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The Productivity Imperative: Policies for a prosperous Australia

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Author:

Nico Louw, Chief Economist and Policy Director, Menzies Research Centre

The Menzies Research Centre Limited

RG Menzies House
Cnr Blackall and Macquarie Streets
BARTON ACT 2600
PO Box 6091
KINGSTON ACT 2604

Executive Director: David Hughes

Phone: 02 6273 5608

Email: info@menziesrc.org

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Introduction

Productivity is one of the least understood concepts in public policy. We need to raise awareness of, and find solutions to, Australia’s declining productivity growth as it is central to our future prosperity.

This report demonstrates why we should all care. Analysis in this report demonstrates how a modest 0.3% increase in annual productivity growth would increase GDP by \$877 billion over the next decade. The Commonwealth Budget would record a cumulative \$12 billion surplus instead of the currently projected \$221 billion deficit.

What is productivity?

Put simply, improving productivity means producing more with less. The practical results can be seen in every sector of the economy. In agriculture for example, comparing output in 2000 to Federation, Australia produced 25 times more wheat and 2.5 times more wool and head of cattle, even though agricultural employees as a proportion of the Australian workforce fell 80 per cent.

Higher productivity is vital to improving real wage growth and living standards, business growth, and work-life balance. Paul Krugman’s 1990 observation that *“Productivity isn’t everything, but in the long run it is almost everything”* remains true. Falling productivity is one of the principal reasons Australian living standards have declined in recent years. Living standards will not improve unless our productivity crisis is solved.

Long term productivity growth is the reason that the average Australian worker now earns seven times more in real terms than they did at Federation, while working 14 fewer hours per week. If we don’t find new ways to kickstart productivity, the rising living standards we have experienced over many decades are at risk.

Productivity in Australia

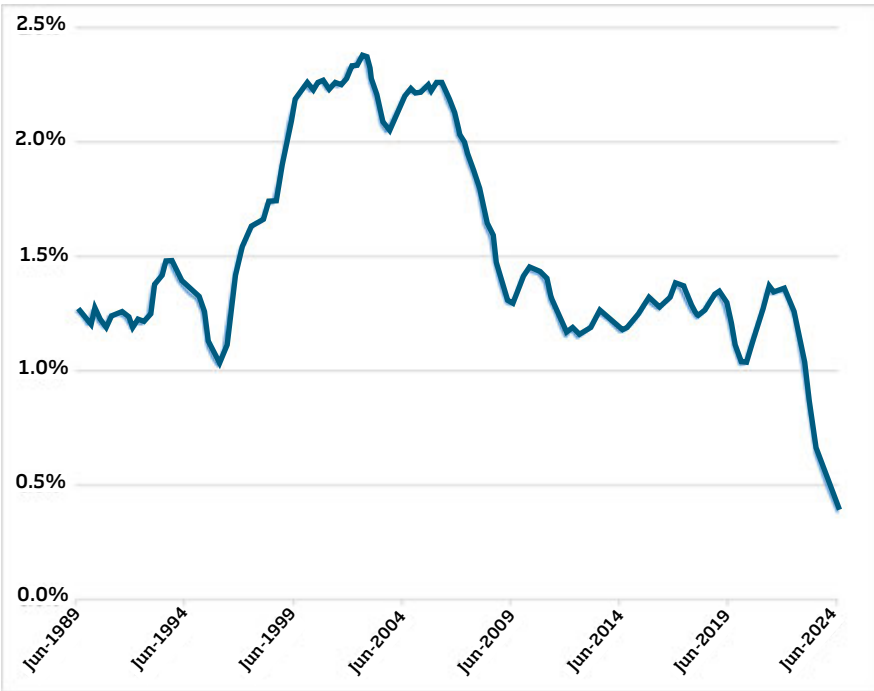
Higher productivity also supports better government services by growing the economy and government revenue. Treasury estimates show that if productivity growth over the longer term were to be a modest 0.3% higher annually than currently forecast, per capita incomes over the next 40 years would be \$11,000 higher. Menzies Research Centre (MRC) analysis shows that the same increase in productivity would mean that the Budget would be in surplus four years earlier, in 2030-31 instead of 2034-35, and, cumulatively to 2034-35:

- GDP would be \$877 billion higher;
- the Commonwealth would receive \$250 billion more revenue; and
- the Budget would record a cumulative \$12 billion surplus instead of the \$221 billion deficit projected at the 2024-25 Budget.¹

Despite significant regulatory and tax reforms over previous decades, analysis by the Productivity Commission shows that Australia’s labour productivity ranking fell from 6th in the OECD in 1970 to 16th by 2010, with no improvement since. Average annual labour productivity growth in the decade to 2020 was just 1.1%, the lowest average in 60 years and significantly lower than the average of 1.8% over that period. More recently, productivity has collapsed, falling 0.5% in the September quarter 2024 to be 5.7% lower since the last election. Recent analysis from McKinsey found that, just to sustain past GDP per capita growth, annual productivity growth would need to average 1.7%.²

¹ Based on 2024-25 Budget figures.
² Anu Madgavkar et al., “Dependency and depopulation? Confronting the consequences of a new demographic reality,” McKinsey Global Institute, January 15, 2025, <https://www.mckinsey.com/mgi/our-research/dependency-and-depopulation-confronting-the-consequences-of-a-new-demographic-reality#/>.

Figure 1: Year-ended growth in GDP per hour worked, 10 year average



Source: ABS 2024, Australian National Accounts: National Income, Expenditure and Product, June 2024

It is often argued that enacting contentious or costly productivity enhancing reforms in the modern political environment is too hard without a ‘burning platform’ such as a recession to create the impetus for change. Even without the clear need to halt the fall in per capita incomes, we believe Australia and developed nations are already facing such a scenario in the form of global geopolitical disorder and strategic competition with the autocracies of China, Russia, Iran and North Korea. Recent months have seen confirmation of North Korean soldiers deploying to fight with Russia, allegations that Russia is assisting the Houthis in Yemen to target shipping in the Red Sea, ballistic missile strikes on Israel by Iran, and China conducting another exercise to encircle Taiwan.



The actions of these countries and last year’s ‘NATO plus four’ summit (Australia, Japan, South Korea and New Zealand) show that the fault lines have been drawn. To confront the challenges ahead, including potential economic decoupling, tariff and trade wars and the direct move of autocracies towards establishing ‘war economies’, it has never been more important for Australia to find ways to improve productivity and become a stronger economy. Addressing this challenge is an opportunity for governments and businesses alike to step up.

There is no consensus on the solutions to lower productivity growth and no single lever that governments can pull to guarantee higher productivity. However, there are many reforms economists generally agree that governments should enact that have been put in the too hard basket for too long. They include removing stamp duty for property purchases and insurance, deregulating retail trading hours, simplifying planning and zoning restrictions, and much more sharing of public sector data. These reforms need to happen. Governments should also seek to lower personal and business taxes to ensure Australia remains competitive, including through the elimination of bracket creep.

The policies above are well understood and this paper does not seek to re-prosecute the arguments for implementing the associated reforms. The focus of this paper is instead to put forward lower-cost but high-impact actions that the Commonwealth can progress unilaterally or at least primarily lead within the Federation. Our focus is on labour productivity, in line with most policymakers.

Policy Solutions

The drivers of previous shifts in productivity were not predictable and governments should not assume that supporting a particular technology or innovation will lead to productivity gains. This uncertainty means we cannot put all our eggs in even a few baskets, as the current Government appears to have done with renewable energy, battery manufacturing and quantum computing. A Government-run ATM for a few sectors is not a productivity policy. We need a plan B (and C and D) that considers what the domestic and international economy might look like in 10 or 20 years. The current Labor Government is betting on Australia becoming a ‘renewable energy superpower’; what do we do if it doesn’t work or another country beats us to it?

This means productivity-enhancing policies must be pursued across a broad range of fronts and constantly reassessed, accounting for the fact that productivity varies widely across the economy. Some sectors perform much better than others – goods generally better than services; the private sector better than government. The Government needs plans to support productivity in both the private and public sector, with particular consideration given to the challenge of improving productivity when delivering both market and non-market (generally government) services.

The role of governments in supporting private sector productivity must be thought through carefully. The overwhelming majority of Australian businesses are not innovators – they incrementally adopt new ideas and technologies, following the most innovative firms. Rather than attempt to decide or predict what these innovations will be, the role of the Government should be to *position* and *enable* these businesses to seize new opportunities with policy settings that get the basics right and support the spread of good ideas across the economy.

The challenge of addressing productivity is further complicated by the significant size of the Australian services sector, which has grown to make up 80 per cent of the economy and 90 per cent of the workforce. Services are generally less productive because they are more labour intensive and complex and therefore more difficult to make more efficient through actions such as automation. As services grow as a share of the economy, this drags down productivity growth nationally. The Government will need to consider broad enabling policies that will have the greatest impact on services productivity, such as supporting the use of AI.

Addressing productivity in non-market (largely government) services is an even greater challenge. The non-market sector is different in almost every respect and includes areas such as healthcare, aged care, disability care, childcare and education. It can be highly regulated, is usually Government funded or operated, have overlapping state and Commonwealth responsibility, and lack competition and even price signals for consumers. Measured labour productivity in the non-market sector has been close to zero for the last 25 years. Recent analysis by the e61 Institute shows the significant drag non-market services can have on national productivity. Research from e61 found that growth in the care sector (medical, aged, child and disability care) as a share of the economy alone has reduced economy-wide productivity by 0.2 per cent a year since 2019.



Improving productivity in education is critical to improving productivity in all sectors.

Addressing productivity in the non-market sector is one area where the Government can and must have a direct influence, especially given the recent rapid expansion of programs such as the NDIS. Improving productivity in education should be a particular area of focus because improving education and skill levels across the workforce is important to improving productivity in all sectors. Driving consistent productivity growth in the non-market sector will require strong leadership from the Commonwealth, including working with state governments that deliver most non-market services in Australia.

This paper recommends a package of relatively low-cost, practical policies that the Commonwealth Government can pursue now to improve productivity growth. The policies we recommend are broad based enablers of productivity across the economy, with a particular emphasis on enhancing productivity in the most challenging sector of services, especially non-market services. These include:

- establishing an ongoing process to cut red tape;
- improving government services and infrastructure procurement practices;
- supporting the uptake of AI in the private and public sector, including through improved sharing of government-held data;
- reforming planning and zoning in line with post-Covid work practices;
- removing barriers to the use of modern construction methods such as prefabrication and modular building;
- backing business investment with targeted tax relief;

- repealing restrictive industrial relations laws;
- supporting an energy market with multiple sources of generation that leads to lower cost energy; and
- investing in research, including establishing an Australian equivalent to the US Defense Advanced Research Projects Agency.

The benefits of these policies will not be felt for some time, so the Government should begin the work of implementing them as soon as possible.

Policy proposals

Cutting red tape

Excessive red tape and poorly designed regulations increase costs for businesses, reducing business dynamism and slowing the formation of new businesses. Regulators and public servants have little to no incentive to proactively reduce regulation to improve productivity without being explicitly directed to do so in an ongoing way.

- Require that all new regulations are offset by removal of an existing regulation on at least a 1:1 basis, aspiring to a 2:1 basis, with no exemption for 'new' regulatory areas such as AI. This could be measured flexibly by either number of regulations or the dollar impact of reduced regulatory burden. Offsets should be flexible enough to include instances where an existing regulation is improved or simplified but not removed.
- Set a minimum quota of regular red tape reductions in all areas of Government.
- Appoint a single Minister with responsibility for removing and improving regulation across all areas of Government, with the resources of a permanent team in a central department such as Prime Minister & Cabinet or Treasury.

