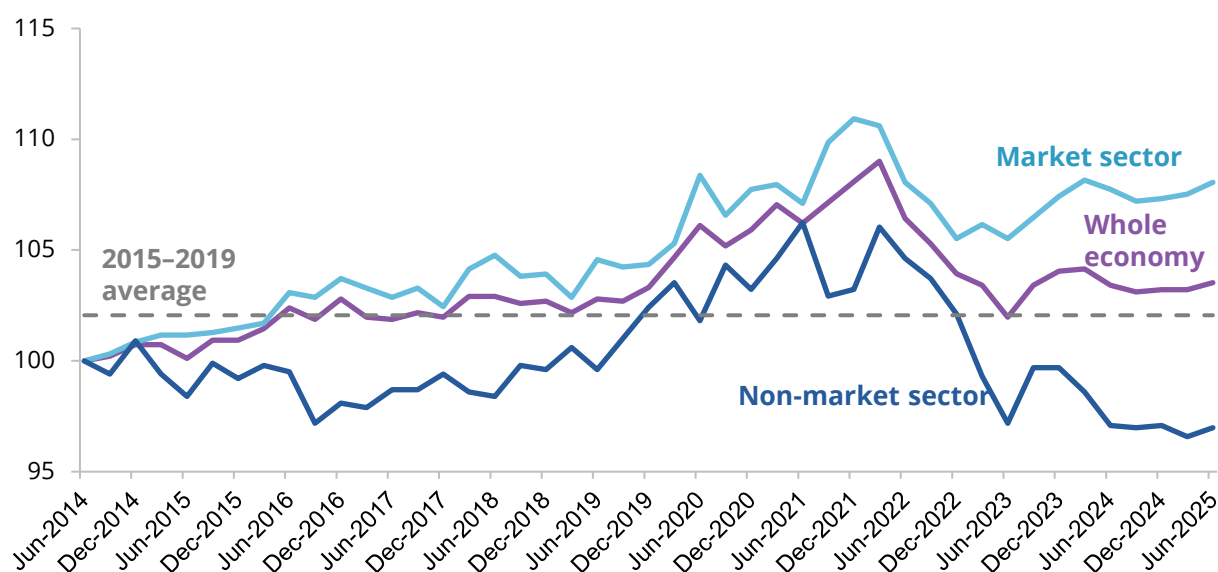


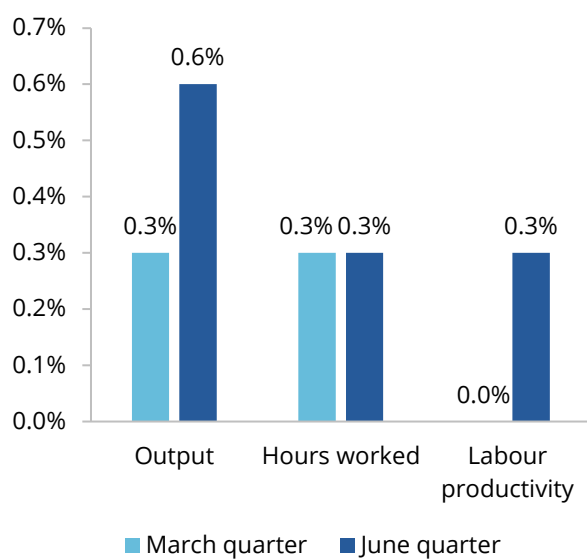


Quarterly productivity bulletin – September 2025

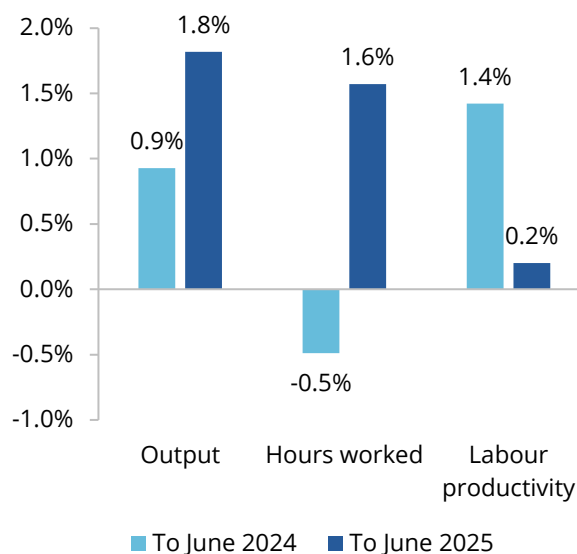
Labour productivity (index, June 2014 = 100)



Quarterly change in labour productivity



Annual change in labour productivity



Source: PC estimates based on ABS (*Australian National Accounts: National Income, Expenditure and Product*, June 2025).



**Update from Alex Robson
Deputy Chair, Productivity Commission**

Despite signs of improvement, it would be premature to say Australia's productivity malaise has passed.

Labour productivity increased by 0.3% in the June quarter and 0.2% over the year to June 2025. While this is good news, Australia's workforce is barely more productive now than it was prior to the COVID-19 pandemic. We will need sustained productivity growth to move the needle.

Labour productivity tends to increase when workers have more or better capital (such as computers and buildings) to work with, which is known as 'capital deepening'. In this bulletin's feature article, PC Economist Daniel Arzhintar found that Australia has experienced little capital deepening in the past decade because we have tended to invest less of our national income in new capital.

