

Productivity and Fair Work



researcher | futurist | activist | thought leader | intelligence source

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Executive Summary

Productivity does not equate with cost-cutting and work intensification.

The starting point of this investigation is to reject the common assumption that productivity simply means cost-cutting and work intensification.

Increasingly, productivity results from transforming business methods and capabilities to better meet customer and market needs and to earn and capture profits that fund further business investment and growth.

Rather, productivity centres on creating new value for customers and new capabilities and opportunities for businesses.

Understanding the concept of productivity is relatively straightforward – examining what you produce compared to what you use to produce it.

Improving productivity is about using human and physical resources in ways that produce more output and value.

It is not just about cost cutting and minimising the use of inputs like labour and capital. It is also about producing the same things in better (smarter) ways, or about using inputs to produce better (higher value) goods and services.

Being smarter and producing higher value business offerings are the pathways to productivity growth that really count over the long run.

Opportunities for productivity growth are changing and multiplying through a shift sometimes labelled as ‘the information revolution’ or the ‘rise of the knowledge economy’.

Productivity growth comes about through a combination of increased opportunities to improve productivity and the ability of businesses to pursue those opportunities to maximise their sustained competitive performance.

Advanced economies have been experiencing a radical shift in what constitutes opportunities for productivity growth, and a consequent rethinking of what businesses need to do to capitalise on these opportunities to increase their productivity performance. This shift is sometimes labelled the ‘information revolution’ or the ‘rise of the knowledge economy’.

Traditionally, opportunities for productivity growth were seen to rest on natural resource endowments benefiting agriculture and mining or on advances in science and technology centred on investments in the manufacturing sector.

A step-change in the available opportunities for productivity growth, including in services, has occurred through advances and uses of information and communications technologies (ICTs). These enable entirely new business methods and capabilities for meeting customer and market needs and earning a premium from doing so.

(Continued)

These advances in ICTs are enabling technologies that help transform the way businesses run – what they do, how they do it and how they earn and capture profits that allow them to invest and grow. That is, this use of ICTs has provided a platform for businesses to innovate, not just in new products and processes, but in their business models, the recipe by which they create value for their customers, suppliers and themselves.

Moreover, these opportunities to innovate and improve productivity are open to all businesses and all sectors – small and large, agriculture and mining, manufacturing and the broad sweep of services from logistics and wholesaling to accommodation and cafes.

This ‘ICT revolution’ not only results in more opportunities for productivity growth, but in more ways to realise such opportunities. ICT-based innovation has brought much more emphasis on business transformation, flexibility and adaptation to changing market circumstances.

Productivity growth in the economy is determined by the performance and transformation of firms.

The shift in how productivity opportunities are emerging requires a similar shift in the intelligence and capabilities of business enterprises to discern and capitalise on these opportunities.

Enterprises need to be engaged in a ceaseless search for market opportunities and in testing how best to apply their distinctive know-how and capabilities so that they gain and retain a competitive edge. They do this by providing solutions that customers worldwide are prepared to pay for.

The ceaseless search by firms for business improvement and for a distinctive and durable competitive edge is central to productivity growth.

Increasingly business improvement comes about through constant analysis of market opportunities and by developing and working with key competencies to capture value. Supply chains, organisational structures and production processes (including importantly, how people are organised and managed) can then be adapted to both capture value and to meet market demands in efficient, competitive ways.

How enterprises apply their skills and competencies to the intensive search and execution of competitive business opportunities increasingly determines Australia’s productivity outcomes.

Executive Summary (*continued*)

The decisions and actions of firms in the competitiveness search are the immediate determinants of productivity...

... but underlying determinants like regulation and government policy have material and powerful effects, whether as constraints or enablers.

Workplace relations regulation can affect the way firms make decisions that lead to better or worse productivity outcomes

But beware of over-statement. A responsive and effective workplace regulatory system is an absolutely necessary, but far from sufficient, condition for fostering Australia's productivity growth.

Determinants of productivity growth operate at three levels:

Immediate determinants are those within the control of producers. They include selection of what goods and services to produce, inputs, purchases, technologies, management and information systems and work practices.

Underlying determinants are those outside the immediate control of producers but which support efficient production activity and improve the quality of inputs available to producers over time. They include regulatory systems such as Fair Work.

Fundamental determinants are factors such as natural resource endowments, climate, distance from large markets, demography and patterns of settlement. They change little or only very gradually over time.

There are two ways in which governments can improve national productivity. First, they can improve the efficiency with which they perform their own activities. Second and most importantly, they can help create the conditions under which businesses can be more productive and realise available opportunities for productivity growth. This means operating through the underlying determinants.

There are a number of different policy settings that can be used to boost productivity and it is essential that they are all present and operating together. The first one provides a reason for firms to be more productive; the last two increase the ability to be more productive.

These policy touchstones are:

- *Incentives* – policies that exert external pressures and disciplines on firms to improve their performance; the key example is competition as the main driver of improved performance.
- *Flexibility* – facilitating the agility of firms to make changes to respond to market developments. Flexibility to alter work arrangements and workforce requirements is essential, as is the reduction of red tape.
- *Capabilities* – the support platforms for innovation, including education, skills and training, appropriate infrastructure and human and organisational capital.

It is unwise to isolate the workplace relations regulatory system and over-burden it with excessive expectations of its role in enhancing productivity growth.

The point is to understand what part workplace relations regulation plays in the key features of productivity growth, and to assess the Fair Work system against these realities.

The Fair Work system is not responsible for Australia's productivity slump, but there are signs that it is hindering business actions to compete, innovate and grow.

The Fair Work Act is not responsible for Australia's productivity slump to date, as declining productivity levels were already well-established before the Fair Work Act came into effect on 1 July 2009 and became operational on 1 January 2010. Its macroeconomic effects, adverse or otherwise, are not yet readily apparent and certainly have not been quantified.

But observations from this study suggest that the Fair Work system operates to constrain business options and the ability to respond to opportunities to create value in a modern, highly competitive business environment.

In particular, the Fair Work system allows little flexibility for employers and employees to establish work arrangements or solve problems in ways that are mutually beneficial and productivity-enhancing in their particular circumstances.

The design of the Fair Work system makes decisions about business operations, work arrangements and change more complex and uncertain.

Interviewees in this study were of the view that the Fair Work system regulating workplace relations put an implementation and compliance overhead on businesses that resulted in a great deal of cost for little gain. Even if they conceded the good intentions of the regulation, businesses in this study experienced it as cumbersome at least, and in some parts quite "heavy handed" indeed. Interviewees did not see the Fair Work system as even coming close to providing a return on the investment employers must make on compliance, nor recognising past positive investments made in employee engagement and related workplace practices.

Nor was it apparent that employees were better off. The system does not seem to provide employees with greater flexibility or choice in making their working arrangements more suitable for their circumstances.

The effort expended on compliance with the Fair Work system was seen as an unfortunate diversion of significant productive effort away from other business initiatives and workplace changes that would have better served business and productivity improvement.

The key concerns with the design and implementation of the Fair Work system can be summarised as:

- the presumption of conflict and the norm of adversarial workplace relations;
- a highly pervasive and prescriptive set of rules that over-regulates for worst cases to the detriment and cost of the majority of employers and employees; and
- the lack of tolerance for customised and diverse workplace arrangements that meet community norms of fairness and freedom to operate, rather than a single mandated solution for all.

Executive Summary (*continued*)

The Fair Work system was examined on five important dimensions of productivity growth, with the following results:

1. The presumption of conflict in the design of the Fair Work system is a massive obstacle to the encouragement of *engaged and empowered employees* as a feature of high performance, productive workplaces.

The presumption of conflict in the design of the Fair Work system, which is at odds with contemporary evidence on how productive high-performance enterprises and workplaces operate, is an obstacle to fostering strong employee commitment, ideas generation and participation in decision making.

This is manifested in the excessively prescriptive rules which encroach on management prerogatives and disenfranchise employees from having their aspirations for their hours and work arrangements heard and acted on by employers. This seems to be the case even in enterprises where goodwill was established and exploitation was absent.

Excessive attention to procedures to satisfy Fair Work Australia, rather than commonplace pragmatic actions agreed by employers and employees to solve problems and meet individual needs in particular workplaces, is a major limitation of the Fair Work system's contribution to productivity improvement.

This rules-based framework and its compliance requirements presume that an adversarial situation is the norm between employers and employees. It does not acknowledge that in the majority of cases, workplace practices to engender a positive and productive workplace culture and sound business outcomes already exceed the requirements of the Fair Work Act.

2. The Fair Work system fails to recognise that *management acumen and agility* is a legitimate and integral feature that a fair, flexible and productive workplace relations system can foster.

While much of the responsibility for action to boost high calibre management must rest with organisations themselves, the Fair Work system as the regulator of workplace relations, has a direct and material influence on management actions.

Our investigation suggests deficiencies in how the Fair Work system influences the exercise of management acumen and agility. The key concerns can be summarised as:

- The 'one size fits all' approach of the Fair Work Act leaves little room for management discretion to tailor workplace arrangements to particular business strategies, levels of demand and changing opportunities. Perfectly acceptable and long-established work practices that satisfy both employers' management prerogatives and the wellbeing of employees, are being disrupted by Fair Work requirements designed for worst cases.
- The diversion of management attention from running and improving the business to the lengthy, uncertain and more expansive process of enterprise bargaining required by the Fair Work Act, which incurs both transaction and opportunity costs for management. The business costs in time and resources far outweigh the benefits.

(Continued)

- Regulation and compliance does not automatically result in 'red tape'. Businesses are often sanguine about reasonable regulation that ensures a level playing field and generally operates in the best interests of the enterprise. However, burdensome regulation and increasing compliance requirements, especially those seen as unnecessary or ineffective, crowd out management attention to the search for new opportunities, customers and markets and for introducing innovations and improvements. In short, it keeps management inward-looking, not market focused.

3. To the extent that the Fair Work system increases the perception of uncertainty and risk, especially when employing people, it reduces the appetite for *competing through making innovative business change*.

Enterprises create competitive advantage through innovation by perceiving and implementing new and better ways to compete.

The Fair Work system in itself is not designed directly to promote productivity through business innovation. But, it is intended to provide a framework for workplace relations that enhances productivity. The findings of this study suggest that the Fair Work system is indirectly limiting the willingness and capacity of business decision makers to make innovative changes in how they run their business and secure their ability to compete.

The appetite for risk is critical to the ability to innovate in business. One observation from interviews in this study is that the Fair Work system has increased the perception of risk, especially the risks associated with employing people. This is evidenced by the uncertainties introduced through, for example, the classification of casual employees, the protracted time and wider scope of enterprise bargaining negotiations with implications for labour costs and the recruitment and retention of employees especially in times of labour shortages.

Overloaded and inward-focused, there is a flight by enterprises to conservatism and organisational stability through preserving the status quo, not pioneering change for a new competitive edge. This is the antithesis of innovation.

Executive Summary (*continued*)

4. The design of the Fair Work system has not caught up with the present day reality of *fundamental changes in the patterns of work and working life.*

Failure to recognise and activate changed assumptions about work organisation and the diversity of choices and aspirations of the workforce limits the adaptability of the Fair Work system and hence, its ability to contribute to productivity growth.

5. The Fair Work system seems to emphasise social outcomes (fairness for working Australians) at the expense of economic outcomes (flexibility for businesses) – contrary to contemporary evidence on the benefits of ‘shared value’ from the *interdependence of social and economic outcomes.*

The concept of ‘shared value’ was introduced by Harvard Business Review thought leaders, Michael Porter and Mark R. Kramer as “creating economic value in a way that also creates value for society by addressing its needs and challenges”.

They argue that shared value can give rise to the next major transformation of business thinking, where the focus is on creating shared value, not on profit per se. This is seen as the driver of the next wave of innovation and productivity in the global economy.

Overall, the Fair Work system underperforms on its stated objective of promoting productivity growth.

It contributes little, and, in some cases, hinders sustained transformations in the competitive capabilities of firms and their workforces that characterise the essentials of productivity growth.

While Fair Work, as a regulatory system, is only one of many policy tools that can influence productivity outcomes, its quality and responsiveness is highly influential in shaping the environment for business competitiveness and the critical contribution made by skilled and engaged employees.

The Fair Work system fails on a number of tests – a ‘one size fits all’ approach unable to tolerate workplace diversity; diversion of management attention away from business improvements; unnecessary, ineffective and highly prescriptive requirements with high levels of cost and overheads; increasing perceptions of risk and uncertainty, especially risks in employing people; underpinned by conflict and adversarial workplace relations as the norm; and perpetuating flawed and outdated assumptions about working life.

The good news is that the Fair Work system can be made more productivity-enhancing without another round of wholesale legislative change. Redesigning for more deft and responsive administrative arrangements will go a long way to ensuring that shared social and economic outcomes are simultaneously achieved.

This would re-set the Fair Work system as a successful example of policy and regulatory innovation, influencing key determinants and attributes of productivity growth, especially in the way employers organise work and business operations and deploy, engage and empower employees.

This would set the scene for action on other fronts to boost productivity – education and training policies, business innovation initiatives, the COAG national reform agenda, and industry policy settings.



1 Introduction

The NSW Business Chamber and its industrial affiliate, Australian Business Industrial (ABI) commissioned this research project on Productivity and Fair Work, led and managed by the Australian Business Foundation and using the services of two specialist consultants, Deepa Economics and ThinkEvans.

This research project into the contribution of the Fair Work system to productivity improvement in Australia was designed to provide Australian Business Industrial and the NSW Business Chamber with independent, expert and rigorous analysis that offers fresh insights on the role of workplace and industrial regulation in the national productivity debate.

Assessing the contribution of the Fair Work system to the productivity of businesses, industries or the nation fundamentally requires two things:

- a contemporary and authoritative understanding of the determinants of productivity growth; and
- an appreciation of the nature of the Fair Work system, sufficient to assess whether or to what extent its characteristics connect to any of the determinants of productivity.

Conventional wisdom is to document and debate the national productivity scorecard contained in measures of labour productivity and multi-factor productivity in the national accounts. The concept of evaluating productivity is straightforward enough: examining what you produce compared to what you use to produce it. However, the conventional approach to national productivity of working backwards from the national accounts offers only limited insight, just as simply reading a profit and loss statement for a year cannot reveal much about the reality of how the firm actually achieved its results day by day through the year.

Accordingly, this research project set out to make a more substantial contribution by illuminating what actually drives the productivity results of an economy beyond just efficiencies to sustained transformations in the competitive capabilities of business enterprises and workplaces.

This project then investigated the operation of the Fair Work system to seek evidence that its characteristics include features that engender, or alternatively, inhibit productivity growth.

This investigation was designed to allow the Chamber and ABI to take public discourse on the Fair Work Act beyond legislative detail and review of process issues, which are being well-covered by others, and lead a wider debate on how the Fair Work system can be applied to create wealth and opportunities, not merely to redistribute them.

This research project sought to increase understanding of how the Fair Work system can contribute to workplace transformation, new skills and management proficiencies, new sources of distinctive competitive advantage and innovative practices in Australian businesses.

ABOUT THE AUSTRALIAN BUSINESS FOUNDATION

The Australian Business Foundation is an independent, not for profit spin-off company established by the NSW Business Chamber in 1997 as a business research think tank. It specialises in collaborative and applied research, in partnership with international and Australian researchers and practitioners, on business innovation and sustainability, new models of competitiveness and opportunities from a knowledge economy. It has produced over 35 expert evidence-based research studies since its inception, including an authoritative study led by Professor Alan Hughes of the University of Cambridge into Australia's productivity performance comparing the low productivity growth period of the 1980s with the productivity surge of the 1990s and early 2000s.

The Australian Business Foundation contributed as a researcher to the Productivity and Fair Work project, as well as leading and managing the research project as a whole through the services of the Foundation's Chief Executive, Narelle Kennedy.

ABOUT THE RESEARCHERS

Deepa Economics

Dean J Parham is the principal of economic research and consultancy firm, Deepa Economics, with a career background with the Productivity Commission and its predecessors. Dean Parham conducted desk research of selected contemporary and authoritative Australian and international literature to distil, summarise and document an overview of the determinants of productivity growth and prescriptions to improve Australia's productivity performance. This included an understanding of the drivers behind the changes in Australia's productivity performance over the past 10 to 15 years.

ThinkEvans

ThinkEvans Pty Ltd is a boutique management consultancy with particular capabilities and track record since 2002 in assisting large and small private sector clients, government agencies and not for profit organisations to tackle knotty, untidy business issues which have often resisted previous attempts to resolve them. Led by Managing Director, Carolyn Evans, their team of consultants specialise in strategic research and options development, business and productivity improvement, corporate governance, and performance measurement and business modelling.

Carolyn Evans and Principal Consultant Tanya van der Wall led the ThinkEvans work on the Productivity and Fair Work project investigating the extent to which the Fair Work system is impacting on the key determinants of productivity growth, as identified in the productivity overview produced by Deepa Economics.



2 Methodology

The research undertaken for the Productivity and Fair Work project consisted of three key components:

- Overview of current research and evidence of the crucial determinants and attributes of Australian productivity growth.

This was undertaken by Dean Parham of Deepa Economics in the first stage of the project and was documented by him in an overview paper, incorporated into this final project report at Chapter 3. This overview paper summarising the key drivers of productivity was designed to form the basis against which the productivity impacts of the Fair Work system would be assessed in the second stage of the project.

- Investigations by desk research and interviews to gain an understanding of the business context, nature and operations of the Fair Work system in a manner that would allow an assessment of their effects on any of the identified determinants of productivity growth.

These investigations, as the second stage of the project, were undertaken by ThinkEvans Pty Ltd, whose team for this project included Carolyn Evans, Managing Director; Tanya van der Wall, Principal Consultant; Glenn Evans, Technical Director; and Alexandra Kirby, Research Assistant.

- The third stage of the project was to analyse and interpret the material gathered to distil and document insights into how the Fair Work system is contributing, positively or negatively, to critical dimensions of Australia's productivity performance and improvement efforts.

This component of the project was led by Narelle Kennedy of the Australian Business Foundation with the expert participation of both specialist researchers.

The methodology of the project is described in more detail in the following section.

Overview of productivity determinants

Desk-based research was undertaken to highlight the key influences on Australia's productivity performance in the modern era. The objective of this stage of the project was to provide a broad context for the study, rather than to examine the detailed relationship between the Fair Work system and productivity.

The first step was to review the evolution of Australia's opportunities for productivity growth, especially through technological advances that add to new business capabilities, and, in recent times, through the pressures of globalisation. The review took account of the industry of application, the applicability of overseas advances in Australia, as well as home-grown opportunities.

Opportunities for productivity growth are one thing, but realising them can be another. The second step therefore was to review the range of factors that determines actual productivity performance. This review discussed the role of businesses and governments and the priorities for promoting productivity growth that have evolved along with changes in the opportunities for productivity growth.

The third step was to review recent trends in Australia's productivity performance, and, in particular, the slump in Australia's productivity growth in the 2000s. Explanations for the trends were canvassed in order to draw any lessons that should be included in the key factors that promote or inhibit productivity growth in Australia.

Based on these reviews, the overview provides:

- broad directions for improving Australia's productivity growth;
- some specific priorities; and
- the key attributes of firms striving for improved productivity performance in the 21st century.

