



ITS Global

Consultants on Global Issues

Improving International Competitiveness in Australian Business

**Submission by the Business Council of
Australia to the Review of Export Policies &
Programs**

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Executive Summary

Australia's future prosperity is inextricably linked to productivity growth and to the commercial performance of its businesses. The increasingly competitive nature of global markets makes strong demands on the operation of Australian businesses which need to continually adapt and improve to succeed. In this environment sustained productivity growth and trading success are critical for raising living standards over the long run.

Much progress has been made in improving the international competitiveness of Australian industry following a series of economic reforms since the 1980s. Australia has benefited handsomely as a consequence with a sustained period of record economic growth and a more globally oriented economy.

This Submission demonstrates, nevertheless, that economic reform is a continuous requirement and much remains to be done to improve Australia's prospects in a global economy worth over \$40 trillion. It emphasises that a comprehensive program of policy reform to remove impediments to and grow opportunities for greater foreign investment and commercial success by Australian businesses is required.

Macroeconomic policy

Policy makers must focus on prudent macroeconomic management that reduces the inflationary pressures on Australian business and maintains the international competitiveness of the export and import competing sectors of the economy. This requires greater fiscal discipline and easing the burden on monetary policy. Poor macroeconomic settings can result in overvaluation of the Australian dollar thereby eroding international competitiveness.

The Federal Government's efforts to apply fiscal discipline and to reprioritize public spending in its 2008-09 Budget are welcome. The current circumstances, however, require further efforts in both directions. This means continuing to place restraint on government expenditures and spending priorities, tighter spending controls, and restoring greater accountability for and transparency in policy outcomes.

Productivity & business innovation

Productivity growth is one of the keys to sustaining and accelerating economic growth as well as enhancing the international competitiveness of the export sector. The National Reform Agenda developed by the Council of Australian Governments (COAG) emphasises the importance of long-term productivity growth and the policy reforms that are required to sustain it.

Business innovation is one of the important drivers of productivity growth — the others are dealt with below. As it generates substantial economic spillovers for the rest of the economy, most industrialized countries seek to encourage innovation by subsidizing it.

In Australia the key challenges for government is to strengthen the national innovation system by investing in improved education and skills training as well as by supporting collaborative research and development by higher education, business and government research institutes.

Workforce participation

To reduce the chronic labour shortages which are adversely affecting the export sector and the economy as a whole, the Government should comprehensively address the barriers to workforce participation and employment. Among other things this will require reform of the vocational education and training system

In addition, the Federal Government must continue to ensure that business can access appropriate skills overseas but a more responsive and more streamlined visa system is needed to do so. As competition for skilled labour intensifies globally, the Government must deal with the issues that adversely affect Australia's ability to attract permanent and temporary workers, including tax and regulatory barriers.

Labour market regulation

The BCA supports the imposition of a safety net in the labour market but, in doing so, emphasises the importance of allowing businesses flexibility in how they employ their workforce, structure their operations and reward their employees

To this end, the BCA recommends:

- a national regime for regulating workplace relations;
- a simpler regime for regulating workplace relations;
- the promotion of flexibility and productivity in the workplace;
- maintaining agreements between employers and their employees at the enterprise level as the basis of the workplace relations system; and
- ensuring that the awards system provides a genuine safety-net.

The reforms should streamline administrative processes, minimize costs for government, employers and employees, and remove barriers and disincentives to workforce participation and skill development.

Education & training

A comprehensive and sustained response to the emerging labour shortages is required if the export sector is not to see its international competitiveness eroded by rising real labour costs. As part of this response, the Federal Government needs to accelerate reform of the vocational education and training (VET) system.

Efforts must focus at improving the quality and increasing the number of workers with VET qualifications. Lifting the participation and completion rates in VET should be another priority. The VET system must be more flexible, market-driven, and responsive to changing demands.

For its part, the higher education sector needs to be better funded and more responsive to employment trends and industry requirements. To achieve this, the Government should collaborate with business in planning and priority setting.

Business regulation

Regulation has an essential role to play in correcting market failure and achieving social objectives but excessive regulation merely distorts business decisions to the detriment of economic performance and the international competitiveness of the export sector. The problems are compounded where regulation is inconsistent or duplicated across jurisdictions.

