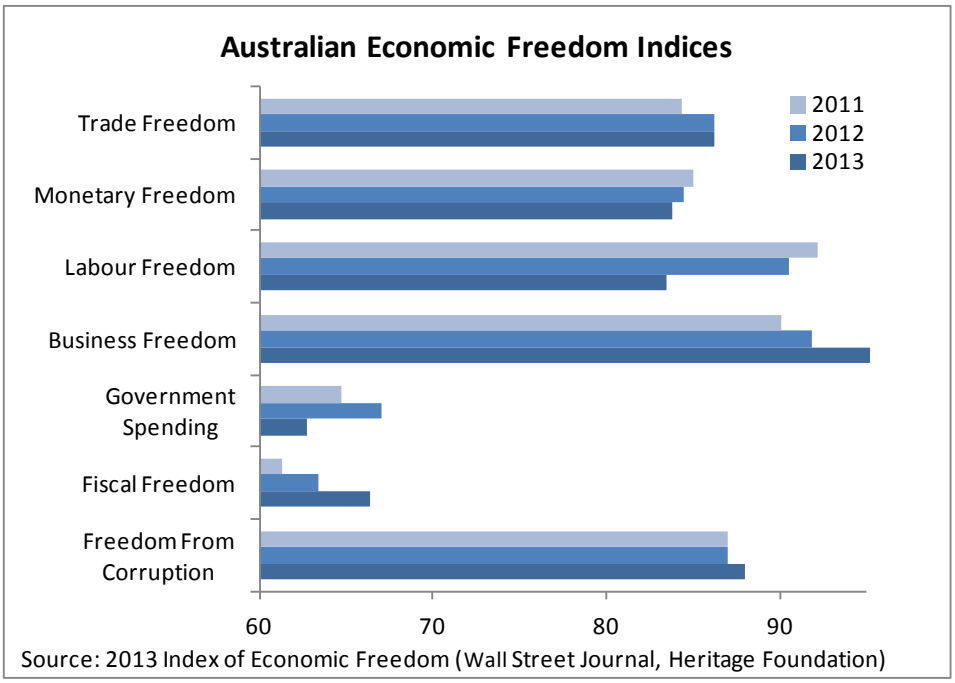

Figure 6: Australian Economic Freedom Index Scores

In the World Economic Forum's *Global Competitiveness Report 2013-2014*, Australia exited the list of the top 20 most competitive countries for the first time to be ranked 21st.[12]

New Zealand, on the other hand, jumped five places to 18th. The report noted that Australia had delivered a consistent performance across the board, with highlights being financial

[11] The Heritage Foundation and the Wall Street Journal, *2013 Index of Economic Freedom*, 2013, viewed 17th September 2013

[12] Klaus Schwab, *Global Competitiveness Report 2013-2014*, World Economic Forum, 2013, p.110

market development, higher education and training, the modest budget deficit and the macroeconomic situation. **The main concern according to the Forum was the rigidity of the labour market, for which Australia fell 12 ranks to 54th**. Australia's rigidity of hiring and firing practices and wage setting placed it 137th and 135th respectively, while the burden of government regulation placed Australia 128th.

The World Bank and International Finance Corporation's *Doing Business 2013* report was more positive[13], ranking Australia 10th of 185 nations for ease of doing business. There is still room for improvement, as other developed nations rank better than Australia, for example New Zealand, which achieved the third rank.

	Australia	Canada	France	Germany	NZ	UK	US
Overall Ease of Doing Business	10	17	34	20	3	7	4
Starting a Business	2	3	27	106	1	19	13
Dealing with Construction Permits	11	69	52	14	6	20	17
Getting Electricity	36	152	42	2	32	62	19
Registering Property	37	54	146	81	2	73	25
Getting Credit	4	23	53	23	4	1	4
Protecting Investors	70	4	82	11	1	10	6
Paying Taxes	48	8	53	72	21	16	69
Trading Across Borders	44	44	27	13	25	14	22
Enforcing Contracts	15	62	8	5	17	21	6
Resolving Insolvency	18	4	43	19	13	8	16

Source: World Bank. 2013. Doing Business 2013: Smarter Regulations for Small and Medium-Size Enterprises. Washington, DC: World Bank Group. DOI: 10.1596/978-0-8213-9615-5. License: Creative Commons Attribution CC BY 3.0

Table 1: Australia's Ease of Doing Business Relative to Other Countries

The Economist Intelligence Unit's *Global Index of Workplace Performance and Flexibility*[14], commissioned by the Australian Human Resources Institute and the Society for Human Resource management, ranked 51 nations on how each was seen as a place to operate a business productively, fairly and flexibly, supported by three sub-index rankings in the fields of economic performance, operating environment, and workplace policy and regulatory framework.

Australia's operating environment ranked 8th best in the world, but our policy and regulatory framework placed at 19th. Australia's economic performance ranked 34th, which Australian Human Resources Institute President Peter Wilson said highlighted Australia's "stuttering productivity record over the last 10 years relative to our global competitors".

While economists and policy-makers have acknowledged for some time the negative impact of the high dollar on sectors such as manufacturing and tourism, the reality is Australia is likely to see more manufacturing production move overseas where production and labour costs are lower if we do not act on certain competitive disadvantages.

Further, if Australia becomes a high cost investment destination with regulatory uncertainty, it may price itself out of future business investment.

[13] International Bank for Reconstruction and Development/World Bank, *Doing Business 2013*, International Bank for Reconstruction and Development/World Bank , 2013, p. 147

[14] Economist Intelligence Unit, *Global Index of Workplace Performance and Flexibility*, prepared for the Australian Human Resources Institute and the Society for Human Resource Management, July 2012

7.2 Absence of Productivity Reforms

There are concerns within the business community that there has been a recent lack of focus on productivity during policy formulation.[15]

RBA Governor Glenn Stevens said in 2012 that **government and business needed to note the Productivity Commission's list of productivity-enhancing reforms that had not been enacted and carry them out.**[16]

Former Productivity Commission Chair Gary Banks then presented his to-do list[17], noting that since the Productivity Commission had been established in 1996, 110 inquiries had resulted in 1,500 policy recommendations to governments, around two thirds of which had been "more or less" implemented.

He admitted that those **items that remained on the to-do list were the "hardest political nuts to crack"** that would often disadvantage a vocal majority. His belief was there was "no single thing that can do the job", but instead what is required is **"good process in policy"**.

7.3 Red tape

Unconsidered legislation can hinder the ability of competitive markets to function. It can also reduce the ability and the incentives for organisations to change, an important factor for productivity growth.

Many considered good processes to be lacking in the significant amount of regulation that had been passed by the Labor Government in its 2010-2013 term – an analysis in June 2013 by the *Guardian* found that former Prime Minister Julia Gillard had achieved the highest rate of acts per day passed of any Australian Prime Minister.[18]

Economist Saul Eslake has stated that the **past decade has seen a significant amount of productivity-stifling legislation and regulation**, most of which was targeted at improving security or corporate governance standards.[19]

He contended that much of it simply copied developments in the United States or England, irrespective of different circumstances in Australia and has only rarely been subjected to any kind of regulatory impact or cost-benefit analysis before being imposed or in retrospect.

He believes that all too often such regulations result in the employment of large numbers of people to do tasks of little real value.

As mentioned in Section 7.1, the Economist Intelligence Unit's Global Index of Workplace Performance and Flexibility ranked Australia's policy and regulatory framework 19th out of 51 economies, leading the report's sponsor to conclude that in a globalised competitive world Australia's regulatory framework "stands out as overly restrictive and conducive neither to optimal performance nor social equity".

7.4 Infrastructure

Both the public and private sector depend on the provision of infrastructure such as roads, rail corridors, energy and water to meet their stakeholder expectations – it provides the platform for production and distribution. Inefficient infrastructure leads to higher costs for businesses and wasted time, affecting their international competitiveness.

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[15] CPA Australia, *Enhancing Australia's Prosperity*, CPA Australia, 2011, p.2.
[16] Stevens, p.97
[17] Banks, p.1
[18] N Evershed, 'Was Julia Gillard the most productive Prime Minister in Australia's History?', *The Guardian*, 28 June 2013
[19] S Eslake, *Productivity on the Decline*, Institute of Chartered Accountants Australia, 22 December 2011

Although Infrastructure Australia's *2013 National Infrastructure Plan* outlined a $300 billion infrastructure deficit[20], focus from many parties has not been on spending more to address this deficit, but rather conducting better analysis of potential infrastructure projects such that the infrastructure that is funded and built is efficient and productivity enhancing.

The Grattan Institute noted in its June 2012 *Game-changers: economic reform priorities for Australia* report that the percentage of GDP spent on public infrastructure had been on the rise in recent years, approximately doubling from 2003 to 2011.[21] It praised the use of Infrastructure Australia's assessments to decide on which projects were to be funded, but highlighted that global costs for infrastructure projects were normally higher than forecast, while benefits were considerably lower.

Working from Infrastructure Australia assessments, the Grattan Institute concluded it was unlikely more than $10 billion in infrastructure projects would actually be considered productivity enhancing and ready to proceed each year. Since that amount was already being funded, there was no likely productivity improvement in increasing investment in infrastructure[22].

In a 2013 presentation, the Institute further stated that in the context of the forecast long run of government deficits, infrastructure spending was actually likely to fall.[23] Given the high failure rate of Public Private Partnerships to build infrastructure, innovative new funding arrangements such as the NSW Government's intention to use money from selling a 99-year ports lease to build the planned WestConnex toll road and then sell it once traffic numbers are known may be a way forward.

Under the Coalition Government, there is likely to be more collaboration on infrastructure between federal, state and territory governments and in general a greater focus on efficient infrastructure, as "productive" infrastructure is a key plank in the Coalition Government's policies. In addition, there is likely to be a greater focus on innovative financing structures that encourage increased public-private collaboration and involving formal recognition of associated productivity imperatives.

The Coalition Government has decreed that Infrastructure Australia will be run more independently than under the former Labor Government, identifying which projects are of national significance and investigating economic and procurement reforms to fund those projects. Evidence-based audits of the infrastructure assets are to be conducted at five-year intervals.

7.5 Taxation

The government influences productivity significantly through tax, which not only affects incentives for work and entrepreneurship, but also for the allocation and efficiency of resource use. Even excluding special taxes such as the carbon tax, **Australia's 30% corporate tax rate is high in comparison to some OECD countries**.

Figure 7 shows the state-level tax rates of selected OECD countries[24], excluding targeted industry taxes.

[20] Infrastructure Australia, *National Infrastructure Plan*, Infrastructure Australia, June 2013, p.6
[21] Grattan Institute, *Game Changers: Economic Reform Priorities for Australia*, Grattan Institute, June 2012, p.27
[22] Grattan Institute, p.62
[23] J Daley, *Budget Pressures and Infrastructure Spending*, Grattan Institute, Speech to the Committee of Perth, 14 September 2013, p.2
[24] OECD, *OECD Tax Database*, OECD, 2013, viewed 12 September 2013

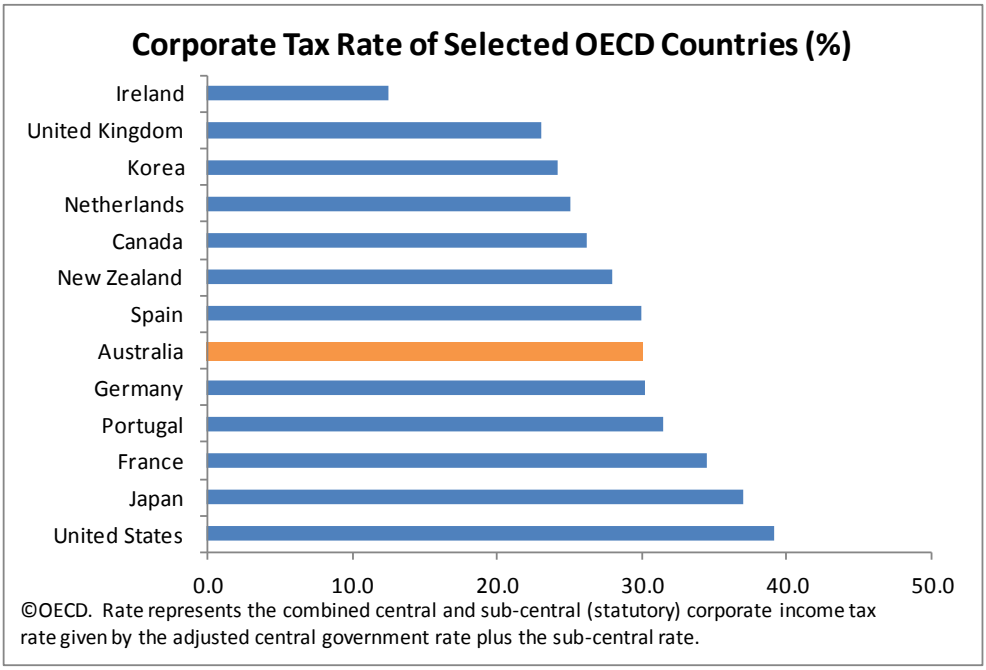

Figure 7: Corporate Tax rates of Selected OECD countries

Business has long argued reducing tax rates supports growth. Certainly by reducing costs and therefore the price of inputs, it would improve business productivity. A 2010 review of Australia's future tax system suggested reducing the corporate tax rate to 25%.[25]

It is not only the cost of paying taxes that impacts productivity negatively. Complex tax systems create confusion. According to the same tax review, of around 120 Australian taxes, ten contributed 90% of government revenue. Collecting the remaining 110 taxes cannot be productive, given the output is so low. More critically, tax systems directly impact the allocation of resources which ultimately impacts the productivity of factor inputs such as the skew of investment towards concessionally taxed intangible assets.

From 138 recommendations of the review mentioned, the prior Labor Federal Government wholly or partially accepted just 19 recommendations, demonstrating how politically charged changes to taxation can prove.

7.6 Innovation

Innovation and technological advances improve productivity by enabling the development of new processes for more efficient workflows or new products that boost the value of outputs, helping a nation to respond to global competitiveness and improve economic sustainability.

According to the Federal Government's *Australian Innovation System Report 2012*, **innovation-active businesses** are defined as those that have introduced an innovation, are in the process of developing an innovation or have abandoned an innovation project. Innovation-active businesses are:[26]

- 42% more likely to report increased profitability;
- Three times more likely to export and 18 times more likely to increase the number of export markets targeted;
- Four times more likely to increase the range of goods or services offered;
- More than twice as likely to increase employment;

[25]Department of Treasury, *Australia's Future Tax System*, Department of Treasury, 2009, p. xix
[26] Department of Industry, Innovation, Science, Research and Tertiary Education (DIISRT), *Australian Innovation System Report 2012*, DIISRT, 2012, p. ix

- More than three times more likely to increase training for employees; and
- Over three times more likely to increase social contributions.

Although the report stated that the amount spent on R&D was rising (companies registering for the R&D Tax Concession rose from 7,906 in 2007-2008 to 9,118 in 2010-2011), it also stated that the number of innovation-active businesses remains constant at 40% and business innovation performance is poor by international standards, particularly for large businesses.

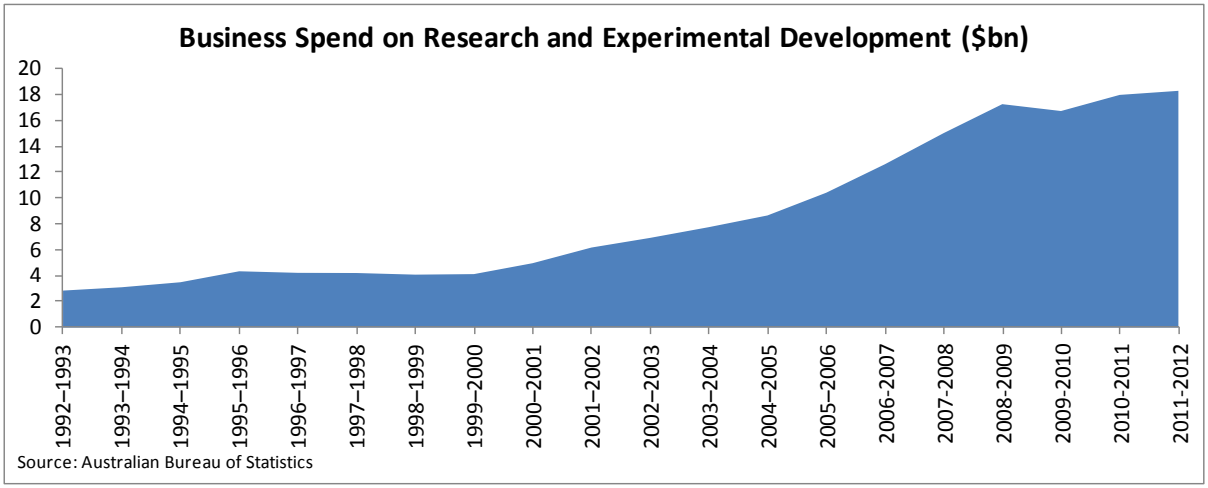

Figure 8: Australian Business Spend on Research and Development

The report painted a picture of Australia as a 'fast-follower' country that does not lead with new-to-the-world innovations, but rather invests in adopting and modifying the innovations of others. Australian businesses are also poor at collaboration and less of them are doing it: the proportion of innovation-active businesses collaborating with universities or other research institutions has declined by 21% since 2006-2007.