In the interim report of our *Creating a more dynamic and resilient economy* inquiry, we recommended revenue-neutral changes to the corporate tax system that would help solve our investment problem. The company income tax rate would be reduced to 20% for companies with annual revenue below \$1 billion and would remain at 30% for companies with annual revenue above \$1 billion. A new 5% cash flow tax would be applied to all companies to maintain revenue neutrality. These reforms would give the 99% of companies with annual revenue below \$1 billion stronger incentives to invest, without significantly affecting investment for the remaining 1% of companies.

As Daniel explains, 'With more of the right tools and resources, we can boost our productivity. The alternative is a future of doing less with less.'

Working with less: The decline of capital deepening

By Daniel Arzhintar, Graduate Research Economist

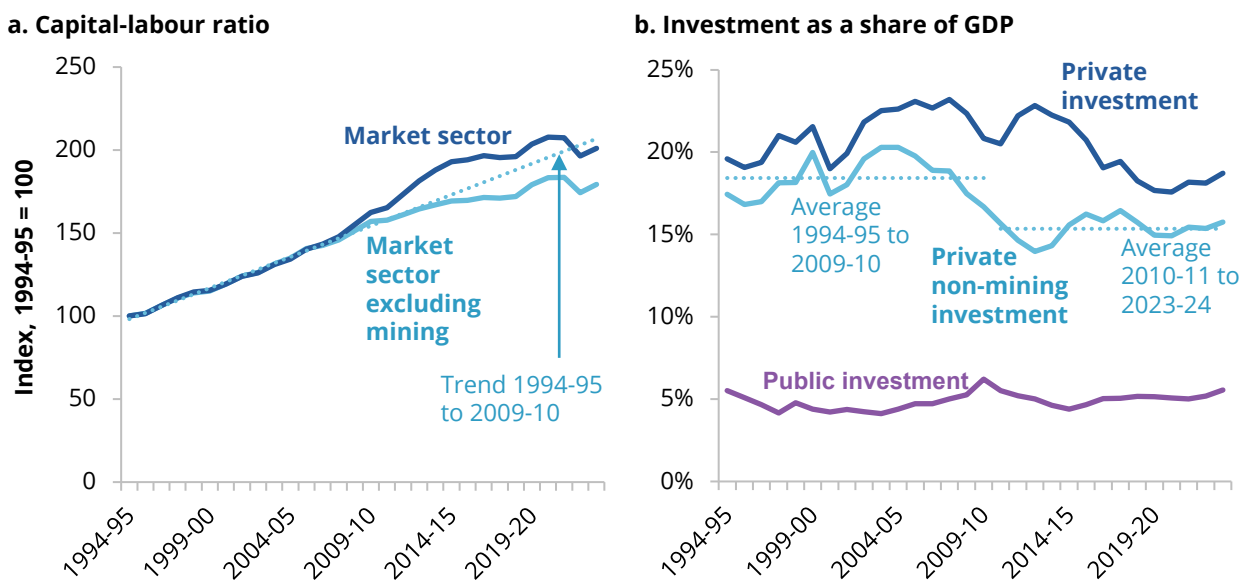
We need capital to be productive. This includes everything from computers to machinery to buildings. A baker can't make bread without an oven and an accountant without a spreadsheet would be a lot less productive. The accumulation of more and better capital per hour of work undertaken – known as 'capital deepening' – is a key reason why Australians have become much wealthier and more productive.