If COAG is to deliver on its reform commitments, it must finally overcome its past inertia and create a seamless economy for business regulation by the end of 2010. This will involve the States completing the reforms that have been agreed by COAG in each of the ten regulatory 'hot spots' it has identified.

The States have had more than two years to progress these reforms. If they cannot agree to regulatory harmonisation in each of the 'hot spots' by the end of 2008, the BCA reiterates its call for the Federal Government to provide for businesses to be able to 'opt in' to national (i.e. Commonwealth) regulatory regimes by the end of 2009.

Business taxation

Taxation plays a fundamental role in shaping the international competitiveness of the export and import competing sectors of the economy, as well as the environment for all business. As all three levels of government levy taxes, the efficiency and effectiveness of the tax system hinges on sound relationships between often competing jurisdictions. The complexity of the system is an impediment to businesses engaged in trade and investment transactions.

The Henry Review of the tax system, which is currently underway, is a major opportunity to deal with these and related issues by putting in place a business tax system that promotes investment, productivity and economic growth.

Economic infrastructure

The situation and outlook for the nation's infrastructure suggests reforms are urgently required to relieve capacity bottlenecks and to remove the impediments created by policy. Recent Government and Parliamentary inquiries, as well as the OECD and the IMF, have amply confirmed the need for reform.

The BCA has formulated an approach to reform that is based on the following foundation strategies:

- The markets for infrastructure services need to be national in scope, rather than state-based. Among other things this requires national regulation.
- Prices for infrastructure services must be market-based, with appropriate internalization of any externalities that they generate.

- Public investment processes need to be transparent, well-coordinated by governments, forward-looking, based on a consideration of all feasible options, and to favour the options with the highest net economic benefits.
- There should be effective competition in all the contestable — i.e. non-network — segments of the market for infrastructure services.
- Private ownership of infrastructure is to be preferred in the contestable market segments.
- Regulation of infrastructure should not discourage investment to meet expected demand.

Trade barriers

Multilateral trade liberalisation remains a high priority for opening up opportunities for Australia's export sector. To that end, the BCA supports the Government's efforts to revitalise the stalled Doha Development Round of trade negotiations being conducted under the auspices of the WTO.

The BCA also support the Government's efforts to conclude regional and bilateral FTAs. As a principle, the Government must work towards ensuring that such FTAs are comprehensive in scope and support Australia's multilateral stance. .

Trade facilitation programs

In its first Budget the Commonwealth Government has fulfilled its election commitment to strengthen its trade facilitation programs.

The announced enhancements involved additional funding of \$50 million for the Export Market Development Grants Scheme (EMDG) in 2009-10 as well as changes to widen the eligibility for assistance. As part of the Budget process, the Government's investment promotion and Global Opportunities programs will also be integrated into Austrade.

The BCA's views on other trade facilitation programs are set out in a companion submission to the Review of Export Policies and Programs. That submission focuses on the trade policy issues before the Review.

1. The Role of Government in International Competitiveness

International competitiveness is a foundational concept in economics but one that is often badly misunderstood. This misunderstanding reflects the fact that its key insights are powerfully contrary to what our intuition leads us to expect.

The idea of competitiveness is generally understood as the capacity to compete with one's rivals. In economics the concept of international competitiveness, properly understood, only applies at the microeconomic level. At that level, it refers to the ability of a business or a group of businesses to sell their product or service on a sustainable basis in a market, which is open to competition from all potential suppliers, including foreign ones.

From this perspective, sustainability means that the compensation, which is paid to the owners of the resources used to produce the goods or services in question, matches what those resources could have commanded elsewhere. In the language of economics, the country is said to have a comparative advantage in producing the goods or services in question — Annex 1 has a discussion of the concept.

Nature of international competitiveness

We can speak of the international competitiveness of a particular business, industry or sector of the economy but not of the international competitiveness of a country or its economy. Widely used measures of the international competitiveness of the export sector are the real exchange rate or real unit labour costs.¹

Countries or economies do not compete for resources that are effectively fixed in space or time — namely arable land, forests, natural ports and man-made structures such as bridges, roads and buildings. Such resources cannot be relocated to other countries or economies once they become unproductive. Moreover, countries or economies do not go out of business, unlike business corporations which, by their very nature, come and go at an astonishing regularity.

