

Productivity in the non-market sector

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A fresh way of looking at productivity

The productivity debate has become overly mechanical. It is time to discuss its benefits to society, including those that do not show up in the official productivity statistics, such as people living longer, healthier lives.

Australia's measured productivity growth has been slowing

Productivity growth has been responsible for almost all the improvement in Australian living standards since Federation. But in the decade 2010-20, Australia's measured productivity growth was its worst in 60 years – recording an annual growth rate of 1.1 per cent compared with the 2.2 per cent annual rate achieved during the productivity boom years of the 1990s.

In the 2020s, Australia's measured productivity performance has been worse again, and is only at its 2016 level following several years of negative measured productivity growth in the early part of the decade.

A transition from capital-intensive goods production to labour-intensive services

Much of the longer-term decline in Australia's productivity growth appears to have been associated with the transition of the Australian economy from high-productivity, capital-intensive agriculture and manufacturing industries to the lower-productivity, labour-intensive services industries.

Services are now responsible for around 80 per cent of Australia's GDP and almost 90 per cent of Australian jobs.

This shift towards services is an indication of a maturing economy. All other advanced economies have undergone the same evolution. China, too, has started down this path, as lower-value manufacturing moves offshore to low-wage countries and the Chinese economy provides services to an increasingly affluent and ageing population.

Non-market services are assumed to have zero productivity growth

In the so-called non-market services – health care and social assistance, education and training, and public administration and safety – measurement difficulties result in productivity being assumed to be zero. What is the productivity of a nurse or an aged-care worker, for example? How much GDP do they produce per hour worked? What is a police

officer's or a firefighter's productivity, or the productivity of a member of the defence force? Their productivity is difficult to quantify, yet these are essential services.

Such measurement problems for the expanding non-market services sector create an impression that Australia's productivity slump is worse than it is. The rise of these types of services, as desirable as it is both economically and socially, makes returning to Australia's glory days of high measured productivity growth in the 1990s impractical.

Australia's actual health sector productivity performance has been among the world's best

A good example is Australia's health sector. Its productivity typically is measured by the resources it takes for a hospital or other health providers to deliver a particular service. Applying this approach, Australia's measured annual healthcare productivity¹ growth has been negligible, at 0.1 per cent in the previous decade, compared with a market sector average of 0.7 per cent.

However, these measured productivity growth statistics are not picking up large productivity improvements in the services sector that, until recently, have proved difficult to quantify. Recent advances in the measurement of productivity in the services sector have told a different story: in a large segment of Australia's healthcare sector that the Productivity Commission has studied, annual healthcare productivity grew by a strong 3 per cent, four times faster than that of the market-based economy, placing Australia third among 28 high-income countries in these health disciplines.

Australia has been highly successful in reducing smoking rates and in the treatment of cancers. These are productivity gains that do not show up in the official statistics. However, we have been far less successful in reducing the incidence of obesity and the chronic conditions that obesity causes.

The Reserve Bank should not rely on quarterly productivity data in setting monetary policy

Despite the low measured productivity of the services sector, especially the non-market services sector, the Reserve Bank of Australia (RBA) frequently refers to Australia's quarterly productivity data in the national accounts in deciding on monetary policy settings. It did so in every RBA Board meeting in 2024.² And in its Statement on Monetary Policy,³ it leans heavily on the most recent productivity statistics in explaining its outlook for the cash rate.

Yet the Productivity Commission cautions that estimated productivity does not approach a 'true' number but rather it is consistently changing, with revisions equally likely to be upward or downward.

¹ The Productivity Commission's study of healthcare has been done for multifactor productivity. See Productivity Commission (2024), [Advances in Measuring Healthcare Productivity](#).

² Reserve Bank of Australia's [Board Minutes](#).

³ Reserve Bank of Australia, [Statements on Monetary Policy](#).

These problems in measuring productivity growth call into question the Reserve Bank's use of quarterly productivity estimates in influencing its monetary policy decisions at its seven or so meetings per year.

Yet Australia's productivity performance remains crucial

Measurement problems should not relieve economists from being concerned about longer-term productivity trends. Rather, they strengthen the need to understand the forces driving productivity growth in the economy.

Nor do measurement problems exempt non-market services from efforts to make their delivery more efficient and effective. Government agencies can be made to operate more efficiently, as can policing, defence, education and training, nursing and aged care.

But it would be an error to increase efficiency in these areas to the detriment of the quality of services delivered. We shouldn't be aiming for larger class sizes per teacher or abandoning face-to-face teaching on university campuses in favour of 100 per cent online lectures and tutorials.

The Productivity Commission has come to the view that increasing the productivity of services will require a tailor-made approach. In the modern version of equipping farmers, mine workers and manufacturing workers with better machinery, Australia can equip service providers with the latest technologies. In these services, we are only seeing the early days of opportunities arising from the deployment of artificial intelligence (AI).

Good examples are rehabilitation in the home for hip and knee replacements, and for many health conditions, home hospital services.

Greater use of patients' homes for care and rehabilitation, enabled by digital technologies to monitor patients, can be a win all round – for patients who prefer recovering in their own homes with family and pets, sleeping in their own beds and eating their preferred meals when they choose, and for the health system through reduced reliance on scarce and expensive hospital beds and facilities.

Digital technologies are not a substitute for personal care but a complement to it, supporting nurses, paramedics and aged care workers in delivering higher-quality services at lower overall cost.

KPMG has worked with Medibank in estimating the net benefits of rehabilitation in the home for hip and knee replacements and of its home hospital services in South Australia, finding they deliver high-quality care and at substantial cost savings.

Digitisation of government administrative services offers further opportunities for productivity gains. Examples are the use of digital execution of statutory declarations, electronic signatures and video-link witnessing in place of the centuries-old ink and paper.

These were initiated by the previous federal government during the COVID-19 period and have been legislated by the present government.

A further example is the proposed Simplified Trade System, otherwise known as Paperless Trade. It would digitise the bills of lading and clearance documents for Australia's imports and exports, greatly reducing administrative burdens and delays in the handling of goods for import and export.

If Australia succeeds in these endeavours, living standards can continue to rise in an ageing population. While the benefits of these reforms might not be reflected fully in the official productivity statistics, we will have achieved productivity growth by delivering higher-quality services at lower cost.