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FLAT WHITE

Forget the virus. We should be panicked by lost productivity

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The very definition of harmful advice is found in the Treasury's five yearly Intergenerational Report, the latest edition of which was handed down on Monday. In The Australian, Treasurer Josh Frydenberg acknowledged "there remains much work to be done", but praised the report for its policy guidance.

In his piece, Josh quoted one of Paul Krugman's rare insights "Productivity isn't everything, but in the long run it's almost everything".

But that quote was probably Josh's sole contribution to the piece. You see, Josh has an economics degree and not all of it involved erroneous Keynesian macroeconomics, which advocates government spending to combat a downturn. Recalling his studies, the real Josh Frydenberg would have absorbed the IGR messages with dread.

He would have read, with furrowed brows, Treasury's *assumption* that, in spite of recent productivity growth languishing at 0.5 per cent, it will return to its long-run rate of 1.5 per cent per year.

He would have recognised even 1.5 per cent is unimpressive when nations with far fewer natural resources than Australia show much faster growth. While attributing the mediocre historical performance to moments of madness when the electorate voted spendthrift ALP governments into power, he might have reflected on some serious policy mistakes of the Howard Government. Among these was getting the ball rolling on renewable energy subsidies that have now undermined a formerly low-cost electricity supply and the expropriation of landowners to prevent them clearing land thereby reducing carbon dioxide emissions. He might also have realised that decisions to constrain supplies of irrigation water in the Murray Darling would not have helped.

But he also would have wondered what had changed to bring productivity rates to decline from poor to miserable.

Reflecting on his undergraduate studies on economic growth theory, he might recall that productivity is fundamentally dictated by two factors.

The first is investment levels, which of themselves lead to "capital deepening" and an increase in productivity per worker.
The second is "multi-factor productivity", which is an additional pay-off from such investment, when combined with other factors like application of R&D, less intrusive regulations, new techniques and improved workplace skills.

On both counts, Josh would recognise that the IGR fails critical tests.

First, business investment, as a share of GDP has fallen to around 10 per cent – a 60 year low in a measure that has previously reached 25 per cent in investment booms and slumped to as low as 15 per cent in recessions. Handouts and disincentives to save would surely have contributed to this.

Secondly, there has been a collapse in multi-factor productivity. Josh's studies into economic history would have led him to recognise that this tends to be damaged if the government gets involved in second-guessing the market outcomes or correcting for "market failures". He would ponder whether a reduction in the potency of investment could have been due to investment being shifted away from high-value areas like coal mining, coal-generated electricity and gas and because land and other resources have been re-assigned to environmental uses. He might also wonder if outcomes from planning applications that have held up mine developments for up to 10 years are playing a role. He might also worry that this would be worsened by the intimidating decision of far-left judge Mordecai Bromberg placing a duty of care for future generations from the burning of coal, and that pressures on firms to incorporate climate risk in their reporting will, as they are intended, coerce them against using or investing in fossil fuels.

Such concerns would be heightened when Josh looked at the structure of investment. He would find governments are subsidising high cost unreliable renewable energy by at least $7 billion a year. The CEFC, the "Clean Energy Bank", is heavily investing in renewables, proudly maintains that, rather than "crowding out" private investment, it is "crowding it in". Australia is spending some $10 billion a year on new wind and solar facilities which the IGR shows is ten times the world per capita average and twice that of the EU and US. The combined spending on renewables subsidies and the wind and solar facilities they engender, correcting for double counting, is at least $15 billion a year. That is equivalent to about eight per cent of business investment that is not only wasted but forces the closure of more efficient electricity facilities.

Josh's depression would have been heightened when he saw the debt and spending commitments that are in place. Net debt for the three golden decades to 2005 averaged only 8 per cent of GDP. Today it is over 40 per cent and will continue to climb – precipitously if even more profligate Treasurers than himself are in the chair. This means not only is the productivity assumption hopelessly over-optimistic but the economy from now on is hampered by the need to service the debt created, which will further cannibalise savings and therefore the availability of capital.
He would sadly recognise that even where there is money dedicated to increasing productivity it inevitably gets captured by woke public servants. Thus the Manufacturing Modernisation Fund provides grants to help Australian manufacturers. But the process involves deflecting firms' management from promoting productivity and understanding customers' needs into a beauty contest refereed by public servants. The referees are biased towards "clean energy" and other environmental goals.
Josh's dejection would be complete when contemplates the adverse effects of the decline in national education standards compared with other

countries and when he absorbs the implications of a belligerent China on the need to spend more on national defence.

The IGR assumes all is hunky-dory and we will grow at the lacklustre pace of previous decades. But even that possibility has been undermined by policies that diverted income into consumption and reduce the value of the savings going into capital investment and by channelling that investment away from areas that offer the best returns.

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