Investigations of the Fair Work system

The approach taken was twofold. Firstly, desk research to gain an understanding of how businesses engage with the determinants of productivity and the key issues surrounding the Fair Work system. Secondly, using the results of this desk research and the overview paper on productivity determinants to structure and conduct a program of interviews primarily with business decision makers, probing a series of assumptions and issues about how businesses interact with the Fair Work system.

Desk research

Desk research was conducted on two broad fronts.

1. The backdrop against which business decisions are made about the use of labour in achieving the productive outcomes of the firm. In particular, from the desk research, business perspectives were examined on:
 - their perceptions of the wider economic and social environment;
 - the expectations that they have of government and the policy framework;
 - their own decisions and actions taken to grow and compete in their own market(s); and
 - overall management of their workforce and its application to productive effort in keeping with their own business ethics and in a manner compliant with the overall regulatory framework.

This resulted in the identification of themes, assumptions and issues to be discussed in interviews.

2. Matters at the forefront of how businesses directly interact with the Fair Work system, as the current workplace relations regulatory environment. This also included evaluation of the ongoing press coverage around the Fair Work system and related commentary.

Further themes, assumptions and issues from this part of the desk research were also identified for discussion in interviews.

2 Methodology (*continued*)

Interview program

Interviews were conducted using open-ended questioning, given the exploratory and investigative character of the research (rather than it being quantitative/diagnostic research) and an ideologically neutral approach (given the highly charged environment of debate running at the time of the project).

The structure of questions aimed to:

- “sense check” the backdrop for decisions in that business;
- draw out unprompted coverage of experiences of that business related directly to the Fair Work system;
- where not covered, prompt comment on issues more generally at the forefront of business interaction with the Fair Work system; and
- seek wider comment on matters thought by the interviewee to be relevant to the effectiveness and efficiency of workplace relations under the Fair Work system.

Almost 70 interviews were carried out during October 2011 to February 2012, involving meetings, Skype conferences and teleconferences as suitable to the interviewee. The respondent group were:

- Individuals being the head of small and medium organisations, the head or one step away in large companies and several board members, plus several expert commentators (such as academics and specialist employment lawyers who act for employees, unions and/or employers).
- In the majority, individuals of long experience of human resource management, workplace relations and/or industrial relations, while the remainder came from more general backgrounds but were routinely involved as decision makers in relevant processes.
- Firms which span small (up to 50 employees) to medium (mostly in the 500-700 range) to large (over 1000, largest couple approaching 10,000 employees).
- In the majority, firms which have been in business for at least ten years (thus spanning multiple workplace relations regimes), with the newest being a start up of less than 1 year and the oldest being a partnership begun in the late 1800s.
- Largely commercial business (listed companies as well as enterprise funded privately or by joint venture or venture capital with various business structures (incorporated companies, partnerships, family businesses and franchises), along with a few not-for-profits and a small side order of government enterprise.
- All businesses started in Australia, but some are now multinationals and a significant minority (encompassing both small and large businesses using various business models) earn substantial income offshore.
- In the majority based in NSW, with the balance spread across Victoria, Tasmania, Queensland, WA and the ACT.
- Located in metropolitan and rural/regional areas.
- From a spread of industries including manufacturing (large and small), mining/mining services, travel/transport, aged care, health, IT (very broadly defined), business services (broadly defined), professional services (broadly defined), retail, hospitality, and education (tertiary), and various aspects of tourism.

Of those respondents, less than 10 were members of the NSW Business Chamber or its associated entities, the balance coming from open calls to participate made through a variety of business networks.

The majority of interviews were 75-90 minutes and followed a reasonably structured approach to the material (while still being consistent with eliciting unprompted responses as far as possible). Around a third of employer interviewees offered access to a workplace and/or opportunity to speak with employees, including some employee representatives.

Analysis and Insights

The combined expertise of the Australian Business Foundation and the two specialist researchers was brought together to digest the findings of the investigations and to distil informed insights about the contribution of the Fair Work system to the important identified determinants of productivity. These insights and their import for action to enhance Australia's productivity performance were further scrutinised by nominated NSW Business Chamber and ABI executives as part of the regular project review process that occurred throughout the conduct of this research. The responsibility for views expressed in this report, however, lies with the Australian Business Foundation.

Structure of Report

The results of the Productivity and Fair Work project are documented in this final report. The structure of this report commences with an Executive Summary. Chapter One covers the Introduction to the project and Chapter 2 describes its Methodology. In Chapter 3, the context is set with Dean Parham's overview paper on 'Raising Australia's Productivity Performance', which distils the essential determinants of productivity growth. Chapter 4 summarises the findings from ThinkEvans' interviews and desk research on the context and nature of the Fair Work system and business perspectives on its productivity effects. Chapter 5 presents Analysis and Insights, and Conclusions are drawn in Chapter 6.

As a supplement to this project report, there is a full stand alone report provided by ThinkEvans on their component of the project, being an investigation of the Fair Work system's contribution to productivity. This supplementary report is titled '*Fair Enough? Investigating Productivity and the Contribution of the Fair Work System*'. The key features of the ThinkEvans report are summarised particularly in Chapter 4 of the project report.

During the course of this research project, the Federal Government announced a Review of the Fair Work Act and called for submissions in February 2012. To assist the NSW Business Chamber and ABI to incorporate the essential findings of this research into their submission within the deadline, an additional paper was delivered. This paper summarised the preliminary findings of the Productivity and Fair Work research project against the list of questions on which submissions and evidence was sought by the Fair Work Act Review. This paper is included as an appendix in the ThinkEvans report '*Fair Enough?*'.



3 Raising Australia's Productivity Performance: the Context

3 Raising Australia's Productivity Performance: the Context

1 INTRODUCTION

This section provides the context for the study of the relationship between the Fair Work Act and Australia's productivity performance. It highlights key factors that influence Australia's productivity performance, with an emphasis on productivity in private businesses. The key factors are identified from reviews of:

- Australia's opportunities for productivity growth;
- the determinants of productivity growth; and
- recent productivity trends—notably Australia's productivity slump in the 2000s—and any lessons on contributing factors that should be taken on board.

Before getting to those reviews, however, useful productivity concepts and measures are explained, followed by a brief discussion about why productivity growth matters so much to the wellbeing of Australians.

2 ABOUT PRODUCTIVITY

2.1 What is productivity?

The simplest way to think about productivity is to consider it as the ratio of outputs produced to inputs used.¹ Productivity measures then capture the rate at which producers generate outputs of goods and services from the inputs they use in producing them—or, broadly, the efficiency of production. This concept of productivity and its measurement can be applied at the level of specific production processes, firms, industries and national economies.

Improving productivity is about using human and physical resources in ways that produce more output. It is not just about cost cutting and minimising input use. It is also about producing the same things in better (smarter) ways or about using inputs to produce better (higher value) goods and services. Being smarter and producing higher value goods is the pathway to productivity growth that really counts over the long run.

Types of productivity measure

Two specific productivity measures are commonly used:

- Labour productivity is the ratio of output to labour input, where output is measured as value added (or gross output less intermediate inputs²). When labour input is measured by hours worked, labour productivity is the amount of output produced per hour worked.³
- Multifactor productivity (MFP) is the amount of output produced from the combined use of labour and capital (the latter being assets such as machinery, equipment and buildings).

1 This simple definition also fits neatly with the way productivity is measured by the ABS in its estimates of Australia's productivity performance.

2 Intermediate inputs cover materials and purchased services for production such as electricity and cleaning.

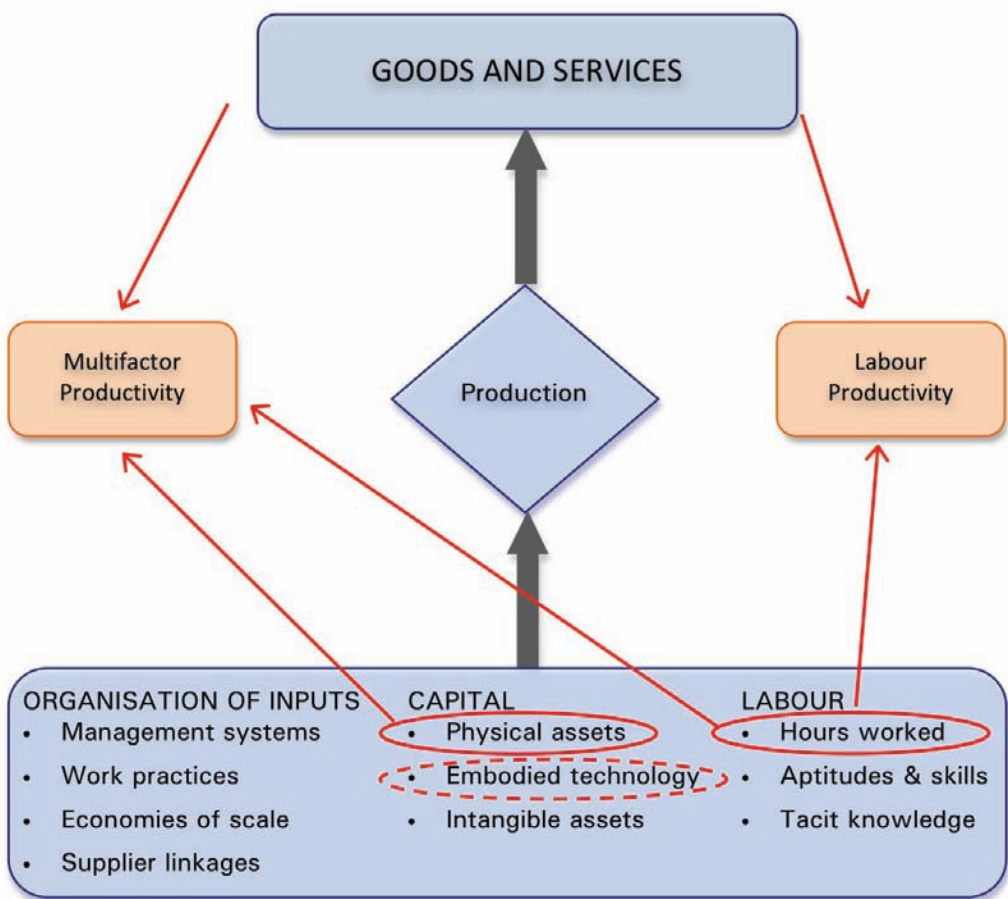
3 An hours-worked measure is preferred over a numbers-employed measure because the hours-worked measure better captures the labour input of part-time employees and the overtime hours of full-time employees.

Productivity measures need to be interpreted with care. In particular, labour productivity should not be interpreted literally as a measure of the efficiency of workers. While worker efficiency does have an influence on labour productivity, there are many other influences as well. The amount of capital available per worker has the most influence. As a simple illustration, one person can produce a lot more output in an hour using a nail gun rather than a hammer. Even the quality of management can affect labour productivity if it affects the total amount of output a workforce produces.

Because the labour productivity measure is affected so much by the capital intensity of production, the MFP measure is usually given preference, whenever it is available. MFP reflects how well the two major inputs of capital and labour are used in combination to produce goods and services.

Figure 1 helps to reinforce these measurement concepts. The figure is a highly simplified representation of production and shows a selected range of inputs, under headings of 'labour', 'capital' and 'organisation of inputs', going through a production process to generate outputs of goods and services.

Figure 1: Productivity measures are the ratios of outputs to specific inputs



3 Raising Australia's Productivity Performance: the Context *(continued)*

The figure shows the measurement of labour productivity as the ratio of outputs to only one input - hours worked. The level of, and growth in, labour productivity is affected by all other inputs that are left out of the measure. These other inputs, generally outside the control of workers, can be large in both number and importance. As can be seen, labour productivity is about more than how hard employees are working, either individually or collectively.

Figure 1 also depicts the multifactor productivity measure as the ratio of outputs to selected inputs, where the selected inputs are hours worked and physical capital (and some technological enhancements that are embodied, for example, in new machinery and equipment). The level of, and growth in, MFP is affected by the factors not explicitly included in the measured capital and labour inputs, such as management and work practices, intangible assets such as intellectual property and the skills of employees.

2.2 Why does productivity matter?

Productivity matters because, if available resources are used in ways that generate more output, they also generate more income. Outputs are sold and the income received can be used to pay for materials, wages and a return on investment. Productivity gains can be distributed as lower prices to customers, higher wages to employees, higher profits to fund the business or return to shareholders and higher taxes to governments.

Productivity growth is the most important source of improvement in material living standards over the long term. Increased workforce participation and employment are good ways to raise income per head of population. Favourable shifts in the terms of trade can also raise living standards, as recent experience has demonstrated. But, over the long haul, improvements in productivity turn out to be the major way to increase average incomes.

Nevertheless, the pursuit of productivity needs to be kept in some balance. Productivity is an intermediate objective and not the ultimate objective. Productivity serves to improve the material wellbeing of Australians. But there are other sources of wellbeing that also need to be considered and any costs associated with productivity-enhancing actions do also need to be considered. For example, there may be employment dislocation that has a disruptive effect for a time. Often though, actions can be taken to improve productivity over the long term without fundamental conflict with social or environmental objectives.

3 INFLUENCES ON PRODUCTIVITY GROWTH

Australia's productivity performance is the combination of the growth in available opportunities for productivity improvement and the ability to realise them. Some opportunities for productivity growth open up in Australia, while many are world-wide developments, especially in technology. But opportunities can be lost if the right productivity-enhancing factors are not in place. This section reviews the evolution of productivity opportunities and the factors that determine the extent to which they are realised.

3.1 Opportunities for productivity growth

Views on the main opportunities for productivity growth in advanced economies have evolved over the past few decades.

A traditional view based on industrialisation

A long-standing view is that opportunities for productivity growth in advanced economies rest centrally on new technological advances that arise predominantly in the manufacturing sector. Productivity in advanced economies grew in the era of industrialisation through two mechanisms: the shift of production resources from low-productivity agriculture to high-productivity manufacturing; and the opportunities for relatively high productivity growth in manufacturing through technological advances.⁴

As advanced economies became richer, their services sectors grew strongly. But most services were thought to, and were shown to, present smaller opportunities for productivity growth.⁵

This traditional view on the opportunities for productivity growth therefore has a strong 'science and technology' foundation. From an international perspective, the pattern of productivity growth across developed economies was influenced by companion elements of 'technological leadership' and 'catch-up'. The view broadly fits a post-WWII pattern in which the US tended to be the overall leader in science and technology and in productivity, while European countries and Japan engaged in a process of technological and productivity catch-up. (Australia also showed evidence of catch-up, but at a slower rate than would be predicted by its starting position.⁶) A few European countries even went ahead of US productivity levels.

Disruptive technologies and globalisation

However, the process of international catch-up showed signs of weakening, if not breaking down, in the 1990s. Productivity growth accelerated in the US and a few other countries (including Australia) while, importantly, most European countries were unable to keep up.

There was a new and far-reaching element. Advances in information and communications technologies (ICTs) presented new productivity opportunities. There had long been opportunities for productivity growth through technological advances in the production of ICTs. But it became clear that opportunities were opening up for productivity growth associated with the use of ICTs. This was not a matter of just investing in ICTs, but of transforming the ways that businesses run—what they did and how they did it. ICTs brought opportunities to substitute capital for labour but, more fundamentally, they provided a platform for businesses to innovate. Opportunities to innovate and improve productivity became widely available—to small and large firms, to operations in agriculture and mining, through manufacturing to services from wholesaling to accommodation and cafes.

4 There have been major advances in process such as assembly lines, lean production and just-in-time inventory management. In terms of industries, the major productivity shifts in the second half of the 20th century have come in industrial machinery and computer equipment and electronic and electric equipment.

5 There have, of course, been major advances in areas such as energy generation.

6 This is widely considered to be because Australia went against the trend in other countries and raised barriers to trade. See, for example, Productivity Commission (1999).

3 Raising Australia's Productivity Performance: the Context *(continued)*

Increased globalisation of production has also influenced where the opportunities for productivity growth lie in advanced economies. Globalisation brings increased international specialisation. Increasingly, while high-skill and high-value-adding activities such as design are retained in advanced economies, the production of standardised manufacturing and service elements is being located in other countries. On the other hand, rapid growth and development in Asian countries has brought opportunities for growth in high-value exports, including in services.

Country-specific differences

There are country-specific differences in productivity opportunities. Many factors, such as resource endowments and geography, can affect a country's opportunities for productivity growth. For example, Australia's natural resource endowments provide important opportunities for productivity growth in agriculture and mining. Australia tends to be at the forefront and continues to push the frontier in many activities in these industries. On the other hand, Australia's isolation from large markets, its relatively small population and its sparse pattern of settlement have traditionally hampered its opportunities for productivity growth in manufacturing activities through technological advances based on large-scale operations. Many opportunities for ICT-based innovations have opened up in Australia. They have not only opened up, but have also been realised. Many of the productivity gains since the 1990s were, for example, in wholesaling and finance where they were facilitated by ICT use.⁷

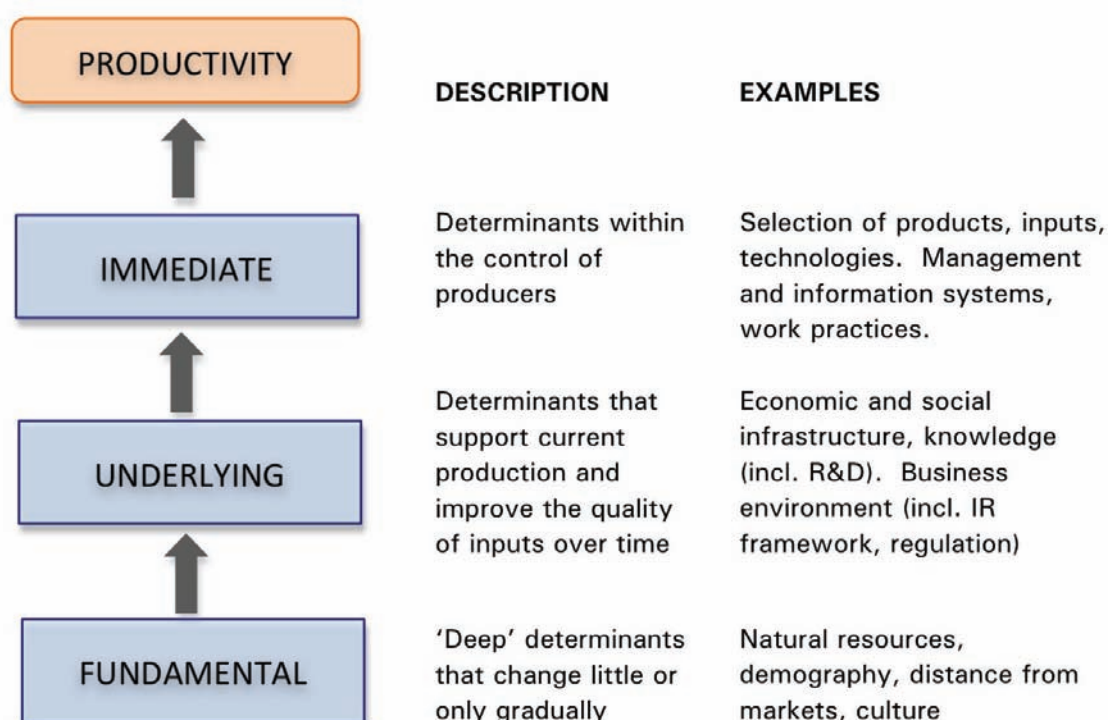
3.2 Realising productivity potential

There is no single factor or simple template for achieving available productivity gains. The influences are many and the interactions and interdependencies can be complex. There is no 'silver bullet'.