Better government services

Productivity in government services has been essentially zero for the last 25 years. Driving productivity growth in government services will require strong leadership from the Commonwealth Government, including with state and territory governments that deliver most government services in Australia.

- The Commonwealth should work with states to replicate a similar shared research model to the new Australian Education Research Organisation (AERO) in other areas of government services that receive substantial Commonwealth funding, such as health and hospitals, and infrastructure. Among other areas, these research institutes could be tasked with researching and vetting the most effective uses of digital technologies such as AI, something the Productivity Commission has already recommended AERO be tasked with.

A smarter infrastructure pipeline

Construction sector productivity has been stagnant for three decades. Better coordination of government-supported infrastructure investments in road, rail, energy, housing, industry and defence could reduce pressure on construction costs and improve productivity. Currently, there is no meaningful mechanism to distribute the flow of Commonwealth infrastructure funds to avoid creating unnecessary pressures on the labour market and supply chains.

- The tools developed for governments by Infrastructure Australia to analyse the impact of construction projects and manage the infrastructure pipeline should be made publicly available.
- All governments should manage the impact of new projects on construction market capacity across portfolios, as recommended by Infrastructure Australia. The analytical tools developed by Infrastructure Australia should be used to better plan these investments.

Backing business investment

Private investment in capital assets can improve the efficiency of workers and act as an important contributor to higher productivity. Australia has a low level of business investment as a share of GDP compared with other OECD countries and non-mining investment has stagnated. To reverse the stagnation in business investment:

- The instant-asset write off should be permanently increased from \$20,000 to the most recent pre-Covid level of \$30,000 for businesses with an aggregated turnover of less than \$10 million. Future Governments should continue to seek to expand eligibility for the instant asset write-off, both in terms of asset size and turnover threshold.
- The Government should allow businesses to defer Capital Gains Tax when the proceeds from asset sales are reinvested into new assets, as already occurs in the United Kingdom.

Artificial intelligence in the private sector

Much like the advent of computers and the internet, successful deployment of AI will make many jobs more efficient and productive. Australia cannot afford to be left behind. Australia needs to:

- Establish a centrally responsible function at the Commonwealth level that monitors and coordinates AI policy across agencies and state governments to ensure best practice technology-neutral regulation, similar to the model proposed by the former UK Government. Ministers should also give clear guidance to regulators on best (and bad) practices regarding AI regulation.
- Vigorously police use of the planned financial sector Regulatory Grid for AI-related regulations and consider expanding the Grid's scope to all AI-related regulation across Government.
- Remove regulatory barriers that unnecessarily inhibit potential AI applications.
- Closely monitor the progress of the US National Artificial Intelligence Research Resource (NAIRR) pilot and the potential for a similar model in Australia.
- Given the fast pace of AI development, consider ways to support practical short courses in AI that are valued by employers and employees.

Artificial intelligence in the public sector

Growth in government services productivity is essentially zero, so finding ways to use AI to drive efficiency in the public sector will be vital as a potential way to kickstart productivity growth.

- Drive adoption of successful AI use-cases that improve productivity and service delivery in the Commonwealth public service.
- Monitor best-practice use of AI in public service provision and disseminate these practices to state and territory governments, especially in areas with substantial Commonwealth funding.
- Significantly uplift accessibility and sharing of public sector data and make this a requirement of state funding agreements.

Post-Covid planning and zoning

The Productivity Commission has recommended standard business and industrial land use zones across local government areas, and aggregating existing zones where possible to broaden the range of permissible activities and reduce the need for costly rezonings. Changes to commuting habits and business practices following the Covid pandemic provide a unique opportunity for governments to reconsider planning and zoning from the ground up along the lines of the Productivity Commission's recommendations.

- The Government should, through the National Cabinet, work with the states and territories to review the appropriateness of current planning and zoning settings, with a view to enacting reforms to modernise these regulations in light of the significant changes to working and commuting habits following the Covid pandemic. This should include consideration of less stringent distinctions between residential and commercial/industry areas.

Supporting modern construction methods

The size of the construction sector in Australia means that even small improvements in productivity could have a substantial effect across the economy.

- The Government should, through the National Cabinet, lead a national approach to removing regulatory and other barriers to the wider adoption of modern construction methods that could reduce construction time and costs and significantly improve productivity, such as prefabrication and modular building.

An Australian DARPA

The US's Defense Advanced Research Projects Agency (DARPA) has played a critical role in developing incredible productivity enhancing technologies. The success of DARPA's high-risk, high-reward approach is supporting leading edge research at the frontier of technology with the backing of Government, but outside the constraints of usual bureaucratic and procurement processes.

- To emulate the model of DARPA, the Government should follow the recommendation of the Defence Strategic Review and make the Australian Strategic Capabilities Accelerator independent of the Department of Defence as soon as possible.

Investing in research

Investment in research and development (R&D) in Australia by both the Government and across the economy is lagging behind other developed economies. A robust R&D ecosystem can boost productivity growth by driving technological progress and innovation.

- The Government should do more to grow Australia's research ecosystem, including considering where research funding could be increased and how to better incentivise private sector investment, with the goal of raising gross domestic R&D spending to at least the OECD average.

The broad enablers – energy and industrial relations

Lower energy costs and an industrial relations system that makes it easier for businesses to hire staff and for workers to change jobs would support productivity across all parts of the economy. Current policy settings are holding Australia back.

- To support least-cost energy generation, Australia's energy policy must be technology agnostic. The ban on civil nuclear power should be lifted and gas generation included in the Capacity Investment Scheme.
- Recent extensive changes to industrial relations laws which provide for multi-employer bargaining, changes to the definition of a casual worker, and the 'right to disconnect' should be reversed.
- The Australian Building and Construction Commission and Registered Organisations Commission should be restored to support productivity in the construction sector.

Part One: The case for change

What is productivity and why does it matter?

Productivity measures the efficiency with which inputs are turned into outputs. Put simply, improving productivity means producing more with less. Productivity is one of the three main drivers of economic growth, along with population and workforce participation. The latter two are both inputs, so increasing productivity is vital (in fact necessary) to improve real wage growth and living standards. Higher productivity also leads to higher business growth, better work life balance, and improved government services as a result of a stronger economy that increases government revenue.

Higher productivity means we can produce more and better products and services with fewer hours of work and fewer resources. In agriculture for example, comparing output in 2000 to Federation, Australia produced 25 times more wheat and 2.5 times more wool and head of cattle, even though the number of employees as a proportion of the Australian workforce fell 80 per cent. To put the economy-wide impact of productivity improvements in perspective – the average Australian worker now earns seven times more in real terms than they did at Federation, while working 14 fewer hours per week.³

There are many measures of productivity, but this paper will focus on labour productivity, in line with most policymakers. There are many potential enablers of higher labour productivity, including technological advances, education and training, capital investment, business management practices, competition, and business dynamism. It is important to note that productivity varies widely across the economy and some sectors may perform much better than others. Generally speaking, improving productivity is harder when delivering services than producing goods, and particularly when providing non-market (largely government) services than market services.

Australia's productivity performance

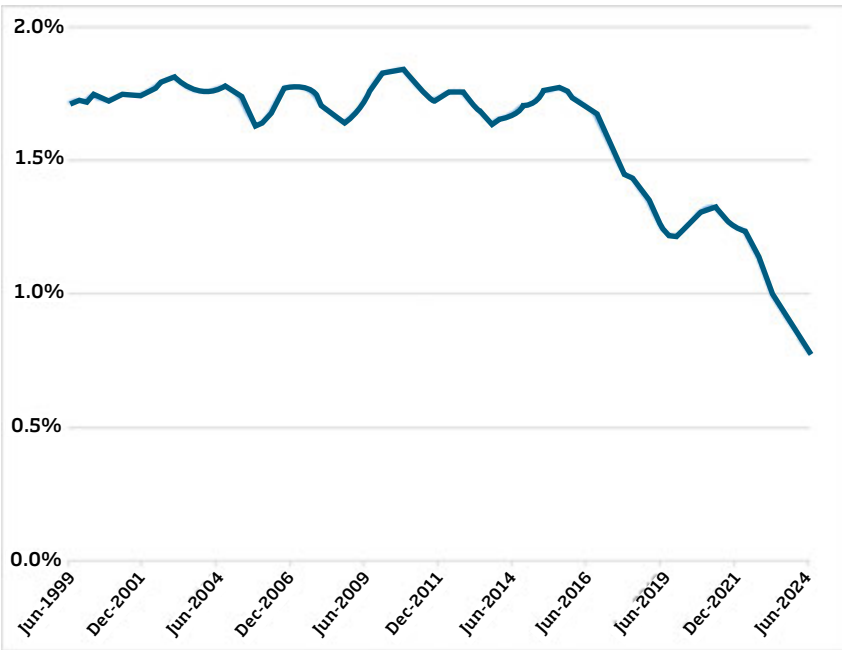
Declining productivity growth in Australia is a critical challenge that must be a priority for all governments. The Productivity Commission has found that average annual labour productivity growth in the decade to 2020 was just 1.1%, the lowest average in 60 years and significantly lower than the average of 1.8% over that period. More recently, productivity has collapsed, falling 0.5% in the September quarter 2024 to be 5.7% lower since the last election.⁴

The plateauing of labour productivity in Australia since the 1990s and more recent precipitous fall can be seen in Figures 2 and 3.

³ Productivity Commission, *5-year Productivity Inquiry: Advancing Prosperity*, vol. 1, Inquiry Report no. 100, Canberra, 2023, <https://www.pc.gov.au/inquiries/completed/productivity/report/productivity-volume1-advancing-prosperity.pdf>, 1.

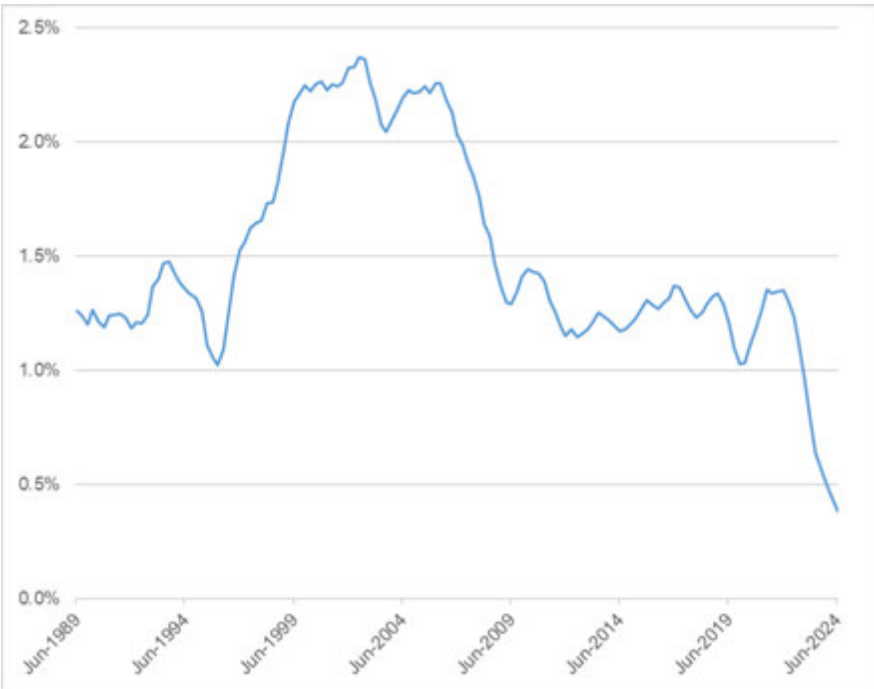
⁴ Australian Bureau of Statistics, *Australian National Accounts: National Income, Expenditure and Product* (Canberra, ACT: ABS, September 2024), <https://www.abs.gov.au/statistics/economy/national-accounts/australian-national-accounts-national-income-expenditure-and-product/latest-release>.