Notwithstanding this, the *Global Innovation Index 2013* conducted by Cornell University, INSEAD and WIPO ranked Australia 19th of 142 countries for innovation, a rise from 23rd in 2012.[27]

Although this ranking secured Australia a position in the "innovation leaders group" as identified by the report, it also classed us as an "inefficient innovator".

While our innovation input ranking is 11, reflecting years of growth in R&D spending, our innovation output ranking is only 32, giving us an innovation efficiency rank of 116.

Our strengths were considered to be our:

- Market sophistication;
- Number of knowledge workers and amount of knowledge-intensive employment;
- Institutions (including the effectiveness of government and regulatory quality); and
- Education system and research efforts.

However, we fall short on our technology exports and on the amount of investment in innovation that comes from overseas due to our poor capital productivity performance.

Australia's rank for Cornell University, INSEAD and WIPO's Network Readiness Index has also been stagnating. This index ranks economies' capacity to exploit the digital age using the quality of their regulatory, business and innovation environments, the degree of preparedness, the actual usage of Information and Communication Technology (ICT) as well as the societal and economic impact of ICT. Australia has gradually fallen from sitting within

[27] Cornell University, INSEAD, WIPO, *The Global Innovation Index 2013*, Cornell, INSEAD, WIPO, 2013, p.135

the top ten in 2003-2004 to only achieving the 18th rank in 2012-2013.[28] **Australia's score has been reduced by the poor affordability of our ICT**, according to the index's creators.

The 2013 GE innovation barometer was more positive, recording that 52% of 3100 executives from 25 markets surveyed regarded the Australian environment as conducive to innovation (67% of Australian executives).[29]

Yet it also noted that the survey items involving government support are more negatively evaluated than the global average and are in decline when compared to the 2012 GE barometer. Executives surveyed indicated that policy objectives for the government in innovation should be:

1. Ensuring business confidentiality and trade secrets are adequately protected;
2. Fighting bureaucracy and red tape for accessing innovation incentives; and
3. Encouraging a stronger entrepreneurial culture in the education system.

7.7 Labour Skills

One of the biggest barriers to innovation named by business in these reports is limited access to skilled people.

The *National Workforce Development Strategy* released in March 2013 stated that improving skills will lift workforce participation, as people aged 25–64 with a qualification are nearly 20% more likely to be in the labour force than those without a qualification.[30]

More Australians are completing tertiary education – the proportion of people aged 25 to 64 who have attained tertiary education rose from 27% in 2000 to 38% in 2011, according to the *OECD Education at a Glance 2013*.[31] This ranks Australia 10th out of 31 countries.

Yet companies complain of being unable to source the skilled workers they require, desiring skilled migration to fill the gaps. Although skills shortages have eased since the advent of the 2007 global financial crisis, without targeted action **Australia could be 2.8 million short of the number of higher-skilled qualifications that industry will demand by 2025,** according to the *National Workforce Development Strategy*.

ABS data for 2011-2012[32] indicates skills that are in the greatest demand include:

- Engineering for the mining industry;
- IT professionals or support technicians for the IT, financial/insurance, professional, scientific and technical services industries;
- Trades for a range of industries including agriculture, forestry and fishing, mining, manufacturing, construction, wholesale trade, accommodation and food services;
- Transport, plant and machinery operation for the mining, construction and transport industries;
- Marketing for the wholesale trade, accommodation and food services, the arts and recreation services industries;
- Business management for the accommodation and food services industry; and
- Financial skills for the transport, postal and warehousing, financial/insurance services, and administrative and support services industries.

[28] Cornell University, INSEAD, WIPO, *The Global Information Technology Report 2013*, Cornell, INSEAD, WIPO, 2013, p.21
[29] Edelman Berland, *GE Global Innovation Barometer 2013 Results Focus Australia*, 2013, prepared for GE, p.40
[30] Australian Workforce and Productivity Agency, *Future Focus 2013 National Workforce Development Strategy*, Australian Workforce and Productivity Agency, March 2013, p.12
[31] OECD, *OECD Education at a Glance 2013 – Australia Country Note*, OECD, 2013
[32] Australian Bureau of Statistics, *Selected Characteristics of Australian Business 2011-2012*, cat. no 8167.0, ABS, Canberra, 19 September 2013

Some unions and employees believe **employers are taking the easy and cheap way out by sourcing labour overseas instead of spending money on training local staff.**

The barriers to further training identified by the Survey of Education, Training and Information Technology (SETIT), last conducted in 2001, were **lack of time, financial restrictions and lack of employer support** – most of which could be attributed to a lack of planning and training culture.[33]

According to the Australian Bureau of Statistics' Training Expenditure and Practices survey, last conducted in 2001/2002[34], when employers provided training:

- 55% aimed to maintain professional or industry standards;
- 38% aimed to meet legislative or regulatory requirements;
- 54% aimed for staff development and advancement;
- 53% aimed to improve the quality of goods and services;
- 35% aimed to develop and maintain a flexible and responsive workforce; and
- 36% aimed to respond to new technology.

The utilities and government sectors provided more training than other sectors.

Innovative businesses were three times more likely to increase training for employees than non-innovators, according to the *2012 Innovation report*.[35]

Figure 9 displays the different skill use of innovation-active and non-innovation active businesses. Interesting is the higher use of IT professionals, marketing, business management and financial skills by innovation-active businesses.

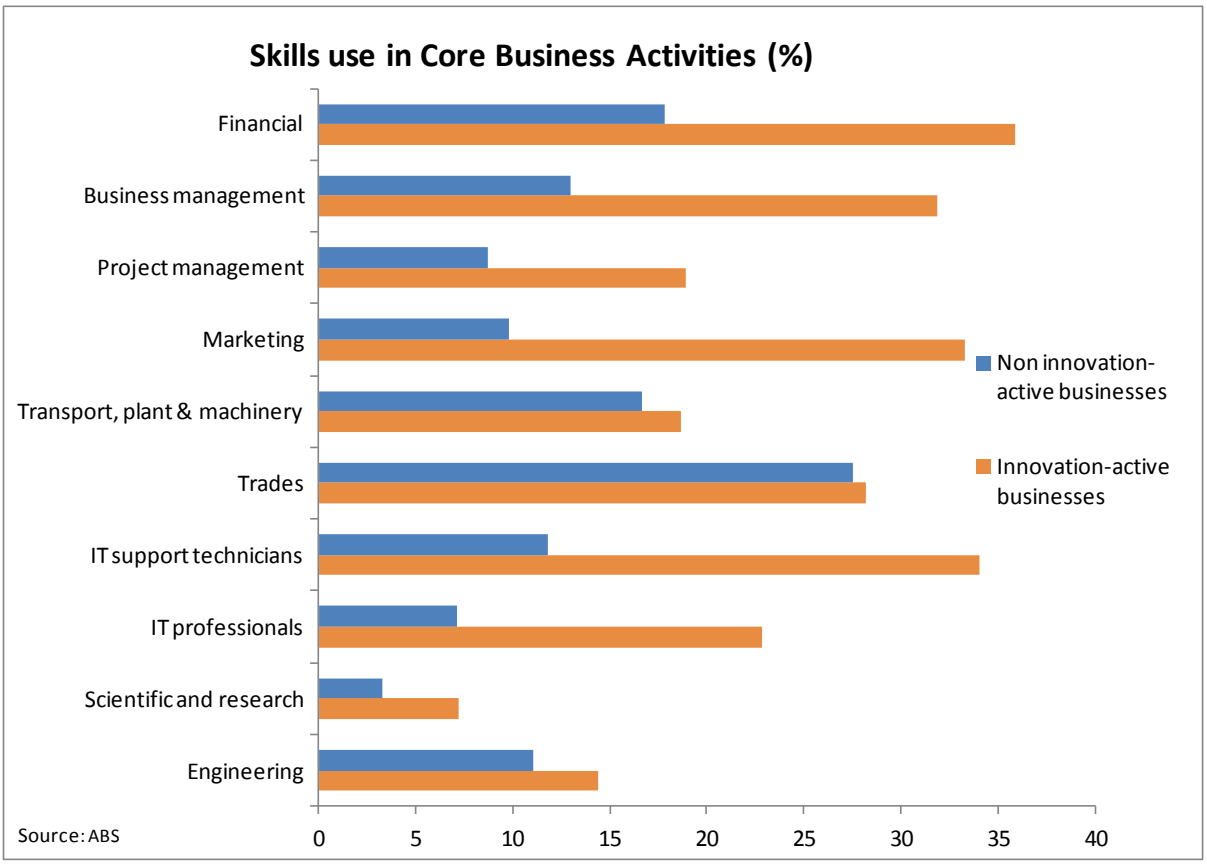

Figure 9: Skills use in innovation-active businesses

[33] Australian Bureau of Statistics, *Education and Training Experience Australia, ABS, Canberra,* 31 May 2002
[34] Australian Bureau of Statistics, *Year Book Australia 2004*, cat. no 1301.0, ABS, Canberra, 27 February 2012
[35] Department of Industry, Innovation, Science, Research and Tertiary Education, p. ix

Wage differentiation between skill levels is one way to encourage workers to obtain skills, but in some cases such as in the education sector, unions resist such differentiation, voicing the belief that workers performing the same task should be paid the same.

Jobs that provide salary increases on time-based progression are not, however, the same as jobs that provide increases for skills-based progression.

The *Australian Public Service (APS) Remuneration Report 2012*[36] revealed that the median increase in Base Salary for APS employees in 2012 was 5.8%. One of the reasons this increase was more than a percentage point higher than the average weekly earnings increase for the year to November 2012 is what is called incremental movement.

Most public service agencies have around two to five increment points in the pay scale for each job classification. Each year, employees advance to a higher increment point if they achieve at least satisfactory performance outcomes and receive higher pay. Once they reach the top of the pay scale, their base salary only increases by the general wage increase.

The report used this example[37] to illustrate this situation:

Classification	Salary before commencement date	Salary from commencement date (3% increase)	Salary from 1 July 2012 (3% increase)	Salary from 1 July 2013 (3% increase)
APS 6	$76,694	$78,995	$81,365	$83,806
	$73,554	$75,761	$78,034	$80,375
	$70,644	$72,763	$74,946	$77,194

If the general wage increase is 3% per year, the actual increase for an employee in the sixth level of the APS classification system (APS 6) over three years would depend on how long the employee had been employed at that level.

If they have served a number of years at that level and already have their maximum increment points, the wage increase (represented by the blue line) would be 9.3% compound. However, for an employee just starting out at the APS 6 classification level and receiving increment points with each year, the total increase in base salary over the same time period would be 18.6% compound (denoted by the red line). It could be questioned whether the latter employee's skills have increased at the same rate as their pay for each additional year they serve.

A number of annual pay increment strategies like the above highlight the challenges faced by employers and the conflict that may exist with employees. In an organisation where incremental adjustments are automatic through a pay range irrespective of performance or the acquisition of additional skills, the pay policy sends an entirely different message from that of an employer which acknowledges the acquisition of additional relevant skills and performance improvement.

Either approach can lead to challenges in managing internal pay equity. Time-based pay increases lead to an exemplary worker receiving the same pay as a satisfactory worker of the same tenure, while flawed systems for performance-based increases can lead similarly performing workers receiving very different levels of pay.

Supporting these observations is the 2012 Innovation Report, which stated that although skills are important, skills utilisation is also key. Achieving this often requires job redesign, employee participation, autonomy, job rotation and knowledge transfer. The extent of skills utilisation is affected by management quality, communications, human resources, and culture. **The report found that Australia's management skills lagged OECD countries**.

[36] Australian Public Service Commission, *APS Remuneration Report 2012*, APS Commission, 2013, p.3
[37] Australian Public Service Commission, p.7, CC BY 3.0

Research into Australian skills will help understand the problem. We note that Professor John Buchanan from the Workplace Research Centre (WRC) at the University of Sydney's Business School and his research group are conducting work in the area including:

- Impact analysis of proposed Australian Qualifications Framework changes and identification of existing issues with secondary schools, vocational centres, universities and industrial relations[38];
- Realising the potential of vocational knowledge as well as the design of vocational pathways using contemporary clusters of competencies (as opposed to siloed ones) as a more relevant measure of how employees deepen their skill base[39]; and
- Exploring sectors where Australia's competitive advantage and disadvantage lies over the next half a century.

WRC is also working on:

- Understanding the key drivers of labour mobility (which relates to productivity by increasing the flow of labour)[40];
- Exploring the minimum wage in Australia, where it lies with respect to other global economies and the role of the minimum wage, including annualisation of wages within the Australian award system; and
- Award and allowance differentials which could lead to distortion in pay equity.

The former Labor Government sought to address skill issues in its *National Workforce Development Strategy*[41] which suggests measures such as:

- Increasing Australia's pool of tertiary qualifications by 3% per annum to 2025;
- Providing greater industry access to government funding for workforce development;
- Raising language, literacy and numeracy levels; and
- Lifting the quality of the tertiary sector through external assessment of VET courses.

7.8 Labour Flexibility

As previously mentioned, the World Economic Forum's *Global Competitiveness Report 2013-2014* found Australia wanting in terms of the rigidity of its labour market, for which Australia was ranked 54th of 148 countries.

Australian labour laws emerged in the 19th century and were further refined during the Second World War. Over time, awards became complicated, redundant and difficult to navigate – often giving rise to confusion and frustration about allowance conditions and directly impacting productivity.

Award modernisation through simplification and rationalisation was an agenda supported and initiated by the Hawke-Keating Government. From 1 January 2010, as part of the move towards a national workplace relations system, thousands of state and federal awards were subsumed into 122 modern awards as part of an award simplification process.

The Australian Council of Trade Unions (ACTU) expressed concerns in 2006 that rationalisation of awards could potentially leave some workers worse off.[42] In spite of this, the government continued with the process in the hope of achieving benefits for the workforce as a whole.

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[38] J Buchanan, S Yu, L Wheelahan, J Keating & S Marginson, *Impact Analysis of the proposed strengthened Australian Qualifications Framework*, Workplace Research Centre, prepared for the Australian Qualifications Framework Council, 2010

[39] J Buchanan, *From skill shortages to decent work*, Workplace Research Centre, 2006

[40] J Buchanan, S Baldwin, S Wright, *Understanding and improving labour mobility: a scoping paper*, Workplace Research Centre, 2011.

[41] Australian Workforce and Productivity Agency, p.18

[42] Australian Council of Trade Unions, *Rationalisation of Award Wage and Classification Structures*, ACTU, 2006, viewed 27th September 2013

Unions have achieved other goals, for example, recent changes to the *Fair Work Act* around consulting employees before altering rosters, the tightening of 457 visas and enshrining penalty rates into legislation.

Business has decried penalty rates, saying they promote a 9 to 5 working week in a more flexible working world. It has also been particularly concerned about unfair dismissal laws, union rights on work premises and the rules around strikes and enterprise bargaining. For example, CSL's new CEO Paul Perreault mentioned recently that Australia's workplace culture and strength of local unions have made the company's Victorian Broadmeadows facility its least productive manufacturing site.[43]

There were 273,200 days lost nationally to strikes in 2012. This was the highest level since 2004, though the number shrank to 200,000 for the year to 30 June 2013, similar to levels during the WorkChoices era. The rise from 2004 to 2012 came despite union membership falling by around 5% in that period. It has fallen from over 40% in the 90s to 20% in 2012.