An organising framework

Because of the multiplicity and complexity of factors that determine productivity, it is helpful to organise them into a framework. Figure 2 displays a hierarchy of determinants.⁸

Figure 2: The hierarchy of productivity determinants



⁷ See Productivity Commission (2004), Hughes and Grinevich (2007) and Tressel (2008).

⁸ The hierarchy presented in Figure 2 is an adaptation of the one presented in PC (2009).

The first level is immediate determinants. These determinants are essentially within the control of producers. They are the things businesses can do, either individually or collectively, to raise productivity by improving their operations. Firms can determine their productivity through selecting such things as: what they produce and the technologies they use, what they outsource, how they organise and manage their production processes and the quality of the people they employ. Better productivity can come through improvements in such areas as intelligence on customer demands, management and information systems, work processes and product delivery. Productivity over time can be improved through adoption of new technologies, investment in R&D, staff training and changes in organisational structures. From a broader perspective, the immediate factors determine how well inputs are allocated and organised to produce goods and services of value.

Underlying determinants are outside the immediate control of producers but nevertheless support efficient production activity and improve the quality of inputs available to producers over time. There are various types of underlying determinants. Economic infrastructure—transport, energy, water and communications systems—supports the efficient production of goods and services through the services it provides to businesses. Good transport infrastructure, for example, reduces the efforts that businesses have to go to in order to distribute or source goods. Economic infrastructure can also improve productivity at large through spillover gains, such as those that come through the expansion of transport and communication networks, enabling production to be organised more efficiently. There is also the development of technical production knowledge, which enhances productivity over time through the development of new technologies and know-how. Technical knowledge is developed through a web of links between businesses, universities and research agencies, often referred to as a nation's innovation system. Health and education systems, sometimes referred to as social infrastructure, help to develop the quality of human inputs over time.

Fundamental determinants are factors such as natural resource endowments, climate, distance from large markets, demography and patterns of settlement. Fundamental determinants tend to explain differences in the levels of nations' productivity. They tend to change only gradually, if at all, and are not readily amenable to influence. But as mentioned before, they do affect where a country's opportunities for productivity growth lie.

The role of governments

There are two ways in which governments can improve national productivity. First, they can improve the efficiency with which they perform their own activities.⁹ Second and most importantly, they can help create the conditions under which businesses can be more productive and realise available opportunities for productivity growth.

Figure 3 puts the immediate and underlying determinants in a different layout so as to highlight the indirect role that governments play in raising productivity. Governments have a strong influence on the business environment in which firms operate. They can make the business environment more productivity-enhancing (or defeating) depending on the degree of competitive pressures firms face, the amount of red tape they are required to go through to do business, the industrial relations framework within which management and workers deal with each other, the governance arrangements for firms and the taxes and charges firms have to pay on their operations. Governments also influence the development of knowledge and the provision of economic and social infrastructure through direct provision, or regulation and promotion of the activities of others.

Governments also play a broad role to the extent that they ensure macroeconomic stability and general conditions conducive to long-term investments.

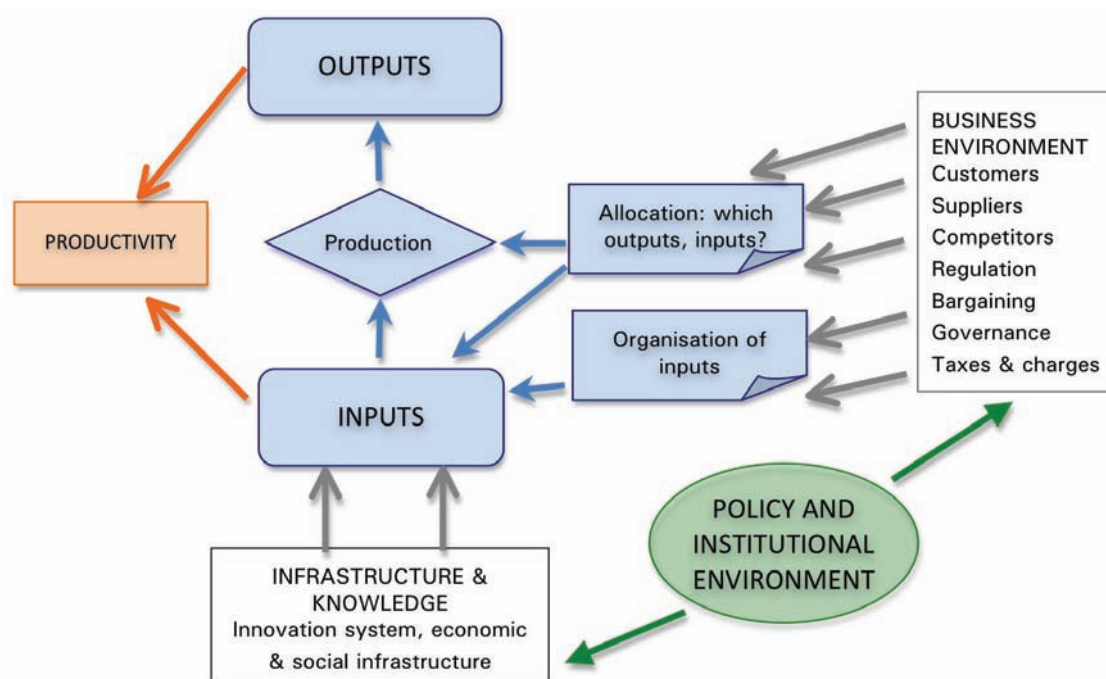
⁹ Even though such efficiency improvements will not show up in the productivity statistics (the government sector is excluded from the productivity calculations) they are productivity gains of benefit nonetheless.

3 Raising Australia's Productivity Performance: the Context *(continued)*

*Some priorities for realising available opportunities*¹⁰

Priorities for promoting productivity growth have evolved along with the different waves of change in the opportunities for productivity growth.

Figure 3: The prime role of governments in influencing productivity



The traditional focus on science and technology in major advanced economies brought an emphasis on investment—investment in physical capital, human capital, and R&D activity. This was based on the view that physical capital often embodies new more-productive technologies and raises the amount of capital available per worker. The human capital element focused on developing people with the education and skills needed to advance and apply technical knowledge. R&D activity has been emphasised as a way to develop, adapt and apply new technical knowledge.¹¹

These areas have also been, and remain, important for Australia, but with a different emphasis. Size and the history of developing research infrastructure and expertise matter. Australia's fundamental determinants (resource endowments, relative isolation and small, sparsely-settled population) make it difficult for this country to participate extensively in the mainstream of developing new production knowledge (except in niche areas).¹² For relatively small and isolated countries like Australia, it is more a matter of applying knowledge developed elsewhere.¹³ Mechanisms for transfer of knowledge between countries, such as open trade and investment, matter in this context.

10 The OECD Growth Project provided one of the most comprehensive and large-scale empirical investigations of factors affecting productivity in advanced economies. It identified the factors highlighted in this section as having important effects on productivity.

11 The focus on science and technology also brought an emphasis on the mechanisms that would encourage productive application of new knowledge, such as patenting systems to protect intellectual property.

12 Australian businesses spent collectively \$16.7 billion on R&D in 2009-10 (ABS Cat. No. 8104.0). The world's top 10 corporate R&D spenders each spent over US\$6 billion in 2008 (www.ieee.org).

13 The Cutler Review of the National Innovation System (Cutler, 2008) noted that 98 per cent of new technologies are sourced from outside of Australia.

Public provision of infrastructure is often seen as a priority for long term improvements in productivity. As noted, it reduces costs for private producers, but also allows more efficient economic activity, such as the organisation of businesses around transport corridors or improved customer links or input sourcing through communications infrastructure.

Priorities have broadened with the advent of innovative uses of ICTs and globalisation. That is not to say that the traditional priorities, based on science and technology, have disappeared. It is more that other considerations have now also gained importance.

The crucial importance of the business environment has been highlighted in the modern era of productivity growth. As a major example, not all countries could access productivity gains based on the use of ICTs, even though the technologies themselves were universally available. (Australia was one of the few countries shown to have accessed productivity gains from the mid-1990s through innovations based on the use of ICTs.) It was not sufficient to simply invest in ICTs. Further productivity drivers and enablers were required. Empirical studies found differences across countries in the ability to access these new productivity opportunities to be associated with product and labour market regulation.¹⁴ Product market regulation was found to inhibit the competitive incentive on firms to undergo the transformations necessary to access the new productivity gains. Labour market regulation was found to inhibit the ability and flexibility of firms to implement fundamental changes to the way their businesses are organised.

The disruptive effect of ICTs and globalisation have helped to stimulate interest in organisational innovation and investment in intangibles, such as marketing, brands and organisational capital—know-how about the business and the ability to anticipate and adapt to change. Empirical analysis has found investment in intangibles to be an important conduit to productivity growth in modern times.¹⁵

Productivity growth also rests on the general economic conditions being conducive to growth. Low inflation and well-developed financial markets to allocate capital efficiently facilitate long-term productive investment.

14 See, for example, Nicoletti and Scarpetta (2003) or Tressel (2008).

15 See Carrado, Hulten and Sichel (2005) and Barnes and McClure (2009).

3 Raising Australia's Productivity Performance: the Context *(continued)*

4 TRENDS IN AUSTRALIA'S PRODUCTIVITY PERFORMANCE

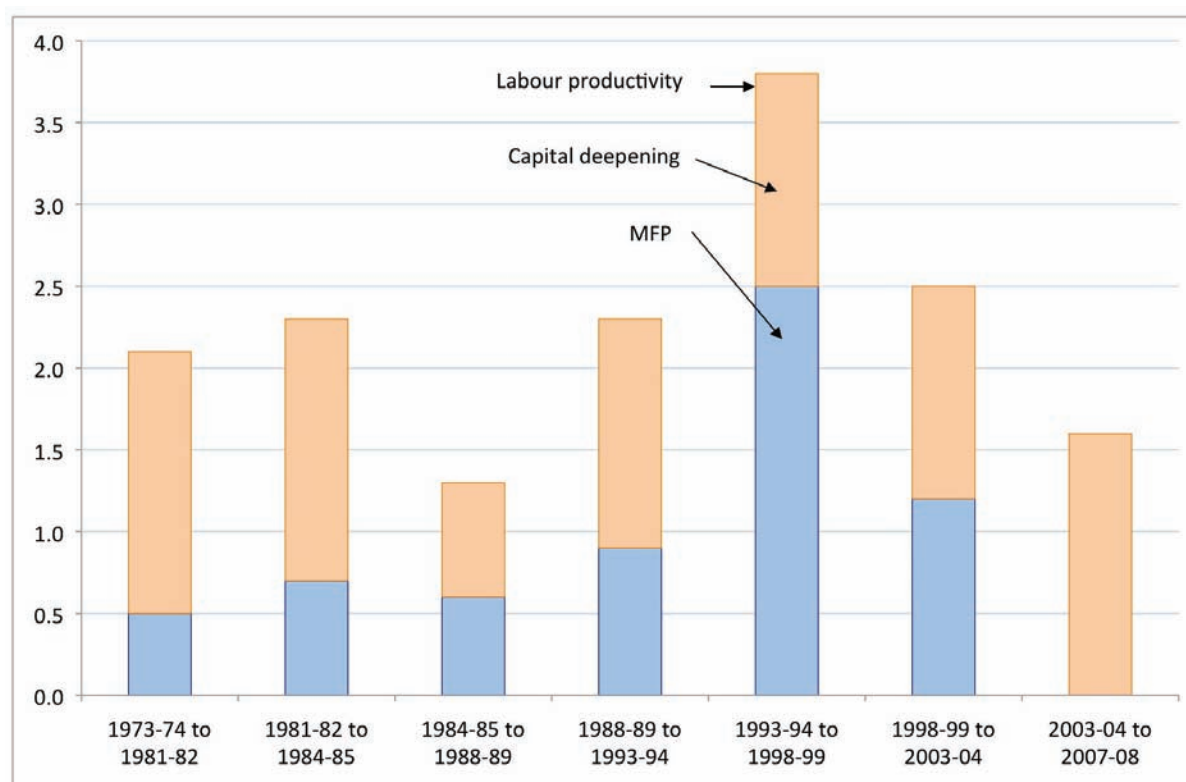
Australia's productivity growth slumped from a record high in the 1990s to a record low in the 2000s. What factors caused these trends? What lessons can be taken forward on what needs to be done and what needs to be in place to invigorate and sustain Australia's productivity performance?

4.1 The trends

Figure 4 presents ABS data on underlying rates of productivity growth since the 1970s. These measures 'look through' the effects of short-term volatility and the effects of the business cycle on estimated growth rates.¹⁶ They show average annual rates of growth over productivity cycles. The height of the bars represents labour productivity growth, which is then split into two components—MFP growth and capital deepening. (Capital deepening is growth in capital intensity and largely reflects changes in the capital-to-labour ratio).

Figure 4 Australia's productivity growth since the 1970s^a

percent per year



^a 12-industry market sector. The periods correspond to intervals between peaks in productivity cycles as determined by the ABS.

Source: ABS Cat No. 5260.0.55.002 (2010-11 issue, released 7 December 2011)

The figure shows the stark contrast in Australia's productivity performance between the 1990s and 2000s. Productivity growth was at a record high over the 1993-94 to 1998-99 cycle. Labour productivity grew at 3.8 per cent a year (compared with a long-term average of 2.2 per cent a year) and MFP grew at 2.5 per cent a year (compared with a long-term average of 0.8 per cent a year). Both labour productivity and MFP returned to more 'normal' rates of growth (2.5 and 1.2 per cent a year respectively) over the next cycle, between 1998-99 and 2003-04. But productivity growth fell to a record low in the 2000s. Over the 2003-04 to 2007-08 cycle, labour productivity grew at a modest 1.6 per cent a year and there was no MFP growth.

16 The ABS identifies peaks in productivity cycles and measures productivity growth from peak to peak in successive cycles. The periods identified in Figure 4 are these peak-to-peak cycles.

4.2 The 1990s productivity surge

It is widely held that a series of microeconomic and macroeconomic reforms through the 1980s and 1990s drove and enabled the productivity surge observed in the 1990s. Those reforms included the freeing up of capital and labour markets, reductions in selective industry assistance, streamlining and removal of unnecessary regulations, commercialisation and privatisation of government enterprises, pro-competitive regulation of natural monopolies, and improvements in the conduct and settings of macro policies to bring more stability in prices and output growth.

With the incremental introduction of these reforms, Australia's productivity growth accelerated in the 1990s as labour and capital were re-allocated to where they were more productive and businesses were driven and were able to take advantage of innovations based on the use of ICTs. Parham¹⁷ reviewed available empirical studies, from which he found that investment in physical and human capital had long-term significance to Australia's productivity growth, while increased R&D spending, increased openness to trade and foreign investment (as sources of knowledge spillovers) and investment in ICTs had more specific relevance to the 1990s productivity surge. Analysis of innovations associated with ICT in Australia has also pointed to the importance of competition, skills, flexibility and business investments in organisational capital as foundations for productivity gains.¹⁸ Tressel¹⁹ found that reforms of both the labour and product markets since the early 1990s could explain Australia's productivity performance and adoption of ICTs.

4.3 The 2000s productivity slump

Given the prominence of productivity growth and its payoffs in terms of improvements in prosperity, it is of no surprise that the 2000s productivity slump has been viewed with considerable concern. What happened in the 2000s? Were there slowdowns or reversals in factors that were responsible for the high gains in the 1990s? Or were there new developments that held back productivity growth?

Diagnoses

Garnaut²⁰ considered that a reform complacency had adversely affected Australia's productivity performance. He drew attention to the lack of meaningful reforms introduced since the GST in 2000. He opined that there had been changes, rather than genuine reforms.

One prominent view, put forward by the Productivity Commission,²¹ is that new developments had a major negative effect on Australia's productivity growth:

- the mining boom: higher commodity prices made it worthwhile to use more inputs to extract resources from lower-quality (depleted or less-accessible) deposits and hefty new investment in mines showed up in capital inputs before output came on stream;
- drought: periods of drought reduced output and productivity in the agriculture sector; and
- changes in the utilities sector (electricity, gas, water and waste services): increased peak energy demands and measures to ensure energy and water security increased capital requirements without much increase in output.

The Productivity Commission²² attributed 70 to 80 per cent of the decline in Australia's MFP growth over the last two productivity cycles to these three industries.²³

17 Parham (2004).

18 Productivity Commission (2004).

19 Tressel (2008).

20 Garnaut (2005).

21 Productivity Commission (2009b); Productivity Commission (2010).

22 Productivity Commission (2010).

23 This was the proportion of the net decline in aggregate MFP growth. There were more negatives (and Manufacturing was a big one) that were offset, to some degree, by industry contributions that were positive (that is, acted to increase aggregate MFP growth).

3 Raising Australia's Productivity Performance: the Context *(continued)*

Dolman²⁴ looked more comprehensively at the reasons for the productivity slump. He endorsed the Productivity Commission's view about the role of special factors in mining and the drought. Also on the 'new developments' side, he considered that higher profits in the 2000s may have slowed productivity momentum by allowing less-efficient firms to stay in operation for longer and by reducing the imperatives on other firms to reduce costs.

And he observed that productivity growth had slowed in many countries, perhaps indicating a slower growth in productivity opportunities. On the 'slowdown or reversals' side, he noted a slower pace of industry-specific reforms in communications, in finance and insurance and in utilities (electricity, gas and water). However, he judged that productivity gains from trimming workforces and improving utilisation of capacity had run their course in these industries. On the other hand, he pointed out that some important factors in long-term productivity growth and in the 1990s surge had not diminished. He marshalled evidence that contributions from investments in ICTs, education and skills, R&D activity and economic infrastructure had not diminished in the 2000s.²⁵ While he acknowledged some slowdown factors, the balance in Dolman's review weighs on the 'new developments' side.

Saul Eslake²⁶ highlighted the 'slowdowns and reversals' side. He contended that the productivity slowdown cannot be attributed largely to lower productivity in mining and the utilities and is more likely due to: the fading of the effects of previous reforms and to a slowdown in implementation of new productivity-enhancing reforms; increased regulation; reform fatigue; the effect of capacity constraints; and lagging uptake of technology (ICTs).

Some have pointed specifically to changes in the industrial relations framework as having adverse effects on productivity. This issue is taken up elsewhere as the central focus of the current study.

Assessment

The slowdown in Australia's rate of productivity growth has been underway since the late 1990s.

Taking Dolman's position on some of the gains running their course and that perhaps there was an easing in opportunities for growth, the 2.5 per cent a year rate of MFP in the mid-1990s cycle was unsustainably high. This means it should not be taken as a benchmark for comparison of rates of productivity growth in following periods.