Figure 2: Year-ended growth in GDP per hour worked, 20 year average



Source: ABS 2024, Australian National Accounts: National Income, Expenditure and Product, June 2024

Figure 3: Year-ended growth in GDP per hour worked, 10 year average

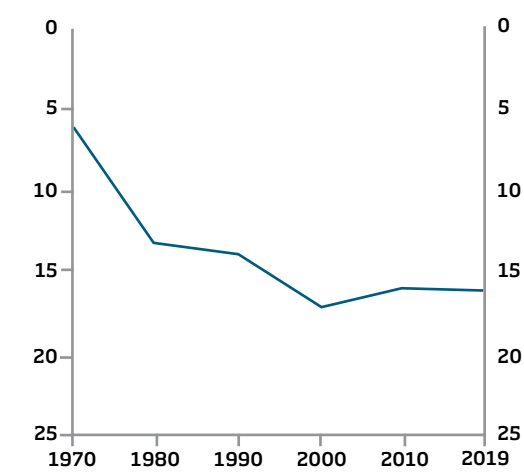


Source: ABS 2024, Australian National Accounts: National Income, Expenditure and Product, June 2024

Declining productivity growth is a problem across the developed world, however Australia’s relative performance is slipping. Despite significant regulatory and tax reforms over many decades, analysis by the Productivity Commission in Figure 4 shows that Australia’s labour productivity ranking fell from 6th in the OECD in 1970 to 16th by 2010, with no improvement since.

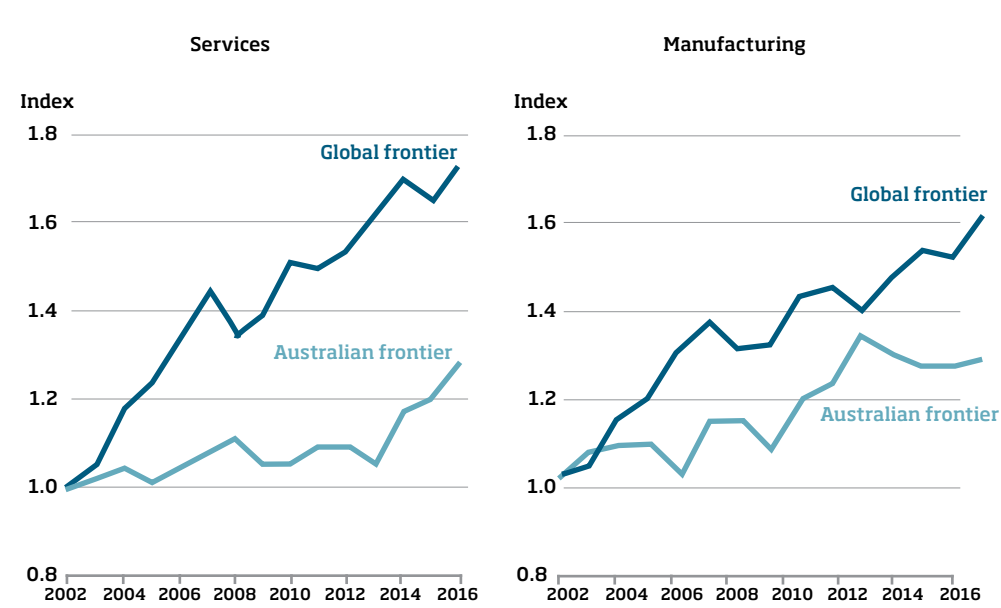
Further analysis undertaken by the Treasury showed that between 2002 and 2016, productivity by firms at the global frontier increased by 60 per cent, whereas the productivity of firms at Australia’s frontier increased only 25 per cent.⁵ Treasury analysis in Figure 5 also reveals how the widening Australian productivity gap has been more pronounced in the services sector compared to the goods-producing manufacturing sector. Lower productivity in services is a challenging problem to solve, because services are more labour intensive and complex and therefore more difficult to automate or otherwise make more efficient.

Figure 4: Australia’s labour productivity rank amongst OECD countries



Source: Treasury

Figure 5: Labour productivity in the services and manufacturing sectors



Source: Treasury
Note: The frontier is defined as the top five per cent of high-productivity firms for each year.

⁵ Australian Treasury, “Reigniting productivity growth,” in *Working Future: The Australian Government’s White Paper on Jobs and Opportunities*, (Canberra: Australian Government, September 25, 2023), <https://treasury.gov.au/sites/default/files/2023-09/p2023-447996-06-ch4.pdf>.77

These wider sectoral productivity trends mask further differences in productivity between the market and non-market sectors, the latter of which is a key driver of declining Australian productivity performance. This is because measured labour productivity in the non-market sector — including healthcare, education and public administration — has been essentially zero for the last 25 years.⁶ These non-market sectors are generally highly regulated and government funded, subsidised or operated, which limits innovation and price signals for consumers, as well as inhibiting or removing any profit (and hence efficiency) motive.

The relatively poor productivity performance of Australian services, and especially non-market/government services, is leading to structural compositional changes in the economy that drag national productivity lower. This is known as the ‘cost disease’. This ‘disease’ spreads when productivity in different sectors diverges. As some sectors become more productive and need fewer resources (as occurred in Australian agriculture as discussed above), these resources are freed up to move to progressively less productive areas such as services. If lower productivity in these sectors is not addressed, then less productive sectors will form a growing share of the economy, reducing overall productivity growth.

Recent analysis of the non-market sector in Australia shows the significant impact of the ‘cost disease’ on productivity. Research by the e61 Institute examining the care economy (medical, aged, child and disability care) found that this sector — which has had virtually no measured productivity growth in 20 years — now employs 15 per cent of workers, up from 10% in the early 2010s, and this substantial reallocation of labour has reduced economy-wide productivity by 0.2 per cent a year since 2019.⁷ Cumulatively over time, e61 found that the effect of reallocation to the care economy amounted to a level of labour productivity by 2023 that was “several percentage points lower than otherwise”.



The ongoing compositional shift in the Australian economy towards services, particularly non-market services, and resultant spread of the cost disease, makes addressing productivity in these sectors urgent. Around two-thirds of jobs created since the 2022 election have been in the non-market sector, even though it accounts for just 17 per cent of the economy.⁸

6 Productivity Commission, *5-year Productivity Inquiry*, Inquiry Report no. 100, Canberra, 2023, <https://www.pc.gov.au/inquiries/completed/productivity/report>.
7 Matthew Maltman and Ewan Rankin, “What if we didn’t care? Implications of growth in the care economy for the broader macroeconomy,” e61 Institute, October 10, 2024, https://e61.in/wp-content/uploads/2024/10/Care_Economy-2.pdf.
8 Jack Quail, “Job losses masked by care economy,” *The Australian*, October 21, 2024, <https://www.theaustralian.com.au/business/economics/job-losses-masked-by-care-economy/news-story/6f81ae8cdf35b32f5fc6876687b9e411>.

The cost of lower productivity

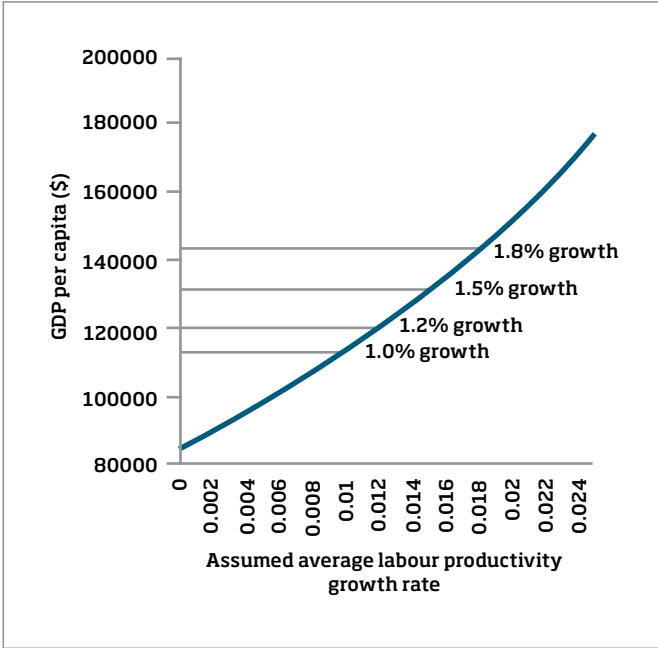
Long-term productivity growth is vital for sustained improvements in living standards. It means getting more from less — new, cheaper or higher quality goods and services with the same or fewer hours worked. The opposite is also true. Lower productivity growth means fewer resources to lift living standards and improve Australia’s resilience to future economic, geopolitical and environmental challenges. This is why the recent slowdown in Australia’s productivity is so alarming.

In 2022, Treasury downgraded its medium-term forecast for productivity to reflect this new reality, lowering projected productivity growth from 1.5% to 1.2%. The impact of this downgrade on Australians’ living standards, if not addressed, is stark (Figure 6 below):

- Compared to 1.5% productivity growth, growth of 1.2% means per capita incomes, over 40 years, will be \$11,000 (or 20 per cent) lower.
- Compared to 1.8% productivity growth, growth of 1.2% means per capita incomes, over 40 years, will be \$23,000 (or 40 per cent) lower and the working week 5 per cent longer.

The cumulative impact of this would be disastrous for Australian living standards.

Figure 6: GDP per capita in 2061-62 for different rates of productivity growth



Source: [Productivity Commission](#)

The impact of lower productivity on the Commonwealth Budget is also significant, with long term consequences for living standards through higher debt and deficits which future generations will have to pay for. MRC analysis shows that, had productivity growth stayed on track for 1.5% growth in the medium term, then compared to the 2024-25 Budget forecasts:

- cumulatively to 2034-35, GDP would be \$877 billion higher;
- the Government would receive \$250 billion more tax revenue;
- the Budget would be in surplus by 2030-31 instead of 2034-35;

- there would be a cumulative surplus of \$12 billion rather than a cumulative deficit of \$221 billion; and
- cumulative debt interest payments would be \$35 billion lower.

Conversely, if productivity growth continues to stagnate and falls further to 1% in the medium term, then compared to the 2024-25 Budget forecasts:

- cumulatively to 2034-35, GDP would be \$573 billion lower;
- the Government would receive \$164 billion less tax revenue;
- the Budget would not reach surplus, with a projected \$24 billion deficit in 2034-35;
- The cumulative deficit would worsen from \$221 billion for \$373 billion; and
- cumulative debt interest payments would be \$23 billion higher.

While lower productivity growth is not unique to Australia, our relative position compared to other countries shows there is clearly room for improvement at a national level. Australia's productivity is around 22 per cent lower than that of the United States and, if Australia's productivity was at the same level as Belgium — a country with a similar GDP per capita — then Australia's GDP per capita could increase by 25 per cent while seeing a reduction of 0.5 hours worked per week per capita.⁹

The role of Government

There is no consensus on the solutions to lower productivity growth and no single lever that governments can pull to guarantee higher productivity. While the shift to market and non-market services can partly explain the fall in productivity, the causes of a more broad-based stagnation across multiple sectors are not well understood. Declining economic dynamism generally and limited government-driven reform are often blamed.