Australia experienced steady capital deepening over the mid-1990s to the mid-2010s, as indicated by growth in the capital-labour ratio (figure 1, panel a). Since then, however, Australia has experienced little capital deepening, aside from temporary deepening during the COVID-19 pandemic due to fluctuations in employment (PC 2025d). In the non-mining market sector, the dip in capital deepening occurred following the Global Financial Crisis (GFC) of 2007–2009 (figure 1, panel a).

The lack of capital deepening over the past decade has contributed to Australia's sluggish productivity growth.

Capital deepening is down because investment is down.¹ As a share of GDP, private investment was lower overall in the past decade than in previous years (figure 1, panel b). Contributing to this, private non-mining investment has been lower since the GFC, and private mining investment (the gap between the blue lines) has also dropped since the mid-2010s. Public investment has remained relatively stable as a share of GDP throughout.

Figure 1 – Capital deepening has declined because investment has declined^{a,b}



a. The capital-labour ratio is the ratio of the dollar value of the flow of capital services to the number of hours worked in the year in question. Except for hours worked, only indices of these data series are published. **b.** The market sector excludes 'public administration and safety', 'education and training' and 'healthcare and social assistance'. No capital-labour ratio estimates are available for these industries.

Source: PC estimates based on ABS (*Australian System of National Accounts*, 2023-24, *Labour Account Australia*, March 2025, *Estimates of Industry Multifactor Productivity*, 2023-24).

¹ Capital deepening is also influenced by depreciation of existing capital, because the change in the capital stock is investment less depreciation. Depreciation appears to have not contributed to the capital deepening slowdown in the non-mining economy – as a share of GDP, it was 0.5 percentage points lower in 2010-11 to 2023-24 than in 1994-95 to 2009-10 (PC estimate based on ABS (2024)), whereas investment was about 3 percentage points lower (figure 1, panel b).

The trends in mining investment have a simple explanation – increased demand for raw commodities from rapidly growing Asian economies, especially China and India, created a mining boom (Makin 2015) that has now dissipated. But the question of why private non-mining investment has fallen, and what Australia should do about it, requires further exploration.

Why has private non-mining investment declined?

The decline in private non-mining investment as a share of GDP since the GFC occurred alongside unusually low nominal and real risk-free interest rates. Other things being equal, this should have boosted investment, which suggests other strong investment-reducing forces were at play. While negative aggregate demand shocks may have played a role during the GFC and COVID-19 pandemic, these are unlikely to explain the entire 15-year period of relatively low investment.