The closest that one can come to capturing a realistic notion of economic rivalry at the international level is generally expressed in terms of absolute productivity levels or the rates of growth in productivity.

For these reasons, the popular metaphor that treats national economies as though they are business corporations has been described as a 'dangerous obsession'.² Although this type of critique has much to commend it, it can also easily be

¹ Two OECD economists have concluded that '...the measurement of competitiveness is — even within a well-defined conceptual framework — very much a matter of compromises with available data, and entails a number of trade-offs among different criteria and objectives. In addition, a number of technical considerations arise in the construction of competitiveness indicators, not all of which have unambiguous solutions, even in theory.' (see Mattine Durand and Claude Giorno, 1987, 'Indicators of International Competitiveness: Conceptual Aspects and Evaluation.', *OECD Economic Studies*, pp. 147-197)

² Paul Krugman, 1994, 'Competitiveness: A Dangerous Obsession', *Foreign Affairs*, Council of Foreign Affairs, Washington, DC, March/April, reprinted in Paul Krugman, 1996, *Pop Internationalism*, The MIT Press, Cambridge, MA

overstated. A nation's level of productivity is crucially important from a public policy perspective as it is the major determinant of domestic living standards, but it must not be confused with other aspects of economic performance.

Current sources of international competitiveness

Comparative advantage in the modern world is increasingly created by man rather than by nature. In the industrialized economies comparative advantage tends to reflect differences in the quality of a country's institutions, the human capital of its citizens and its access to global industrial 'know how'.³

The fact that some comparative advantage may be man-made does, not however, mean that it has been consciously created by any one person or group of people. Like language, the law — in a broader sense than legislation — and markets themselves, some of the man-made comparative advantage has emerged spontaneously as the unintended consequence of multiple decisions by a multitude of individuals — none of which were directed at such an end.

The productivity differences that exist between countries increasingly reflect the creation and application of practical knowledge in a world where the natural barriers to the global transmission of such knowledge are declining rapidly. These barriers are coming down due to advances in knowledge that have been applied to transport, communications and data processing.

As a consequence of technological progress and business innovation, most financial capital is internationally mobile and becoming more so. Moreover, the international movement of labour increasingly finds itself restricted by man-made barriers specifically designed for that purpose, rather than by those barriers that have either emerged spontaneously — as a consequence of language or culture — or those that have always been there — such as the barriers of geography or time.

Role of government

The core role of government in international competitiveness and economic development more generally is concerned with the institutional framework, within which the economy is meant to operate. The key institutions are those that:

- protect and extend property rights;
- protect other economic freedoms, such as the freedom to contract;
- enforce contractual promises that were freely made; and

³ 'Institutions' encompass the formal and informal 'rules of the game' that regulate economic behaviour. These 'rules' are the well-established arrangements and structures, which are part and parcel of a culture or a society, such as competitive markets, the banking system, property rights and the law of contract. Douglass North shared the Nobel Prize in Economics in 1993 for showing how important such institutions are to economic development (see Douglass C North, 1993, 'Economic Performance through Time', *Prize Lecture in the Memory of Alfred Nobel*, The Nobel Foundation, Stockholm, 9 December [accessed at http://nobelprize.org/nobel_prizes/economics/laureates/1993/north-lecture.html on 16 April 2008]).

- secure the rule of law.

In economic terms the performance of these functions by the government may be thought of as it providing public goods to the community as a whole — they benefit everyone and no one can be excluded from their benefits. The role of government is concerned with the maintenance of these institutions as well as the supply of those public goods such as national defence, roads and other infrastructure that are unable to be provided by private voluntary action on its own.

Markets do an excellent job in ensuring that a community's resources are allocated in ways that generally produce the best outcomes from the perspective of the community as a whole. This is particularly true over the longer run. If there were unrealised gains from reallocating resources at any time, the individuals and the individual businesses that make up the economy have the strongest incentives to identify them and co-operatively exploit them for their mutual gain.