The role of governments — particularly the Commonwealth Government which is the focus of this paper — must be thought through carefully. The factors that led to previous shifts in productivity were not predictable and governments should not assume that supporting a particular technology or innovation will lead to future changes in productivity. This uncertainty means we can't put all our eggs in even a few baskets (say for example, renewable energy, battery manufacturing and quantum computing); productivity-enhancing policies must be pursued across a broad range of fronts and constantly reassessed.

The role of the Government in supporting productivity growth can be divided into three broad areas: productivity in private businesses generally, in the services sector specifically, and in the non-market/ Government sector.

Productivity in private businesses is crucial, given around 83 per cent of Australian workers are not employed in the public sector.¹⁰ Importantly, 98 per cent of Australian businesses are not innovators — they incrementally adopt and adapt to new ideas, technologies and innovations made by the most innovative frontier of firms.

Rather than attempt to decide or predict what these innovations will be, the role of the Government should be to *position* and *enable* these businesses to seize new opportunities with policy settings that support the spread of good ideas across the economy. A principal area of focus should be broad enablers of competition and investment such as red tape removal, lower taxes and more flexible land use regulation.

The challenge of addressing productivity is further complicated by the significant size of the Australian services sector, which has grown to make up 80 per cent of the economy and 90 per cent of the workforce. As outlined above, lower productivity in services is a challenging problem to solve that is not unique to Australia, because services are more labour intensive and complex and therefore more difficult to automate or otherwise make more efficient. This leads to what is known as 'cost disease', whereby the lower productivity service sector keeps growing as a share of the economy, dragging down productivity growth.

The economic influence of services means addressing lower productivity in this sector is vital to creating sustained productivity growth across the economy. This is a significant challenge that will require additional attention from the Government. The growing share of services reflects changing consumer preferences and behaviour and it is not the role of Government to attempt to reverse this. Rather, the Government will need to develop broad enabling policies that will have the greatest impact on services productivity. This should include policies to support use of AI and improvements to the efficiency and quality of government services, especially education.

Labour productivity in the non-market sector has been close to zero for the last 25 years and addressing this is a uniquely difficult challenge. The non-market sector is different in almost every respect. It can be highly regulated, Government funded or operated, have overlapping state and Commonwealth responsibility, and lack competition and even price signals. These and general cultural factors in government service delivery greatly inhibit the diffusion of new ideas and innovations that can improve productivity.

Addressing productivity in the non-market sector is one area where the Government can and must have a direct influence. Because the community expects Governments to continue to maintain and improve service levels in this sector — in education, health, public safety — failure to improve productivity means the 'cost disease' will continue to spread across the economy. Driving consistent productivity growth in the non-market sector will require strong leadership from the Government, including with state governments that deliver most non-market services in Australia.

⁹ Productivity Commission, *5-year Productivity Inquiry: Keys to growth*, vol. 2, Inquiry Report no. 100, Canberra, 2023, <https://www.pc.gov.au/inquiries/completed/productivity/report/productivity-volume2-keys-to-growth.pdf>.

¹⁰ Australian Bureau of Statistics, *Public sector employment and earnings* (Canberra, ACT: ABS, 2023-24), <https://www.abs.gov.au/statistics/labour/employment-and-unemployment/public-sector-employment-and-earnings/latest-release#cite-window1>.

Part Two: Proposed reforms

There are innumerable factors affecting productivity growth, in every business and at all levels of Government.

Many potential reforms to improve productivity face substantial cost constraints, legislative barriers, or require actions to be undertaken by state or local governments.

The focus of this paper is on implementable, low-cost actions that can be taken unilaterally by the Commonwealth Government or where the Commonwealth can provide national leadership that assists in spreading productivity-enhancing behaviour to state and local governments.

Cutting red tape

Red tape stifles productivity by increasing costs for businesses and by inhibiting or entirely preventing certain activities. Excessive red tape and poorly designed regulations reduce business dynamism and slow the formation of new businesses. While some regulations are of course necessary, the constant flow of new regulation and changing technology and business practices means there will *always* be a stock of regulations that can be safely removed or improved to lower costs for businesses and enhance productivity.

This is because the incentive structure for government officials leans heavily towards rewarding more regulation, not less. Regulators and government departments and officials have little to no incentive to proactively reduce regulation without being directed to do so, since there are limited risks in leaving existing rules in place. In contrast, it is easier to respond to calls for new regulations to protect from apparent risks, particularly in new areas (for instance, AI). This incentive structure needs to be flipped on its head.

Previous attempts to incentivise red tape reduction across Government have had some success, but did not go far enough. The Abbott Government committed to holding two ‘red tape repeal days’ per year to achieve \$1 billion in annual red tape reductions, effectively requiring officials and Ministers to establish a process to deliver these reductions. Despite this, and numerous other concerted efforts by multiple administrations, clear examples of unnecessary red tape were being identified years later. For example in 2019, former Morrison Government Minister Ben Morton, tasked with delivering deregulation, found that food exporters had to wait for approved permits to be mailed to them or travel to Melbourne to collect them in person before their goods could be exported (since rectified so they can receive them digitally).¹¹ How this requirement was not identified by government officials when they were previously directed to find examples of red tape to remove is mind-boggling. There are doubtless countless more such examples.

¹¹ Australian Treasury, *Busting congestion and supporting investment and jobs - the Government’s deregulation agenda*, (Canberra: Australian Government, 2019), https://treasury.gov.au/sites/default/files/2019-11/p2019-37103_0.pdf.



One way to visualise the poor incentive structures driving Australia’s red tape problem is to map the relationships between Cabinet Ministers, their portfolios, key Government departments and agencies, and overarching policy areas. Figure 7 below (pages 20-21) shows an unwieldy and complex series of overlapping responsibilities and relationships that the average business or citizen cannot easily understand or navigate – and this is without including a multitude of other smaller agencies, non-Cabinet Ministers or state and local governments. Faced with such an impenetrable web, few businesses have the time or sophistication to successfully argue for removal of unnecessary red tape, let alone prevent new red tape from being dreamt up.

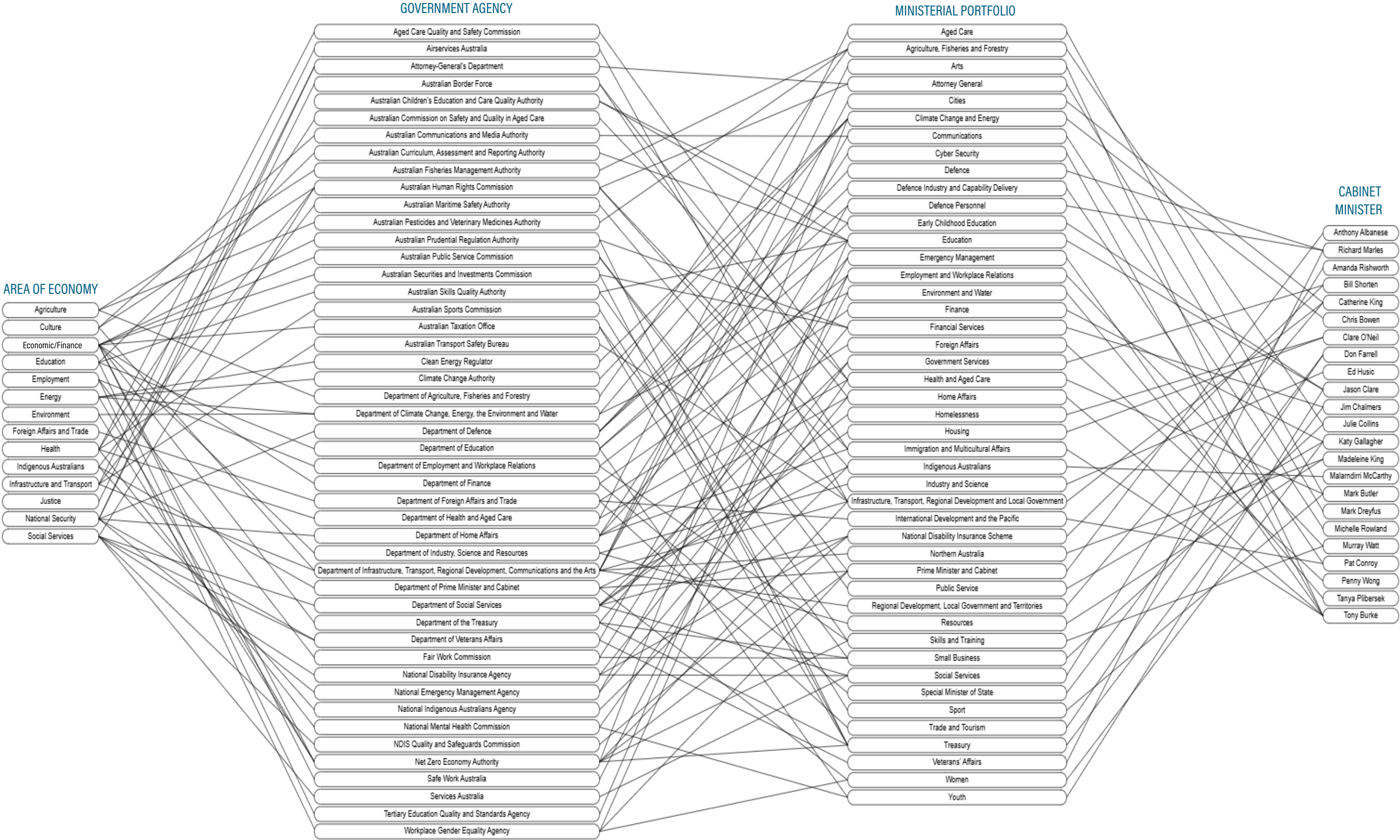
The experience of former Minister Morton provides an important lesson on how to deliver red tape reductions across Government when faced with the complexities of Government in Figure 7 — there must be a single Minister given ongoing responsibility for this important task, with the backing of the Prime Minister and resources of a permanent team in a central department such as Prime Minister and Cabinet (PM&C) or Treasury. The alternative — where every Minister is indirectly expected to deliver red tape reductions — means that no one is responsible and regulatory inertia can be expected to continue.

In addition to having a Minister solely responsible for deregulation, the Government should impose a requirement that all new regulations are offset by removal of an existing regulation, with no exemption for ‘new’ regulatory areas such as AI. This could be measured flexibly by either number of regulations or the dollar impact of reduced regulatory burden and should occur on at least a 1:1 basis - ideally aspiring to the 2:1 rule imposed under the first Trump administration so as to achieve a net reduction in red tape. Offsets should be flexible enough to include instances where an existing regulation is improved or simplified but not removed, as occurred with the food exporter example above.¹² The Government could nominate higher-value priority areas (such as AI) where removal would most enhance productivity to incentivise red tape reductions in these areas, and should allow departments/Ministers to identify unnecessary regulations in other portfolios for removal. A minimum quota of regular reductions should also be set in all areas of government to eliminate the incentive to ‘bank’ red tape reductions, and consideration given to reinstating the ‘red tape repeal day’ process established under the Abbott Government.

¹² Other examples could include reducing the frequency of registrations, aligning reporting requirements across portfolios or jurisdictions, lowering direct fees/costs, or presuming approval of low-risk activities.