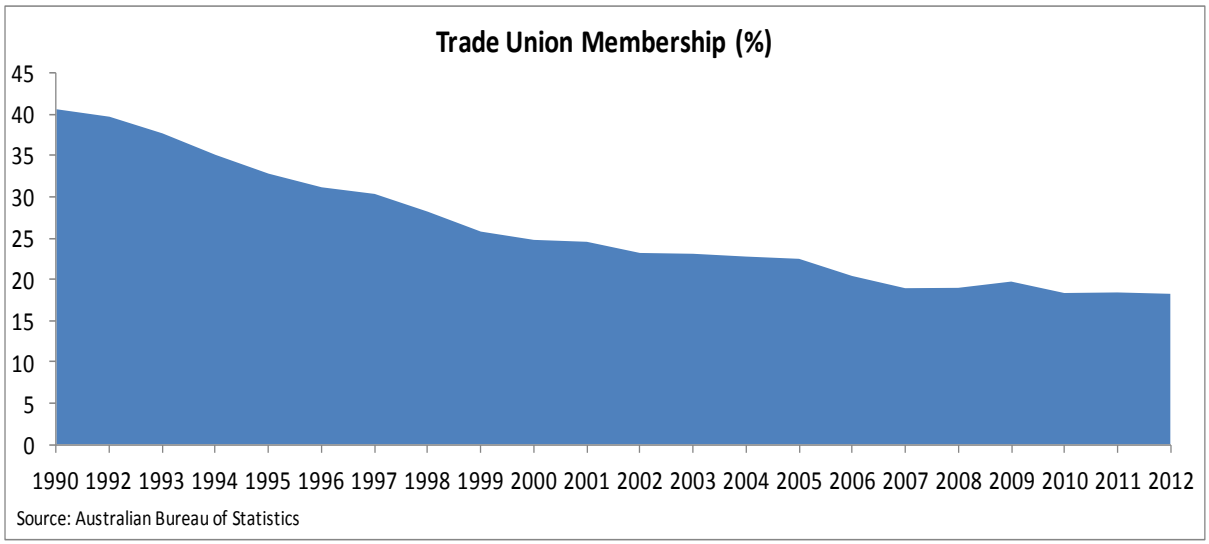


Figure 10: Trade Union Membership

A key factor in labour flexibility is workforce mobility. In its September 2013 submission to the Productivity Commission regarding labour mobility[44], the Business Council of Australia (BCA) revealed that the benefits of reducing barriers to geographic workforce mobility include:

- Employees being less restricted in taking up jobs that they value;
- Employers being more able to attract the staff they need at a reasonable cost;
- Reducing regional labour imbalances, as people are more able to move to areas where employment is growing and leave places where it is low or falling; and
- Improving the capacity of our economy to adapt to changing competitive pressures and a more global economy.

The report notes that many Australians relocate or commute long distances for employment reasons, including using 'fly in fly out' (FIFO) arrangements. The BCA believes these arrangements should be encouraged as they are likely to help meet Australia's future employment needs.

[43] Jessica Gardner, 'CSL site is world's least productive', *Australian Financial Review* , 14 August 2013

[44] Business Council of Australia, *Submission to the Productivity Commission regarding the Geographic Labour Mobility Issues Paper*, Business Council of Australia September 2013, p.2

The BCA recommended the following government initiatives to reduce barriers to geographic labour mobility:

- Recognise occupational and trade licences regardless of the Australian jurisdiction in which they are obtained;
- Remove restrictions in enterprise agreements to casual and labour hire employment;
- Remove new labour market testing reporting requirements for temporary employer-sponsored (skilled subclass 457) visas as they increase employment costs without improving local employment outcomes;
- Support FIFO arrangements through tax and other concessions and developing efficient transport links;
- Implement a common school starting age and national curriculum by progressing work under the 2012 National Education Agreement;
- Remove or lower stamp duties – transactional taxes on house sale – in favour of less distorting tax bases; and
- Remove impediments to the timely release and use of land for housing to improve the operation of regional housing markets.

7.9 Labour Costs

Deutsche Bank research (April 2013) **named Australia the most expensive country in the world on a Purchasing Power Parity basis**.[45] Many things that cost more in Australia, such as hotel rooms, a flower delivery or a beer in a pub, involve labour, reflecting Australia's high wages.

Wages in Australia are about 50% higher than in the US or New Zealand, and average weekly earnings have risen roughly 3.5% a year for the past five years. Australian wages have outstripped inflation for more than a decade. The last five years of wages growth compared to inflation can be seen in Figure 11.

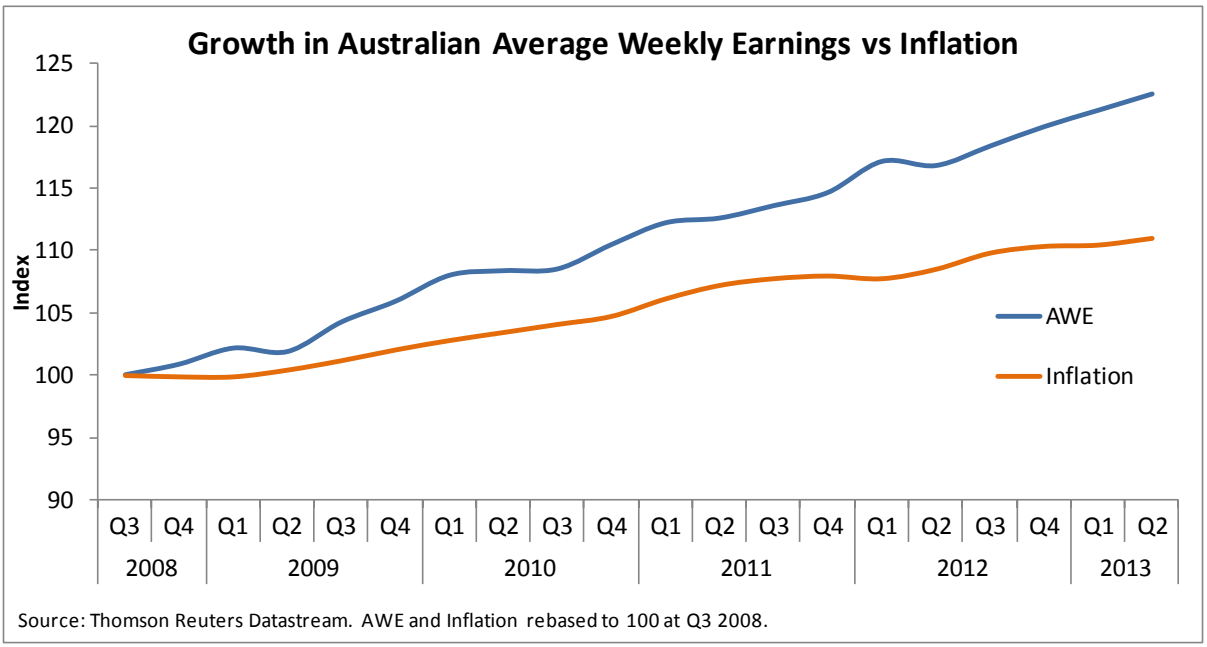


Figure 11: Average Weekly Earnings Versus Inflation

Figure 12 shows significant differentials in ordinary time average weekly earnings by industry sector, which may or may not be aligned to the sector's progress in improving productivity.

[45] S Sanyal, *The Random Walk Mapping the World's Prices*, Deutsche Bank, 2013, 3 April 2013

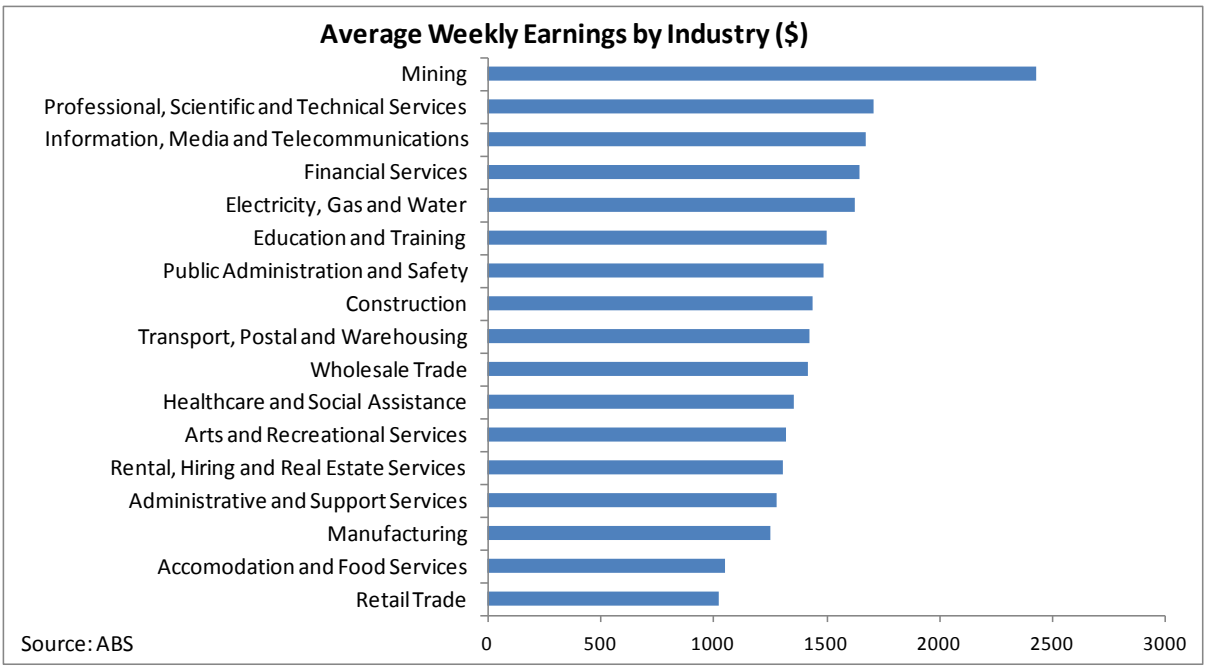


Figure 12: Average Weekly Earnings by Industry

The **highest average wage costs** are **in mining**, then professional, scientific and technical services; information, media and telecommunications; and financial services.

Figure 13 demonstrates that **Australia's minimum wage** (taken before the latest 2.6% increase[46]) is the **third highest in the OECD** on a purchasing power parity basis.

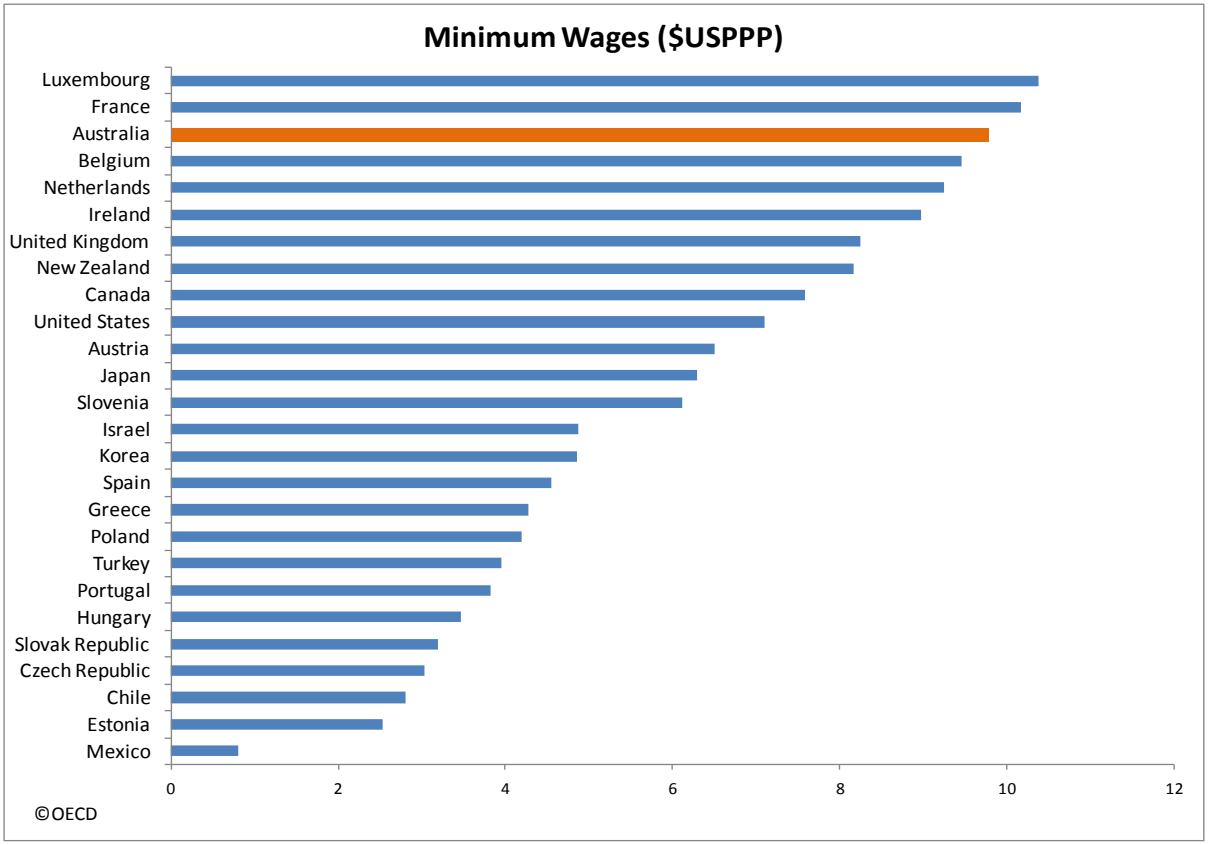


Figure 13: Minimum Wage Comparison across OECD Countries

[46]Fair Work Commission, *Minimum Wages to Increase by 2.6%*, media release, 3 June 2013

The OECD provides a general indicator of labour costs in terms of productivity by calculating a unit labour cost (ULC), which measures the average cost of labour per unit of output (total labour costs/real output).[47] The data is available for most OECD countries to 2011. While Australia shows a lower absolute cost per unit than many OECD countries including the UK, Figure 14 shows a **large rise in its labour unit cost over the last ten years**.

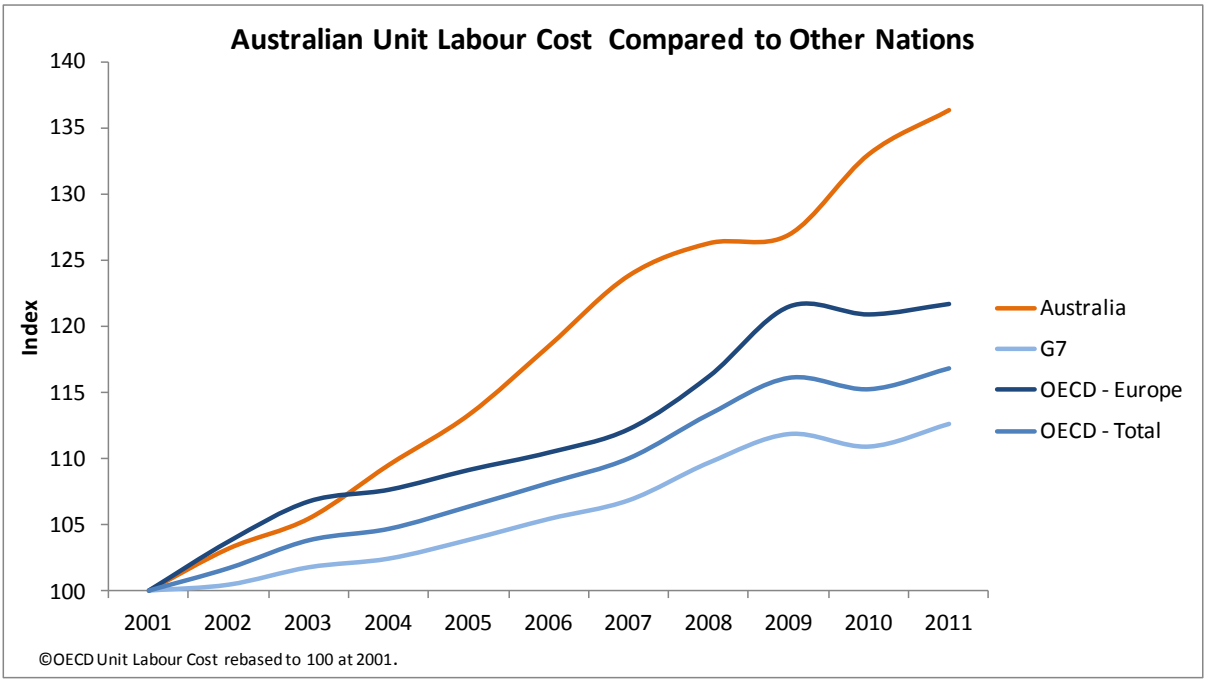


Figure 14: Australian Unit Labour Cost Compared to Other Nations

Another measure, labour compensation per unit labour input, is defined as compensation of employees divided by total hours worked by employees. In Figure 15, unit input has been compared in $US on a purchasing power parity basis.