The rate of productivity growth halved over the next productivity cycle. In addition to the elements Dolman highlighted, some 'new developments' started to kick in around the turn of the millennium. Productivity began to turn negative in the utilities and in mining.²⁷

While 'slowdowns and reversals' could account for some further reduction in productivity growth, it is hard to see how they could take productivity growth below the long-term average. Even then, productivity growth would only fall back fully to a pre-reform rate if there were no ongoing dynamic productivity gains from reforms, such as might come from ICT-based innovation. This seems unlikely. Moreover, it is significant that generally-available factors that helped raise productivity in the 1990s—R&D spending, education and skills, economic infrastructure and ICT investment—held up in the 2000s.

For productivity growth to fall below the long-term average, as it did, there must have been something else going on. In fact there must have been something extremely unusual and 'out of the box' to have driven productivity growth to zero. That zero rate is an underlying rate over a productivity cycle and not a short-term blip. It is very unusual to have no productivity growth in an advanced economy such as Australia's. Moreover, such a low rate could not persist indefinitely.

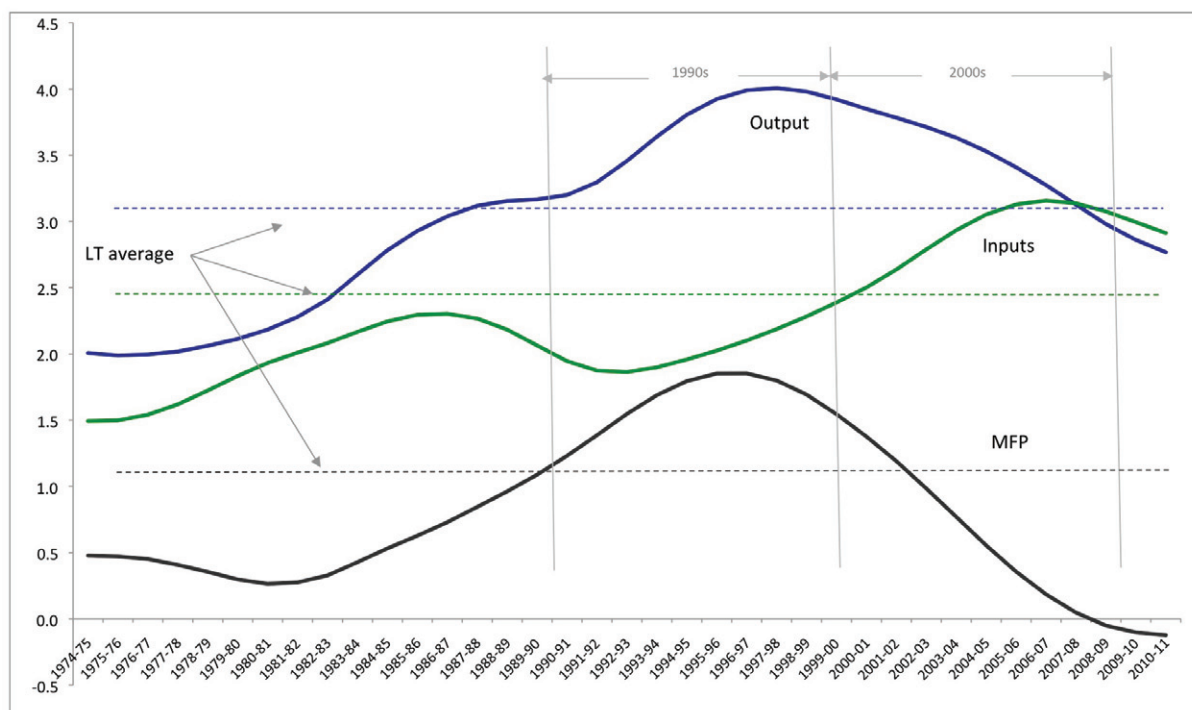
24 Dolman (2009).

25 He did note that congestion at bulk commodity ports was, however, a constraining factor.

26 Eslake and Walsh (2011); Eslake (2011).

27 Electricity, Gas, Water and Waste Services (EGWWS).

Figure 5: Annual growth in Australia's MFP growth, input growth and output growth^a



^a 12-industry market sector. Original data have been smoothed. Source: Parham (forthcoming)

Figure 5 illustrates that something different was indeed going on. It represents the year-by-year growth rates in MFP in a way that also 'looks through' the short-term volatility and cyclical ups and downs of productivity growth. The figure allows MFP growth to be viewed as the difference between output growth and input growth. MFP growth was high in the 1990s when there was a large gap between accelerating output growth and more-stable input growth. MFP growth slowed in the 2000s as output growth slowed, whereas input use accelerated very strongly.

These facts point to some key differences between the 1990s and the 2000s. MFP growth was a source of growth in output and income in the 1990s. But, in the 2000s, there was a strong push to accumulate more inputs, while there was little or no productivity growth to provide income to help fund that accumulation. Rather, massive investments, particularly in mining, have been driven by higher profit expectations as a result of higher commodity prices. There have also been new investments in the utilities, driven by changes in preferences and regulations, but also supported by relative price rises.

It does not make sense that producers would invest so much more and employ so many more, if the only thing that had happened was that productivity growth had declined as result of slowdowns and reversals on reforms.

A large part of the productivity growth decline is a reflection of adjustments to changes in relative prices—an economy in transition, responding to a terms of trade shock and other structural pressures. Mining and utilities have undertaken investments in capacity that have not yet been matched by output growth (and may never be matched by measured output growth²⁸). They have brought average productivity growth down as a result.

28 Mining output is measured by recovered ore, whereas capacity may also be determined by the need to remove additional overburden or impurities. Additional capacity is needed in power generation to meet occasional peak demands. But output is measured by the amount of power generated and transmitted.

3 Raising Australia's Productivity Performance: the Context *(continued)*

Mining, utilities and agriculture (drought affected) together accounted for a total of 0.8 of a percentage point of the decline in productivity growth between the last two productivity cycles.²⁹ That is about 70 per cent of the 1.2 percentage points net decline in aggregate productivity growth. It is about 45 per cent the total of all negative contributions (the gross decline) of 1.8 percentage points.

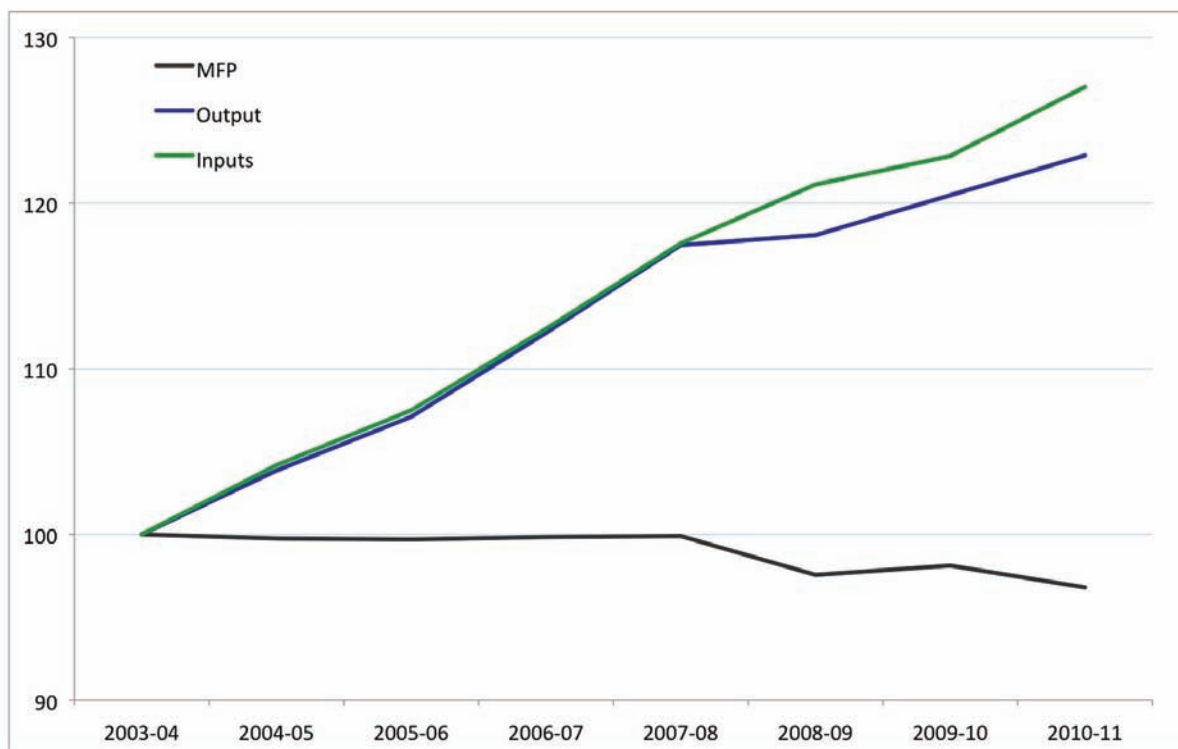
It is true, as Eslake pointed out, that the sources of the productivity slump lie beyond these three industries. In particular, the manufacturing sector made the largest negative contribution of any industry of 0.5 of a percentage point.³⁰ The reasons for this decline, however, are not yet understood. There could be some 'new developments' in the form of pressures exerted on the sector by the mining boom (not least being the higher exchange rate). But there could also be some elements of 'slowdowns and reversals'.

The assessment to this point has relied heavily on trends over completed productivity cycles. It is important to look at what has happened since 2007-08, especially as this covers the period since the introduction of the Fair Work Act. On the other hand, distilling trends from incomplete cycles and recent years' data that are often revised can be hazardous.

The data from 2003-04 are presented in Figure 6. This shows a fall in MFP for the four years after 2007-08. The fall appears to be an extension of the earlier trends in which strong input growth dominates, with some slowing in the rate of output growth. This period does include the fallout from the GFC around 2008-09, during which there was some fall in output growth, but also a cutback in hours worked. Agriculture has recovered from drought, but productivity declines in mining, utilities and manufacturing have continued.

Figure 6: Movements in MFP, output and inputs since 2003-04

indexes, 2003-04 = 100



Data source: ABS Cat No. 5260.0.55.002 (2010-11 issue, released 7 December 2011)

29 Parham (forthcoming).

30 Parham (forthcoming).

To sum up, Australia has experienced some very major disruptions to productivity trends in both positive and negative directions over the past two decades. The exceptional performance in the 1990s may have stretched expectations of what is subsequently achievable. The record-high rate of productivity growth was unsustainable. On the other hand, the massive structural adjustments in the 2000s have obscured Australia's 'true' underlying rate of productivity growth and make it difficult to determine whether and to what extent policy factors have contributed to the slump.

It is most likely that 'new developments' explain the majority of the slowdown in productivity growth. They may even account for the vast majority, as there are a number of possible knock-on effects of the mining boom to other industries. Nevertheless, it is also likely that 'slowdowns and reversals' have accounted for some of the slump. Even if they accounted for a few tenths of a percentage point, this would be viewed in normal times as an important loss of productivity growth (and growth in the prosperity of Australians).

The Productivity Commission noted that the mining boom, while reducing productivity growth, has not had a negative impact on prosperity. It has also lifted the terms of trade (the ratio of export prices to import prices), which lifts prosperity by raising the purchasing power of Australian incomes. Australians are able to purchase cheaper imported goods, such as cars and electronic goods. To that extent, the circumstances are special and the productivity slump does not represent a crisis in terms of the prosperity of Australians. However, with warnings that the terms of trade are not likely to continue to fuel further increases in prosperity, the focus comes back onto productivity growth as the most important long-term source of prosperity.

The lessons to be taken forward are:

- policy reforms of the type introduced through the 1980s and 1990s bring productivity-enhancing gains, although they may not bring as large dividends now, as they did in the past;
- the full extent of the productivity slump does not represent a crisis in terms of improvements in Australians' prosperity;
 - to a large extent, the slump represents an economy in transition and, to that extent, productivity growth can be expected to recover as a matter of course;
- changes in the policy and institutional framework can and have contributed to slower productivity growth, albeit on a smaller scale;
 - examples can be found in the utilities area, where mandated changes in technology and standards have reduced productivity (but the benefits side also needs to be considered); and
- it is important that if governments are to intervene, they intervene in the most 'productivity-friendly' way possible.

5 SIGNPOSTS TO BETTER PRODUCTIVITY

Irrespective of the causes of the productivity slump and whether or not they impact on prosperity, the key question to be asked is, 'Can Australia do better on productivity than it currently is?' The widespread view is that it can.

As has been stated, there is no single pathway or 'silver bullet' measure to raise productivity performance. For example, there will continue to be a blend of the traditional technical knowledge pathway and the modern organisational change pathway to productivity growth. Australia has shown the ability to take both pathways—the traditional pathway through application of technical knowledge and development of new knowledge in niche areas and the modern pathway through the successful application of ICT and innovations based on its use.

3 Raising Australia's Productivity Performance: the Context *(continued)*

5.1 Broad directions

The Productivity Commission³¹ suggested a good framework for developing and reviewing policies to improve Australia's productivity performance. It has wide application, for example, to traditional and modern pathways. The framework has three planks that should be touchstones for policy and institutional settings to foster productivity growth.

- Incentives—external pressures and disciplines on firms to improve their performance;
 - competition is the key driver of improved performance;
 - unnecessary regulatory restrictions and burdens provide disincentives to be productive;
 - appropriate direct incentives for firms to undertake R&D help the development and application of technical knowledge;
 - the tax regime provides incentives for productive investment and work and entrepreneurial effort.
- Flexibility—the agility of firms to make changes to respond to market developments;
 - flexibility to alter work arrangements and workforce requirements is essential;
 - regulations can also unnecessarily inhibit firms' ability to adapt.
- Capabilities—the support platforms for innovation;
 - human attributes, education, skills and training are needed to support innovation and to manage adaptation;
 - stable conditions for making long-term investments need to be in place;
 - a well-functioning national innovation system, which builds on links between business innovation programs universities and TAFEs, assists the development and application of knowledge;
 - there needs to be appropriate (and efficient provision of) infrastructure capital; and
 - there needs to be efficient delivery of government services.

Aside from the specifics, it is absolutely essential to work on all three planks. They need to be integrated, if productivity is to be improved. It is not sufficient to have the capabilities to be more productive if the driving incentives to be productive are not sharp enough. It restricts improvement in firms that have the incentives and capabilities to be more productive, if they do not have the flexibility to adapt and implement needed change. And there is little point in being flexible if businesses do not have driving incentives or the capabilities to be more productive.

5.2 Specific routes

While there may be some uncertainty or differences of view about the diagnosis of Australia's productivity slump, there is little disagreement about the need for, and directions of, productivity-enhancing reforms. After all, if there are worthwhile productivity gains to be had, they are worth having, irrespective of where the starting point may be or why it is the starting point.

Just two of the many calls for further reforms are mentioned here.

In a 'recap' of productivity-enhancing reform priorities, Gary Banks, Chairman of the Productivity Commission, stressed the importance of reducing costs and maintaining flexibility in current economic conditions.³² While he drew attention to the importance of the human capital and infrastructure streams of the ongoing COAG Reform Agenda, he also noted the need for fiscal discipline in government procurement and infrastructure projects and to ensure efficient delivery in health services. He emphasised the need to reduce regulatory burdens and restrictions on flexibility, particularly in the markets for labour and capital. He considered the industrial relations framework to arguably be the most important to get right. He also called for carbon-abatement measures to be streamlined along the lines of using the most-efficient means.

Eslake³³ endorsed Banks' views and added specific areas of regulation for investigation. He reiterated the importance of taxation reform, following the Henry review of Australia's future tax system, and called for a reconsideration of factors in the business environment that could support greater innovation by Australian firms.

Key factors to raise business productivity in the 21st century

A prominent focus of this study is on the productivity performance of a wide range of businesses and the attributes that help or hinder them in their efforts to be more productive. The specific focus on the effects of the Fair Work Act must be seen in the context of a number of key factors that are central to businesses thriving and improving in the 21st century.

Increasingly, business improvement comes about through constant analysis of market opportunities and working with where key competencies lie to capture value. Supply chains, organisational structures and production processes can then be adapted to not only capture value but also meet market demands in efficient, competitive ways.

Key attributes are:

- focusing on the market and working backwards, rather than focusing on the product and going on to think about markets;
- continuous search for ideas, opportunities and improvement;
- looking to capture value along the supply chain;
 - high-value components can include design, customisation of products to specific customer's needs, or bundling service elements (such as maintenance) in with products;
- being creative and applying new ideas to generate more income and not just looking to cut costs;
- defining areas of competence and looking for new ways to apply competencies that capture value;
- flexibility and agility to introduce new business models, organisational structures, supplier arrangements, technologies and work arrangements;
 - more emphasis on experimentation, anticipation of change and adaptation to it;
- the ability to analyse markets, problem solve, manage people and change;
 - managing relationships is fundamental to doing business;
 - management needs to deal with complexities and ambiguities and needs to be responsive to change.

³² Banks (2010).

³³ Eslake (2011).



4 Investigations of Productivity and Fair Work

4 Investigations of Productivity and Fair Work

The last chapter presented research findings from the first stage of this project on the essential determinants and attributes of productivity growth. This chapter reports on the second stage of this project, namely investigations into how the features of the Fair Work system interact with these essential determinants and attributes of productivity growth.

The investigations of the features of the Fair Work system and how they influence any of the drivers of productivity were designed to focus on the decision-making perspective of business enterprises.

A program of interviews primarily with business decision makers was undertaken, substantiated by relevant desk-based research, which explored:

- the realities of how businesses make decisions about the use of labour in achieving the productive outcomes of the firm; and
- how businesses directly experience and interact with Fair Work as the current regulatory system for workplace relations.

This enterprise-level focus of the second stage of the project's investigations directly addresses the issues raised in the first stage of the project. The first stage research addressed the crucial factors contributing to productivity growth and in particular, the key attributes of firms striving for improved productivity performance. This set the context for investigating how business decision makers were engaging with these productivity determinants and the operations of the Fair Work system in reality.

The specific significant messages on the essential features of productivity growth that shaped the interviews in the second stage of the project are as follows:

- productivity growth results from a combination of more opportunities to improve productivity and the ability of individual businesses to pursue those opportunities to lift their competitive performance;
- sustained competitive performance of individual businesses results not just from cost minimisation, but from transforming business methods and capabilities for better meeting customer and market needs and earning and capturing profits that fund further investment and growth; and
- while the decisions and actions of firms in their competitiveness search are the immediate determinants of productivity, underlying determinants like regulation and government policy have powerful effects, whether as constraints or enablers.