Figure 7 - The complex web of Government agencies and portfolios*

*As at December 2024



Better government services

Labour productivity in government services has been essentially zero for the last 25 years. Because the community expects governments to continue to maintain and improve service levels — in education, health, public safety — failure to address productivity in these areas will continue to drag productivity down nationally. Productivity Commission Chair Danielle Wood recently identified the health and education sectors as areas with ample opportunities to improve productivity, including through reduced duplication, better data sharing and the use of technology, including AI.¹³ Improving productivity in education is particularly vital, given better educational outcomes across the workforce can drive productivity across the economy (for further detail on potential productivity gains in education, see Box 1, p24).

Driving productivity growth in government services will require strong leadership from the Commonwealth Government, including with state and territory governments that deliver most government services in Australia. Without strong direction from Commonwealth Ministers, there is no incentive for officials to improve productivity as there is in the private sector, where the reward for improving efficiency and productivity is higher profits. Governments that ignore the need to improve productivity in these services are more likely to react to demands for higher quality or lower costs by reaching for policies that can actually reduce productivity, such as mandating staff ratios and increasing subsidies. Governments must make this *someone’s* responsibility (whether a Minister, official, new body, or some combination) or it will continue to be no one’s responsibility.



13 Tom McIlroy and Michael Read, "‘Care economy’ won’t boost productivity: Wood," *Financial Review*, July 19, 2024, <https://www.afr.com/politics/federal/care-economy-won-t-boost-productivity-wood-20240717-p5juc0>.



This principle is equally applicable to the Commonwealth’s relationship with state governments, which have proven to be even worse at productivity enhancing reforms than the Commonwealth. Despite ample opportunity to learn from one another, in many instances it appears we have eight state and territory governments acting alone without attempting to learn best practice from one another. For example, despite overwhelming evidence that deregulating retail trading hours benefits consumers and businesses alike, restrictions still exist in Queensland, South Australia and Western Australia decades after deregulation in other states. This is despite the Western Australian Government’s parliamentary majority granting it essentially unfettered power since 2021 (and arguably 2017) and Queensland’s unicameral Parliament lacking the Upper House that can act as a key barrier to reform in other jurisdictions. Strong leadership from the Commonwealth is clearly needed to achieve progress in more complex or contested areas.

We believe that the Commonwealth should work with states to replicate a similar shared model to the new Australian Education Research Organisation (AERO) in other areas of government services. AERO is a national education evidence institute, jointly funded by the Commonwealth and the states under the National School Reform Agreement, that researches and collates effective teaching and learning practices and shares them nationally to drive improvement across the education system. In essence, this model recognises that, with responsibility for education split across eight jurisdictions, it makes sense to pool resources and centralise the research and dissemination of best practice.

In principle, there is a strong case to replicate this model to other areas of state responsibility that receive substantial Commonwealth funding (i.e. health and hospitals, infrastructure, planning), since with eight jurisdictions there will always be knowledge to share and best practices to adopt. Among other areas, these research institutes could be tasked with researching and vetting the most effective digital technologies such

as AI, something the Productivity Commission has already recommended AERO be tasked with.¹⁴ These bodies could also be tasked with coordinating the open provision of public data for analysis and research aimed at improving service quality and productivity (as discussed above, this is also vital to unlocking the productivity potential of AI).

Box 1 - Productivity in education

A highly educated and skilled workforce is vital to continued productivity growth, especially with the widespread adoption of technology in many workplaces.

The Productivity Commission has found that Australia has achieved huge gains in productivity by adding additional *years* of education, but with diminished scope to add more time in education and limited resources (i.e. teachers and capital), overwhelmingly future gains will need to come from higher *quality* education for each dollar spent. That is to say, education productivity needs to improve. This will require more effectively using education resources, such as by finding ways to free up teachers’ time spent on administrative tasks so they can focus on teaching.

The vast majority (86 per cent) of teachers say they do not have enough time for high-quality lesson planning and more than 40 per cent report their school does not have access to common, detailed lesson plans and assessment. The Grattan Institute found that only 15 per cent of teachers have access to high-quality, evidence-based curriculum resources backed by Governments.

An obvious starting point to free up teachers’ time and improve productivity would be finding ways to incorporate AI into teaching. This could include using AI to assist with scheduling, lesson plans, content generation, transcribing, and grading.

A key issue appears to be the high-level standards in the Australian Curriculum, with schools and teachers left to their own devices to work out what to teach and how. This introduces variability in the design and quality of lesson plans which can flow through to student outcomes. The Productivity Commission has recommended that governments curate evidence-based curriculum resources and make them available for schools from a single source.

There is clearly scope to significantly improve productivity by providing better and consistent curriculum resources to teachers. This has the potential to diffuse the best evidence-based teaching practices so teachers do not have to waste time reinventing the wheel individually every day and can focus on customising classes to their students.

Recently announced reforms to the New South Wales curriculum, to give teachers detailed, clear and sequenced guidance on what students need to learn, appear to be a welcome improvement that other states should seek to emulate in cooperation with the Commonwealth. Apparent significant improvements in educational performance at schools adopting explicit instruction in recent years, such as ACT and Goulburn Catholic schools, are also encouraging and worthy of further detailed study.

Sources: Productivity Commission; Australia’s productivity predicament - Podcast (grattan.edu.au); NAPLAN results prove old-school teaching methods work best in Australian classrooms | The Australian

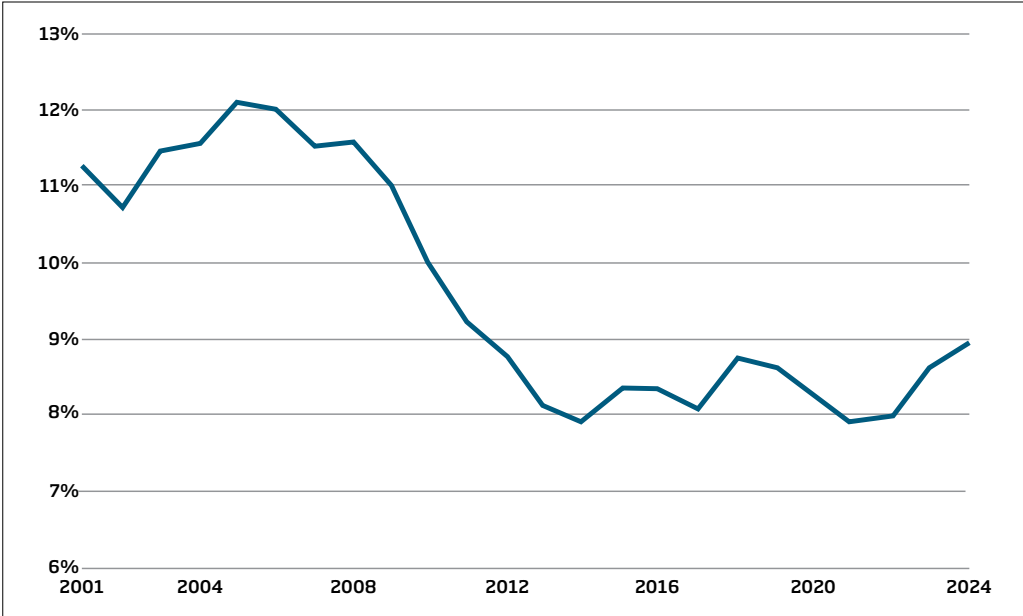
14 Productivity Commission, *5-year Productivity Inquiry: Advancing Prosperity*,” vol. 1, Inquiry Report no. 100, Canberra, 2023, <https://www.pc.gov.au/inquiries/completed/productivity/report/productivity-volume1-advancing-prosperity.pdf>.

Backing business investment

Investment in capital can improve the efficiency of workers and act as an important contributor to higher productivity.

Australia has a low level of business investment as a share of GDP compared with other OECD countries and non-mining investment has stagnated (Figure 8).¹⁵ This stagnation is concerning given one would expect the end of the mining boom to have shifted investment to non-mining sectors. A key contributor to this is likely high investment hurdle rates following the GFC, meaning investors require a higher rate of return before they will contribute capital than was previously the case. This situation may deteriorate further if interest rates and inflation stay higher for longer.

Figure 8: Non-mining business investment as % of GDP, annual to June quarter



Source: ABS Australian National Accounts: National Income, Expenditure and Product, June 2024

The instant asset write-off is an excellent policy to support business investment to improve productivity. By simply bringing forward the cash-flow benefits of business investments, this policy makes it easier for growing businesses to make profitable investments without incentivising investment for investment’s sake. The instant-asset write off should be permanently increased from \$20,000 to the most recent pre-Covid level of \$30,000 for businesses with an aggregated turnover of less than \$10 million. Future Governments should continue to seek to support productive business investment that enhances productivity by expanding eligibility for the instant asset write-off, both in terms of asset size and turnover threshold.

In addition to expanding the instant asset write-off, the Government should consider how to replicate capital gains tax (CGT) relief for business asset rollovers similar to that available in the UK. The UK permits businesses to defer any CGT due when certain assets are disposed of and funds are reinvested into new assets.¹⁶ Importantly, the new assets do not need to be direct replacements for the old assets or serve the same purpose, allowing business owners the flexibility to use the cash flow benefits of deferring CGT to invest in the assets they deem most productive (or even a new business within time limits).

15 Australian Treasury, *Working Future: The Australian Government’s White Paper on Jobs and Opportunities*, (Canberra: Australian Government, September 25, 2023), <https://treasury.gov.au/employment-whitepaper/final-report>.
16 “HS290 Business Asset Roll-over Relief (2024),” GOV.UK, last modified April 6, 2024, <https://www.gov.uk/government/publications/business-asset-roll-over-relief-hs290-self-assessment-helpsheet/hs290-business-asset-roll-over-relief-2024>.

In contrast, CGT relief in Australia is only available to small businesses with an aggregated turnover under \$2 million, and the rollover may only be applied to replacement assets or capital improvements on existing assets.¹⁷ Expanding the Australian CGT rollover regime to be similar in scope to the UK regime would enhance productivity across the economy by providing businesses greater flexibility to reinvest capital gains in the way they deem most productive.

Artificial intelligence

The rapid growth in applications for AI, particularly generative AI such as ChatGPT, has the potential to reverse the decline in Australian productivity growth, especially in the services sector.



AI has conceivable applications in almost every type of business, profession and government service. While there will always be commentary about how new technologies could lead to job losses, it is more likely that successful deployment of AI will, much like the advent of computers and the internet, lead to outcomes such as the automation of *parts* of jobs and the creation of new roles that are made easier by AI. Research conducted by Microsoft and LinkedIn of AI use globally found that white-collar workers said AI helps them save time (90%), focus on their most important work (85%), be more creative (84%), and enjoy their work more (83%).¹⁸ Similar widespread outcomes that make workers’ lives easier and free up labour come with significant potential for productivity gains.

There is a growing body of evidence supporting the impact of AI on productivity. Analysis conducted by leading global consultancy McKinsey found that generative AI has the potential to increase Australian labour productivity by between 0.1 and 1.1 percentage points a year through to 2030, by freeing up time that could be deployed for more productive uses.¹⁹ A recent report by the Tech Council of Australia also found that greater adoption of AI could contribute \$115 billion in annual economic benefits to Australia – 70 per cent of which (around \$81 billion) could be attributed to productivity gains.²⁰ At a firm level, a 2023 experiment conducted by Westpac found that software engineers aided by AI were 46 per cent more productive with no loss in quality.²¹

17 “Small business roll-over,” Australian Taxation Office, last modified June 6, 2023, <https://www.ato.gov.au/businesses-and-organisations/income-deductions-and-concessions/incentives-and-concessions/small-business-cgt-concessions/small-business-roll-over>.