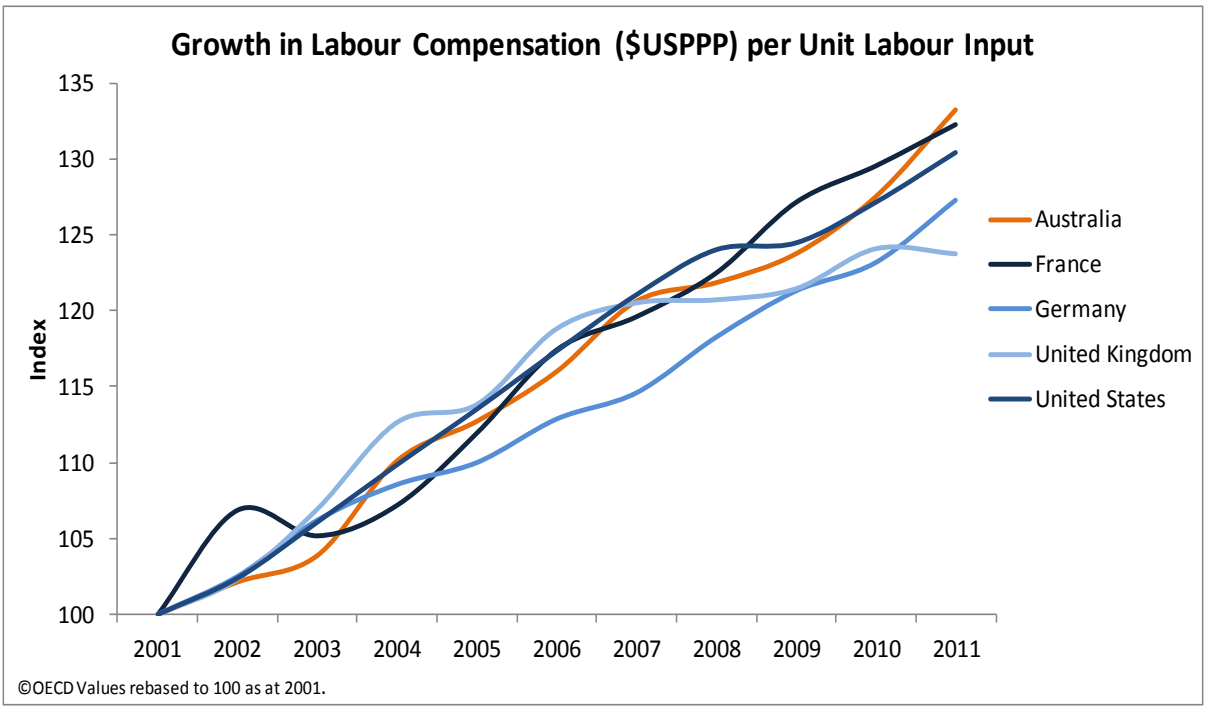


Figure 15: Labour Compensation Per Unit Labour Input

[47] OECD, *Unit Labour Costs Annual Indicators*, 2013, viewed 30 August 2013

As can be seen, the **amount paid to Australian workers has increased at a higher rate than other developed nations**, even when the high Australian costs of living are taken into account.

To complicate matters, there is often difference between what wage increases Australian employers believe reasonable and what employees expect. According to Hays research[48], about 20% of employees expected a pay increase of over 6% in the 2013 calendar year while only 3% of employers planned to increase salaries by the same percentage.

Unions in Australia are keen to preserve conditions related to overtime, penalty rates including shift allowances and rostered days on and off, drawing strong reaction from business leaders. Reaching mid-way through open communication seems to be the most effective mechanism in handling disproportionate expectations, either with the organised labour or at an individual level.

While collective bargaining has addressed equity issues from the point of view of employees, until recently considerations of efficiency important to productivity were either not addressed, or were accorded relatively little importance. Increasingly, the view of employers has been that the process should address not only how the gains of improved performance should be shared, but also how to increase the productivity 'cake'. This is the only way in which regular pay increases can be absorbed without eroding profitability and jeopardising competitiveness.

Despite rising labour costs, **unions are of the opinion that labour is only receiving what is owed it as companies make large profits**.

Indeed, according to a study called *A Shrinking Slice of the Pie* released by the ACTU[49], real wages have not kept pace with labour productivity growth over the last decade. It stated that although real output per hour worked has risen, real hourly labour income has not increased at the same rate, resulting in a **fall in the labour share of national income and an increase in the capital share of that income**.

It reported that the fall in Australia's labour share in the first decade of the current century was larger than the fall in any other OECD 15 country, representing the fifth largest fall of any of the 27 advanced economies for which the OECD has comprehensive data.

The **ACTU stated that to make up for this loss in the labour share of total income, wage increases would have to be higher than labour productivity for a period of time**.

The ACTU postulates on a series of reasons for the decline in labour's share and acknowledges that the current setting could well be driven by factors such as economic globalisation and the changing influence of the deployment of capital as distinct from labour compared to other OECD countries. It is interesting to note that in developing its position on the relative decline in labour share, the ACTU considers the increase of real output per hour of labour without considering the contribution of capital in terms of technology and innovation in the achievement of that improvement.

The Productivity Commission also recently addressed the issue of labour share of prosperity in a September 2013 research paper it sponsored entitled *Labour's Share of Growth in Income and Prosperity*[50]. It also noted that labour share had dropped, because although labour income rose at a faster level in the 2000s than the 1990s (5.8% versus 4.3%), capital income rose at a faster rate.

The Commission highlighted that Australia's terms of trade jumped by over 80% in the first decade of the current century to levels rarely seen over the past 140 years. Export income

[48] Hays, *Good communication is needed to close the salary expectation gap between candidates and employers*, Media Release, 1 August 2013
[49] M Cowgill, *Shrinking Slice of the Pie*, Australian Council of Trade Unions, 2013
[50] D Parham, *Labour's Share of Growth in Income and Prosperity*, Productivity Commission Visiting Research Paper, September 2013

was significantly influenced by mineral exports, with currency appreciation contributing to the purchasing power of the Australian dollar. The significant improvement in Australia's terms of trade had a significant impact on the health of the Australian economy and provided scope for growth in both labour and capital income to rise.

The paper noted that the mining boom was principally responsible for the fall in labour's share in Australia, despite high industry wages as previously revealed in Figure 12. The development of mining and associated capacity added substantially to the economy's capital stock, leading to a greater level of capital intensity in production overall, in parallel with higher output prices for minerals.

The report also highlights two industries, construction and manufacturing, which served to increase the labour income share. The slowdown in manufacturing in capital income growth led to a circumstance where the manufacturing sector contributed more to labour income than to capital income at an aggregate level. In construction, although the industry had stronger growth in capital income than labour income, because of its labour intensity and the effect of the mining boom on wages, growth in labour income had a more significant aggregate impact than growth in capital income.

Despite the fall in labour share, the report contended **labour was no worse off** – the reason for the decline in labour's share was because of the greater acceleration in capital income growth. Hence, while labour received a proportionally smaller proportion of income growth the real value of its share continued to grow in absolute terms and indeed at a faster rate than previously.

Also, because of the higher purchasing power of the dollar, while labour received a smaller share of income, the slower growth in consumer prices meant that the real value of each dollar earned was worth more in terms of purchasing power.

Other high income countries also experienced a decline in labour income share, but due to a different set of factors. The same report nominates two prominent causes, one being **globalisation** and the other **technological change**. The former is seen to have reduced employment opportunities and wage growth in advanced economies, especially for the middle income and skilled employment sector, arising from a significant increase in the world supply of cheap labour and cheaper goods. Technological change is seen to have created substitution of capital, particularly in information and communications equipment, for unskilled labour. While Australia experienced a growth in labour incomes alongside the fall in labour share, this has not been the case for other economies experiencing a fall in labour share, particularly in well established northern hemisphere economies.

The report predicts that **as the terms of trade decline, the labour income share will rise**, though with a more capital intensive economy the share is unlikely to revert to levels of some two decades earlier. Among the report's conclusions is that with the prospect of declining terms of trade, there will be greater focus on productivity growth, which will be seen as the prime driver of any degree of sustainability in growth in real wages.

The report concludes that **significant productivity growth will be required to maintain the rate of improvement in Australian living standards** and that labour productivity growth would have to return to something in the order of 2.5% to 3% a year for growth in real average income to continue at around the rate that has been experienced over the last two decades.

In our judgement, the quality of the analysis of both reports is worthy of careful consideration and review. Their focus and hypothesis testing is different, though both organisations appear to have appropriately entered the national conversation on productivity and wages growth.

It is our opinion that this discussion needs to be further extended through the ranks of middle management and senior executives and criteria established to develop national policy for improved business and government productivity.

8 Management and Productivity: A Global Perspective

Shareholder demands on remuneration committees of listed public companies have required an increased focus on reward strategy development as companies in various industry sectors adjust to changing circumstances in the global world of business.

Management influence the productivity of organisations not only in the decisions they make to improve capital and labour efficiency, but also in how they perform relative to the cost they represent to the business.

Similar lenses to those employed to explore productivity for workers covered by awards and/or enterprise agreements should be used to view pay for senior managers, executives and key management personnel (KMPs) in the Australian market because:

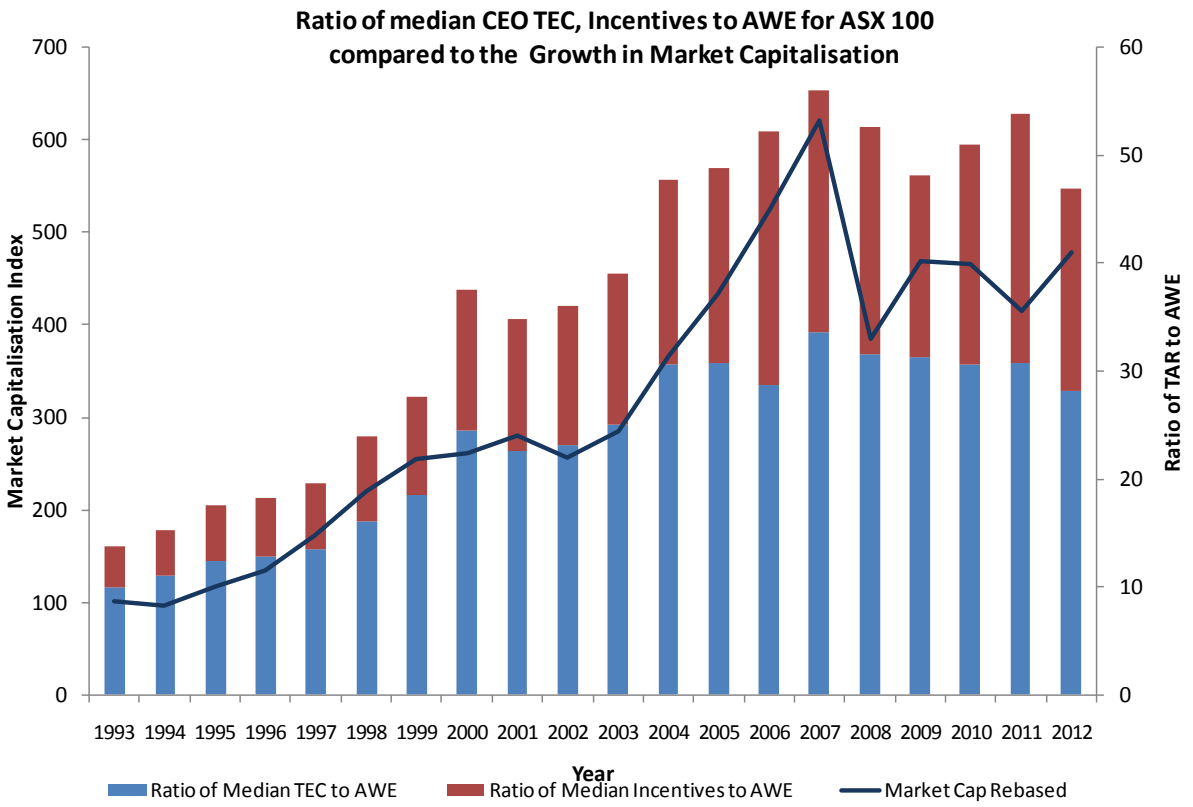
- The cost per employee in the management group is much greater than the average worker;
- Shareholders expect a reasonable return as a direct result of the decisions and performance of senior management;
- Globally, there has been legislation around executive compensation including:
    - The US' Dodd-Frank Act mandated the disclosure of the ratio of the annual remuneration (intended) of the CEO to the median worker amidst considerable resistance by corporate management and lawyers. Implementation of this rule has been delayed, though a proposal for its introduction has recently been released[51].
    - The EU Parliament and the Council of the European Union approved a legislation package that will cap banking executive bonuses to one times fixed remuneration, unless shareholder approval is sought, when it can rise to twice fixed remuneration.[52] Discount factors are applied for deferred remuneration. This is to be in place for 2014 awards.
    - A 2013 referendum in Switzerland led to the decision to legislate 24 initiatives including a binding annual shareholder vote on executive pay; a ban on severance, sign-on and merger payments; and the introduction of annual elections for Board Directors.[53] Breaches will result in up to three years jail and fines. Legislation for the initiative has yet to be drafted; Implementation isn't expected until 2015. Another vote is scheduled for November on whether executives should be able to earn more than 12 times the organisation's median worker pay.
    - Regulation has just come into effect in the UK that provides more power to shareholders to decide whether executive pay is appropriate by laying out minimum requirements for remuneration policy disclosure to inform a new binding vote on pay policies. The regulations also facilitate understanding by mandating a "single figure" approach to disclosure in remuneration reports.
    - Australia has been increasing its regulation on executive remuneration disclosure and shareholder power over KMP pay. The 2011 AGM season was the first year that the 'two strikes rule' came into effect, strengthening shareholders' non-binding remuneration vote such that two consecutive votes of over 25% against the remuneration lead to a vote on whether to spill the board. In 2012, the previous Labour government proposed legislation to mandate "if not, why not" disclosure for executive clawback and the

[51] US SEC, *Pay Ratio Disclosure*, 2013, viewed 30 September 2013
[52] Council of the European Union, *New Rules to Strengthen Banks: Final Council Approval*, media release, 20 June 2013
[53] C Matlack, *Swiss Limits on Executive Pay: Less than Meets the Eye*, *Bloomberg Businessweek*, 4 March 2013

disclosure of crystallised, present and future pay; however, there are numerous concerns with the draft legislation and given the recent election outcome, it is uncertain whether this legislation will be put to the Parliament.[54]

In the context of the Dodd-Frank Act, for illustrative purposes Egan Associates has explored the relationship between the ratio of annual CEO pay (fixed remuneration plus bonus) among the ASX 100 to the average worker and the increase in market capitalisation. We have also mapped the increase in CPI and average weekly earnings (AWE).

A key question when exploring ratios with the average worker is whether the differential rate of increase should focus on fixed pay or total reward, which is highly variable and performance dependent. Figure 16 below reveals market capitalisation (reflecting company size and value) has increased fivefold over the last 20 year period. Fixed pay for CEOs – total employment cost (TEC) in the figure – has remained broadly aligned with company growth among Australia's top 100 listed companies, though total annual pay including incentive has increased disproportionately.



© 2013. All Rights Reserved. Egan Associates. From 1993 to 2003, Remuneration Bands were used. From 2004 onwards, CEO Actual Total Annual Remuneration (TAR) was used. TAR comprises base salary, superannuation, benefits, the grossed up impact of fringe benefits and annual incentive payments. Companies are ranked by Market Capitalisation at 30 June of each year (excludes property trusts, funds, overseas entities and subsidiaries). Market Capitalisation rebased to 100 at 1993.