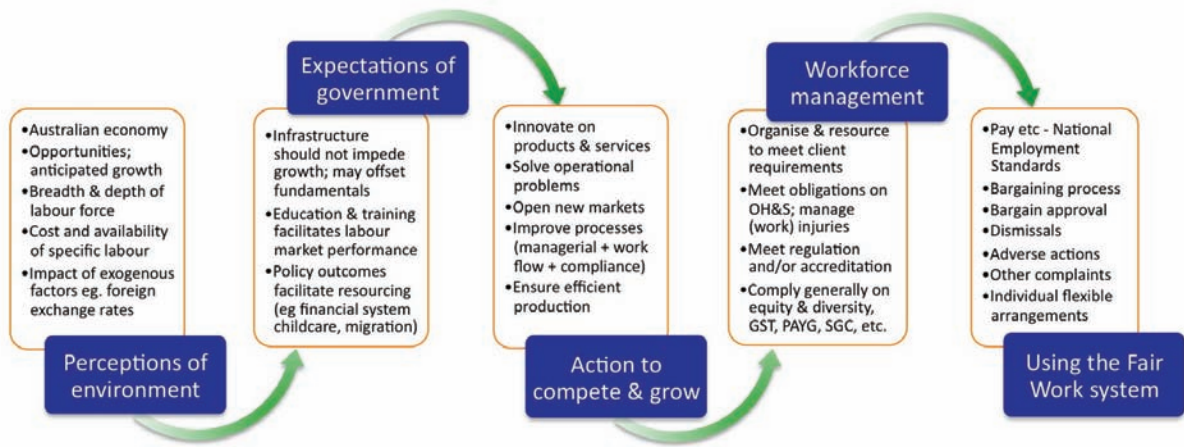
In short, how enterprises apply their skills and competencies to the intensive search and execution of competitive business opportunities increasingly determines Australia's productivity outcomes.

These were the issues tested in the business interviews about Fair Work and productivity, especially decisions about the use of labour. In general terms, propositions (developed from desk research) were put to interviewees, and then probed in discussion. This allowed the team to assess the extent to which the person could support that proposition on the basis of their experience, taking note of examples used to draw distinctions between the Fair Work system and the workplace regulation approaches that preceded it.

The findings and observations from the interviews were ordered by the ThinkEvans research team against five important and interrelated elements that affect decision-making about what and how an enterprise does business and in particular, how it selects, organises and manages its workforce. This is illustrated in Figure 7. The central element is action by the firm to compete and grow. This is influenced by both perceptions of business conditions and expectations of government. It then results in workforce management decisions and, in particular, the firm's experience of the Fair Work system.

Findings of the interviews and related observations from desk-based research affecting Fair Work and productivity are presented against the key elements of business decision making illustrated in Figure 7.

Figure 7: Making decisions about labour in firms

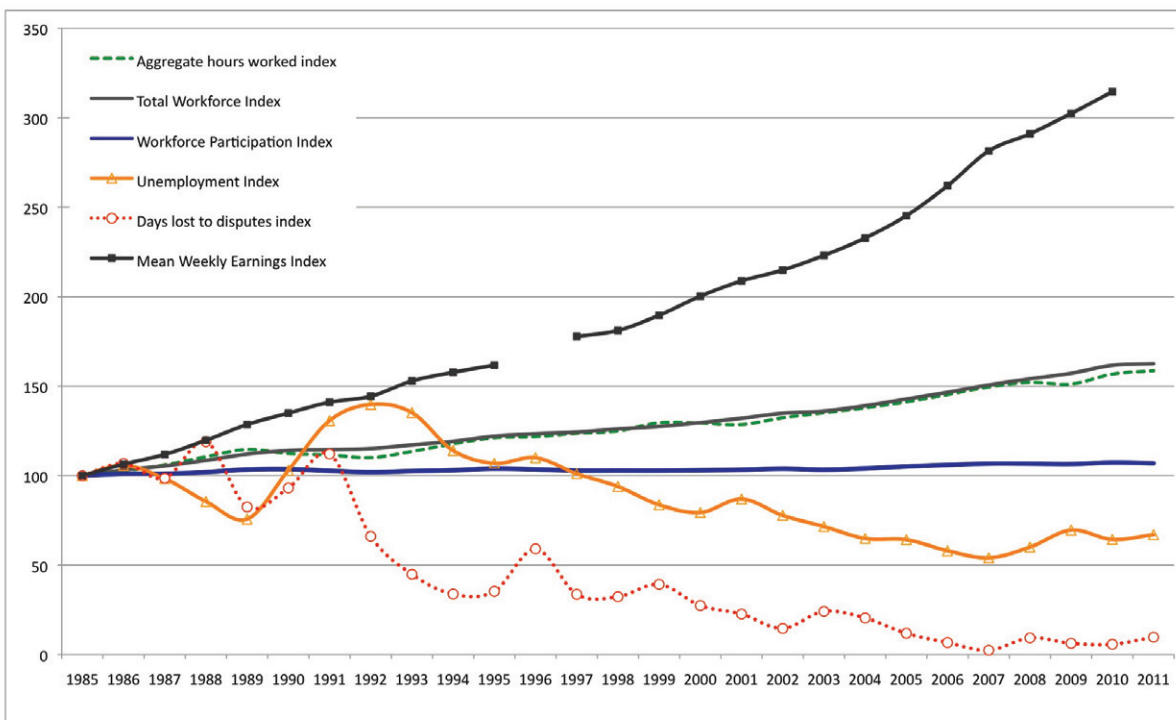


BUSINESS CONDITIONS AND EXPECTATIONS

Opportunities for a business to compete and grow arise in the context of the prevailing business environment, such as the state of the global and/or national economy. Perceiving and interpreting those opportunities occurs against the backdrop of expectations that firms have of government to set and implement relevant policy, including in relation to the underlying determinants of productivity discussed in Chapter 3: economic infrastructure, technical knowledge and the nation’s innovation system, social infrastructure such as the health and education systems, and so on.

Decisions in businesses about *how* to compete and grow are bounded by the ability of the firm to execute those decisions. This includes the limits created by market conditions impacting the supply of, or demand for, relevant commodities or products. In particular, the availability of sufficient suitably qualified labour is a crucial boundary to the ability of a firm to carry out decisions.

Figure 8: Indicators about conditions for business^a



^a Data extracted from ABS (2010a), ABS (2010c), ABS (2011a) ABS (2011b), ABS (2011c). Using the ABS data, all series were re-indexed to begin in 1985 to facilitate comparability. Mean weekly earnings - please note that ABS did not run the relevant survey in 1996.

4 Investigations of Productivity and Fair Work *(continued)*

Figure 8 shows selected indicators of the prevailing economic environment. Businesses need to interpret these economic conditions in order to make decisions. The following presents a “business-eye view” of the implications of these indicators:

- **Near full employment makes labour the scarce resource:** Persistently high levels of employment have contributed to the prosperity of Australia. However, this being the case across the economy makes labour the scarce resource, and may leave businesses to solve a long term problem (scarcity) with a short term solution (such as paying “over the odds”, or hiring temporary migrants from overseas). This may have negative impacts on the firm’s productivity performance in the immediate term (for example, higher labour costs and/or under-performing employees). Alternatively, immediate opportunities are foregone and a solution unfolds in the medium term, such as through increased use of technology and/or offshoring. Depending on the level of investment required, this may also have a productivity impact.
- **Low aggregate unemployment shifts the balance in bargaining power:** Viewed from inside a business, the impact of very low unemployment across the economy militates against viewing people as interchangeable, motivating businesses to ensure very careful engagement with, and shaping of, a highly effective workforce to ensure business outcomes are achieved. However, this may have mixed results for productivity performance of the firm depending on the cost of labour as an input.
- **Rare industrial disputes are a return on time invested in workplace relations:** Australia has seen a long term steady decline in production days lost to industrial disputes.³⁴ This is the product of more harmonious workplace relations achieved by developing goodwill and sound practice between all parties. However, this shapes business expectations about the future environment for decision making - meaning a high profile dispute may have a disproportionate impact on business confidence.
- **Skills levels help but don’t fully compensate for scarcity:** The ambient level of skill is rising across the economy, and in most sectors. Importantly, this includes ambient skill levels for women which have often lagged in other OECD countries. This provides greater access to work by individuals and greater choice for employers. However, it is clear that labour is still short in many areas, shown in near full employment generally and unmet demand for certain skills sets particularly (eg. registered nurses, various engineering disciplines and metal trades). Employers will continue to take labour wherever it can be found and to seek workplace innovation to overcome shortages. This includes part time and casual roles to engage with those not wishing to work full time, but also the use of migrant labour and greater reliance on technology where feasible.
- **Rising wages demand best application of labour:** The Australian labour force has benefited from a long term and continuing rise in earnings, which underpins economic prosperity. Beyond the necessity of making best use of scarce labour resources, firms cannot make use of any group (eg. those choosing other than full time work) for which workplace regulation creates a barrier; as well, those individuals are cut off from the benefits of economic prosperity that are shared through wages.
- **Hours worked show the benefits of real flexibility:** The aggregate of hours worked across the Australian economy has risen, but only in line with the growth of the aggregate workforce. Mild improvement in participation by the OECD’s “at risk” groups (such as the long term unemployed) assists in spreading the load. Although some underemployment also occurs, within the confines of a single firm adjusting the hours but keeping the worker is an effective response to immediate term negative movements in client demand. The harsher alternative of terminating the worker also means carrying the productivity hit of recruitment, induction, training, inculturation, and so on in order to put labour back on in an upturn. From a business perspective, this shows the benefits of efforts by the firm to fit job shape (in terms of full time, part time or casual, but also day of the week and day/night work) to the work and the preferences of individuals, and underscores the importance that this continue to be facilitated in the future.

Overall, the “business-eye-view” of these trends is that there is now more work, more jobs and more harmonious workplace relations. It also means for businesses that good help is even harder to find at present, and probably costs more every year. The higher the skill level, the more that is true. These trends have persisted for the bulk of the time covered by the last several changes of government and of workplace relations arrangements. Taken together, these business realities put the boundaries around action that the firm can take to compete and grow.

ACTION TO COMPETE AND GROW

The sentiment most consistently evident in interviews about business actions to compete and grow is that the search for a competitive edge is ongoing and relentless. In this sense, business innovation and change in products, markets and customer service are not separated from decisions about improving capabilities, processes and work flows or solving operational problems. Thus the capacity for innovation in a firm is both critical to improved productivity and directly linked to the organisational and managerial capacity to implement change. This capacity is finite.

In a substantial quantitative analysis of small firms, Gronum and Verreyne studied the scope and performance limits of innovation, finding that:

[The] innovation-performance relationship is a mutually beneficial, reciprocal relationship.

This means that innovation is not only positively associated with future performance, but also that small firms exhibiting higher levels of performance tend to innovate more.

Innovation breadth, as used here, is an indicator that a small firm innovates across a broad range of areas, such as product/service, operational and managerial processes. Innovation breadth exhibits characteristics of diminishing returns; implying that small firms should carefully consider on how many fronts they want to innovate to optimise performance benefits.³⁵

Elsewhere termed “decision fatigue”,³⁶ a similar pattern surrounds the need for managers to deal routinely with a significant volume of decisions spread across a spectrum of subject matter. Not unexpectedly, the sheer volume matters to the quality of decisions. However, it also impacts the generic nature of the direction set by those decisions. In a scientific study of decisions by judges, researchers found that repeated decision making caused a preference for the status quo to emerge.³⁷ Assuming that managers would do no better, “decision fatigue” is likely to prompt more conservative management decision making that would run counter to innovation.

There is a limit to the innovation and change that an organisation or team can digest. Overloaded, the tendency may well be to seek organisational stability through preservation of the status quo. Even if this works in the short term, it is a strategy fraught with competitive peril over the medium and longer term as the business fails to keep pace with changes in the market place.

This tendency is likely to be exacerbated to the detriment of productivity if legislation and regulation intrudes into or makes decisions about business operations and changes more complex or uncertain. By allowing, or preventing, some of the options that a firm has for solving the business issues that arise, government policy enables or precludes some options for action to compete and grow.

Interviewees were of the view that the Fair Work system of regulating workplace relations puts an implementation and compliance overhead on businesses that resulted in a great deal of cost for little gain. Even if they conceded the good intentions of the regulation, businesses in this study experienced it as cumbersome at least, and in some parts quite “heavy handed” indeed. Interviewees did not see the Fair Work system as even coming close to providing a return on the investment employers must make on compliance, nor recognising past positive investments made in employee engagement and positive workplace practices. The effort expended on compliance with the Fair Work system was seen as an unfortunate diversion of significant productive effort away from other business initiatives and workplace changes that would have better served business and productivity improvement.

35 Gronum and Verreyne (2011).

36 By ThinkEvans in a variety of client reports from engagements over nearly 10 years.

37 Danziger et al (2011).

4 Investigations of Productivity and Fair Work *(continued)*

This effect goes well beyond workplace relations, as the Productivity Commission notes:

There is a range of other regulations that can reduce an organisation's adaptability or responsiveness, and burden it with unnecessary costs. Compulsory standards, complex requirements, or marked differences across jurisdictions can all limit, or raise the cost of, organisational change needed for successful innovation.³⁸

One conclusion from this study of productivity and Fair Work is that the operation of ill-designed or poorly-executed workplace regulation impacts the capacity of organisations to successfully implement change and so limits their decisions on how best to innovate, compete and grow.

MANAGING A WORKFORCE

Labour is not a commodity

Beyond the overarching actions businesses take to compete and grow, how enterprises perform in deploying and managing their workforce is central to productivity growth. The research team would suggest that Gittins is quite correct in his summary of the essential problem:

... unlike all the other "factors of production", labour isn't inanimate. Every unit of the stuff comes with a human attached. This means labour can give you trouble that other raw materials can't. The worse you treat it, the more it looks for ways to get back at you. The worse you treat it, the more you have to spend supervising it to prevent shirking. ... You can treat it inconsiderately only when it's in plentiful supply. If it's in short supply, it will up and leave. Smart employers ... understand this, dumb ones don't.³⁹

That challenge is not small. Every person brings to the team a different cocktail of contributions, even when their specific professional knowledge or technical skills might be relatively interchangeable. For example, it is normal and reasonable to accept that two otherwise equally technically qualified and similarly experienced aircraft mechanical engineers could bring a different breadth and depth of interpersonal skills, administrative skills, technical problem solving, or experiences such as exposure to quality systems and lean engineering. Accordingly, a manager's skill lies in composing the team to begin with, to best serve the interests of all concerned, and then, as the team operates, balancing that diversity within the team to deliver the overall outcomes needed.

In addition, balancing the team for best effect is itself a composite of interactions with the larger environment of which the business is a part. These include:

- Assessing the mix of individuals going into the labour market: How freely available in the labor market are people with the right qualifications and other mix of attributes to fit on the team? Are there ongoing shortages? How can short, medium and long term shortages be overcome by the immediate decisions of the firm?
- Interacting with the labour market to hire: including all the steps required to bring a person on to the team with due regard to compliance with the legislative and regulatory framework, as well as the firm's internal sense of culture and business ethics.

The point is that labour cannot be treated as just another commodity if the business is to achieve its targets and competitive strategies.

Flexibility in workplaces

The daily practicalities in managing a workforce may be at odds with the Fair Work system. A case in point is the extent of flexibility available for solving the issues that arise in deploying a workforce to best effect. Information gathered in the interviewing process showed that there were pervasive issues to do with both structuring workforces and engaging with individuals.

³⁸ Productivity Commission (2008), 18.

³⁹ Gittins (2011a).

Structuring a workforce

The productivity performance and competitive positioning of a firm is deeply impacted by its ability to structure the workforce to best effect. For example, occupancy of tourist accommodation can be highly variable, and challenging to meet with the necessary number of service staff having an appropriate mix of work skills.⁴⁰ When workload is variable:

- full time jobs (in sufficient numbers for higher levels of occupancy) can embed a lot of idle time (when occupancy is lower); and
- lower occupancy can be met by using fewer full time jobs, but this embeds inefficiency (by calling for too diverse a set of work skills to be acquired and maintained when practiced less frequently by an individual).

So unless occupancy is persistently high, using “full time permanent” service staff will be unacceptably costly. Moreover, particularly in smaller venues, the ongoing quantum of each type of work to be done routinely may simply be insufficient for structuring “full time permanent” roles based on skills sets that make sense, or that are even available in the local area.⁴¹

The need to manage variability in quantum and composition of work is also often found in general support functions. While the work skills required may not initially appear to be demanding to fill, similar challenges commonly arise in terms of the time commitment required and in what mix of skills.

This issue was raised by employers from various industries. The representative example was provided by an interviewee from a service business in a major metropolitan centre.

In a recent search for new staff, the employer simply needed to replace a single individual working slightly extended hours on a routine basis. That individual had a particularly diverse mix of skills that proved to be unavailable from the market place, despite extensive searching and a very competitive offering on wages and other conditions of employment. The solution was to restructure the job into three part time roles crafted to match highly skilled individuals. Each person offered some but not all of the skills required, and none wished to work full time. As a team, they now comfortably cover the necessary working hours, and additional hours can be accommodated from time to time in arrangements that offer the business and the individuals the flexibility needed.

These examples highlight that the productivity performance of the firm rests on having sufficient flexibility in structuring roles to be both effective in how they apply the skills of individuals available in that locale, and efficient in how much those individuals are called on in response to client demand. For most businesses interviewed, this involved finding a mix of full time, part time and casual roles that provided an appropriate blend of efficiency from retained skills and sound productivity from variable capacity.

In the view of those businesses interviewed, this is not facilitated under Fair Work. Instead, the push to a standard of “full time permanent” work as the norm creates a barrier to the legitimate use of part time and casual work to ensure an adequate productivity performance by firms.

40 Naturally, offsetting variability by drawing patrons from a variety of sources (including non-tourism travellers, for example) will be part of an overall business strategy. However, the opportunity to do this tends to diminish in line with distance from major population centres (which impacts the basic likelihood of demand) and with the size of the venue (which impacts the likelihood of potential buyers being aware of the venue as an option).

41 In rural and regional areas, the local area is literal - search is limited to those people physically able to be present in that location. In major metro areas, the issue is more traffic and travel times that delimit a practical area from which to draw people. In conditions of near full employment may be more limited due to the surfeit of jobs from which individuals can choose in some cases at least. These issues were raised in context by all employers and employees interviewed.

4 Investigations of Productivity and Fair Work *(continued)*

Questioning “casualisation”

A current debate is that the rise of casual work is of concern because it represents unfair working conditions that favour employers over employees. In some views, casual work is equated with insecure work lacking in basic employee rights and entitlements.

It is this view that underpins the Fair Work Act, which treats casual work as aberrant and it is a circumstance against which employees should be protected. However, the case for casualisation as a problem is not yet proven.

Firstly, the question is one of choice – is casual work a positive informed choice⁴² by employees or the only option available?

Secondly, the trend towards casualisation must be seen in context of its contribution to increased workforce participation overall.

Finally, there is evidence that the patterns of working life are changing and this heralds more diverse forms of employment in the future that are legitimate and in keeping with community expectations of fairness for employees and freedom to operate for employers.

In interviews for this project, employers reported experiences (in various industries) showing that part time and casual work - fundamental to achieving efficiency in firms - are viewed negatively, even with suspicion, in the Fair Work system. This is the case even though the concept of permanent part time is a long-standing, well-accepted and legitimate workplace arrangement. In fact, elsewhere in the world, Australia is given credit for introducing the concept of permanent part time work as an effective and fair workplace arrangement.

Engaging with individuals

Employers routinely deal with individuals who wish to have personal preferences accommodated in their working arrangements in terms of start and finish times, days on which they work, shift selection and so on. Businesses interviewed noted individuals have higher expectations that these preferences will be accommodated when staff are aware that “good help is hard to find” (ie. when labour is scarce as discussed earlier).

Employers interviewed cited an extensive array of ways in which such arrangements have been made in the past.⁴³ The strong common theme from their responses was that doing this efficiently and equitably involves having some standard ways of accommodating preferences, rather than creating a “special case” set of arrangements for each person.

