What is productivity and why does it need to improve?

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Key points

Productivity measures how much value we produce from the resources we use.

Australia's productivity growth has slowed, but parts of the modern services economy are difficult to measure.

Business investment, technology, skills and better ways of working could help lift productivity and living standards.

Politicians, economists and business leaders regularly say Australia needs to improve productivity if living standards are going to rise.

"The best way to sustain and grow living standards over time is to make our economy more productive," Treasurer Jim Chalmers said recently.

"Higher living standards is the holy grail, and a more productive economy is how we deliver it."

So why is productivity so important to our living standards? Let's start by looking at what it means.

What actually is productivity?

At its simplest, productivity is a measure of how much we can produce with what we have.

In economic terms, the most often discussed measure is labour productivity, which looks at the amount of economic output produced for every hour worked.

For example, if a factory can make 110 products in the time it previously took to make 100, productivity has increased.

A tradie using software to quote jobs faster, a supermarket improving stock management or a nurse spending less time duplicating paperwork are all also examples of productivity improvements.

Importantly, productivity isn't the same as working longer. You can lift output by working longer hours, but productivity improves by getting more value from each of those hours.

Economists also look at multifactor productivity, which attempts to measure how efficiently labour and capital, such as machinery, buildings and technology, are used together.

What's productivity got to do with living standards?

Quite a lot. Over the long term, it's one of the main ways an economy can sustainably increase incomes and living standards.

Imagine a business can produce 10% more without asking staff to work 10% longer. That creates more income that can potentially flow into higher pay, profits and investment, as well as government revenue through taxes.

Across an entire economy, those gains will add up. The Productivity Commission says productivity growth has been one of the primary drivers of higher Australian living standards because it allows more goods and services to be produced from the same resources.

But better productivity on its own doesn't automatically translate into a bigger pay packets or higher living standards. Housing costs, inflation, taxes, interest rates and how income is distributed will all affect how well-off people feel.

How does productivity affect inflation?

Productivity also helps determine how fast an economy can grow without putting extra pressure on prices.

Economists call this an economy's "speed limit". If businesses can produce more from the same number of workers and resources, the economy has more capacity to grow before demand starts running ahead of supply.

The reverse is also true. When productivity is weak, the speed limit falls. Businesses have less room to increase output without running into shortages of workers and equipment. If demand keeps growing faster than supply, businesses may respond by raising prices, adding to inflation. CBA economists have estimated Australia's sustainable growth rate has fallen as productivity growth has slowed. Chief Economist Luke Yeaman argues that persistently weak productivity has lowered the economy's speed limit, meaning stronger growth can generate inflation sooner than it did in the past.

That matters for interest rates. If stronger productivity allows Australia to grow faster without generating inflation, there may be less need for the Reserve Bank to slow demand through higher rates.

Retro view: The 90s productivity boom

Australia experienced a strong burst of productivity growth from the early 1990s into the early 2000s, with growth in productivity more than doubling.

Australia went from an international laggard to one of the world's stronger performers.

There was a lot of economic reform during that period, including lower trade barriers, greater competition, changes to government-owned businesses and more flexible markets . The Productivity Commission says these reforms likely contributed significantly to the boom.

Australian businesses also rapidly adopted IT and communications technology, particularly from the mid-1990s. The Productivity Commission estimates this added up to about half a percentage point to the acceleration in annual labour productivity growth.

Living standards lifted. Australia's per-capita income growth during the productivity boom outpaced every G7 economy, while stronger productivity also supported real wage growth.

The boom ran out of steam during the 2000s.

Is it just an Australia problem?

In short, no. Productivity growth has slowed across much of the developed world.

The OECD says median productivity growth across its members was just 0.4% in 2024, compared with 1.8% during the early 2000s. Canada recorded almost no growth in 2024, while the UK went backwards.

OECD data puts Australia around the middle of the pack among advanced economies, and below economies including the US and several northern European countries.

Canada, New Zealand and the UK face many of the same problems Australia does: ageing populations, economies dominated by services and weaker investment growth than in earlier decades.

How do we actually measure productivity?

Producing more tonnes of steel or boxes of cereal per worker is relatively easy to measure. It’s much harder to answer the same question about a teacher, nurse, aged-care worker or public servant.