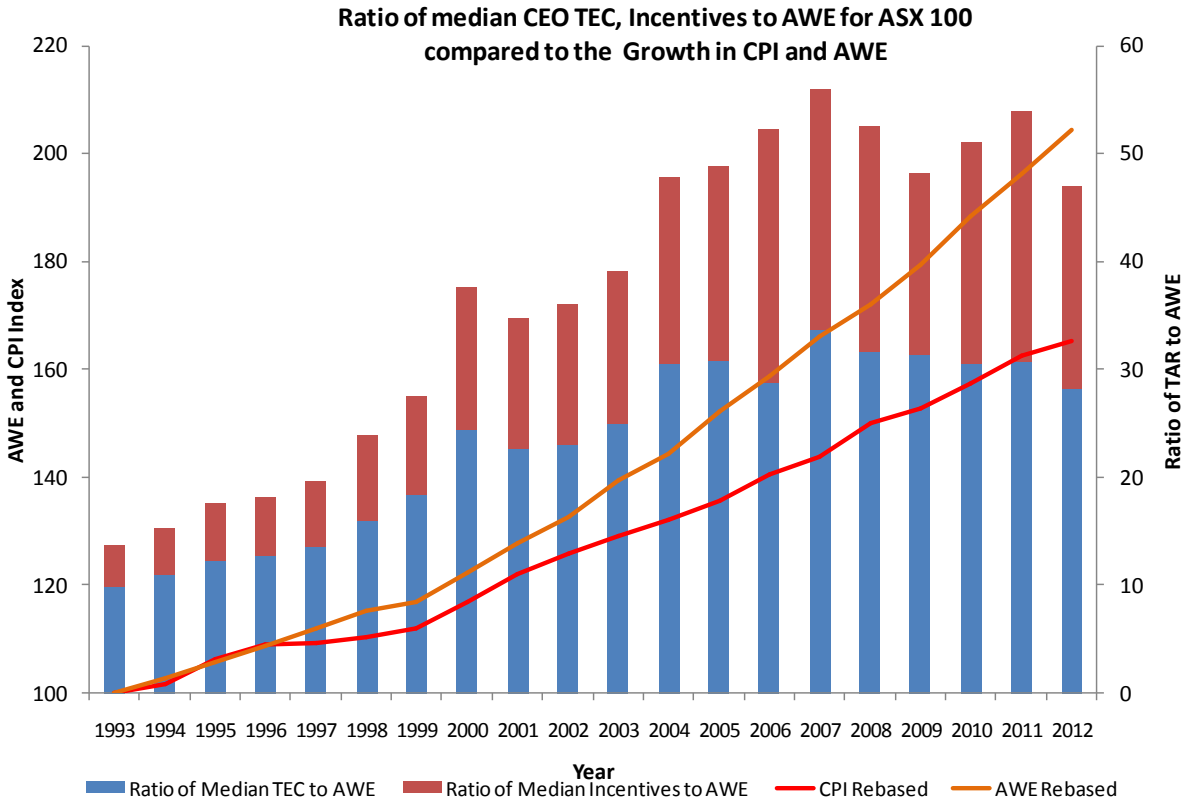
Figure 16: Ratio of CEO Remuneration to Average Worker Pay Versus Increases in Market Capitalisation

It would be our assessment that CEO pay increases in the ASX100 reflect the **changing work demands on CEOs over the past twenty years**, arising from the fivefold increase in the scale of companies, reflecting acquisition and internationalisation. This growth has created senior management roles which did not exist in the early 90s: today's leading enterprises are complex, employ several thousand staff – an increasing number of which are

[54] Egan Associates, *Towards Clarity in Remuneration Disclosure*, February 2013, accessed 30 September 2013

overseas – and require a knowledge of multiple jurisdictions and trading conditions as well as emerging technologies relevant to each business.

In this context, senior professionals and management find themselves regularly working in different locations around the world for periods often extending several months, managing many commercial, technical and operational complexities, including work practices. A growing proportion of these employees are being called upon to work on any day of the week, often over extended hours and occasionally with no break for more than seven days.



 From 1993 to 2003, Remuneration Bands were used. From 2004 onwards, CEO Actual Total Annual Remuneration (TAR) was used. TAR comprises base salary, superannuation, benefits, the grossed up impact of fringe benefits and annual incentive payments. Companies are ranked by Market Capitalisation at 30 June of each year (excludes property trusts, funds, overseas entities and subsidiaries). CPI and AWE rebased to 100 at 1993. Four quarters of AWE averaged and annualised.

Figure 17: Ratio of CEO Remuneration to Average Worker Pay versus increases in Average Weekly Earnings and the Consumer Price Index

As can be seen in Figure 17, average weekly earnings have increased faster than the increase in the consumer price index over the latest 20-year period, but CEOs fixed pay compared to the average worker has also significantly increased: the ratio rose from less than 15 times to around 30 times average worker pay. With the inclusion of performance bonuses the ratio extends by 50%.

Yet the rate of change to the role of the average worker would be far less over the last two decades than that of the CEO, despite the increasing use of technology, capital equipment and computers and the significant increase since 1993 in the volume and speed of data which many of the workforce have to deal with on a daily basis.

Therefore, it would be our general observation that **CEO prosperity in relative terms to the average worker (halted to an extent by the global financial crisis) primarily reflects the increased scale of the nation's leading enterprises**.

The data also reveals that since the global financial crisis, there has been a decline in market values. Corporate organisations have clearly adjusted in part to the decline, with a

reduction in CEO reward in relation to the average worker, although the decline in reward has not been as sharp as that reflected by the market index.

Indeed, as we further investigate the relationship between executive and CEO remuneration and company outputs, it becomes apparent that while the ratio between CEO and worker pay has experienced decline for the ASX 100, a combination of CEO fixed remuneration and bonuses appear to have risen in many companies in absolute terms since the financial crisis.

8.1 Performance and Executive Reward

We examined fixed remuneration and bonuses received (including deferred payments) for CEOs and top 5 executives other than the CEO over the five years to the end of calendar 2012 against three organisation outputs: market capitalisation, revenue and operating profit.

We display our results over the next few pages split into each organisational output. Our data excluded those executives based overseas, those who had not worked a full year, those who had changed their position and those who had left the company during the year. In addition, the analysis draws on different constituents of the ASX 300 in the various bands for each year with changes arising from mergers, delisting and new entrants to the ASX 300.

We have considered in the following ranges: ASX top 50, ASX 50 to 100, ASX 100 to 200, ASX 200 to 300.

8.1.1 Market Capitalisation

Trends across the ASX 300 can be observed in Figure 18 to 21.

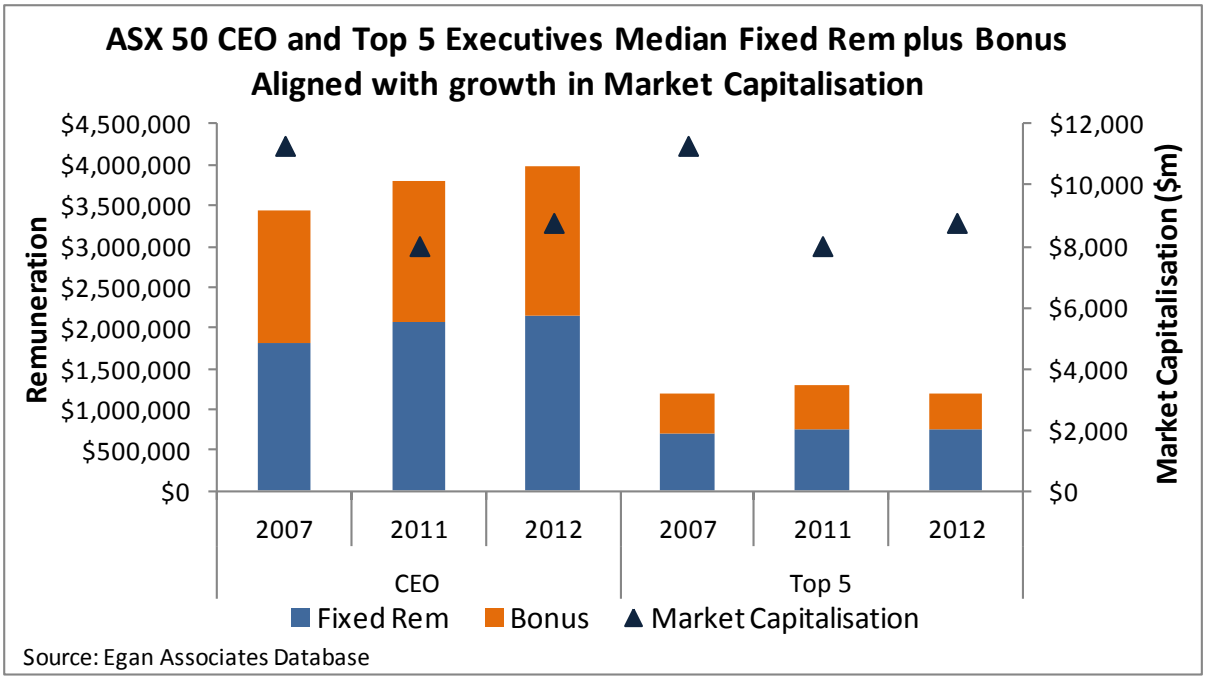


Figure 18: ASX 50 and Top 5 Executive Remuneration versus Market Capitalisation

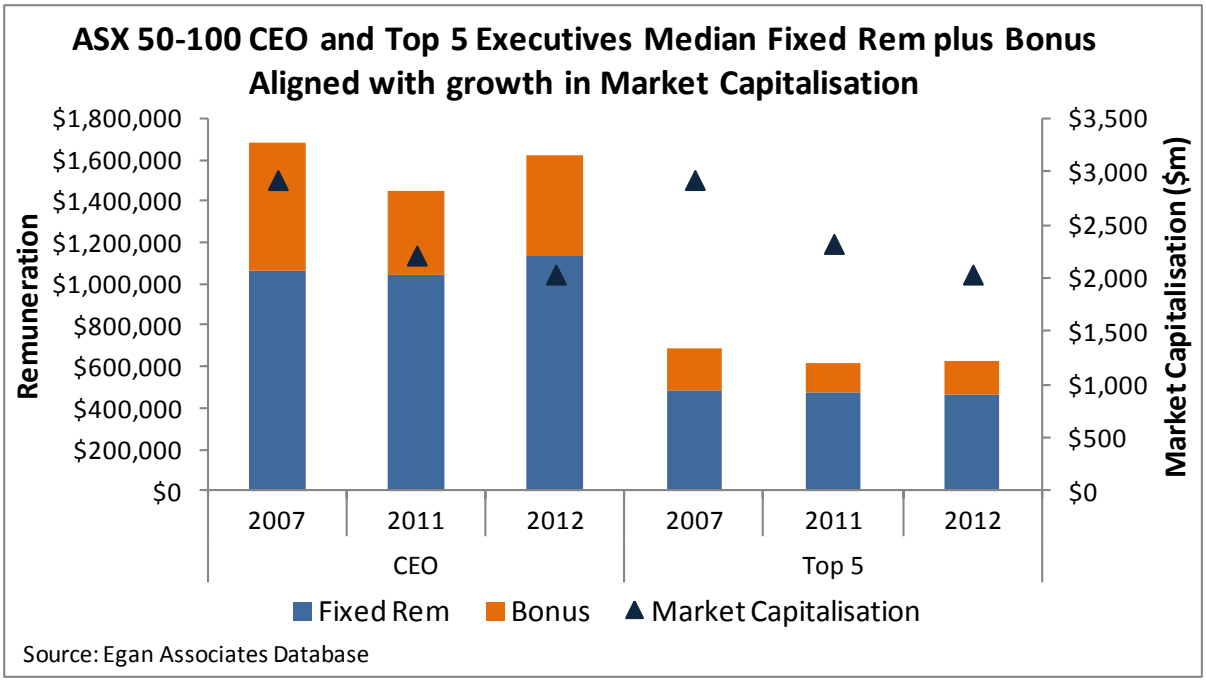


Figure 19: ASX 50-100 CEO and Top 5 Executives Remuneration versus Market Capitalisation

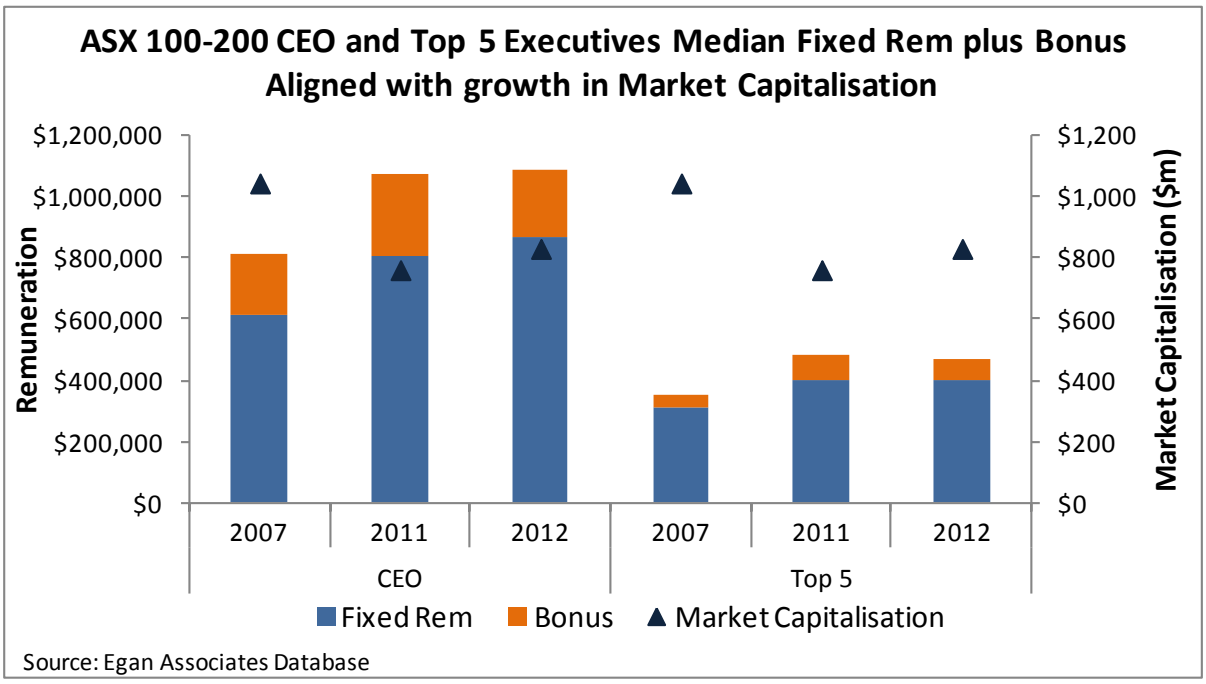


Figure 20: ASX 100-200 CEO and Top 5 Executive Remuneration versus Market Capitalisation

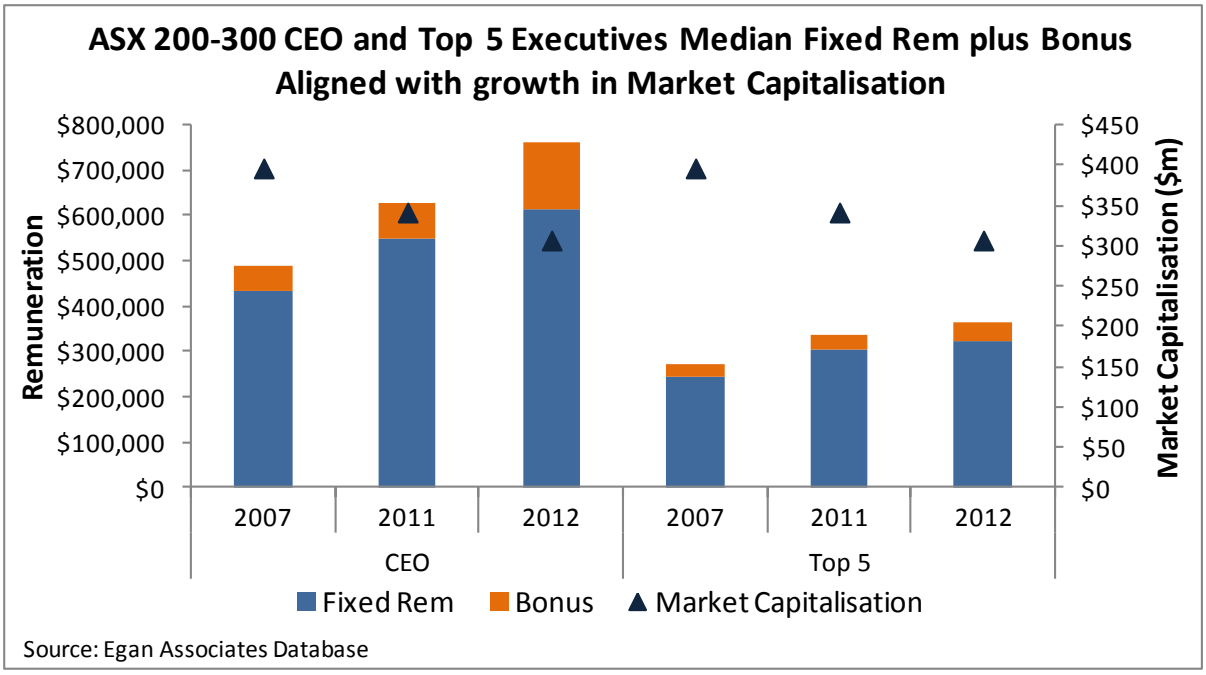


Figure 21: ASX 200-300 CEO and Top 5 Remuneration versus Market Capitalisation

8.1.2 Revenue

Trends across the ASX 300 can be observed in Figure 22 to 25.

