Non-technical summary for 'Doing Less, with Less: Capital Misallocation, Investment and the Productivity Slowdown in Australia'

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Labour productivity growth is the key driver of living standards over the medium term. However, growth in labour productivity has slowed markedly over recent decades in Australia and other advanced economies, leading to slower growth in people's incomes. It is crucial to understand why productivity growth slowed, as this could provide insights into what policies could be used to improve outcomes.

One factor that contributed to slower productivity growth was unexpectedly low levels of non-mining investment over much of the 2010s. When there is less investment, workers have less (or less well-suited) equipment and other capital to work with, making them less productive.

A second factor is that the economy appears to have become less dynamic: fewer new firms are opening and people are less likely to change jobs. As a result, the pace at which workers tend to move, or are 'reallocated', from less productive firms in an industry to more productive ones has slowed since the mid-2000s. This has meant a larger share of the workforce is at low-productivity firms, meaning national productivity is lower than it might otherwise be.

Previous work has examined these two factors separately. This paper tries to bring these two observations together to gain a greater understanding of both by answering three questions:

1. Could the same factors be driving both weaker investment, and slower reallocation and dynamism?
2. Has the reallocation of capital from less to more productive firms slowed, similar to what we have seen with labour? And therefore, are we not only doing less investment, but is it also being put to less productive uses?
3. Can we gain additional insights into why the economy has become less dynamic and reallocation has slowed by focusing on capital reallocation and investment?

Key findings

- Low-productivity firms experienced the smallest decline in investment over the past decade or so. As such, low-productivity firms are now doing a larger share of the investment in the economy.
- Consistent with this finding, while productive firms tend to invest more than low-productivity firms, the gap in outcomes has closed: the reallocation of capital to more productive firms has slowed. In the mid-2000s, the capital stock of the most productive firms grew 1.8 percentage points faster than that of the least productive firms. But this gap shrunk to 0.6 percentage points in the mid-2010s.
- Simple back-of-the-envelope calculations suggest that if the flow of labour and capital to more productive firms had not slowed, the economy would have been around $13 billion, or 0.75 per cent, larger in 2017. This equates to around $550 per person, or around $1,000 per worker.
- The weaker relationship between firms' investment and their productivity was more evident in industries where:
    - competition appears to have declined the most, suggesting that declining competition may have weakened firms' incentives to improve and grow (the decline in aggregate investment was also more evident in these sectors)
    - firms tend to be more dependent on debt finance, suggesting that highly productive firms may be having more trouble borrowing than they did in past.