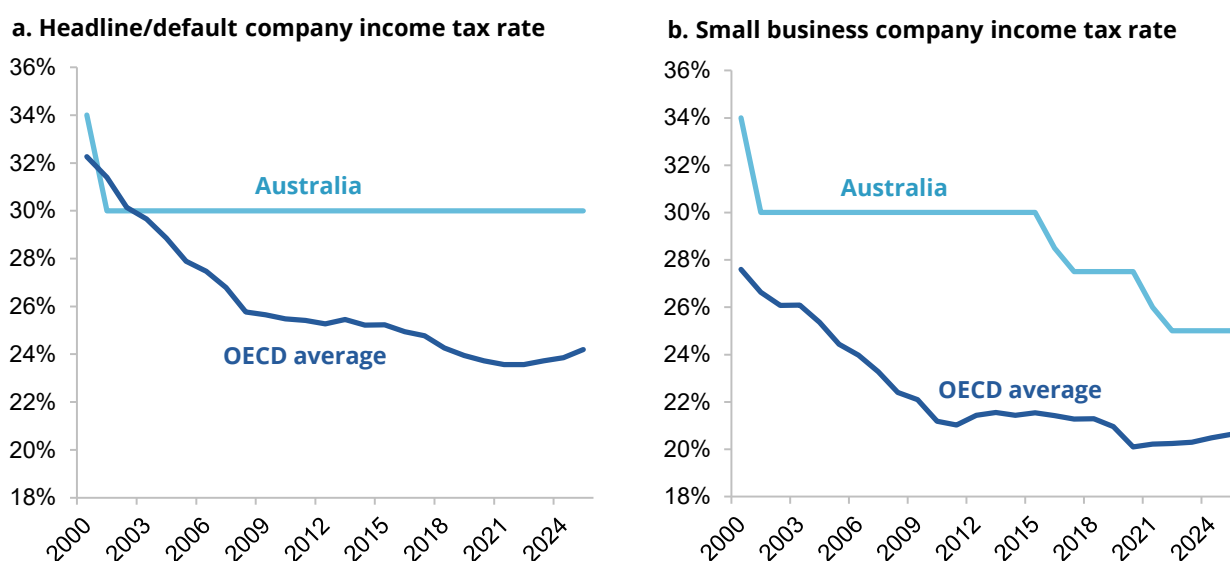
Several factors contributed to the slowdown.

First, businesses have either become more averse to risk or perceive that investments have become riskier. The additional return investors require to take on risk, also known as ‘the market risk premium’, has increased in Australia since the GFC – it was two percentage points higher on average between 2009 and 2020 than between 1997 and 2008 (Evans et al. 2024). As real interest rates were on average two percentage points *lower* between 2009 and 2020 than between 1997 and 2008, this meant that the rise in the market risk premium roughly offset the effects of lower interest rates on investment.

Second – and more disputed – is the role of weakening competition. The extent to which businesses charge above a hypothetical competitive market price has increased in Australia since the mid-2000s, which suggests a decline in competition (Hambur 2023). Industries that had larger declines in competition by this measure also tended to have larger slowdowns in investment, which suggests that declining competition may have caused lower investment (Hambur and Andrews 2023). However, analysis by Productivity Commission staff of market risk premium dynamics since the GFC found that market power did not change the expected returns that businesses require to invest (Evans et al. 2024). More generally, weakening competition does not necessarily reduce investment – it can also lead to higher (but inefficient) investment (King 2023).

Third – and far less studied – Australia’s policy settings may have made us less attractive to private investment relative to other countries. Australia’s corporate tax system has become less competitive in recent decades. OECD countries have cut their company income tax rate for large businesses while Australia’s has remained at 30% (figure 2, panel a).² And while Australia cut its small business tax rate to 25% over the past decade, other OECD countries made similar-sized cuts a decade prior (figure 2, panel b). Studies have consistently found that company income tax rates influence investment, so increases in the gap between Australia’s rate and other countries’ rates might have reduced investment in Australia (Rose et al. 2021). On regulation, Australia slipped from fifth to 14th in the World Bank’s ease of doing business indicator between 2005 and 2020, and from second to 15th of 28 countries in the OECD’s product market regulation indicator between 2003 and 2023 (World Bank 2005, 2020, 2024).