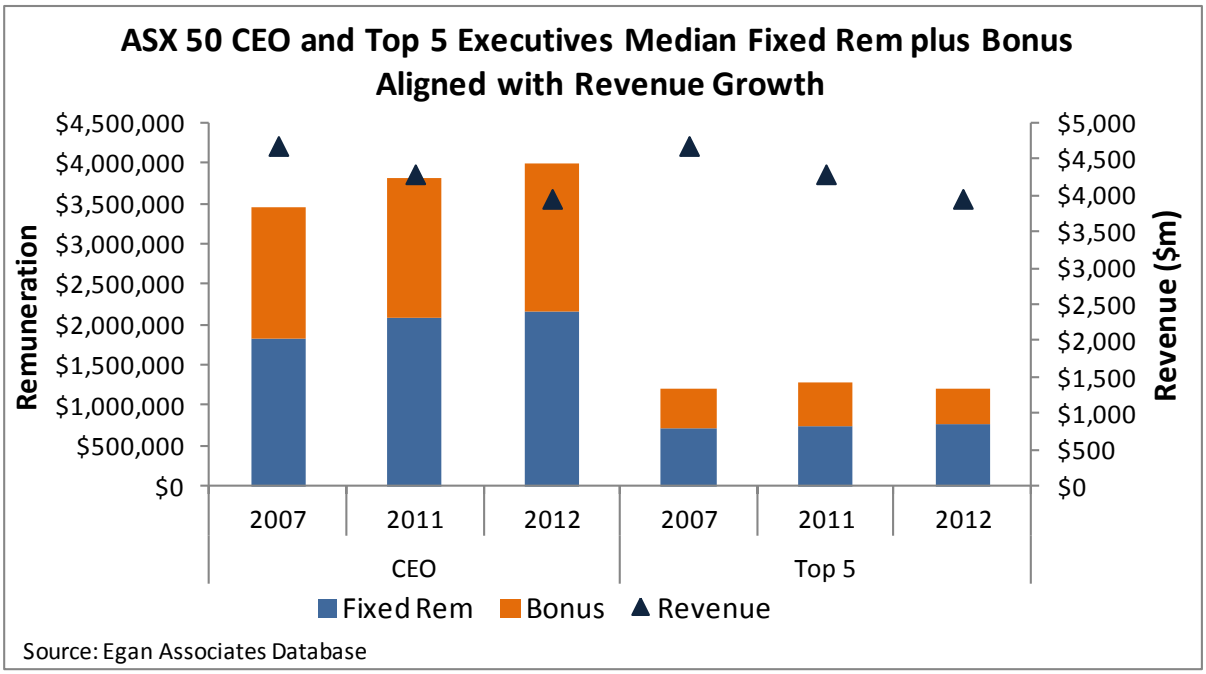


Figure 22: ASX 50 CEO and Top 5 Remuneration versus Revenue

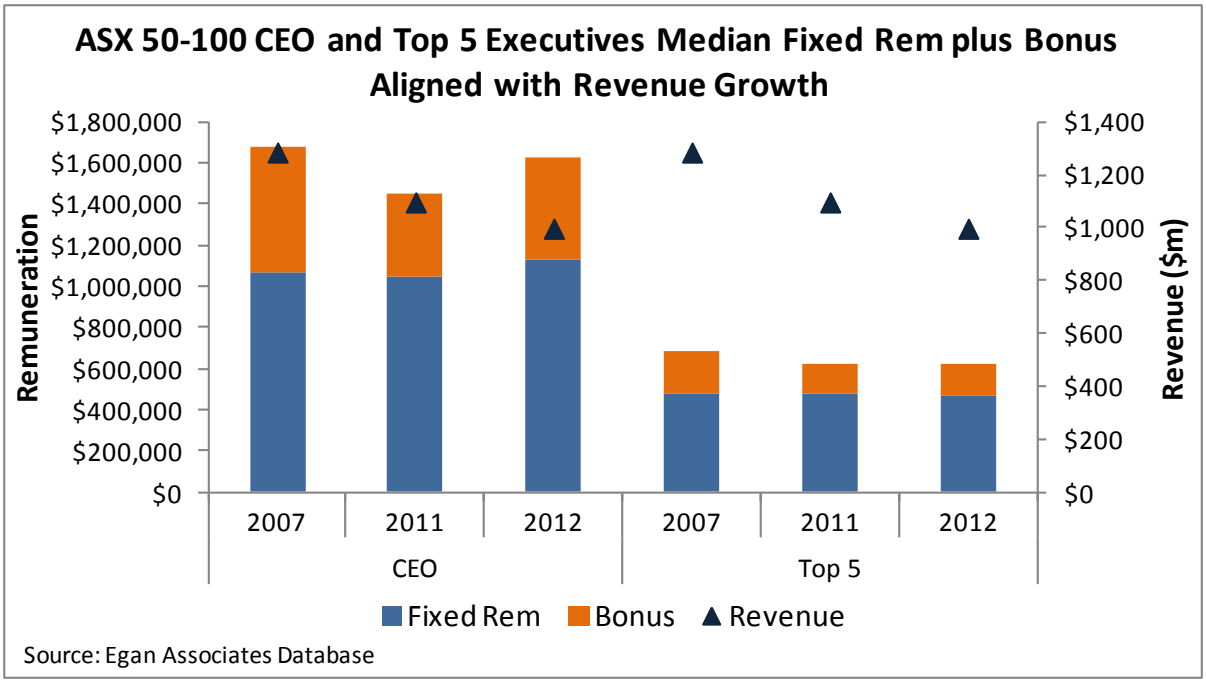


Figure 23: ASX 50-100 CEO and Top 5 Executive Remuneration versus Revenue

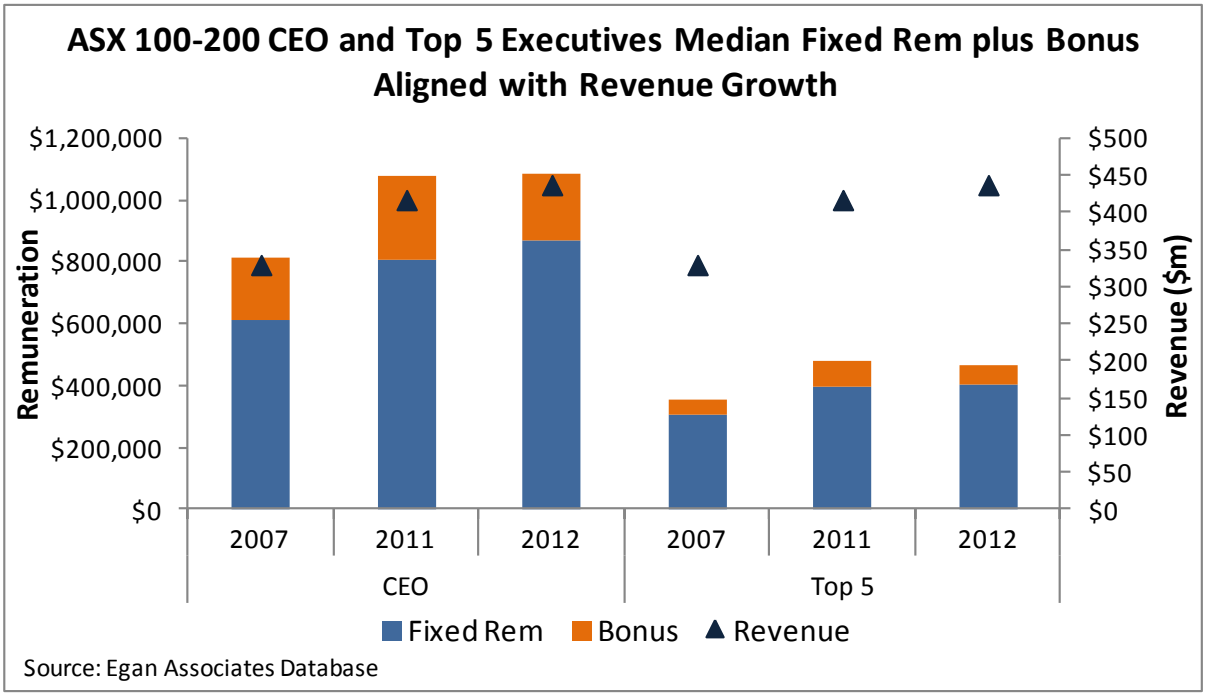


Figure 24: ASX 100-200 CEO and Top 5 Executive Remuneration versus Revenue

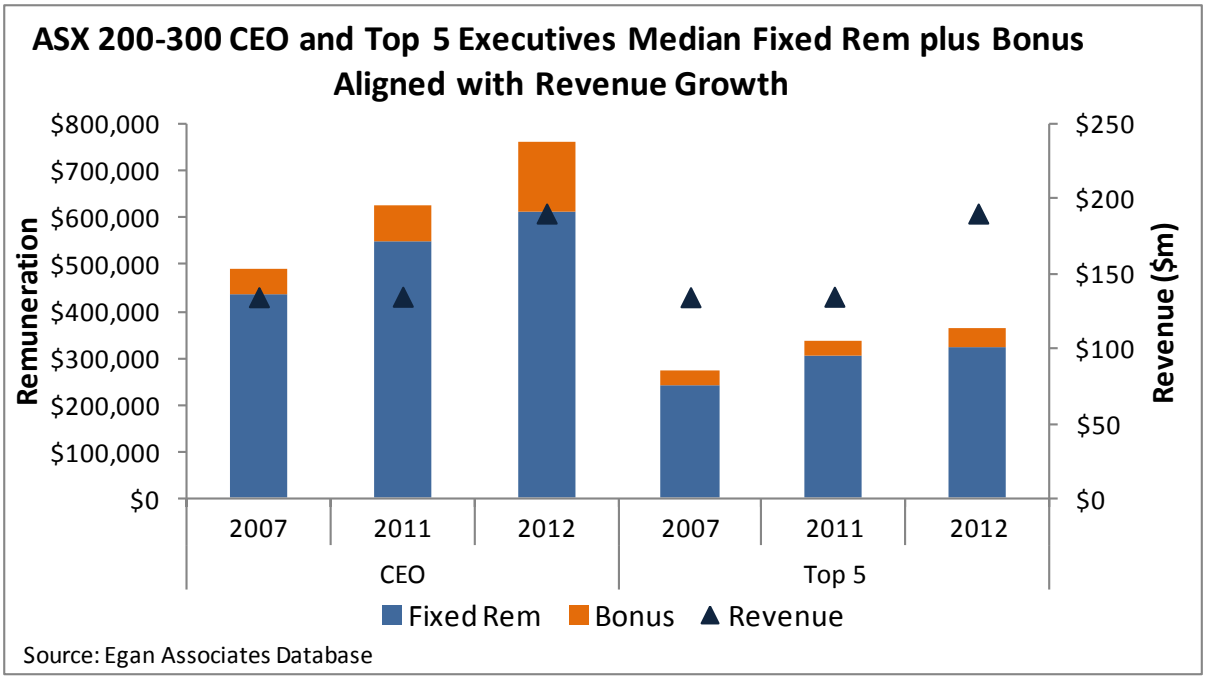


Figure 25: ASX 200-300 CEO and Top 5 Executive Remuneration versus Revenue

8.1.3 Operating Profit

Trends across the ASX 300 can be observed in Figure 26 to 30.