18 2024 Work Trend Index Annual Report, Microsoft and LinkedIn, “AI at work is here. Now comes the hard part,” *2024 Work Trend Index Annual Report*, Microsoft, May 8, 2024, https://assets-c4akfrf5b4d3f4b7.z01.azurefd.net/assets/2024/05/2024_Work_Trend_Index_Annual_Report_663d45200a4ad.pdf.

19 Chris Bradley et al., “Generative AI and the future of work in Australia,” McKinsey Global Institute, February 12, 2024, <https://www.mckinsey.com/industries/public-sector/our-insights/generative-ai-and-the-future-of-work-in-australia>.

20 “Meeting the AI Skills Boom,” Tech Council of Australia, June 2024, <https://techcouncil.com.au/wp-content/uploads/Meeting-the-AI-Skills-Boom-2024.v2.pdf>.

21 Kripa Krithivasan, “How AI will shape the future of banking,” Westpac, November 30, 2023, <https://www.westpac.com.au/news/indepth/2023/11/how-ai-will-shape-the-future-of-banking/>.

While significant productivity gains from AI usage are by no means assured, their potential should be taken seriously by governments. Australia’s uptake of AI lags many other developed countries, with one Global AI index ranking Australia 15th overall on a scale measuring AI output and relative intensity.²² Most concerningly, Australia’s AI operating environment was ranked lowest of the 62 countries assessed.

The Commonwealth should adopt policies both to support (or at least not hinder) dissemination of AI in the private sector, and to drive adoption of successful AI use cases through the public service and by state governments.

To support dissemination of AI in the private sector, the Government must:

- Establish a centrally responsible function that monitors and coordinates AI policy across agencies and state governments to ensure best practice technology-neutral regulation, similar to what has been proposed in the UK. Ministers should also give clear guidance to regulators on best (and bad) practices regarding AI regulation.
- Vigorously police use of the planned financial sector Regulatory Grid for AI-related regulations and consider expanding the Grid’s scope to all AI-related regulation across Government.
- Remove regulatory barriers that unnecessarily inhibit potential AI applications.
- Closely monitor the progress of the US National Artificial Intelligence Research Resource (NAIRR) pilot and the potential for a similar model in Australia.
- Given the fast pace of AI development, consider ways to support practical short courses in AI that are valued by employers and employees.

In the public sector, the Government must:

- Drive adoption of successful AI use-cases in the public service.
- Monitor best-practice use of AI in public service provision and disseminate these practices to state and territory governments, especially in areas partly funded by the Commonwealth.
- Significantly uplift accessibility and sharing of public sector data and make this a feature of state funding agreements.

Private sector

Uptake of AI will happen without government assistance, however it could be hindered by poor government policy. As outlined above, the role of Government in supporting productivity in the private sector should be to establish policy settings that best enable businesses to seize new opportunities and support the spread of good ideas across the economy.

A critical enabler (or inhibitor) of AI will be the regulatory environment. Many potential AI uses will simply provide more efficient ways of completing existing tasks and raise limited risks, or raise risks that are no different to those of other technologies. Existing technology-neutral frameworks such as competition and consumer laws should be sufficient to protect Australian consumers and businesses from many of these risks. The impacts of AI use will only become apparent as the technology is developed and deployed, so any regulation based on predicted or speculated uses/harms is only likely to stop innovation and stifle productivity.

22 “The Global AI Index,” Tortoise Media, 2024, <https://www.tortoisemedia.com/intelligence/global-ai#rankings>.

As is often the case, the EU provides us with a case study of what not to do. The EU has invented an entirely new statutory approach for regulating AI across the economy through an *Artificial Intelligence Act*. The Act pre-categorises all potential AI uses into four risk categories: unacceptable, high, limited and minimal. AI uses predetermined as ‘unacceptable risk’ are prohibited, while those deemed high-risk are subject to stringent and costly red tape requirements that will no doubt limit or prevent innovation in the EU. Examples of high-risk AI applications include:

- critical infrastructure (such as road traffic management or utilities);
- education and vocational training (such as assessment of students);
- employment and workers management (such as recruitment or task-allocation);
- access to essential services (such as health insurance risk assessments, healthcare triage systems, dispatching emergency services, credit scoring);
- migration and border control (such as assessing security risks or examining visa and residency application);
- administration of justice (such as researching and interpreting facts and the law);
- use in any product covered by EU product safety laws (e.g. toys, machinery, cars, medical devices).²³

The Australian Government’s current approach to AI regulation appears to be on the wrong track. The MRC has significant concerns that the options put forward by the Government in its recent proposals paper for ‘mandatory guardrails’ for AI are too risk averse and risk significantly hindering the potential of AI to reverse Australia’s productivity decline. We put these concerns on the record in a [submission](#) in response to the proposals paper, the contents of which are reflected in this paper.

The Government appears to be assuming that it is best to follow whichever jurisdictions move first with the strictest regulations (i.e. the EU), rather than considering whether Australia can design a better approach for other countries to emulate. In doing so, the Government risks joining a race to the bottom — chasing the highest regulatory burden — which only rewards more red tape and believes the optimal amount of risk is zero.

The Government’s current approach is almost exclusively focused on harm prevention, making AI ‘safe’ and how to respond to higher risk uses, rather than considering how to support low risk uses that could improve productivity and living standards.²⁴ The Government appears to assume that new or imagined harms will occur as a result of AI usage, requiring pre-emptive intervention to shape the development of this new, innovative technology and how it can be deployed.

It seems a contradiction in terms to state that the Government wishes to take a “risk-based approach” to AI regulation, while also adopting the “precautionary principle with a focus on preventative measures”. The concept of applying pre-market obligations on AI products that are focussed on “preventing harms ... before they arise” and requiring developers to address risks against “all foreseeable use cases by their clients” seems unrealistic and excessive. This is akin to banning the development of fast cars because drivers might speed, rather than making speeding illegal.

Had governments taken the same *ex ante* approach to regulating the use of computers or smartphones — which, like AI, experienced rapid changes with myriad unpredictable applications and uses — the impact on technological development, innovation and productivity could have been devastating.

²³ Regulation (EU) 2024/1689 of the European Parliament and of the Council of 13 June 2024 laying down harmonised rules on artificial intelligence and amending Regulations (EC) No 300/2008, (EU) No 167/2013, (EU) No 168/2013, (EU) 2018/858, (EU) 2018/1139 and (EU) 2019/2144 and Directives 2014/90/EU, (EU) 2016/797 and (EU) 2020/1828 (Artificial Intelligence Act).

²⁴ Department of Industry, Science and Resource, “Safe and responsible AI in Australia consultation – Australian Government’s interim response,” Australian Government, January 17, 2024, https://storage.googleapis.com/converlens-au-industry/industry/p/prj2452c8e24d7a400c72429/public_assets/safe-and-responsible-ai-in-australia-governments-interim-response.pdf.

At no point has the Government identified potential harms that justify this extreme *ex ante* regulatory approach. In fact, almost all the examples of potential harms put forward in its recent proposals paper — such as bias, scams, discrimination, and privacy — could be addressed under existing legislation.

The mixed approach that Australia’s key financial regulators have taken to AI regulation demonstrates the need for Government leadership to deliver sensible regulation that supports innovation and productivity. The mindset of ASIC appears similarly risk-averse as the Government’s, whereas APRA is taking a sensible technology-neutral, wait-and-see approach that backs the effectiveness of existing regulatory frameworks (see Box 2, p30).

The MRC believes an Australian AI regulatory system should, as far as possible, resemble the approach taken by APRA — it should be technology-neutral, flexible and adaptable, and make use of existing regulatory frameworks. Importantly, it should limit any *ex ante* regulation of potential AI uses in order to avoid stifling new innovations before they occur.

Box 2 - ASIC and APRA’s approaches to AI regulation: two very different speeches

ASIC

Quotes taken from 31 January 2024 address by ASIC Chair Joe Longo: *We’re not there yet: Current regulation around AI may not be sufficient* [emphasis added]

*It’s clear, then, that a divide exists between our current regulatory environment and the ideal. Today’s theme of ‘bridging the governance gap’ **presupposes such a divide**. It invites us to consider what AI governance and regulation might look like in the ideal, how great the divide is between that ideal and current circumstances – and, of course, how we might go about bridging that divide.*

*... in what way might the current regulatory framework inadequately prevent AI-facilitated harms? This question is key. We can only bridge the gap – and create our best approximation to the ideal – if we know where that gap lies. So **my purpose today is to look for that gap**.*

... just because existing regulation can apply to AI, that doesn’t mean there’s nothing more to do.

*Bridging the governance gap means strengthening our current regulatory framework where it’s good, and shoring it up where it needs further development. But above it all, it means asking the right questions. **And one question we should be asking ourselves again and again is this: “is this enough?”***

APRA

Quotes taken from 22 May 2024 address by APRA Member Therese McCarthy Hockey: *Taking flight: navigating the new challenges posed by generative artificial intelligence* [emphasis added]

*Given the materiality of some of the threats I just outlined, **you might think APRA would be looking at introducing new regulatory requirements to mitigate those risks but we currently have no such plans**.*

*But the primary reason is that we believe our prudential framework already has adequate regulations in place to deal with generative AI for the time being. **Our prudential standards may not specifically refer to AI but nor do they need to at the moment. They have intentionally been designed to be high-level, principles-based and technology neutral**.*

Given the potential benefits for both business and customers, APRA broadly supports our regulated entities beginning to test how they can incorporate AI into their practices.

Sources: *We’re not there yet: Current regulation around AI may not be sufficient* | ASIC; Member Therese McCarthy Hockey’s remarks to AFIA Risk Summit 2024 | APRA

The Government should adopt a deliberate policy to drive a technology-neutral regulatory approach across all agencies and regulators. A sensible starting point would be the model adopted by the previous UK Government for a principles-based, non-statutory framework, driven from within the existing UK Department for Science, Innovation and Technology (DSIT). This approach involved no new AI legislation and no new AI regulator.

Instead, a ‘Central Function’ within DSIT will formally coordinate the approach of existing regulators to limit regulatory uncertainty for business that could result from regulators taking divergent approaches to AI. In Australia, PM&C or the Treasury seem the most logical department in which to house a similar model.

On top of this, Ministers should be directed to give clear formal guidance to regulators on best (and bad) practices regarding AI regulation.

This approach would not preclude the need for AI-specific regulation in the future. Rather, it would be aimed at allowing flexibility for AI to be deployed in productive and innovative ways, while being closely monitored under existing regulatory frameworks that provide sufficient protections for consumers. Should evidence emerge that AI-specific regulation is required in certain cases, nothing would prevent the Government from acting then.

The Government is already planning to establish a financial sector regulatory initiatives grid, modelled on the grid already in place in the UK, that will provide a rolling, 24-month forward program of regulatory initiatives of major regulators that materially affect the financial sector. AI regulation will be a major first test for the grid. The Government should vigorously police the use of the grid for AI-related regulations and consider expanding its scope to all AI-related regulations outside the financial services sector (which could occur through the proposed ‘central function’ proposed above).

In addition to the above forward-looking approach to AI-regulation, the Government should actively seek to remove any existing regulatory barriers to adopting AI. This could include rules and regulations that specify how a task is to be performed, which may unwittingly prevent consideration of using AI. This could form part of an ongoing process to remove red tape (discussed further in the *Cutting Red Tape* section above).