The Australian Bureau of Statistics measures labour productivity by comparing economic output with hours worked. For businesses selling goods and services at market prices, those prices provide useful information about the value of what’s being produced.

But much of health, education and government administration doesn’t have a meaningful market price. The ABS may therefore measure things such as hospital admissions or student enrolments.

While those numbers can tell us how many services were provided, they don’t tell us whether a patient recovered faster or a student received a better education.

So are we getting worse at productivity, or worse at measuring it?

Over time, Australia’s economy has shifted heavily towards services, which now account for around 70% of GDP, compared with roughly half of GDP in the 1960s. Manufacturing, meanwhile, has fallen from around a quarter of the economy to under 7%.

Productivity Commission research estimates services industries account for close to nine in every 10 jobs.

And services productivity, as we’ve seen, is harder to measure.

The problem is particularly important in what economists call the non-market sector, which includes health, education and public administration.

The share of Australian hours worked in those industries rose from about 20% in 1994-95 to 28% in 2024-25, driven largely by health care and social assistance. The Productivity Commission says conventional statistics are likely to miss some improvements in quality and efficiency in these areas.

But productivity has also been weak in areas where measurement is easier, while slower business investment and weaker uptake of new technologies have been identified as contributing factors.

Still, it’s probably true to say that a single headline productivity number doesn’t tell the whole story.

Better tools and technology

New machinery, software and AI can help workers get more done in the same amount of time.

More business investment

Productivity tends to improve when businesses invest in equipment, technology and new ways of working.

Skills that keep pace

Technology delivers more when workers have the skills and training to use it well.

Stronger competition

Competition can push businesses to innovate, cut waste and find better ways to serve customers.

Smarter infrastructure

Better transport, energy and digital networks can reduce the time and cost of doing business.

Well designed, better regulation

Cutting unnecessary paperwork and delays can free businesses and workers to spend more time on productive activity.

Better ways of working

Investment alone isn’t enough. The biggest gains often come when businesses redesign processes and use technology to remove repetitive or inefficient work.

Does business have a role to play here?

One of the most important ways to lift productivity is to give workers better tools.

That could be new machinery in a factory, better software in an office, upgraded vehicles or technology that cuts repetitive administration.

Economists call this “capital deepening”. In everyday terms, it means workers can generally do more when they have better equipment and technology to work with.

The Productivity Commission says investing in new technologies, and using capital more effectively, is important for lifting labour productivity and living standards.

Recent CommBank data provides an example at the business level. Almost nine in 10 businesses surveyed reported productivity gains of more than 10% after recent asset upgrades. CommBank asset finance data also showed financing for technology assets was 48% higher in December 2025 than a year earlier.

Investment alone, though, doesn’t guarantee a productivity gain. What matters is whether the new machinery, software or technology actually allows a business to do something better or faster.

Where does technology fit in?

Technology has driven some of the biggest productivity changes in history, from mechanisation and electricity to computers and the internet. It's a big reason productivity boomed in the 1990s, and AI is now being talked about in similar terms.

CommBank's Luke Yeaman estimates economies that integrate AI deeply and widely could lift labour productivity growth by around 0.8 to 1 percentage point a year.

The real gains come when businesses change the way they work to make the most of the new tech: redesigning processes, training staff and using technology on tasks where it genuinely saves time or allows people to do more valuable work.

CommBank Group Executive Business Banking Mike Vacy-Lyle says productivity for businesses can be as practical as "quoting faster, cutting time from admin, using data to manage stock, adopting technology, or freeing teams up to spend more time with customers".

That distinction will become increasingly important. Australia could experience a major investment boom in AI infrastructure without necessarily receiving the full productivity benefit if businesses across the economy are slow to adopt the technology.

If productivity matters so much, why is it so hard to fix?

Because productivity isn't one policy or one industry.

It's the accumulated result of millions of decisions about investment, technology, skills, infrastructure, regulation and how workplaces operate.

Governments can influence many of those things, but they can't simply mandate higher productivity.

And some changes take years before they show up in the numbers.

That helps explain why productivity keeps returning to political and business debates. It can sound like an abstract economic measure, but over time it helps determine something much more tangible: how much Australians can earn and consume without simply having to work longer to get there.

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