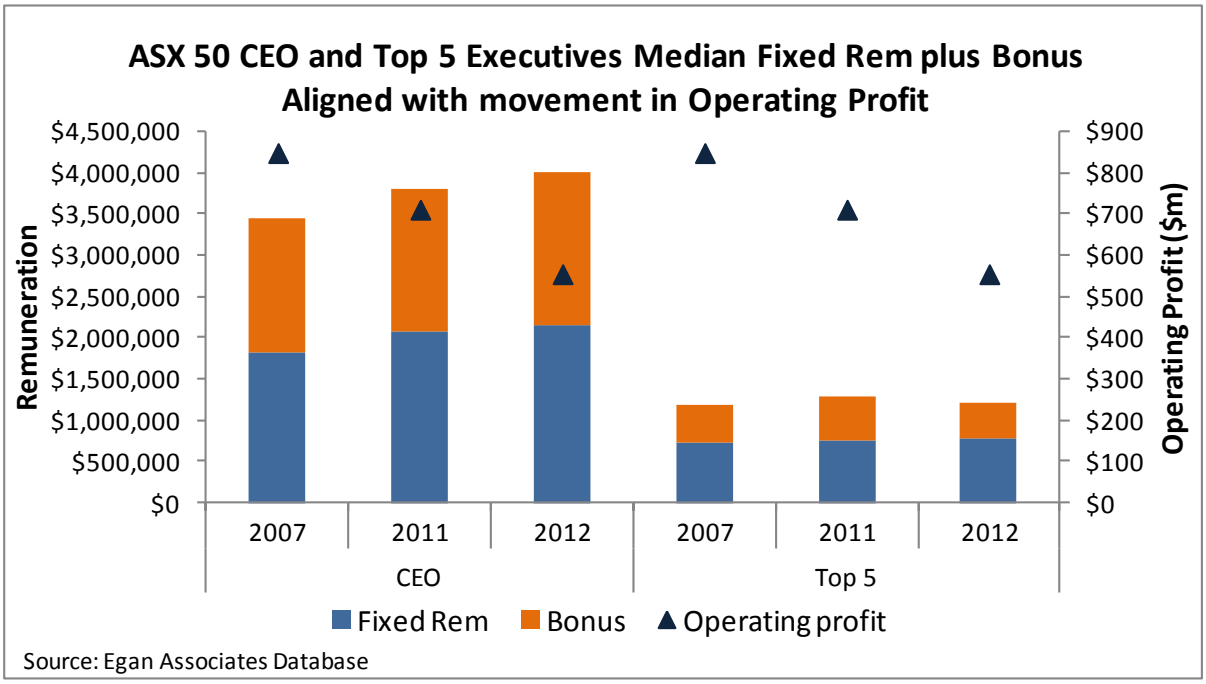


Figure 26: ASX 50 CEO and Top 5 Remuneration versus Operating Profit

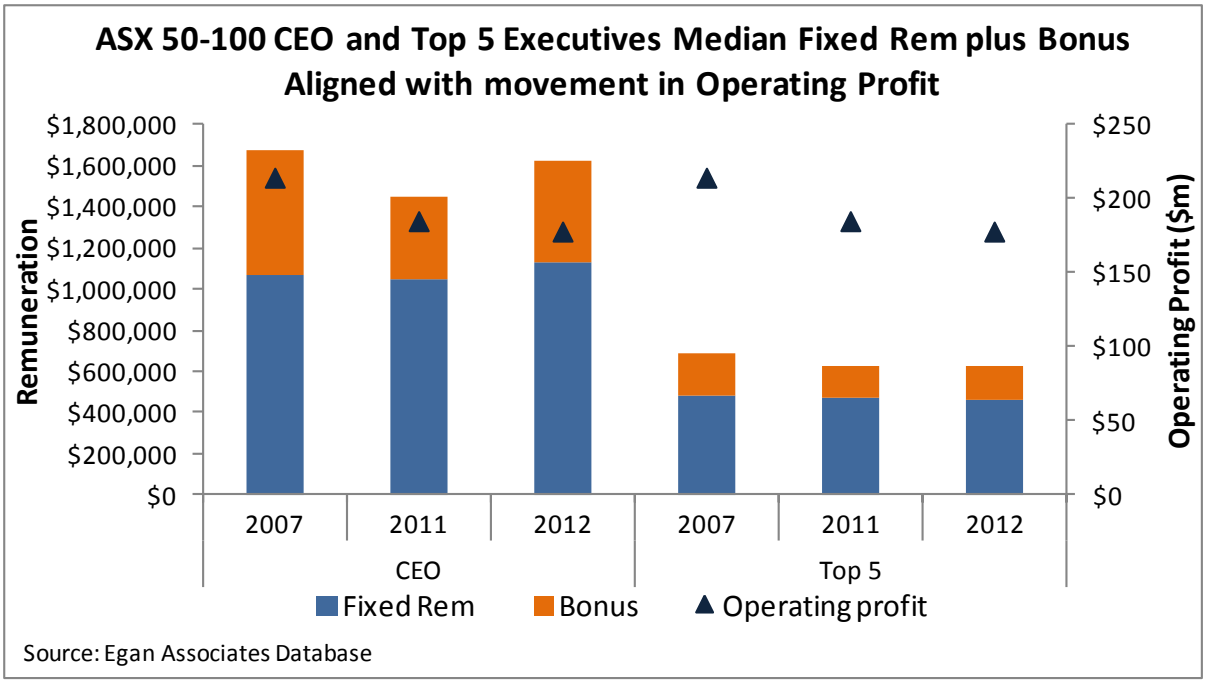


Figure 27: ASX 50-100 CEO and Top 5 Remuneration versus Operating Profit

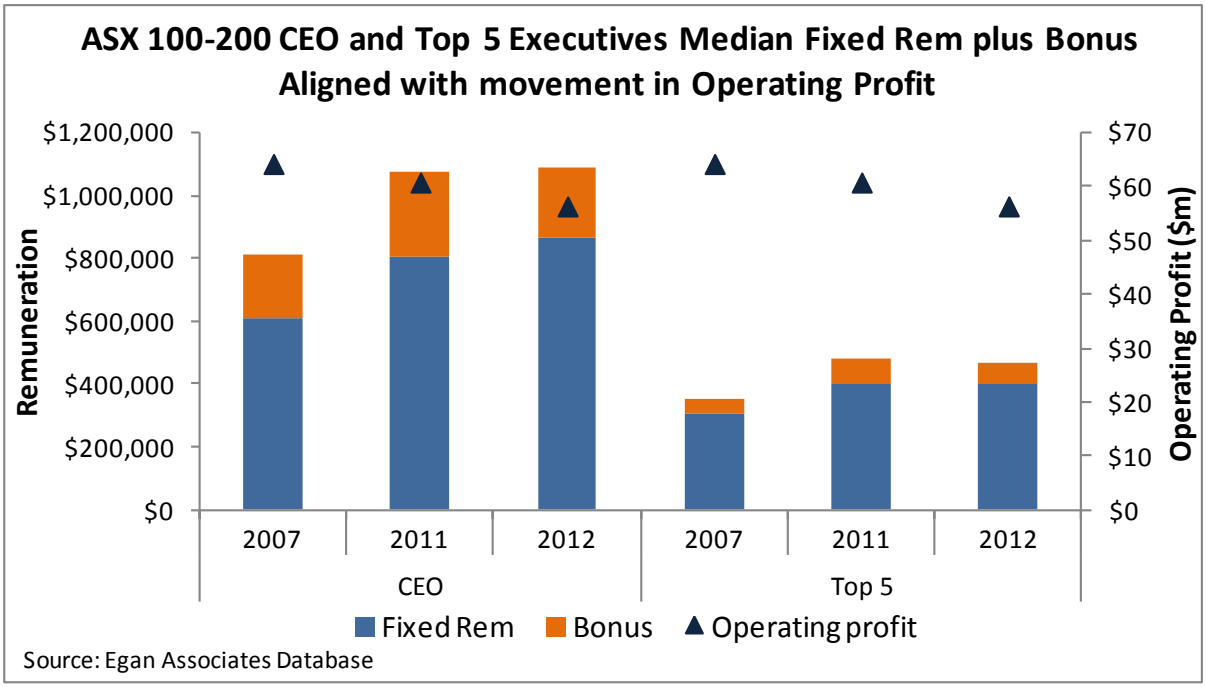


Figure 28: ASX 100-200 CEO and Top 5 Remuneration versus Operating Profit

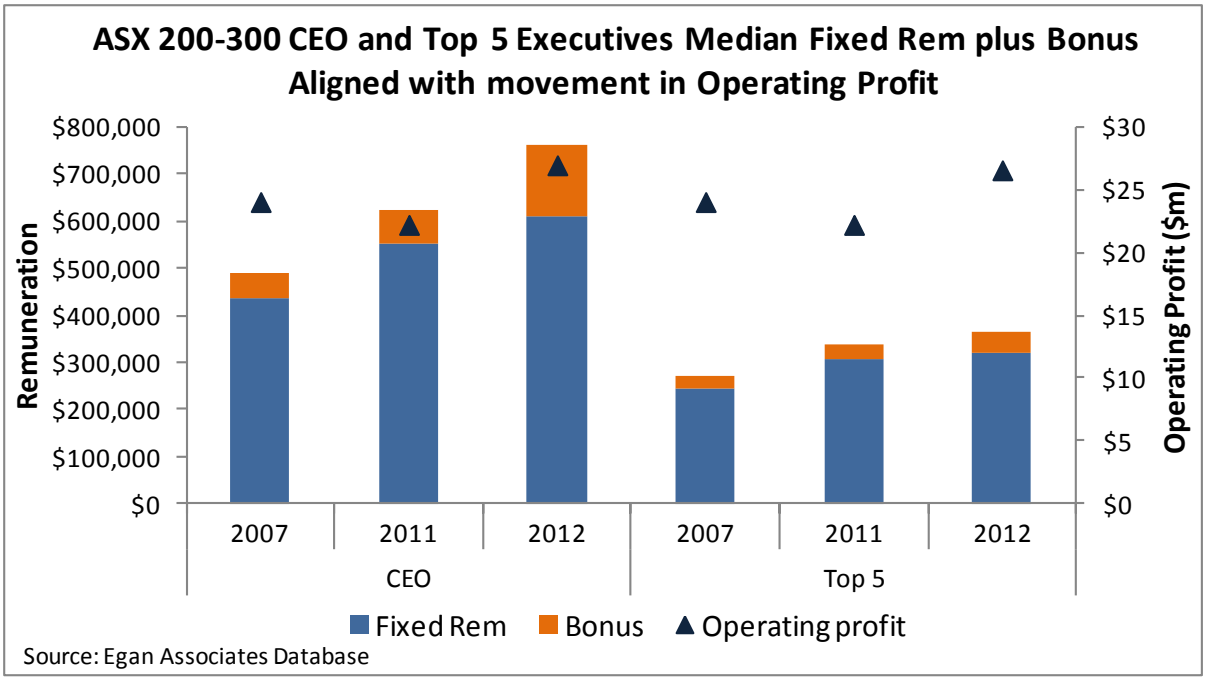


Figure 30: ASX 200-300 CEO and Top 5 Remuneration versus Operating Profit

8.1.4 Commentary

Our research reveals **senior executive reward is not always aligned with revenue growth, profit improvement or value creation**.

Market Capitalisation among Australia's leading companies was clearly affected by the global financial crisis. Movement in revenue over the period since 2007 among the ASX 100 has also reflected a decline. All categories other than the ASX 200 to 300 reveal a decline in operating profit.

Yet while the data indicates a general pause in the rate of increase of CEO fixed remuneration, it does not generally reflect a decline either in fixed remuneration or bonus levels as an adjustment to market capitalisation, revenue and operating profit movements. It is clearly this circumstance which has led to a more active engagement and commentary from leading investors and advisers to major institutions and superannuation funds, as well as general media comment.

From a management and governance perspective it is neither common practice nor of significant precedent for boards to dramatically adjust prior contracted arrangements without regard to prevailing market practice and a degree of consultation with management and shareholders.

The last period similar to the GFC was the early 90s, when companies faced recession conditions from which it took a couple of years to recover. As in the period following the GFC, during the early 90s we observed modest upward adjustments to fixed remuneration

It is difficult to reduce entitlements that have already been enjoyed by incumbent personnel, contractually and in terms of retention. If an organisation dramatically changes its remuneration practices out of step with the market, it risks losing executives to competitors. Therefore, organisations generally make gradual changes as market perception shifts and turnover enables the implementation of the new remuneration reality role by role.

This has been the case in the period since the GFC, when r**eplacement of senior executives**, particularly at the level of CEO, enabled Boards to reduce remuneration by appointing new entrants to the role **at a discount in fixed remuneration to their long serving predecessors**. With approximately one in five CEOs stepping down each year over

the last five years there has been a substantial replacement among Australia's leading companies at this level.

Yet as market performance improves, changes can occur more swiftly. When conditions improved from around 1993 to 1997, they were matched by a more rapid uplift in total reward. Modest increments in fixed remuneration were supplemented though accelerating adjustments to annual incentive or bonus payments.

This process continued apace until the beginning of the current century, though there is evidence of variability reflecting both the changing of the guard and an increased emphasis on at risk or performance pay within the context of annual reward reviews.

The progress over the 1998 to 2002 period saw a degree of pause in fixed remuneration followed by a period of five years' acceleration leading up to the global financial crisis, which after the shocks subsided heralded a period of uncertainty and partial recovery.

In the 2010 calendar year there was a general expectation in the private sector that the economy was in recovery mode, with remuneration increases likely to continue. This came to an abrupt halt by mid 2011, with increasingly volatile markets, declines in commodity prices and other trading conditions not previously anticipated. It led to a pause in the rate of improvement in annual bonuses and in many companies a further wage freeze in the 2011-12 financial year.

Considering this data, it appears clear there is a disconnect between how swiftly organisations can adjust down to reflect company attributes and market performance as compared to how rapidly they can adjust up.

Given the performance of the Australian economy and a significant number of Australia's leading companies, the urgency of Australian boards in addressing fixed remuneration has been far less than that prevailing in many industry sectors in Europe and North America – the latter affected by the Omnibus Budget Reconciliation Act of 1993 placing restrictions on the deductibility of executives' non-performance aligned remuneration for amounts in excess of $1,000,000.

It has become increasingly obvious that while global levels of fixed remuneration in the period from around 1994 to 2004 were influential in Australia's executive pay adjustments, Australia has very much pursued its own path, which may internationally have been exacerbated by the rising value of the Australian dollar until the recent correction.

This independence has been compounded by the fact that Australian executive incentive opportunity is a ratio of fixed remuneration, leading to the structure of reward among leading Australian companies taking on a pattern unique to itself. Potential reward outcomes are not dissimilar from international patterns of reward, but fixed remuneration levels are higher and there are proportionally lower annual incentive and equity-based reward opportunities than North America.

Australian CEOs have a significantly higher bonus opportunity than their executive team, with the level of leverage most prominent among the ASX top 50 and diminishing with reduced scale. This level of leverage has increased over time. Reflecting this, the level of reward appears more static among KMPs other than the CEO.

Parallel research in other economies will highlight the difference in dynamics, if any, in economies that have favoured less positively than Australia over the period since 2007.

In the 2014 calendar year we will update our research when companies reporting on the current calendar year's remuneration are published. Recent months have clearly seen an improvement in market capitalisation, though volatility remains due to the uncertainty in relation to debt management of a number of European economies and more recently the US economy as well as a decline in the rate of growth of Asian economies highly relevant to Australia's prosperity.

During the period since the GFC the two strikes legislation and feedback from proxy advisers, remuneration consultants and others has persuaded many boards to adopt a more cautious and thoughtful approach to the structuring of their leadership team's remuneration arrangements, reflecting on the relevant external marketplace and the circumstances of the company and foreshadowed opportunities.

The key challenge for many boards in governing executive remuneration outcomes is the reconciliation of managing reward for improvement when improvement continues to represent a decline in shareholder investment value at the end of a fifteen year bull market.

We believe we will see the remuneration mix change so that fixed remuneration becomes a smaller portion of the overall executive reward package, with short term and long term incentives becoming proportionally more significant. We have already seen an increased level of short term incentive deferral; we expect this to continue.

These measures will help align executive productivity by further aligning reward with output, but will need to be carefully communicated with shareholders as the incentive proportion becomes a multiple of fixed remuneration.

During this period the Commonwealth Government and other governments have also recognised appropriately that their most senior executives have been significantly underpaid and in order to retain a key proportion of their best advisers governments have responded to market influences. Given recent restraint in private sector pay, this will reduce the discount for senior government employees and facilitate movement between the public and private sectors.

Egan Associates believes the nation will be best served by having a proportion of its most capable and effective executives working for Ministers in managing an increasingly complex and demanding constituency, both domestically and internationally.

9 Stakeholder Views on Improving Productivity

9.1 Australian Council for Trade Unions (ACTU)

The ACTU[55] has recommended numerous productivity improvement initiatives to business leaders and government including:

- Continuous training for company executives in identifying and implementing genuine productivity improvement measures;
- True collaboration on productivity through industry councils bringing together unions, government and employers;
- Commitment to skilling up Australians with a push to boost participation and completion rates in vocational and educational training;
- A structured approach to driving innovation by increasing engagement between industry and the research sector to generate new processes and products; and
- A national infrastructure plan to target investment projects critical to improving productivity.

Yet while the ACTU agrees that productivity is important to improve living standards, it cautions that if labour income fails to keep up with productivity, productivity growth will not be sufficient to ensure the living standards of the typical worker rise over time.

"Productivity may be almost everything, but distribution is not nothing," it stated in the aforementioned *Shrinking Slice of the Pie* report.[56]

Despite wages increasing during the boom times, the ACTU does not believe distribution has been occurring in a fair manner, stating that the proportion of labour share of national income has decreased during the 2000s. According to the ACTU's research, in 2000 the labour share was 65.6%. This had fallen to 59.7% by 2012. The report then compares the decrease with other OECD countries and found that Australia's fall in labour share was larger than most. Even removing the capital intensive mining boom from the equation, the ACTU still found the labour share had fallen, noting that decoupling had also occurred in retail trade and accommodation and food services. It concludes that any suggestion Australia had a labour cost problem was unfounded and that in fact, wages growth would have to increase to reclaim the productivity share.

The ACTU notes that in the high productivity period of the 90s, the labour share remained constant, such that as productivity rose, labour received the benefits of it. It hypothesised that this in part has been a factor in Australia's elevated productivity growth, stating **"there is a greater incentive to actively participate in productivity-enhancing changes when you have a reasonable belief that you will benefit from them"**.

9.2 Australian Government

The recently elected Coalition Government in Australia has developed policies addressing productivity improvement in the hope of creating a stronger economy capable of delivering higher real wage growth and job creation.

The Coalition's September policy document acknowledges that the key challenge of Australia's economic future is to compete successfully in a more fiercely competitive world.[57]

[55] B Ruse, *Innovation, Training, Better Management: Time to Address the Real Drivers of Productivity*, media release, Australian Council of Trade Unions, 24 July 2013

[56] M Cowgill, 2013, p.2

[57] Coalition Party, *Our Plan: Real Solutions for All Australians*, Coalition Party, September 2013

While the needs articulated in the policy document are diverse, those which are relevant to this paper include the need:

- To improve productivity competitiveness and growth;
- To address Australia's growing workplace militancy, flexibility and productivity challenges;
- To scrap unnecessary taxes;
- To reduce the cost base of significant projects; and
- To increase the flexibility of our economy to respond where economic shocks hit.

We note in this context that the government has established a Productivity Priorities Working Group to consult with business and community stakeholders on the implementation of the Coalition Government's Better Productivity Plan. It is the new government's intention to:

- Provide incentives for employers to employ young people and seniors;
- Ensure people of working age are actually working;
- Support parental leave;
- Introduce a new job commitment bonus for prior welfare recipients who remain employed for a minimum of twelve months; and
- Introduce a new job seeker relocation bonus.