A very common “standard” solution was structuring a role to be “permanent part time” work (especially involving later start times and earlier finish times to mesh with family and/or carer responsibilities). The total number of hours to be worked was structured to fit employee availability to the needs of the business.

Other common solutions were permanent night or weekend rostering - for example, to allow coordination with other family members caring for children, or to accommodate work for a second employer with whom the individual wished to engage as well.

Employers interviewed were universally of the view that the management overhead of many special cases is simply too high, making managers rather less productive than they need to be for the sound performance of the business.

42 For example, Workpro (2011), from a survey conducted in November 2011 among a sample of 2,328 contractor and temporary employees applying for work through recruitment agencies across Australia, concluded that “contingent work, such as temping and contracting, is a positive alternative to permanent work for many Australians, who are attracted by the flexibility and variety of work, understand their rights, feel well-treated and are happy doing it.”

43 Within the limits of the character of how productive work is carried out in their industry.

An individual right to request flexible working arrangements forms part of both Modern Awards and National Employment Standards introduced by Fair Work. The majority of employers interviewed reported that they had received such requests. However, they also observed that there were few of these arrangements actually in place.

The reasons given were that:

- The specific flexibility requested by the employee could already be provided within “standard” solutions. This allowed the firm to meet the request without the overhead of agreeing an individual arrangement. Individuals found this acceptable and management found it preferable (being much easier and more efficient to administer).
- In a variety of cases, agreeing the arrangements requested did not provide the certainty that the individual required. Since “individual flexibility arrangements” can be terminated (by either party) usually with only four weeks of notice, the employee would not have gained what they were actually seeking - the guarantee of long term commitment to a specific arrangement.⁴⁴ Certainty for the individual was better obtained by the standard solution of “permanent part time” employment. Again this was preferable from a management point of view, accommodating the needs of the individual with the least administrative overhead by use of a “standard” solution.
- HR executives interviewed noted a few cases where an individual had left the employer for a role elsewhere that offered arrangements more suitable for their particular circumstances. They had done this rather than request “individual flexible arrangements”. This was revealed in an exit interview. The individuals were reported to believe that their direct supervisor would be “unreceptive” to their request, even though the firm provided the option of making such requests. In every case, the individual had already found another role structured to their liking, and none involved seeking “individual flexible arrangements” with their new employer.

Employers (of all sizes) noted in interviews that the Fair Work system was capable on face value of resolving the employment issues of their business. However, they each provided examples (including those cited above) to show that their flexibility in reality was limited by arrangements that were awkward at best, or offered little or no value to previous workplace practices.

Some of these previous practices, perfectly acceptable to the employer and employees, are actively discouraged under the Fair Work regime.

Other flawed assumptions evident in the Fair Work system were raised at interview. These are summarised below.

Presumption that employer-initiated terminations are always unfair

Employers found that any termination *not* at the instigation of the employee is interpreted in the Fair Work system as unfair *per se*. In the various processes by which Fair Work Australia is intended to investigate, mediate and resolve complaints of unfair dismissal, the overwhelming experience of employers is that these processes are led by the question from the Fair Work Australia representative of “Can’t you pay something to make this go away?”

Employers had the same experience when answering employee complaints that did not result in a dismissal, and were of the view that “go away money” was consequently more common now than in earlier times.

False assumption that reinstatement is “best”

Seeing reinstatement as the ideal solution to any dismissal found to be unfair, the Fair Work approach puts to one side the question of whether this is in the best interests of the individual. Employers were of the experience that this was often not the case.

“Better off overall” test is unnecessarily rigid

For employers conducting a bargaining process, the “better off overall” test was seen as a retrograde step. Moving from a “no disadvantage” test to the “better off overall” test has shifted the basis for evaluation of bargains from “no one should lose out” to “every employee must win” based on a quantitative summation of benefits.

⁴⁴ This was most commonly the case where the individual was seeking certainty in order to commit to a second job elsewhere.

4 Investigations of Productivity and Fair Work *(continued)*

As applied in decisions by Fair Work Australia, employers observed that this standard has introduced rigidities in work practice and can significantly increase the costs of doing the same work. To the account of employers experienced in completing the bargaining process,⁴⁵ there is also real uncertainty about the result likely to be achieved in Fair Work Australia, as results are not consistent. Consequently, part time and casual work, or work undertaken outside of “standard” hours, has become more costly in the observation of employers interviewed.

Failure to recognise the needs of small businesses

These issues are highly pervasive in business because the scope of the Fair Work system embraces businesses of all sizes, including a very large number of micro and small employers (where part time and casual work is very common). Small employers were not previously subject to key elements of workplace regulation, and many reported preferring to forego opportunities for growth and fall back on the use of more hours from “owner managers” in the face of risks associated with:

- being found to be “non-compliant” in taking on part time or casual staff, and/or
- facing a complaint for not being able to accommodate “individual flexibility arrangements” if requested, and/or
- believing they had properly followed the Small Business Unfair Dismissal Code but finding that they were judged to have unfairly dismissed an employee.

Learning by making these mistakes (and recovering from the experience) is beyond the capacity of most small and many medium businesses, which lack the depth of financial resources to fund the costs involved (including penalties in some cases).

Little impact on individuals, more overhead for businesses

Taken together, these examples indicate principally that positive problem solving (regarding how work is organised and individual circumstances are accommodated) is part and parcel of the practice of most employers, regardless of the legislative scheme prevailing at the time.

The more skilled the business is at doing this, the greater their ability to retain good staff. From that perspective, employers expressed the view that this particular regime had ultimately had negligible impact on most employees. The impact on businesses, however, was considerable management overhead required for compliance with new provisions (such as the “individual flexibility arrangements” discussed above). In the words of one interviewee, “the Act seems to have been written here to help a few people who are particularly hard up, and while we do our best to help those on our team, it is a pity the Act seems to be a pretty bad fit for the general run of us.”

Reality check on Fair Work assumptions

Observations from interviews have identified instances where some key design features of the Fair Work system are contrary, or irrelevant, to established and effective business practices.

Overall, the experiences of interviewees gives sound reason to question the fundamental logic evident in the Fair Work Act, the structural concepts of modern awards specifically, and the representative norms of working Australians in particular.⁴⁶ For example, the norm for working hours anticipated by the Fair Work system appears to work 9 to 5, Monday to Friday. This appears so strongly to be the assumed norm that other working arrangements seem to be regarded as aberrant *per se*.

⁴⁵ And reported in the media, for example, Sloan (2011).

⁴⁶ In statistical terms, a “modal” group is the most frequently occurring case in the population. Simplifying system design by orienting it to the modal group may have many benefits, so long as that modal group actually represents the population. That will not be the result if that group is not representative of the whole, even if it is numerous. So if working “standard” hours of 9 to 5, Monday to Friday is the single most common case of working hours for Australians, and there is little variation from this in other arrangements, that may be a reasonable design basis. However, its worth is questionable if there is frequent, material departure from this “norm” (eg on start/finish times, or on working days) - which appears to be the case now in Australia.

The following key assumptions underpinning the Fair Work system all seem to be at odds with the reality of modern Australian workplaces:

- **All employees want “permanent” “full time” work.** Moreover, those without it are seeking it actively as a primary goal. On the contrary, contemporary employees manifestly express a much more diverse range of preferences in their choices (including how they personally choose to manage their work life balance). Perhaps more importantly, the assumed norm embodies tastes and choices that are not necessarily representative, because the diversity of millions of working Australians is much greater than anticipated in the framing of the Fair Work system.
- **“Permanent” work equates with “lifetime” work or “no risk of job loss”.** This assumes that security can only be provided by “permanent” work. This assumption is in denial of conditions in a given industry, Australia or the global economy that routinely necessitate evolution and change in business. On the contrary, businesses reasonably adjust staffing and properly retrench or make redundant employees despite their “permanent” status.
- **In a “multi-speed” economy, work opportunity is still evenly spread.** The consequence of this is that improving conditions for current employees is more valuable for economic prosperity than facilitating engagement for those seeking work. On the contrary, the OECD’s “at risk” workers (including school leavers, women re-entering the workforce and less skilled older workers in transition and needing to re-engage) are left on the periphery, because employment opportunities self-evidently occur more in “clumps” in thriving industries and sectors that may not be structurally amenable to the risks of taking on such employees. This raises barriers to entry in the labour market for such people.
- **Individuals need new legislated arrangements to achieve work life balance.** To the contrary, extensive examples showed that employees were less able to achieve work-life balance. Moreover, to the chagrin of employers facing prolonged labour shortages, the needs of employees could not be accommodated cost-effectively (by using part time or casual arrangements that would be both compliant and affordable for the business). Many other investigations of working life (by diverse authors) document that exogenous factors are by far more significant impacts on the daily lives of employees - such as the lack of availability of appropriate childcare and the desire to avoid traffic congestion, whether or not the person has a family.
- **“Individual Flexibility Arrangements” will be a net productivity gain for the business.** From interviewees in this study, after all relevant administrative processes for compliance have been completed, this assumption is threadbare at best. However, it is hard to assess given the very low take up by employees even requesting such arrangements.
- **Creating many “special cases” of individual work arrangements won’t impact productivity.** On the contrary, accommodating individuals by using the well-established practices of part time and casual arrangements was more than sufficiently flexible, and well-rehearsed enough to be “low overhead” to implement for both the individual and the business.

It is the experience of interviewees that working Australians demonstrate a great deal more diversity of working life choices than the Fair Work system assumes. They ask: why should businesses be prevented from connecting to those preferences in order to achieve more productive use of labour? This point is even more potent in contemporary society defined by diversity, as compared to a more homogenous pattern of work and life in earlier times. In making this point, interviewees cited a compelling range of demonstrated preferences for groups in their industry.

These examples materially undermine the idea that the largest sub-group is sufficiently or fairly characteristic of the whole group (say, of Australian employees) to be used as the baseline, or the norm, on which design of a system is based. The readiest examples were “off peak” workers who deliberately choose jobs with hours that are not 9 to 5 so as to, for example, avoid traffic congestion, cover family duties at one end of the day matching their partner covering the other, undertake further studies, pursue hobbies or sports through the week that require daylight or any of a long list of other legitimate personal choices to achieve work life balance.

4 Investigations of Productivity and Fair Work *(continued)*

USING THE FAIR WORK SYSTEM

The business viewpoint

All businesses interviewed took the unprompted view that competitive forces are the main driver of innovation and change in their business. A cause of their decisions, the competitive forces in their marketplace are also partly a result of their decisions. Ergo, competition is more relevant than regulation, although all voiced a clear intention to comply and foster ethical standards in their business as part of being a decent employer looking to engage collaboratively with their workforce.

In regard to workplace regulation specifically:

- for those employers who have spent decades creating harmonious working relationships in their business, the Fair Work system changes have had little or no impact to date;
- for those with fraught workforce relationships, the Fair Work system has not helped;
- for those new to bargaining and other regulated activities, including all small employers newly dealing with relevant aspects of workplace regulation, the Fair Work system is cumbersome of process and highly uncertain in outcomes; and
- for any with a recollection of pre-“Work Choices” times, the Fair Work system is widely perceived as pitching to the very lowest common denominator, when their work practice now far exceeds that bar and has done over more than a decade.

In terms of direct links, every interviewee from a medium or large employer noted the lack of a systemic link in the Fair Work system between wage claims and a productivity improvement. From their own industry environment, they provided evidence that this has re-shaped the nature of the negotiating process and that negotiations are now often linked to a myriad of specific issues that would be better dealt with separately.⁴⁷

Where a positive track record in bargaining and workplace relations generally “greased the wheels of negotiating progress”, employee representatives fairly quickly acknowledged that their best interests were served by developing a productivity return, and they were instrumental in making that a reality in implementing the subsequent agreement. That result was not credited to the Fair Work system but to the good sense of seasoned and level headed employee representatives.

A downside from the Fair Work system was noted by all interviewees, in that the labour productivity of managerial staff and senior executives has been impacted negatively. More time and process is required on human resources matters without a commensurate productive outcome, or in most cases any outcome at all. The effort invested goes mostly to building greater confidence that the documentary expectations of Fair Work Australia representatives (including those from the Office of the Fair Work Ombudsman) can be met in the future.

The search for competitive advantage and replicable business success is everyday life in a firm. It involves evaluating and potentially changing each element of product, processes, markets/marketing and organisation of the firm. The capacity for innovation in any given firm, and the overall productivity level of a firm, is thus the foundation for its capacity to compete successfully in the market place, and to grow sustainably as a business and as an employer.

Accepting that regulation can only make quite a limited direct contribution to productivity growth, the question is then does it hinder productivity growth unduly?

To explore these issues in the interview programme, the research team developed a structured list of propositions based on the issues and assumptions identified in desk research. The propositions covered the areas of economic conditions and the environment of business, how the firm makes decisions to compete and grow, their action to structure and engage a workforce, and using the Fair Work system.

In keeping with the scope of this research project, probing these propositions in interviews was not as formal an approach as stating an hypothesis for testing, and then gathering quantitative data to confirm or deny the hypothesis. However, the research team did follow the same basic form in order to probe the applicability of the propositions developed.

Interviews proceeded in two main parts:

- A portion was necessarily invested in understanding the business backdrop for that particular firm, to obtain the context for the business decisions and actions typically required in that firm to meet market challenges, run the business, innovate and grow.
- Approximately three quarters of each interview was spent discussing the Fair Work system, including the legislation, the regulations and their implementation by Fair Work Australia (including the Fair Work Ombudsman). As applicable to the interviewee, the interview team sought preferably unprompted, but otherwise prompted, responses to all the propositions based on actual experiences with workplace regulation generally and the Fair Work system specifically.⁴⁸

Views expressed by interviewees were collated against the propositions developed from desk research. This allowed the research team to assess the majority view from those with experience of the issue or assumption reflected in the proposition which was discussed.

Comments were collated, synthesised and analysed in terms of their import and pervasiveness. This allowed the team to discern a priority about that issue or assumption in terms of the overall picture of workplace regulation at this time, at least in the eyes of the businesses interviewed.

Suggested responses in the Fair Work system were also reviewed in terms of how amenable they were to policy change, including to inform revision of regulation and other aspects of system implementation.

The information gathered in interviews is summarised in the tables that follow. The tables are organised against the propositions developed in desk research and probed in the interview process, prioritised according to the views from interviewees:

- Figure 9 - very high priority issues,
- Figure 10 - high priority issues,
- Figure 11 - medium priority issues, and
- Figure 12 - issues not a priority in the view of the majority of those interviewed.

Key findings from interviews

Key findings from the interviews include that:

- A national system of workplace relations is seen as clearly beneficial. Notwithstanding other observations, employers were effectively unanimous in their agreement that a national system was preferable to dealing with multiple State systems.
- The notion that a national system was principally a consideration for “big business” was not the view of SMEs interviewed. This included quite small employers, who pointed out that their regulation and compliance burden increased significantly as soon as they expanded across a State border, which was relatively common even in quite small businesses. They noted that interstate expansion was often the best growth pathway for niche businesses using contemporary business models. In fact, those wishing to grow saw that a national system could enable this in ways that would be impeded by multiple State systems.
- Overwhelmingly, businesses of all shapes and sizes have told the research team that their enterprise cannot bear the uncertainty of, and cost of compliance with, further substantial changes to the system. That is not what they

⁴⁸ While the team did not shut down discussion of matters that were more speculative, or “second hand” being related from other places, the track taken by the team put the preponderance of emphasis on first hand experiences.

4 Investigations of Productivity and Fair Work *(continued)*

are advocating. Some selective amendments would, however, enhance the system (despite some of the flawed assumptions in its design), and most of those are in the implementation of the overall regulatory system rather than in the Act itself.

- The “better off overall” test is where legislative change would be welcomed by businesses. The complexity of negotiating to this standard, the uncertainty of having agreements accepted by Fair Work Australia, and the difficulty of demonstrating compliance over time, each adds considerably to the business management costs, without there being necessarily any improvement in the outcomes (including productivity performance) of the business.
- The applicability of the Fair Work system is considerably wider than previous workplace relations systems. Interviewees felt that it intruded on many acceptable practices that presented no problems to employees.
- The implementation of the Small Business Unfair Dismissal Code, and especially the manner in which it has been presented to SMEs, created the expectation that small businesses would avoid adverse findings and penalties under the Fair Work system simply by complying with the Code. This is not the case in practice, as the Code is expressed in words that have specific legal meanings. This is something that small businesses have found out “the hard way”, and some will not recover from the experience.
- The Fair Work system was predicated on the idea that “go away money” would become a thing of the past. In fact, most employers reported an increase in unfair dismissal claims and a related increase in payouts after pressure put on the employer from Fair Work Australia.
- Time limits put on unfair dismissal claims in the Fair Work system were intended to increase the likelihood that a person unfairly dismissed could be reinstated, and this is treated as the ideal solution (the logic for which was found to be highly questionable by interviewees). The experience of employers is that, when in doubt and faced with the deadline, employees increasingly choose to make a complaint rather than “miss out”. Even though the claims may be tenuous, in the reality of business decisions risk management judgments will often lead to a payout rather than suffer the business distraction and adverse publicity from defending the case.

Figure 9: Very high priority issues as assessed based on views expressed by interviewees

PROPOSITION BASED ON DESK RESEARCH	MAJORITY VIEW – AGREE?	FROM ...	COMMENTS	FAIR WORK SYSTEM RESPONSE?
Using the Small Business Unfair Dismissal Code in the Fair Work system effectively allows a small business to self-regulate their hiring, deployment and dismissal of employees - following the Code is a complete defence against later complaints.	x	All small businesses interviewed	Hidden “special meanings” of legal terms (eg “reasonable”) is quite misleading.	Reconsider in keeping with the objects of the Fair Work Act.
The Small Business Unfair Dismissal Code allows small businesses to quickly and effectively understand their situation regarding an unfair dismissal claim.	x	All small businesses interviewed	Hidden “special meanings” of legal terms (eg “reasonable”) is quite misleading.	Reconsider in keeping with the objects of the Fair Work Act.
Reinstatement is the best solution to unfair dismissal.	x	Those who have dealt with a claim	Flawed logic in terms of simple feasibility.	Reconsider on more advice about practical remedies.
Reinstatement is always in the best interests of the (wrongly) dismissed employee.	x	Those who have dealt with a claim	Flawed logic in terms of best interests of employee.	Reconsider on more advice about practical remedies.