The Government should closely monitor the progress of the US National Artificial Intelligence Research Resource (NAIRR) pilot. The NAIRR is a concept for a national infrastructure that connects researchers to the data and resources they need for AI research, with the pilot initially focussed on addressing societal challenges such as health, infrastructure and the environment. In contrast to the Australian and EU approaches, partners in the pilot include federal agencies such as the Department of Education and National Institutes of Health, which are providing access to datasets such as secure biomedical data and educational statistics. The successful implementation of a similar model in Australia could support innovative research that improves the productivity of Government services and outcomes for all Australians.

To support AI uptake in the private sector, education and training programs in relevant fields need to keep pace. Given the fast pace of AI development, it is likely that there will be an important role for short courses to fill this gap, rather than multi-year university degrees. The Government, in consultation with employers, should continuously consider ways to support practical short courses in AI that are valued by employers and employees.

Public sector

Growth in government services productivity is essentially zero, so finding ways to use AI to drive efficiency in the public sector will be vital as a potential way to kickstart productivity growth. For example, AI has the potential to enhance productivity in almost every aspect of the healthcare sector, but this sector is one of the least mature industries in terms of AI implementation, both in Australia and internationally.²⁵ Australian governments are unlikely to be innovators at the forefront of AI use, so policies that ensure widespread dissemination of successful private sector and international approaches to AI will be vital.

²⁵ Productivity Commission, *Leveraging digital technology in healthcare*, Research paper, Canberra, 2024, <https://www.pc.gov.au/research/completed/digital-healthcare/digital-healthcare.pdf>.

There does not appear to be any part of Government tasked with overseeing the potential deployment of successful AI to public service delivery at the Commonwealth or state and territory level.²⁶ With dozens of departments and agencies across eight states and territories, there will always be someone using AI better than others. It makes no sense to expect all agencies and departments at all levels of government to continually reinvent the wheel and start from scratch, which seems the likely outcome without concerted policy change.

In addition to the establishment of a ‘central function’ for AI regulation, the Government should consider making one Minister and/or department responsible for coordinating the deployment and effective use of AI across the public services. This should also include a strong leadership role in disseminating best practice to state and territory governments, which are responsible for most public service delivery in Australia. Potential candidates for this role are the Finance Department (for Commonwealth departments) and the Treasury (to work with the states).

The Commonwealth should also directly act to ensure that the states adopt best practice AI use in service delivery, leveraging the tens of billions of dollars the Commonwealth provides for these services. Funding agreements with the states in areas such as education should require that states coordinate AI policy with each other and the Commonwealth, adopt best practice, and actively remove barriers to AI use in areas being funded. There could also be a role for bodies such as the Australian Education Research Organisation (discussed in the *Better Government Services* section above).

All Governments need to greatly improve the sharing of public data, including for AI use. Australia is one of the poorest performing countries in the OECD in terms of data availability, data accessibility, and government support for data re-use.²⁷ Estimates of the benefits of Australian public sector data availability and use vary from \$625 million to \$64 billion per year.²⁸

Governments hold significant amounts of data in areas such as healthcare that could be de-identified and shared with minimal risk and for high public benefit. Public-sector data is a public asset and safe sharing and use of this data would enable and support innovation and research, including by the private sector, that could boost productivity and benefit all Australians. Recent Productivity Commission modelling found that a 1% increase in health sector labour and capital productivity as a result of data sharing could increase GDP by around \$1.6 billion and slightly lower healthcare prices.²⁹ Given that state governments hold much of the most useful data relating to government services, the Commonwealth should make data sharing and availability a requirement of state funding agreements.

The broad enablers - energy and industrial relations

Cheaper energy and an effective industrial relations system are broad enablers of productivity. Lower energy costs and an industrial relations system that makes it easier for businesses to hire staff and for workers to change jobs would support productivity across all parts of the economy. Current policy settings are holding Australia back by suppressing some types of energy generation and adding complexity and red tape to industrial relations.

²⁶ The National Artificial Intelligence Centre has a vague mandate to ‘uplift safe and responsible AI practice’ and ‘supporting AI adoption for small and medium businesses’, however does not appear to have any responsibility, power or levers to support good AI use in the public sector.

²⁷ OECD, “2023 OECD Open, Useful and Re-usable data (OURdata) Index: Results and key findings,” *OECD Public Governance Policy Papers*, No. 43, OECD Publishing, Paris, December 22, 2023, <https://doi.org/10.1787/a37f51c3-en>.

²⁸ Productivity Commission, *National Competition Policy: modelling proposed reforms*, Research paper, Canberra, November 1, 2024, <https://www.pc.gov.au/inquiries/completed/competition-analysis/report/competition-analysis-with-appendices.pdf>.

²⁹ Ibid.

Energy costs touch every part of the economy and keeping energy prices low is vital to supporting productivity. To support least-cost energy generation, Australia’s energy policy must be technology agnostic. A low emissions power system still requires stable, baseload power to support intermittent renewables, which means nuclear power cannot be ruled out and gas generation is a necessity. This means Australia’s ban on civil nuclear power must be lifted and gas generation must be included in the Capacity Investment Scheme.



Recent extensive changes to industrial relations laws have significantly increased complexity and compliance costs for businesses, especially small businesses. Laws which provide for multi-employer bargaining, changes to the definition of a casual worker, and the ‘right to disconnect’ should be reversed.

In addition to the above industrial relations changes which affect all sectors, the Australian Building and Construction Commission and Registered Organisations Commission should be restored to support productivity in the construction sector. The construction sector is a significant part of the Australian economy where lower productivity and higher costs can impact on many other sectors. Restoring these regulators will also be important to enable implementation of wider reforms such as the support of modern construction methods, discussed below on Page 35-36.

A smarter infrastructure pipeline

There is significant scope to improve the productivity of public infrastructure investment, beginning with better pipeline planning and procurement practices across all portfolios. The size of Australia’s public infrastructure programme — \$230 billion over five years from 2022-23³⁰ — means that even marginal improvements in costs and efficiency could have a substantial national impact on construction sector productivity, which has been stagnant for over three decades.

The scope of productivity improvements goes well beyond government road and rail projects — investments in energy, housing, industry and defence all compete for construction market capacity. Poor coordination of these projects across portfolios can squeeze the construction supply and labour markets, increasing costs and lowering productivity across the economy. Infrastructure Australia has already recommended that the Government develop a whole of government approach to monitoring and managing the cross-sectoral impacts

³⁰ Infrastructure Australia, 2023 *Infrastructure Market Capacity Report*, Report, December 12, 2023, <https://www.infrastructureaustralia.gov.au/publications/2023-infrastructure-market-capacity-report>.

of investments on construction market capacity and better planning the delivery of projects. Infrastructure Australia has existing analytical infrastructure pipeline tools, developed for governments to understand the impact of new projects and manage infrastructure demand. All governments should use these tools to better plan investments across portfolios.

One simple way to better understand the impact of infrastructure projects and improve productivity would be to make the analytical tools developed by Infrastructure Australia, and their source code and data, publicly available. Making these tools public would allow for much greater scrutiny of the impact of potential infrastructure projects by the private sector and researchers, as well as allow key stakeholders to suggest improvements to these tools and Government infrastructure pipelines that could lead to higher productivity.

Post-Covid planning and zoning

Planning and zoning restrictions have long been a source of frustration for businesses and builders. These restrictions increase costs, slow commercial and residential development, constrain businesses and make it harder for Australians to own a home and live where they want to. Reforming planning and zoning is widely recognised as an avenue to enhance productivity, but has proven incredibly challenging due to disparate views and entrenched approaches across local and state governments.

Planning and zoning regulations serve legitimate purposes including environmental protection and health and safety. However, these restrictions can be overly prescriptive and poorly implemented and therefore act as a barrier to productivity growth by impeding investment, increasing costs and inhibiting competition and business dynamism. This can include unnecessarily prohibiting certain activities or business practices and preventing new businesses from entering viable local (physical) markets.

The number of planning zones varies widely by jurisdiction (see Table 1) and there is doubtless scope for improvement and simplification of current arrangements. To support productivity, the Productivity Commission has recommended that governments implement standard business and industrial land use zones across local government areas, and aggregate existing zones where possible to broaden the range of permissible activities. A wide range of consistent allowable uses would provide certainty, clarity and flexibility for businesses, promote competition, and reduce the need for costly and time-consuming rezonings.

Table 1 - Planning zones by jurisdiction

Jurisdiction	Commercial zones	Industrial zones	Residential zones
New South Wales	3	2	5
Victoria	3	3	6
Queensland	6	9	7
Western Australia*	Not available	Not available	Not available
South Australia*	65 zones total		
Tasmania	4	2	~5
ACT	6	2	5
Northern Territory	4	3	8

* Western Australian zoning varies across local government and the exact number of zones is not available. South Australian zones do not fall neatly into the three zone classifications.

Source: Productivity Commission

The Productivity Commission has also found that improvements to residential planning restrictions such as allowing for greater density and mixed land use would support productivity growth. Improvements to productivity would come through a reduction in transport times between homes and workplaces and an increase in ‘agglomeration benefits’ (i.e. self-reinforcing growth where more jobs attract more workers; productive firms attract other productive firms; specialist firms, industries and professionals congregate). More flexible residential planning that allows for greater density would also be highly likely to significantly reduce costs for building new homes.

The substantial changes to working and commuting habits and business practices as a result of the Covid pandemic, including the normalisation of remote-work and explosion in online retail, have arguably made the long-standing planning framework that divides residential and commercial areas outdated. This provides a unique opportunity for governments to reconsider and reform planning and zoning from the ground up along the lines of the Productivity Commission’s recommendations. Less stringent distinctions between residential and commercial/industry areas could allow for more creative and productive land use that reflect modern preferences, such as allowing for small online-retail warehouses and more small-format grocery stores in residential areas closer to their customers. It could also unlock the potential for more residential development in commercial areas such as CBDs.

This reform should be considered nationally, requiring leadership from the Commonwealth. The Government should, through the National Cabinet, work with the states and territories to review the appropriateness of current planning and zoning settings, with a view to enacting reforms to modernise these regulations in light of the post-Covid economic environment and in line with changes recommended by the Productivity Commission. Such a reform should be considered in *addition* to other, long overdue reforms more directly aimed at reducing the complexity and cost of development.

Supporting modern construction methods

The size of the construction sector in Australia means that even small improvements in productivity could have a substantial effect across the economy. Recent modelling by the Productivity Commission suggests that policies to support modern construction methods such as prefabrication and modular building could be one way to achieve such productivity gains.

Prefabrication and modular construction techniques involve offsite construction and transport which can result in reduced construction time (of 20 to 50%) and costs (15 to 20%) compared to onsite construction, as well as safer working conditions and better building quality.³¹ These techniques can be used in both residential and non-residential buildings and are likely to have the most potential in projects with standardisation or economies of scale such as higher density apartments, retirement villages, housing estates (including social and affordable housing) and schools.

31 Productivity Commission, *National Competition Policy: modelling proposed reforms*, Research paper, Canberra, November 1, 2024, <https://www.pc.gov.au/inquiries/completed/competition-analysis/report/competition-analysis-with-appendices.pdf>.



Policies to support modern construction methods, such as prefabrication, could help improve productivity.

In recent years, prefabricated construction in Australia has ranged from 3-5% of all building construction, compared to 45% percent (and up to 80% of residential construction) in the Nordic countries, 20-33% in Singapore, 10-20% in Germany and the Netherlands, 15-20% in Japan, 8-16% in Canada and 5-10% in the UK.³² Productivity Commission modelling suggests that reforming the National Construction Code, standards and building regulations to support modern construction methods and increasing prefabricated and modular construction in Australia to 10-20% would grow the economy, even with a relatively small increase in construction output. The Commission's modelling found that a 2% increase in construction output as a result of wider use of modern construction techniques would result in:

- an increase in real GDP of \$4.1 billion due to higher residential building construction output; and
- an increase in real GDP of \$1.7 billion due to higher non-residential building construction output.