In parallel with these initiatives, the government is also proposing to review and improve the Fair Work Laws to ensure they are both balanced and effective, embracing common sense to provide practical solutions to everyday workforce problems. We note that the policy will:

- Keep and improve the *Fair Work Act* – including the independent umpire;
- Re-establish the Australian Building and Construction Commission;
- Provide better protection for members of registered organisations;
- Provide practical help to small business work places;
- Guarantee workers have the right to access fair flexibility;
- Create realistic time frames for greenfield agreements;
- Ensure union right of entry provisions are sensible and fair;
- Give unpaid workers a better deal;
- Promote harmonious, sensible and productive enterprise bargaining;
- Ensure the laws work for everyone and undertake an independent review of the Productivity Commission;
- Deliver a genuine paid parental leave scheme and lift female participation rates in the Australian workforce;
- Ensure workplace bullying is comprehensively addressed;
- Review the Remuneration Tribunal for the trucking industry; and
- Implement recommendations for the Fair Work Review Panel report.

The government's agenda is comprehensive and challenging. If achieved in collaboration with all stakeholders it will be a strong endorsement of a Coalition Government's ability to address many significant challenges in the period ahead.

9.3 Australian Industry Group (AI Group)

In March 2013, AI Group chief executive Innes Willox outlined some steps the government could take to benefit productivity including:[58]

- Abolishing the carbon tax;
- Cutting business tax rates and renovating the state and territory tax systems including raising the rate of the GST;

[58] I Willox, *Innovation and Productivity: Opportunities and Challenges for Australian Industry*, Speech to the French-Australian Chamber of Commerce and Industry, 21 March 2013, p.6

- Investing in value added services and advanced manufacturing;
- Encouraging business innovation – no matter the business size;
- Recommitting to openness to migration;
- Implementing "sensible" changes to the IR regime in the areas of:
  - Individual flexibility arrangements,
  - Bargaining laws encouraging unions to seek restrictions on contractors and labour hire,
  - Transfer of business laws that impede restructuring and outsourcing,
  - General protection laws which have encouraged spurious termination of employment claims,
  - Laws providing unions with power that cause discord in the workplace;
- Selling down long-held public sector assets and newly built assets to superannuation funds;
- Cutting red and green tape by removing duplication between states and the Commonwealth, having effective regulatory impact assessment procedures, streamlining reporting, implementing risk-based approaches to audit, introducing codes of regulatory conduct and measuring and reporting on regulatory burdens; and
- Reforming apprenticeship and improving science, technology, engineering and mathematics (STEM) teaching and skills. Willox proposed that Australia lift teacher quality and adopt innovating teaching strategies to engage students in STEM learning, improve career advice to highlight opportunities in STEM careers, introduce STEM KPIs in school resourcing negotiations, introduce semester long work placements for new STEM undergraduates.

According to Willox, **workplaces could take their own steps** by improving: [59]

- Managerial skills;
- Skill levels of the broader workforce, how well these skills are utilised and the opportunities and willingness of individuals to upgrade these skills;
- Technical, process and business model innovation;
- Efficiency of supply chain management and channels to market;
- Organisational leadership and cultures; and
- Engagement of the workforce.

In particular, Willox believed businesses **fell short on their collaboration with the publicly funded research sector**.[60]

He also stated that many workplaces were a fair way short of being high performance workplaces, which AI Group defined as:

> High performance workplaces are focused on maximising the potential of their workforce and utilising this potential for mutual benefit and competitive advantage. They do this by recruiting competent workers, involving them in extensive training and creating or redesigning jobs which will provide them with challenge, responsibility and control.

[59] I Willox, *The Challenge of Workplace Productivity*, Speech to the Centre For Workforce Futures Macquarie University, 29 November 2012
[60] I Willox, *Getting Productivity Right for a Modern Economy*, Proceedings of the Australian Mining Productivity and Competitiveness Summit 2013,9 April 2013, p.4

In so doing, they enable the effective utilisation of skills and reduce the occurrence of skills mismatch (that is, where workers do not have the skills for the jobs they are doing, or are over-skilled for their jobs).

High performance organisations have flatter management structures, promote participatory decision-making, and share business information with employees. They apply performance-related reward and recognition systems. Work is organised around principles of teamwork, lean production and quality management, and processes are supported by current and relevant technologies.

AI Group has developed a "workplace productivity tool" for businesses to use to measure their practices against those of top performing businesses[61].

9.4 Australian Mines and Metals Association

A workplace relations survey of 52 members of the **Australian Mines and Metals Association** found:[62]

- Respondents believed rising labour costs are the main factor harming the Australian resource industry's competitiveness;
- Almost half of respondents had wound back projects in the half-year preceding the survey;
- Almost 90% of respondents had not negotiated any productivity offsets as part of their agreements under the *Fair Work Act*;
- Three quarters of respondents believed their productivity levels had fallen due to the current workplace relations legislation;
- 90% of respondents had received an adverse action claim from former employees;
- 40% had received claims from current employees; and
- A lack of skilled labour in Australia meant that 68% of respondents had needed to recruit skilled labour from overseas.

It is worth noting that a review by an independent expert panel into the *Fair Work Act* found that the legislation did not have a negative impact on productivity.[63]

9.5 Australian National Retailers' Association

The Australian National Retailers' Association's 2011 submission to the Productivity Commission inquiry into the retail industry[64] stated that the industry faced structural challenges.

Changing consumer demands, including online shopping habits, increased competition from overseas companies, and consumers' ability to compare costs across the globe have all had an impact on the industry. Restrictions such as opening hours and issues with labour force flexibility have caused the industry to struggle to compete against online sales. The globalisation of the industry also presents opportunities in the form of international

[61] Australian Industry Group, *High Performance Organisations: Maximising Workforce Potential*, AI Group and the Department of Education, Employment and Workplace Relations, February 2012

[62] Dr S Kates, *The AMMA Workplace Relations Research Project – A Survey Based Analysis*, RMIT University, August 2013, p.5

[63] Department of Education, Employment and Workplace Relations 2012, *Towards more Productive and Equitable Workplaces – An Evaluation of the Fair Work Legislation*, DEEWR, p.19

[64] Australian National Retailers Association, *Economic Structure and Performance of the Australian Retail Industry*, Submission to the Productivity Commission, May 2011

customers for Australian retail goods, but the association believed this opportunity could only be accessed via the right policy settings.

The association set out a number of recommendations to help the industry, some of which were:

- Retailers should be allowed to open at any time they choose aside from some public holidays, with incentives provided to states to take action on opening hours.
- There should be restraint in minimum award wage increases during the current weak economic conditions.
- The government should assist the industry with direct sourcing agreements and/or free trade agreements.
- The Australian government should remove customs duty from all consumer goods imported into Australia except for clothing, textiles and passenger vehicles, and the duty for these items should be reduced. However, the GST threshold should be reduced to $100.
- The Productivity Commission should review the taxes facing retailers with a view to reducing the number and size of the taxes paid.
- Parallel importing restrictions should be removed.
- The government should not act to distort market structure through changes to the *Australian Competition and Consumer Act*.
- The government should continue to support retail-based apprenticeships and traineeships.
- The government should minimise the growth of green tape.

The Productivity Commission[65] made 14 recommendations in its final report, some of which echoed the association's recommendations, including looking into parallel imports, changing the low value threshold exemption for GST if cost effective, deregulating trading hours and examining employee concerns regulations and workplace relations issues.

9.6 Business Council of Australia (BCA)

In a speech to the Prime Minister's Economic Forum, BCA CEO Jennifer Westacott suggested there was **overwhelming agreement in business that for Australia to remain competitive it must improve its productivity**.[66] She further added that productivity was not merely working harder at lower wages but it referred to the ability of driving innovation and research, as well as capturing numerous cost savings.

In the BCA's *Action Plan for Enduring Prosperity* the Council laid out nine "things to get right" to secure enduring prosperity. Each area had a list of recommendations for federal or state governments, some of which touched on productivity and are summarised below.[67]

1. *Put tax and fiscal policy settings and the operation of the federation on a sustainable footing*

   - Hold an independent whole-of-government audit on spending and program efficiency;
   - Overhaul Australia's taxation system and begin a process to progress administrative simplification of the tax system;
   - Reduce the company tax rate to 25%; and
   - Introduce a new system of national productivity payments to the states and territories to encourage the passage of difficult structural reforms.

[65] Productivity Commission 2011, *Economic Structure and Performance of the Australian Retail Industry*, Report no. 56, Canberra, 4 November 2011
[66] J Westacott, *Address*, Proceedings of the Prime Minister's Economic Forum, Brisbane, 13 June 2012
[67] Business Council of Australia, *Action Plan for Enduring Prosperity*, BCA, 2013

2. *Pursue sustainable population growth in Australia's cities and regions*

   - Commit to well-maintained population growth; and
   - Maintain current migration policy settings, with two thirds of migration being skilled migration.

3. *The provision of infrastructure for a modern, liveable, productive economy*

   - Invest in infrastructure at a rate of approximately 4% of GDP and together with the states create a long term national infrastructure policy;
   - Update Australia's infrastructure competition regulations;
   - Reinstate the Australian Building and Construction Commission; and
   - Conduct strategic assessments of national infrastructure policies and recommend reforms every five years.

4. *Realising the potential of people and labour markets*

   - Make immediate changes to the *Fair Work Act* including:
     - Reducing the range of matters that unions can bargain over;
     - Providing access to employer only greenfield agreements;
     - Enhancing the capacity to agree to flexible arrangements with employees;
     - Reducing the scope of the adverse actions provisions;
     - Limiting access to protected industrial action where its use is unreasonable or capricious;
     - Limiting union entry rights to employer premises;
     - Banning clauses that exclude the engagement of contractors or labour hire companies;
     - Modifying the better off overall test;
     - Modifying provisions relating to majority support determinations; and
     - Amending the transfer of business arrangements to include a sunset clause after 12 months;
   - Commission a Productivity Commission enquiry into the workplace relations system, examining the system's impact on productivity, the deterrence of the high minimum wage on new labour market entrants, the impact of penalty rates on competitiveness, the role of individual agreements in productivity, and working arrangements that encourage the take-up of innovative practices;
   - Address literacy and numeracy deficiencies;
   - Encourage excellence in school teaching by raising the entry requirement for teachers, giving them better training and support, providing principals with more autonomy and differentiating teacher pay;
   - Possibly deregulate fees paid by university students and reduce red tape for university funding;
   - Increase work integrated learning such as internships and cadetships and increase focus in tertiary vocationally oriented courses on employability skills such as problem solving, team work and effective communication;
   - Improve financial incentives to encourage older Australians to remain in work;
   - Remove structural incentives for unemployed people to withdraw from the labour market by reducing differences between the pension system and the allowance system; and
   - Support geographic mobility by removing financial impediments and state-based differences that discourage moving house and family.

5. *Dramatically rethink our approach to regulation and strengthen governance and institutions*
   - Make the preparation of regulation impact statements a statutory requirement for all new regulations with a significant impact;
   - Consult with the ASX Corporate Governance Council before introducing new corporate governance regulation to see if the issue can be addressed by the Council's principles and recommendations;
   - Establish a comprehensive framework for the regular review and updating of the stock of regulation and competition policy;
   - Link ministerial remits and senior executive performance indicators and remuneration to demonstrating efficient regulatory outcomes in their portfolio; and
   - Charge the Department of Finance, the ABS and the Productivity Commission with developing a framework to measure productivity in the public sector.

6. *Realising deeper global engagement*
   - Intensify efforts to conclude free trade agreements under negotiation;
   - Maintain an internationally open labour market; and
   - Establish CEO-level dialogue with economic partners in the region with an eye to removing impediments to trade and investment.

7. *Preserving a strong, stable and competitive financial system*
   - Address tax biases between different savings and investment options and minimise market distortions; and
   - Review the financial services sector including the effectiveness of the current regulatory model.

8. *Adopt a coherent and comprehensive energy policy that maintains Australia's competitive advantage*
   - Reset policy settings so we reduce greenhouse emissions at least cost and commensurate with global efforts to support Australia's competitiveness;
   - Require the Productivity Commission to regularly review the impact of emission reduction policies on business costs;
   - Address regulatory barriers to supplying gas to Australian consumers;
   - Remove retail price regulation where there is effective competition; and
   - Privatise remaining energy assets.

9. *Creating the right environment and systems to drive innovation*
   - Establish a national innovation council to identify areas of comparative advantage and national priorities;
   - Implement the National STEM strategy called for by the Chief Scientist of Australia;
   - Harmonise intellectual property frameworks across the publicly funded research sector;
   - Adopt a digital first policy to increase the government's use and application of innovative ICT; and
   - Improve collaboration between public research bodies and business.

9.7 Master Builders Australia

A 2013 report released by Master Builders Australia (MBA) and conducted by Independent Economics examined the effect of earlier reforms to the building and construction industry on productivity.[68] It noted the impact of the abolition of the prior Australian Building and Construction Commission and its replacement by a new agency within the Fair Work Australia Commission in June 2012, which acted like an industry watchdog over wage negotiations between companies and unions.

The MBA highlighted certain changes under the new agency, which it stated had resulted in a regression of the regulatory environment prior to the Royal Commission into the industry in 2003, including:

- Narrower circumstances under which industrial action attracts penalties, bringing construction in line with other industries;
- Reduction in maximum penalties applicable for breaches of industrial law, bringing construction in line with other industries;
- Restricted use of compulsory examination notice powers;
- Inability for the agency to participate in or initiate proceedings on settled matters; and
- Increased rights for union officials to enter work sites.

The report claimed this had led to more days of industrial action and a reduction in Australian household welfare through a loss in productivity.

We note that the MBA are highly supportive of the new Federal Coalition Government to reinstate the ABCC or a similar body in the hope of achieving further reforms which will lead to higher construction productivity and lower construction prices.

9.8 Minerals Council of Australia

Minerals Council of Australia published a report in September 2012 postulating that if Australia maintained its current minerals market share, resource sector revenues would rise to $121 billion per annum by 2031 – a 65% increase.[69]

Yet with competitor markets improving their policy settings and prices coming down from their record highs while costs increase, **Australia is already experiencing stagnation in market share**, according to the report. Australia's market share in coal, copper, gold, iron ore, uranium, nickel and bauxite all reduced from 2000 to 2010.

More than half of Australia's mines have costs above global averages, with labour and capital costs rising, it stated. Australia's iron ore projects are 30% more expensive than the global average; thermal coal projects are 66% more expensive. It stressed that future growth has to come from new low cost ventures.

Meanwhile, **wait times for approvals have been increasing** and are higher than global averages – for example, in thermal coal, the average Australian project experiences 3.1 years of delay, compared to 1.8 years for the rest of the world.

Modelling conducted for the Council suggested that without improvements in competitiveness, real GDP in 2040 will be 5.3% lower and real wages 6.3% lower than they would be if competitiveness is improved.

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[68] Independent Economics, *Economic Analysis of Building and Construction Industry Productivity: 2013 Update*, prepared for Master Builders Australia, 26 August 2013

[69] Port Jackson Partners, *Opportunity at Risk - Regaining our Competitive Edge in Minerals Resources*, Commissioned by Minerals Council of Australia, 2012

The Minerals Council of Australia's report recommended that Australia:

- Change the dialogue from how to distribute the earnings of the minerals sector to how to ensure the benefits continue;
- Recognise the competitiveness problem;
- Immediately address cost pressures on current projects by addressing skills shortages with labour from inside and outside Australia; ensuring competitive access to supplies such as fuel and equipment; and achieving budget surpluses to reduce pressure on inflation;
- Grow skills through building university capacity and increasing completion of technical training;
- Make sure R&D achieves returns;
- Rework the *Fair Work Act* to encourage collaborative relationships between employees and employers;
- Maximise throughput on multi-user infrastructure chains;
- Reform approvals process for clear and predictable rules and timeframes; and
- Lock in competitive tax and royalty arrangements.

9.9 Productivity Commission

Gary Banks, former Chairman of The Productivity Commission has outlined numerous possible ways to boost Australia's productivity growth including:[70]

- Abolish remaining tariffs, limit provisions for anti-dumping action and abolish further competition restrictions;
- Terminate industry subsidies and innovation subsidies that do not deliver demonstrable benefits;
- Phase out public sector procurement preferences;
- Make better use of salary differentials and performance appraisals in education;
- Focus government support where market failures are potentially greatest rather than commercialisation activities;
- Reform the governance of public utilities;
- Conduct cost benefit analyses before major infrastructure investments; and
- Extend the use of cost reflective pricing.

Small changes in productivity translate into large benefits. According to Banks[71], **if Australia were able to regain the 2% annual growth of the 1990s, we would on average gain $18,000 in GDP per capita**.

[70] G Banks, p.6
[71] Ibid.