Figure 10: High priority issues as assessed based on views expressed by interviewees

PROPOSITION BASED ON DESK RESEARCH	MAJORITY VIEW – AGREE?	FROM ...	COMMENTS	FAIR WORK SYSTEM RESPONSE?
Owner managers (where they are employees) are treated equitably with other employees under the Fair Work system.	✘	All SMEs	Little recognition that they are both owner & employee earning average wage (not premium), under uncertain conditions and providing employment for others.	Reconsider in keeping with the objects of the Fair Work Act.
“Go away” money is a thing of the past.	✘	Those who have dealt with a claim	Despite this intention in the design, if anything there is more pressure to “pay something to solve this”.	Rethink FWA approach to resolving claims.
Prescriptive regulation is a more effective approach to workplace relations than providing a safety net for the weakest employee and against the worst employer.	✘	Majority of employers interviewed	Prescriptive solutions from a general case never fit the specific situation.	Rethink assumptions about how to achieve flexibility
The “better off overall” test is an improvement to the bargaining process over the “no disadvantage” test.	✘	All those interviewed who have used it	Logic is hard to manage in bargaining and even FWA having problems applying it.	Reconsider: Usefulness? Cost benefits of complexity?
A national system for workplace relations is beneficial to the performance of businesses in achieving their business objectives.	✓	All those interviewed but one	Resounding endorsement. Critical success factor for growing across a State boundary without drowning in red tape.	Reinforce and/or accelerate all contributory outcomes from COAG National Reform Agenda.
Additional measures in the Fair Work Act were necessary to prevent discriminatory behaviour in the workplace.	✘	All those who’ve been involved	An inconsistent set of legal definitions and tests was further exacerbated by provisions in the Fair Work Act.	No, proliferation of definitions very unhelpful so prefer consolidation of better balanced anti-discrimination legislation.
“Permanent” work is the primary requirement for job security.	✘	All interviewees	Flawed assumption, does not recognise diversity of expectations, tastes and preferences about work.	Recognise part time and casual work as legitimate.
“Full time” work is a universal preference for employees.	✘	All interviewees	Flawed assumption, does not recognise diversity of expectations, tastes and preferences about work.	Recognise individual will make their own (diverse) choices.
Work during standard hours provides the range of efficient goods production and service delivery consistent with prosperity in contemporary Australia.	✘	All interviewees	Flawed assumption, unrealistic view of how businesses manage their circumstances.	Recognise business issues need a solution in context
Employees universally aspire to a long term job commitment.	✘	All interviewees	Flawed assumption, does not recognise diversity of expectations, tastes and preferences about work.	Recognise individuals will make their own (diverse) choices.

4 Investigations of Productivity and Fair Work *(continued)*

Figure 10: High priority issues as assessed based on views expressed by interviewees (continued from previous page)

PROPOSITION BASED ON DESK RESEARCH	MAJORITY VIEW – AGREE?	FROM ...	COMMENTS	FAIR WORK SYSTEM RESPONSE?
Work during standard hours (broadly 8am to 6pm Monday to Friday) is the default preference for individuals and families across the spectrum in Australia.	✘	All interviewees	Flawed assumption, does not recognise diversity of expectations, tastes and preferences about work.	Recognise individuals will make their own (diverse) choices.
Individual Flexible Arrangements are useful to employees in managing their circumstances.	✘	Interviewees who had experienced	Little used and other mechanisms preferred by most individuals.	Reconsider, as not an effective solution.
The Fair Work system is an improvement to the capacity of employees to arrange their working lives to suit their personal circumstances.	✘	Most interviewees	Irrelevant to most employees, who solve their own problems very well.	None, but needs support elsewhere in underlying determinants.
Full time work and part time work combine to allow sufficient flexibility for employers to structure their workforce to respond to market opportunities.	✓	All interviewees	Better working assumption, and reflects long standing experience.	Recognise part time and casual work as legitimate.
The workplace relations regimen has an important and direct impact on labour productivity, managerial productivity and the overall productivity of the business.	✘	All interviewees	Any impact is indirect and probably negative due to excessive procedure and restrictions on work structure.	Revisit key items impeding actual flexibility.
Enforcing procedural fairness will ensure a fair resolution of workplace issues.	✘	Those who have dealt with a claim	May actually impede rights of other employees, by focusing on the first to raise a complaint at the expense of others impacted.	Revisit to lighten the directive elements and focus on fair outcomes.
The Fair Work system fits well with other regulatory systems applicable to workplaces.	✘	Most interviewees	Bright spot is that it is a national system, but it clashes with other State and Federal regulatory schemes; provides opportunities for worst employees to hide. Conflicting instructions from State and Federal agencies leave businesses with practical difficulty in reconciling action to meet standards required (for example, by OH&S regulations or applicable industry certifications) with process required by FWA.	Revisit in line with COAG NRA but also by listening to employers in certain industries.

Figure 11: Medium priority issues as assessed based on views expressed by interviewees

PROPOSITION BASED ON DESK RESEARCH	MAJORITY VIEW – AGREE?	FROM ...	COMMENTS	FAIR WORK SYSTEM RESPONSE?
Rights and obligations of employees are made known to them by Fair Work Australia.	x	All who have interacted with FWA	FWA responds to enquiries from employees with sole focus on their rights to the exclusion of obligations, even the obligation to perform assigned tasks.	Reconsider & train FWA staff routinely handling enquiries
Rights and obligations of employers are made known to them by Fair Work Australia.	x	All who have interacted with FWA	FWA responds to enquiries from employers with sole focus on their obligations to the exclusion of rights, even for very small employers. Advice is not included on what they can reasonably expect from employees.	Reconsider & train FWA staff routinely handling enquiries
Less formal processes are beneficial in dealing with unfair dismissal.	x	All those who've been involved	Helps weak employees but creates opportunity for worst employees.	Ensure FWA reps are appropriately skilled and very organised.
Telephone conciliation is beneficial to resolving claims made by employees.	?	Interviewees who've been involved	Works better than originally anticipated but much depends on the FWA rep.	Ensure FWA reps are appropriately skilled and very organised.
Approval of agreements made under the Fair Work system is more effective and efficient than under previous regimes.	?	Employers involved	Once in FWA, this may be true but currently all the work is before that step.	Mitigate high levels of uncertainty about FWA outcomes.
Unions need a broad right of entry to ensure employees have options for representation.	✓	All employers	Well-established workplace norm; reps who follow the process & actually assist employees are welcome.	Seen as important but no specific action on experience so far.
Modern awards are beneficial to business performance.	✓	Employers using Awards	Vast improvement over previous patchwork.	Could be more "user friendly".
Collective bargaining and the right to industrial action are accepted as an enshrined feature of workplace relations in Australia.	✓	All interviewees	Not at issue from an employer perspective.	Less cumbersome would be helpful.
The Fair Work Ombudsman (and staff) can be a source of educational material of use to employees and employers.	✓	Some employers, some employees	Can be, but verified examples of where they do not deliver.	Need to improve implementation
On balance, the impact on managers of implementing the Fair Work system was positive.	x	All managers	Little gain for considerable pain; effort could have been much better spent on firm's own innovations etc.	Revisit - directive legislation, linear implementation are a productivity leakage.

4 Investigations of Productivity and Fair Work *(continued)*

Figure 11: Medium priority issues as assessed based on views expressed by interviewees (continued from previous page)

PROPOSITION BASED ON DESK RESEARCH	MAJORITY VIEW – AGREE?	FROM ...	COMMENTS	FAIR WORK SYSTEM RESPONSE?
The safety net under the Fair Work system actually provides a useful safety net for workers.	?	Employers	Irrelevant to most.	No further action.
The safety net under the Fair Work system represents less managerial overhead to use than in previous regimes.	?	Employers	Irrelevant to most.	No further action.
A low paid bargaining stream is necessary to assist some employees.	?	Employers	Irrelevant to most.	No further action.

Figure 12: Issues not a priority as assessed based on views expressed by interviewees

PROPOSITION BASED ON DESK RESEARCH	MAJORITY VIEW – AGREE?	FROM ...	COMMENTS	FAIR WORK SYSTEM RESPONSE?
The Fair Work system enhances business outcomes including the productivity performance of the enterprise.	✘	All businesses	Competitive pressures are the active ingredient; regulation need not help but shouldn't hinder.	Fair Work is an underlying determinant of productivity. Ensure it does not unduly hinder business decisions.
Proactive regulation can enforce a higher standard of labour relations across the board.	✘	All interviewees	Initiative sits with each workplace to develop collaboration & engagement.	Reconsider highly prescriptive regulation that may run counter to positive, well-established practice and productive workplace relations.
Compulsory conciliation is a useful feature of a workplace relations regimen.	✓	All who've experienced a dispute	In a dispute, a safety valve to break a deadlock is essential.	Concept well accepted, no further action.
A regulatory framework is essential to negotiating and concluding bargains.	✓	All who've experienced a dispute	Brings some order to the process.	Concept well accepted, no further action.
A regulatory framework is a key ingredient to negotiating and concluding bargains.	✘	All who've experienced a dispute	It can enable good process but cannot deliver a good outcome (or any outcome).	No further action in legislation, rather ensure positive practices.
A regulatory framework is instrumental in improving workplace productivity.	✘	All interviewees	In terms of business decisions to improve productivity in order to compete and grow, it can enable good process but cannot deliver a good outcome (or any outcome).	Fair Work is an underlying determinant of productivity. Ensure it does not unduly hinder business decisions.
Protected action ballots were in need of being simplified.	✓	Some interviewees	Quite possibly true, but not sure it was achieved.	No further action.

Figure 12: Issues not a priority as assessed based on views expressed by interviewees (continued from previous page)

PROPOSITION BASED ON DESK RESEARCH	MAJORITY VIEW – AGREE?	FROM ...	COMMENTS	FAIR WORK SYSTEM RESPONSE?
The Fair Work system is an improvement to the capacity for employers and employees to resolve workplace relations issues collectively.	✘	Almost all interviewees	The major active ingredient is the collaboration in each workplace.	No further action, system is a framework not a causal factor.
Problem solving processes are core to workplace relations.	✔	All interviewees	System is only a framework - workplaces craft their own solutions, let them at it.	No further action, system is not a causal factor but beware impeding sound, long established workplace problem solving.
Employees need protection to ensure workplace rights can be exercised.	✔	All interviewees	Definitely agree with the need to protect employees from some employers, but the worst employers are very few in number.	None, but don't lead with this as the default or expected norm.
Preferences about working life are static in the long term.	✘	All interviewees	Have an independent agency gather the data.	Not a Fair Work task, perhaps ABS.

4 Investigations of Productivity and Fair Work *(continued)*

BUSINESS ENGAGEMENT WITH DETERMINANTS OF PRODUCTIVITY

Examining how the determinants of productivity are engaged by the Fair Work system highlights that even a perfect regulatory regime cannot *in itself* enhance productivity growth.

Businesses describe a reality that confirms immediate causes of productivity performance lie within the firm's decision making, including the competitive fabric to which they contribute by their decisions.

Given the underlying scope and nature of the markets within which businesses operate and which circumscribe the results and benefits of their decisions, the outcomes of public policy and regulation are significant underlying factors affecting productivity performance by firms. Public policy and regulation in Australia shape the environment in which business decisions are made, and, rightly or wrongly, often work to limit the options for how businesses solve problems, deploy resources, innovate and plan to thrive in their circumstances.

Policy that actually promotes the ability of firms to deploy labour effectively, and to *make changes that improve productivity*, will be a potent influence, but so will education and training policy that is critical to ensuring overall development of the Australian labour force.

In that light, the importance of a well-crafted Fair Work system is underscored by the observations of the Productivity Commission in regard to regulation generally:

Regulation has grown at an unprecedented pace in Australia over recent decades. As in other advanced countries, this has been a response to the new needs and demands of an increasingly affluent and risk averse society and an increasingly complex (global) economy. This regulatory accretion has brought economic, social and environmental benefits. But it has also brought substantial costs. Some costs have been the unavoidable by-product of pursuing legitimate policy objectives. But a significant proportion has not. And in some cases the costs have exceeded the benefits. Moreover, regulations have not always been effective in addressing the objectives for which they were designed ...⁴⁹

The view of Fair Work from businesses interviewed is that the assumptions upon which it was designed are dated or wrong, and some elements of the system are poorly crafted. Supporting evidence has been identified from other sources on key issues.

Designing a system to assumptions that represent only parts of, or minorities within, the labour force has the impact of unreasonably constraining the choices of employees, as well the decisions of enterprise in engaging with their workforce. There are consequent impacts on the productivity performance of firms and hence their overall ability to innovate and thrive in a global economy.



5 Analysis & Insights

In this chapter, the task is to draw together the analysis and insights from our investigations and to present:

- The essential factors for lifting productivity growth, decoupled from views that are pre-determined by the responsibility to serve particular interests.
- Assessments of the relative importance of workplace relations regulation (in the form of the Fair Work system) to productivity growth.
- An understanding of how the features of the Fair Work system affect the essential determinants of productivity growth, positively or negatively, and implications for action.

ESSENTIAL FEATURES OF PRODUCTIVITY GROWTH

Earlier in this report, Dean Parham has set out an up to date and evidence-based overview of the nature and measures of productivity, influences on and opportunities for productivity growth, particularly Australia's recent experience and the most essential determinants and attributes of productivity growth. Together, these point to the key factors vital for raising business productivity in the 21st century and therefore, the benchmarks by which to test the Fair Work system's impact on productivity.

The import of this analysis of productivity is that the core concept is the ability to transform business capabilities in response to markets, customers and growth opportunities. In short, contrary to conventional wisdom, productivity is about business transformation, not just cost cutting or work intensification.

The concept of evaluating productivity is straightforward enough: examining what you produce compared to what you use to produce it. This is the productivity measure that appears in the national accounts. It shows the productivity outcome of the economy, but not what actually drives these results.

This report serves to illuminate the active ingredients of productivity growth in the economy beyond just cost minimisation to sustained transformations in the competitive capabilities of business enterprises and their workforces.

The significant insights to be noted are:

- Productivity growth comes about through a combination of increased opportunities to improve productivity and the ability of businesses to pursue those opportunities to maximise their sustained competitive performance.
- Advanced economies have been experiencing a radical shift in what constitutes opportunities for productivity growth, and a consequent rethinking of what businesses need to do to capitalise on these opportunities to increase their productivity performance. This shift is sometimes labelled the 'information revolution' or the 'rise of the knowledge economy'.
- Traditionally, opportunities for productivity growth were seen to rest on advances in science and technology centred on investments in the manufacturing sector. Services sectors, while growing strongly, were seen to present smaller opportunities for productivity growth. A new and far-reaching element has created a step-change in the available opportunities for productivity growth. This is the advances and uses of information and communications technologies (ICTs) that enable entirely new business methods and capabilities for meeting customer and market needs and earning a premium from doing so.
- These advances in ICTs are enabling technologies that help transform the way businesses run – what they do, how they do it and how they earn and capture profits that allow them to invest and grow. That is, this use of ICTs has provided a platform for businesses to innovate, not just in new products and processes, but in their business models, the recipe by which they create value for their customers, suppliers and themselves.
- Moreover, these opportunities to innovate and improve productivity are open to all businesses and all sectors – small and large, agriculture and mining, manufacturing and the broad sweep of services from logistics and wholesaling to accommodation and cafes.

- These new opportunities for productivity growth have been influenced further by increased globalisation. Globalisation has resulted in opportunities for smart specialisation from outsourcing and from the trend to unbundled global value chains where production and business processes, including high-value services like design, are spread around the world. New niches in high-value and high-skill activities, especially those that serve rapid-growth emerging economies, represent new productivity opportunities for Australia.
- The shift in how productivity opportunities are emerging requires a similar shift in the intelligence and capabilities of business enterprises to discern and capitalise on these opportunities. Enterprises are engaged in a ceaseless search for market opportunities and in testing how best to apply their distinctive know-how and capabilities so that they gain and retain a competitive edge. They do this by providing solutions that customers worldwide are prepared to pay for.
- How enterprises apply their skills and competencies to the intensive search and execution of competitive business opportunities increasingly determines Australia's productivity outcomes.

These significant insights about the key determinants of productivity growth are reinforced by earlier research intelligence from Professor Alan Hughes and Vadim Grinevich of the Centre for Business Research of the University of Cambridge for the Australian Business Foundation in their 2007 study titled 'The Contribution of Services and Other Sectors to Australian Productivity Growth, 1980-2004.'

Hughes and Grinevich attributed Australia's productivity surge of the 1990s to the high technology using sectors, not the high technology producers. The business transformations and new capabilities behind these productivity gains came from:

- use of enabling technologies especially ICTs;
- greater management competencies; and
- capitalising on regulatory reforms.

The key concept that emerges is that innovation-led productivity results from transformations in business enterprises and workplaces. Innovative managers and workforces create productivity by demonstrating agility and adaptability in transforming the capabilities of their businesses: finding imaginative new ways of problem-solving for customers and communities; collaborating with customers, suppliers and even competitors; adapting existing technologies and processes to new uses; and devising fresh solutions and experiences to meet the needs of demanding, paying customers.

This is the backdrop against which the Fair Work system's effects on productivity are tested.

A NOTE OF CAUTION

There are exaggerated claims and great (even excessive) expectations of how the Fair Work system impacts on Australia's productivity performance. A note of caution is needed to put on a sound footing an analysis of the effects of the Fair Work system on the key drivers of productivity growth.

Some critics of the Fair Work system blame the new industrial relations regime for being a primary reason for Australia's productivity slump, calling it a "job-killing machine" or commenting that an "adversarial legacy threatens the nation's competitiveness". On the other hand, proponents of the Fair Work Act reinforce its stated goal of "a balanced framework for cooperative and productive workplace relations that promotes national economic prosperity and social inclusion for all Australians". They point to the creation of a clear and stable framework which sets the scene for good faith bargaining by employers, employees and their representatives, thus achieving the twin goals of fairness for working Australians and flexibility for businesses.

The following comments serve as a reality check on some of the hyperbole in the current public debate.

5 Analysis & Insights *(continued)*

Firstly, the Fair Work Act is not responsible for Australia's productivity slump to date, as declining productivity levels were already well-established before the Fair Work Act came into effect on 1 July 2009 and became operational on 1 January 2010. Its macroeconomic effects, adverse or otherwise, are not yet readily apparent and certainly have not been quantified.

Any regulatory regime, such as the Fair Work system, is only one of many policy tools that can influence productivity outcomes. The hierarchy of productivity determinants detailed earlier in this report highlights the part regulation can play.

Determinants of productivity growth operate at three levels:

- *Immediate determinants* are those within the control of producers.
- *Underlying determinants* are those outside the immediate control of producers but which support current production and are intended to improve the quality of inputs over time. They include regulatory systems.
- *Fundamental determinants* are factors such as natural resource endowments, climate, distance from large markets, demography and patterns of settlement. They change little or only very gradually over time.

Competitive forces to which firms respond are the most potent influences on decisions that affect the factors in the immediate control of producers and that result in the productivity performance of firms. Other crucial underlying determinants of productivity performance are government policy and regulation, whether as constraints or enablers.

The same point is made by the former Deputy President of the Australian Industrial Relations Commission, Keith Hancock in the Australian Financial Review on 16 February 2012. He comments that in the long term, the crucial factors in productivity growth are “the fruit of long-term forces” such as technological innovation, rising standards of education and better health that lift the quality of the labour force, and the accumulation of capital. While in the short term, productivity levels are affected by industry-specific factors that change the relationship between production and the inputs used for that production.

The earlier overview of productivity determinants also identified the following ‘touchstones’ for policy and institutional settings that put the workplace relations regulatory system in context. To paraphrase, these settings when used together, can foster productivity growth:

- Incentives – external pressures and disciplines on firms to improve their performance.
- Flexibility – policies and program that assist the agility of firms to make changes to respond to market developments.
- Capabilities – policies that support the platforms for innovation through for example, investment in education, skills and training, appropriate infrastructure capital and the like.