Removing regulatory and other barriers to the wider adoption of modern construction techniques would be a low-cost policy for governments to adopt with potentially high productivity rewards. The Commonwealth should lead a national approach to achieve this to ensure a single, consistent national market for modern construction techniques, products and services.

An Australian DARPA

The US's Defense Advanced Research Projects Agency (DARPA) has played a critical role in developing incredible productivity enhancing technologies, including the internet, GPS, the computer mouse, drones and digital personal assistants (e.g. Siri, Alexa, Gemini).

DARPA's success is grounded in fostering innovation at the frontier of technology and supporting blue sky research with the backing of Government, but outside the constraints of usual bureaucratic and procurement processes. Rather than undertaking research in-house, DARPA's high-risk, high-reward approach involves channelling funds to highly competent researchers on a project-by-project basis. Being unencumbered by bureaucratic and political constraints and using external researchers helps foster a strong leading-edge research network that can have cascading effects across the economy.

The UK recently established its own version of DAPRA, the Advanced Research and Innovation Agency (ARIA). ARIA is established as a statutory independent body.



Productivity enhancing innovations, such as the technology underlying digital assistants, have been fostered through policy settings that have enabled those at the forefront of developing new technologies to operate without bureaucratic and political constraints.

At the 2022 election, the then-Labor Opposition promised to establish the Advanced Strategic Research Agency, "modelled on the highly successful DARPA in the United States" and describing ARIA as a "counterpart"³³. This would be an excellent policy if it were true. Unfortunately, despite the *Defence Strategic Review* strongly recommending that this new organisation "must be an unencumbered entity outside of Defence", the Albanese Government did the opposite and established the Advanced Strategic Capabilities Accelerator (ASCA) within the Defence Department.

This means we are left with a supposedly Australian version of DARPA which does not emulate the most successful aspects of that agency (and its UK equivalent, ARIA). Rather than a bold, independent research agency with the ability to engage in long-term thinking, ASCA appears to be simply another part of the Defence behemoth. It is unclear how ASCA is meant to simultaneously be a disrupting centre of excellence and part of the business-as-usual defence procurement system. ASCA processes have already come under heavy

³² Ibid. Productivity Commission, *National Competition Policy: modelling proposed reforms*, Research paper, Canberra, November 1, 2024, <https://www.pc.gov.au/inquiries/completed/competition-analysis/report/competition-analysis-with-appendices.pdf>.

³³ Brendan O'Connor and Matt Keogh, "Labor's AUKUS Boost: An Australian Strategic Research Agency," media release, April 28, 2022, <https://anthonyalbanese.com.au/media-centre/labors-aukus-boost-an-australian-strategic-research-agency-oconnor-keogh>.

criticism following the sudden cancellation of a major project under its ‘Mission 1’ stream, with one industry figure describing ASCA as “worse than the defence innovation hub it replaced”.³⁴

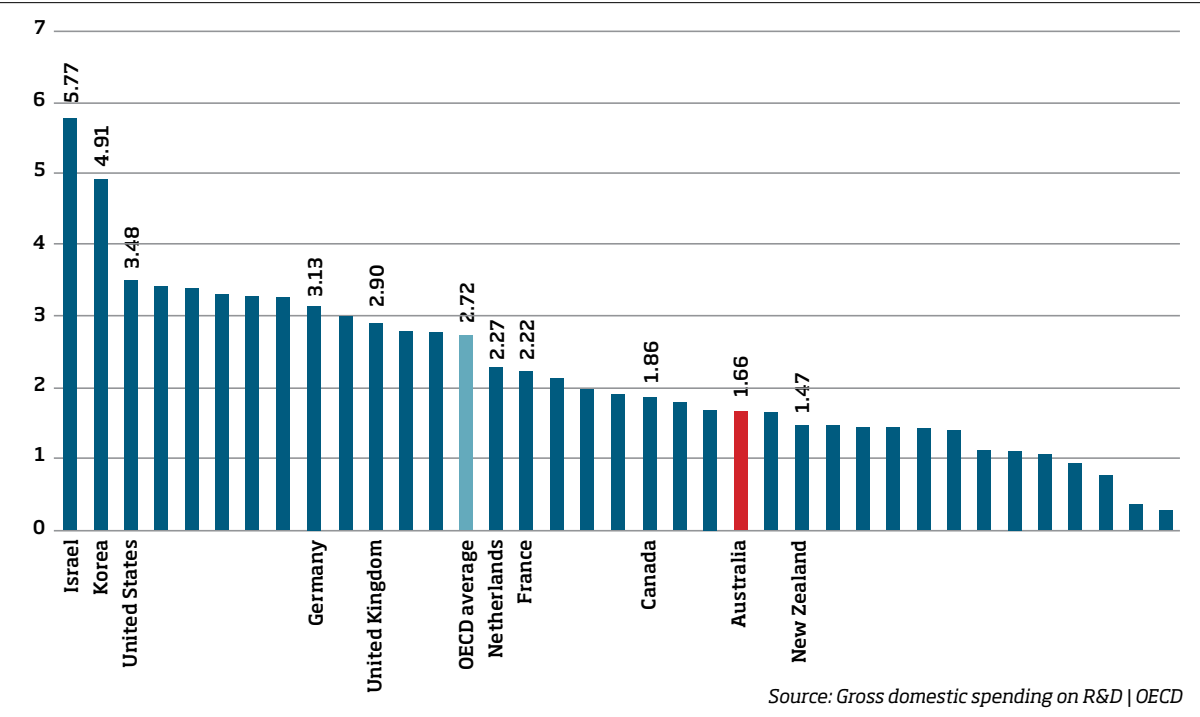
An ASCA that actually emulates DARPA and is truly independent of Defence would be a boon to the Australian research ecosystem that would be a true long-term investment in productivity. The Government should move to adopt the recommendation of the *Defence Strategic Review* and make ASCA independent of Defence as soon as possible.

Investing in research

A robust research and development (R&D) ecosystem can boost productivity growth by driving technological progress and innovation. Unfortunately, investment in R&D in Australia by both the Government and across the economy is lagging behind other developed economies.

Australian Government investment in R&D (including tax incentives) as a proportion of GDP was 0.49% in 2022-23, the lowest since records began in 1978-79.³⁵ This places Australia in the bottom quarter of OECD countries (28th out of 36), below Canada (0.62%) and the United States (0.69%), and well below countries such as the United Kingdom (0.95%), the Netherlands (0.95%), Germany (1.12%) and South Korea (1.45%).³⁶ This poor performance is also reflected in gross national spending on R&D (including non-Government spending). Australia’s gross domestic R&D spend is equivalent to 1.7% of GDP, placing Australia 22nd out of 36 OECD countries and well below the OECD average of 2.7%.³⁷ Australian R&D spending is significantly lower than in the UK (2.9%) and the US (3.5%).

Figure 9: Gross domestic spending on R&D in OECD countries, % of GDP, 2021



³⁴ Andrew Greene, “Military companies warn of bankruptcies as defence project faces criticism for being ‘too slow,’” ABC News, November 4, 2024, <https://www.abc.net.au/news/2024-11-04/defence-technology-project-cancelled-following-investment/104560128>.
³⁵ Robyn Prior, “Funding trends,” *Science and Research*, Commonwealth of Australia, last modified May 2023, https://www.apf.gov.au/About_Parliament/Parliamentary_departments/Parliamentary_Library/Budget/reviews/2023-24/ScienceResearch.
³⁶ “Science, research and innovation (SRI) budget tables,” Department of Industry, Science and Resources, last modified October 18, 2024, <https://www.industry.gov.au/publications/science-research-and-innovation-sri-budget-tables>.
³⁷ “Gross domestic spending on R&D,” OECD, accessed December 15, 2024, <https://www.oecd.org/en/data/indicators/gross-domestic-spending-on-r-d.html?oecdcontrol-8027380c62-var3=2021>.

In addition to establishing a true Australian equivalent of DARPA, the Government should do more to grow Australia’s research ecosystem, with the goal of raising gross domestic R&D spending to at least the OECD average. This should involve both considering where research funding could be increased and how to better incentivise private sector investment.

Any increase in direct Government funding should be targeted and only considered in institutions with a proven track record of delivering results, groundbreaking research and productivity gains for the economy. This could include CSIRO, noting that the organisation already receives around \$1 billion per year and has recently stated that the budget of one research unit needs to be reduced by 25% in order to “reduce costs, complexity and duplication”. The Government’s Cooperative Research Centre (CRC) program already funds research across a wide range of areas totalling over \$1.2 billion between 2018 and 2024, including cyber security, energy, mining, plastic waste, batteries and digital health.³⁸ The Government should continually review CRCs to ensure they are delivering value for money and proven results, and to consider opportunities for new research areas and consolidation of existing research.

³⁸ “Current Cooperative Research Centres,” Australian Government, accessed December 11, 2024, <https://business.gov.au/grants-and-programs/cooperative-research-centres-crc-grants/current-cooperative-research-centres-crcs>.

Conclusion

Falling productivity is a principal reason Australians’ living standards have been falling and reversing this trend should be a priority for all governments. In the long run, there is no substitute for lifting productivity if we want to enjoy higher wages and economic growth. Without reforms to improve productivity, Australia will be left behind at a time when growing geopolitical disorder means it has never been more important to remain competitive.

If productivity growth were to be a modest 0.3% higher annually than currently forecast, per capita incomes over the next 40 years would be \$11,000 higher. Over the next decade, GDP would be \$877 billion higher and the Commonwealth Budget would record a cumulative \$12 billion surplus instead of the currently projected \$221 billion deficit.

There is no consensus on the solutions to lower productivity growth and no single lever that governments can pull to guarantee higher productivity. What is clear however, is that previous shifts in productivity were not predictable and governments should not assume that supporting a particular technology or innovation will lead to future changes in productivity. This means we can’t put all our eggs in even a few baskets, as the current Government seems to be doing. A Government-run ATM to support a few chosen sectors is not a productivity policy.

Productivity-enhancing policies for both the private and public sectors must be pursued across a broad range of fronts and constantly reassessed. In the private sector, the role of the Government should be to *position* and *enable* businesses to seize new opportunities with policy settings that get the basics right and support the spread of good ideas across the economy. Addressing productivity in the public or non-market sector is one area where the Government can and must have a direct influence, especially given the recent rapid expansion of programs such as the NDIS. Driving consistent productivity growth in the non-market sector will require strong leadership from the Commonwealth, including working with state governments that deliver most non-market services in Australia.

The MRC has put forward a package of relatively low-cost, practical policies that the Commonwealth Government can pursue now to improve productivity growth. The policies we recommend are broad based enablers of productivity across the economy, with a particular emphasis on enhancing productivity in market and non-market services. In addition to these recommended policies, governments should pursue more challenging reforms such as removing stamp duty on property purchases and insurance, simplifying planning and zoning, and lowering taxes. The benefits of these policies will not be felt for some time, so the Government should begin the work of implementing them as soon as possible to ensure a more prosperous Australia in the future.



RG Menzies House
Cnr Blackall & Macquarie Streets
Barton ACT 2600
PO Box 6091, Kingston ACT 2604

www.menziesrc.org