² Unlike most OECD countries, Australia’s corporate tax system allows for dividend imputation, so dividends paid to *domestic* investors are taxed only once (income tax) rather than twice (corporate tax and income tax). However, *foreign* investors are more relevant when considering the competitiveness of corporate tax systems.

Figure 2 – Australia’s corporate tax system has become less competitive^a

a. Other OECD countries use different definitions of company size when distinguishing small businesses for tax purposes.
Source: PC estimates based on OECD (2025).

Another factor to consider is the growth of service industries as a share of the economy. Since services tend to use less physical capital than goods-producing industries, this might be expected to influence rates of investment. However, this seems to have accounted for very little of the change in investment levels in the decade following the GFC (Hambur and Jenner 2019). The same is true for changes in the age of businesses or their date of formation (Hambur and Jenner 2019).

Other OECD countries have also experienced weak investment since the GFC. Recent OECD research suggests higher uncertainty and weaker competition were potential contributors (Dlugosch et al. 2025), which echoes the Australian experience. It also suggests reduced aggregate demand as a key driver, but this appears to have played less of a role in Australia (Dlugosch et al. 2025).

What should be done about the decline in investment?

Policy should seek to facilitate efficient investments: those for which the expected benefits exceed the expected costs. The PC has made several recommendations that would facilitate efficient investment, boosting capital deepening and labour productivity.

Chief among these is corporate tax reform. As mentioned, Australia’s corporate tax system has become increasingly uncompetitive. It makes marginally profitable capital investments in Australia unprofitable and favours debt financing over equity financing, which can give a leg-up to larger businesses that find it easier to borrow.

The challenge is that most proposals to make our corporate tax system more investment-friendly would also reduce corporate tax revenue. These proposals could be funded by increases in other taxes, reductions in spending, or, if revenue neutrality was not a constraint, greater government borrowing. The right approach is open for debate, but the PC has recommended revenue-neutral but investment-boosting changes to the corporate tax system.

In the interim report from its *Creating a more dynamic and resilient economy* inquiry, the PC recommended the company income tax rate be reduced to 20% for companies with annual revenue below \$1 billion, and that it stay at 30% for companies with annual revenue above \$1 billion (PC 2025a). To maintain revenue neutrality, the PC recommended introducing a 5% net cashflow tax on all companies. Net cashflow taxes

effectively tax only the returns on an investment over and above the minimum amount necessary to make it worthwhile for the business, whereas company income taxes tend to tax the other returns too. This makes net cashflow taxes more investment-friendly than company income taxes. In all, the proposed reform would be expected to give the 99% of companies with annual revenue below \$1 billion stronger incentives to invest, without significantly affecting investment for the remaining 1% of companies. Modelling suggests this would increase investment by \$7.4 billion, GDP by \$14.6 billion and labour productivity by 0.4%.

The PC also recommended other additional investment-boosting reforms in the interim reports to its five pillars of productivity inquiries.

- Reducing regulatory burdens on businesses to reduce the uncertainty and cost of business investment by:
 - committing to the principles of good regulation
 - tracking quantitative measures of regulation and improving scrutiny of new regulations
 - directing regulators to prioritise growth and dynamism and better holding regulators to account (PC 2025a).
- Assessing clean energy projects faster to increase and speed up investment by:
 - reforming national environmental laws to introduce national environmental standards and statutory deadlines for assessments
 - establishing a dedicated team to assess priority renewable energy projects, and establishing an independent coordinator to work across regulators and approval bodies (PC 2025c).
- Providing a stable and pro-innovation regulatory environment for artificial intelligence by:
 - assessing whether existing regulations sufficiently address artificial-intelligence-related risks
 - only introducing new regulations where there are gaps in these regulations that cannot be addressed with better guidance and enforcement
 - ensuring any new regulations are technology-neutral as much as feasible (PC 2025b).

Kickstarting investment and capital deepening is essential to ensuring our living standards continue to grow. With more of the right tools and resources, we can boost our productivity. The alternative is a future of doing less with less.

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