Perhaps too much is being expected of Fair Work as a workplace relations regulatory system, where the objective of achieving fairness and equity in the workplace extends its scope into larger social policy issues of social inclusion and anti-discrimination. While these are valid goals, they are catered for in separate legislation and policy and thus, could serve to divert the Fair Work Act from its core purpose.

That said, the quality and responsiveness of the Fair Work system in reality is highly influential in shaping the environment for business competitiveness and the critical contribution made by skilled and engaged employees.

Finally, in assessing the extent to which the Fair Work system is relevant to the key drivers of productivity growth, the following commentary from Dean Parham is useful. In an opinion piece in the Australian Financial Review on 22 February 2012, Dean Parham noted:

An industrial relations system can affect productivity both directly and indirectly. The direct effect is the amount of resources the system consumes to settle work arrangements, terms and conditions.

The indirect effects, which are potentially more important, lie in the extent to which the system facilitates or inhibits innovation based on the transformation of individual businesses.

To conclude, a workplace regulation system is an absolutely necessary condition for Australia's productivity growth, but is by no means the only condition needed. The task now is to assess exactly how the characteristics of the Fair Work system and its operations are affecting any of the important determinants of productivity growth.

PRODUCTIVITY AND THE FAIR WORK SYSTEM

Investigations through this project have identified five significant and interrelated dimensions on which the Fair Work system's effects on key productivity determinants can be judged. These are:

- encouragement of engaged and empowered employees;
- the exercise of management acumen and agility;
- doing business competitively by adopting market-led, customer-responsive and innovative business practices;
- recognising and activating changing patterns of work and new innovative business models; and
- simultaneous achievement of social and economic outcomes ('shared value').

These factors do not stand alone, but interact with each other to paint a picture of the productivity impacts of Fair Work that reflect the realities and complexities.

Engaged and empowered employees

Ensuring employees are engaged and empowered is more than just a noble social objective or an expression of workers' rights or workplace democracy. It is an essential factor for business enterprises being able to compete successfully in modern, globalised 'knowledge-based' economies.

Knowledge and its use can give enterprises a competitive edge, especially today where information can be accessed anywhere and anytime with the click of a mouse. In this environment, knowledge that makes a business distinctive really counts. Such knowledge is rarely 'codified', but rests in the know-how and know-who of people in the business – their learning and their relationships. This is tacit knowledge in the form of 'ownership' of customers, market intelligence, early warning signals about problems or opportunities, experience from past practices or mistakes and the like.

It can only be unlocked to benefit the business if the workforce is engaged and empowered. So treating labour as a commodity – interchangeable, low priced, direction takers not decision makers – is counter-productive.

The recent study by the Society for Knowledge Economics referred to earlier (Boedker et al, 2011) on the characteristics of high performance workplaces that make them more profitable and productive highlights the importance of excellent employee relations.

High performance workplaces are effective managers of people, demonstrating clear values and practising what they preach. They give employees opportunities to lead work assignments, and encourage employee development and learning and high levels of participation in decision making. They achieve on-the-job learning through mentoring and job rotation. They welcome criticism and feedback, give increased employee recognition and acknowledgement, foster involvement and cooperation among employees and encourage employees to think about problems in new ways. As a result, these workplaces experience lower levels of staff turnover and rate better on job satisfaction, employee commitment and willingness to exert extra effort, and satisfaction with being paid and treated fairly.

5 Analysis & Insights *(continued)*

The Fair Work system has the stated intention of being a framework for fairness and equity in the workplace, particularly through new cooperative bargaining rules and a stronger safety net of minimum entitlements for employees. It might be expected then that the Fair Work system would help create the conditions to encourage engaged and empowered employees, as far as any workplace regulatory system can. The Fair Work system has a direct effect on the management on the workforce for the productive use of labour, but this project's analysis points to a fundamental obstacle to its ability to encourage engaged and empowered employees.

This obstacle is the presumption of conflict in the design of the Fair Work system, which is at odds with contemporary evidence on how productive high-performance enterprises and workplaces operate, particularly fostering strong employee commitment, ideas generation and participation in decision making.

The presumption of conflict manifests itself in the excessively prescriptive rules which encroach on management prerogatives and disenfranchise employees from having their aspirations for their hours and work arrangements heard and acted on by employers. This seems to be the case even in enterprises where goodwill was established and exploitation was absent. Excessive attention to procedures to satisfy Fair Work Australia, rather than commonplace pragmatic actions agreed by employers and employees to solve problems and meet individual needs in particular workplaces, is a major limitation of the Fair Work system's contribution to productivity improvement.

This rules-based framework and its compliance requirements presume that an adversarial situation is the norm between employers and employees. It does not acknowledge that in the majority of cases, workplace practices to engender a positive and productive workplace culture and sound business outcomes already exceed the requirements of the Fair Work Act. In this study, most interviewees readily cited examples that show a pattern of positive collaboration with employees to find mutually satisfactory solutions to cases where individuals required some flexibility in how and when they wished to work.

The effect is an unreasonable constraint on the choices of employees and on the decisions of enterprises in engaging with their workforce. In this respect, the Fair Work system can act to erode goodwill in workplaces and the intangible benefits and social capital that come from shared interests. It undervalues sound informal working relationships, knowledge-sharing, joint problem-solving and trust between employers and employees and their workplace representatives.

These features are essential to competing in the modern business environment where to be productive, enterprises must be able to be adaptable at speed, elicit more discretionary effort from employees and operate in a way that empowers and engages employees to achieve business goals and targets.

Management acumen and agility

Management and leadership capabilities in enterprises are critical to creating long-term growth. In fact, the definition of multifactor productivity is (in important part) about managing, organising and using the combined inputs of labour and capital, i.e. human and physical resources, in a way that produces more output and value.

The significance of management capability to business performance was well-canvassed in Australia in the 1995 Karpin Report. This report emphasised non-technical dimensions of management and the key role of innovation and creativity, people management, communication and negotiation skills and change management as central competencies.

Some recent studies suggest ways in which Australia's management performance could be strengthened to ensure more highly productive workplaces. The 2009 report by Professor Roy Green and colleagues, "Management Matters in Australia: just how productive are we?" benchmarked Australian manufacturing management in 18 dimensions of performance against 15 other countries showed that Australian firms are much weaker in people management than operations management. In particular, these firms lagged in advanced human resources practices such as attracting, developing and retaining talent, and in identifying innovative and practical ways of developing their people to improve performance and add value to organisations.

The Society for Knowledge Economics led a study on 'Leadership, Culture and Management Practices of High Performing Workplaces in Australia' (Boedker et al, 2011) which examined 78 companies in the services sector with more than 5600 employees. They measured the performance of businesses in six categories: profitability and productivity; innovation; employee emotions; fairness; leadership; and customer orientation.

Among its findings, this study reinforced the fundamental point that improved people management skills, including the constructive engagement of workforces, will be critical to the development of high performance workplaces and highly productive enterprises. The study identified five management practices associated with this type of productivity:

- Higher levels of responsiveness to changes in stakeholder and customer networks
- Higher levels of employee participation in decision making processes
- Higher levels of behavioural and skills flexibility in employees
- Good use and quality of information, communication and technology
- Excellence in attracting and retaining high quality people.

The evidence is clear that productivity growth will benefit if the management and leadership capabilities across all organisations in the Australian economy are improved. While much of the responsibility for action to boost high calibre management must rest with organisations themselves, the Fair Work system as the regulator of workplace relations, has a direct and material influence on management actions.

Our investigation suggests deficiencies in how the Fair Work system influences the exercise of management acumen and agility. The key concerns can be summarised as:

- The 'one size fits all' approach of the Fair Work Act leaves little room for management discretion to tailor workplace arrangements to particular business strategies, levels of demand and changing opportunities. Perfectly acceptable and long-established work practices that satisfy both employers' management prerogatives and the wellbeing of employees, are being disrupted by Fair Work requirements designed for worst cases.
- The diversion of management attention from running and improving the business to the lengthy, uncertain and more expansive process of enterprise bargaining required by the Fair Work Act, which incurs both transaction and opportunity costs for management. The business costs in time and resources far outweigh the benefits.
- Regulation and compliance does not automatically result in 'red tape'. Businesses are often sanguine about reasonable regulation that ensures a level playing field and generally operates in the best interests of the enterprise. However, burdensome regulation and increasing compliance requirements, especially those seen as unnecessary or ineffective, crowd out management attention to the search for new opportunities, customers and markets and for introducing innovations and improvements. In short, it keeps management inward-looking, not market focused.

The intent, objectives and provisions of the Fair Work Act simply do not recognise management capabilities as an integral and important component of securing a fair, flexible and productive workplace relations system. This is a major shortcoming in the Fair Work system's ability to advance the quest for enhanced productivity.

Doing business competitively and innovatively

The search for competitive advantage and replicable business success is a business enterprise's reason for being. It is by definition a dynamic and entrepreneurial drive for change. It involves finding ways of creating and capturing value by satisfying customer needs better than competitors do, and continually being on the look-out for new customers, markets, growth opportunities and applying the resources and operations necessary to deliver fresh and valued business offerings.

5 Analysis & Insights *(continued)*

This is the working definition of market-led business innovation at the enterprise level, not innovation focused just on science, technology and research. This concept of enterprise-level business innovation is an active ingredient for boosting productivity. It means creating value from doing something new that solves problems or provides opportunities that someone is prepared to pay for.

Enterprises create competitive advantage through innovation by perceiving and implementing new and better ways to compete. This innovation can occur not just in products and services, but in a number of dimensions: new delivery and distribution channels; new attributes of business offerings; new organisational arrangements, work organisation or business processes; adapting technologies to new uses; new ways of managing supplier or customer relationships or providing better customer experiences. In short, doing business competitively and innovatively contributes to the core concept of productivity identified in this study as involving the transformation of the capabilities of individual businesses.

The Fair Work system in itself is not designed directly to promote productivity through business innovation. But, it is intended to provide a framework for workplace relations that enhances productivity. The findings of this study suggest that the Fair Work system is indirectly limiting the willingness and capacity of business decision makers to make innovative changes in how they run their business and secure their ability to compete.

The appetite for risk is critical to the ability to innovate in business. One observation from interviews in this study is that the Fair Work system has increased the perception of risk, especially the risks associated with employing people. This is evidenced by the uncertainties introduced through, for example, the classification of casual employees, the protracted time and wider scope of enterprise bargaining negotiations with implications for labour costs and the recruitment and retention of employees especially in times of labour shortages.

Further, consistent concerns were raised by interviewees about the inordinate rise in the costs in time, overheads, specialist advisers, administration, new compliance and procedural record-keeping and learning Fair Work Australia protocols and practices. This results in the diversion of management attention to internal procedures and rules and away from the outward-looking competitiveness search essential to innovation and productivity. More importantly, as uncertainties and compliance requirements multiply, 'decision fatigue' sets in and prompts more conservative management decision-making that runs counter to innovation.

Overloaded and inward-focused, there is a flight to conservatism and organisational stability through preserving the status quo, not pioneering change for a new competitive edge. This is the antithesis of innovation.

Changing patterns of work and new business models

The design of the Fair Work system has not caught up with the present day reality that there have been fundamental changes in the patterns of work and working life, heralding radically different business models for the future. Failure to recognise and activate changed assumptions about work organisation and the diversity of aspirations of the workforce limits the adaptability of the Fair Work system and hence, its ability to contribute to productivity growth.

Chief examples of this are flawed, outdated assumptions about the nature of work security and the composition and preferences of the workforce. To illustrate, the Fair Work system is misconceived on the following key issues:

- Standard secure work equates with a permanent job.
- Full time work is a universal aspiration.
- The workforce is relatively uniform in terms of work preferences, priorities and objectives.
- Casual work is against the interests of employees.

Contrary to these design features of the Fair Work system, evidence uncovered in this investigation shows that increased workforce participation and reinvented business models addressing more intensive competitive pressures are a reality. It is therefore reasonable to expect that the aspirations of family breadwinners in the prime years of employment, while important, will not define the contemporary Australian workforce. They will not necessarily align with the priorities of persons without dependents, older workers, students, parents or other adults with care responsibilities for elders or other dependents, the long term unemployed or those returning to the workforce.

The case for casualisation of the workforce as a problem is far from proven. In 2007 ABS found that only about half of all casual employees reported a desire to work on other than a casual basis. Casual work is not necessarily poor quality work with little economic security or control over an employee's working life. It may be a positive choice. This assumption that casual work is always undesirable also denies the reality of industry conditions or the global economic environment that routinely necessitates evolution and change in business and jobs, specifically how work is structured and organised outside standard hours and across international time zones.

To treat part time and casual work as aberrant under the Fair Work system and to seek to reverse this trend as a social benefit is misguided.

By seeking to shield the weakest employees from the excesses of the worst employers, a legitimate form of work arrangement that contributes positively to productivity performance is being eroded. A more targeted tool to deal with worst cases is needed, rather than a blanket policy that unreasonably constrains the choices made by employees and hinders more productive workplace management decisions.

Simultaneous social and economic outcomes for 'shared value'

The Fair Work system fails to take into account the contemporary evidence about the concept of 'shared value' where economic objectives are met only if social objectives are also met. Rather, the Fair Work system seems to emphasise social outcomes at the expense of economic outcomes.

It should be recognised that the introduction of the Fair Work Act was presented as a policy innovation. It was seen as a change to the prevailing workplace relations system to achieve largely social benefits and to solve perceived problems of fairness, equity and cooperation in Australia's workplaces. The implementation of the Fair Work Act was an innovation in policy described by the Commonwealth Government as "essential to maximise workplace cooperation, improve productivity and create rising national prosperity". The research in this Productivity and Fair Work project tested whether this policy innovation has succeeded overall.

Any innovation must overcome considerable risk and uncertainty to succeed and many are not as successful as anticipated. It is important to learn from the experimentation, improvisation and even, failure of innovations. Innovations are tested on whether they achieve their intended purpose; whether the form and fit of the innovation is suitable to the problems to be solved; and whether the solutions are well-crafted and executed and cost-effective.

This study suggests that the Fair Work system still has to prove itself as successful innovation. There are also worrying warning signs that it is not fulfilling its complex objectives of providing simultaneously for flexibility for enterprises and fairness for employees. In particular:

- as a regulatory scheme, the Fair Work system has overly ambitious goals that extend beyond labour relations to national prosperity and social inclusion;
- the design of the Fair Work system is based on flawed and outdated assumptions about the nature of working life and is intolerant of variety and diversity in a 'one size fits all' set of rules; and
- the requirements of the Fair Work Act and its administration are highly prescriptive and uncertain in their application, and so reduce the options for enterprises and their workforces to be agile and responsive to new business opportunities and changing circumstances.

5 Analysis & Insights *(continued)*

The concept of 'shared value' introduced by Michael Porter and Mark R. Kramer in January 2011 in the Harvard Business Review provides a new model that could redesign the Fair Work system for greater success as a policy innovation.

Porter and Kramer describe the principle of 'shared value' as "creating economic value in a way that *also* creates value for society by addressing its needs and challenges".

Importantly, relevant to the productivity effects of Australia's Fair Work system, the following comments by Porter and Kramer suggest a way forward:

We believe that (shared value) can give rise to the next major transformation of business thinking... it needs a greater understanding of the true bases of company productivity... Government must learn how to regulate in ways that enable shared value rather than work against it...

The purpose of the corporation must be redefined as creating shared value, not just profit per se. This will drive the next wave of innovation and productivity in the global economy.



6 Conclusions

Overall, the Fair Work system underperforms on its stated objective of promoting productivity growth. It contributes little, and, in some cases, hinders sustained transformations in the competitive capabilities of firms and their workforces that characterise the essentials of productivity growth.

While Fair Work, as a regulatory system, is only one of many policy tools that can influence productivity outcomes, its quality and responsiveness is highly influential in shaping the environment for business competitiveness and the critical contribution made by skilled and engaged employees.

The Fair Work system fails on a number of tests - a “one size fits all” approach unable to tolerate workplace diversity; diversion of management attention away from business improvements; unnecessary, ineffective and highly prescriptive requirements with high levels of cost and overheads; increasing perceptions of risk and uncertainty, especially risks in employing people; conflict and adversarial workplace relations as the norm; and perpetuating flawed and outdated assumptions about working life.

The good news is that the Fair Work system can be made more productivity-enhancing without another round of wholesale legislative change. Redesigning for more deft and responsive administrative arrangements will go a long way to ensuring that shared social and economic outcomes are achieved simultaneously.

In particular, the following fundamental principles of the Fair Work system need to be changed in practice:

- the presumption of conflict and the norm of adversarial workplace relations;
- a highly pervasive and prescriptive set of rules that over-regulates for worst cases to the detriment and cost of the majority of employers and employees; and
- the lack of tolerance for customised and diverse workplace arrangements that meet community norms of fairness and freedom to operate, rather than a single mandated solution for all.

This would re-set the Fair Work system as a successful example of policy and regulatory innovation, influencing key determinants and attributes of productivity growth, especially in the way employers organise work and business operations and deploy, engage and empower employees.

This study into productivity and Fair Work concludes that while there is considerable room for improvement, it is important to put the contribution of the Fair Work system to productivity growth in perspective.

There are other critical and effective areas of action to boost productivity. Action is required on other fronts, such as:

- Education and training policies that enhance the ability of individuals and enterprises to develop new skills and capabilities, reflecting emerging patterns of work, new or rejuvenated industries and business models, areas of strong demand and growth markets. This covers action to prepare Australians to compete in the high performance workplaces of the future, for example, greater Asian cultural and language literacy, proficiency in maths, sciences and engineering, excellence in problem-framing and problem-solving and in collaboration and cross-disciplinary teamwork drawn from the arts and humanities.
- Innovation policy and programs that do not stop with investment in science and technology or R&D, but extend to building capabilities in a critical mass of Australian enterprises and workplaces for transformative business model change and organisational and managerial innovation.
- Actions to advance the operation of a seamless national economy particularly through achievement of the COAG national reform agenda. This is necessary to limit the drain on productivity growth by removing impediments to labour mobility and accelerating other capacity-enhancing reforms.
- Reinvention of more deft industry policy that positions Australia to capitalise on its global strengths and comparative advantages, rather than a narrow focus on subsidies or bailouts for failing industries. Industry policy needs to be redefined from a justification only to redress market failure to a positive stance of intelligently facilitating market success.

This research paper investigating how the Fair Work system is contributing to the crucial determinants of productivity growth has deliberately taken a wide view in its analysis and conclusions. This investigation has made observations on the direct, but relatively limited, effects of the Fair Work system on productivity. It has also probed the indirect effects, showing how the Fair Work system overall may be impeding growth and innovation in an increasingly globalised and knowledge-intensive business environment. Further, its findings have addressed the social outcomes that the Fair Work system seeks to advance and how they intersect with economic objectives to affect productivity.

The broad scope of this analysis aims to meet the goals of the NSW Business Chamber and Australian Business Industrial in commissioning this research. The Chamber and ABI were keen to act as thought leaders on this increasingly prominent public issue, drawing on accessible and credible analysis that lends itself to practical action.

Consequently, this research on Productivity and Fair Work has marshalled its findings to allow commentary not only on the legislative and administrative detail of the Fair Work Act, but on actions to address Australia's urgent productivity imperatives that go beyond the traditional landscape of industrial and workplace relations. This opens up opportunities to reframe the partisan public debate.



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