There is, moreover, no reason to believe that this is not so for the resources allocated to the economic sectors exposed to international trade. An international border may complicate the analysis but it does not alter it in any fundamental way.

Market failure & government intervention

When markets fail, the failure is mostly thought to reflect the presence of either legal impediments to private initiative in the area in question or of transaction costs.⁴ The legal impediments in question include legislatively enforced monopolies and regulatory barriers to the entry of new participants into a market.

Originally it was thought that market failure may also be due to the absence of well-defined property rights but that is now less clear cut.

In the most quoted article in the vast literature on this subject, Ronald Coase demonstrated that the absence of well-defined property rights, of itself, was not sufficient to prevent the emergence of privately organised solutions to apparent market failures — such as the pollution of the environment — but transaction costs most certainly were an impediment to the emergence of such solutions.⁵

Coase's profound insight has been repeatedly confirmed by subsequent research.⁶ It has also focused professional attention on the critical role that transactions costs play in apparent market failure, thereby spawning a huge literature on the subject.

⁴ Transaction costs are the costs that are involved in using the market mechanism. They include the cost of identifying the contractual partner(s), negotiating a contract with them, supervising their performance under the contract, and enforcing its provisions. Transactions costs reflect the absence of relevant information.

⁵ Ronald Coase, 1960, 'The Problem of Social Cost', *Journal of Law & Economics*, 3(1), pp 1-44

⁶ For example see: Steven NS Cheung 1969, *The Theory of Share Tenancy*, University of Chicago Press, Chicago, IL; Steven NS Cheung, 1973, 'The Fable of the Bees: An Economic Interpretation', *Journal of Law & Economics*, 16(1), pp 11-33; Ronald Coase, 1974, 'The Lighthouse in Economics', *Journal of Law and Economics*, 17(2), pp. 357-376; Elizabeth Hoffman and Matthew L Spitzer, 1986, 'Experimental Tests of the Coase Theorem with Large Bargaining Groups', *Journal of Legal Studies*, 15(1), pp. 149-171; Daniel F Spulber, 2002, *Famous Fables of Economics: Myths of Market Failures*, Blackwell Publishing, New York, NY; Tyler Cowen and Eric Crampton (eds), 2003, *Market Failure*

Where co-operative voluntary action persistently fails, government may be able to correct the failure but there is no certainty that its intervention will make the community as a whole better-off as a consequence. The reasons are several.

- The transaction costs in a solution might be greater than the benefits to be obtained from it. In this case, the cause of the market failure is not capable of being altered, even by government, as it reflects intractable ignorance.
- There are inherent impediments to government obtaining the information needed to design and implement effective and efficient intervention. As much of the information is tacit and informal, the impediments can be fatal to the success of intervention from the community's perspective.
- Even if the informational impediments are not fatal, intervention may fail due to the nature of the public sector. There are limits on the public sector's ability to align the incentives faced by public officials with the public interest. While such 'principal-agent' problems exist in the private sector, constitutional government limits the use of private sector solutions.

The key policy issue, therefore, is whether to leave the solutions to private voluntary co-operation or to have the government intervene in the process. The choice as to which one will produce the 'least worst' outcome for the community as a whole reduces to the need for a realistic assessment of the expected consequences of continued market failure versus the risk of government failure.

Addressing the impediments to international competitiveness

Now that comparative advantage is more likely to be man-made it may be thought that government has a larger role in its creation. This may be so but the role is essentially the indirect one of ensuring the continued health of those institutions critical to the maintenance and development of comparative advantage, while actively removing any artificial impediments to international competitiveness.

The specific institutions that are crucial to the development of international competitiveness over the longer term are those concerned with: the education and training of the workforce; the conduct of research and development; and the dissemination of business innovations.

The education and training institutions are important to the formation of the human capital utilised by business.

Research and development organisations make an important contribution to business innovation through the successful commercialisation of their output by business. The research and development institutions provide the advances in science and technology that form the basis of significant business innovation. At the same time, business innovation occurs in every aspect of a business, including processes and marketing. Finally the faster that technological progress and

or Success: The New Debate, Edward Elgar, Cheltenham, UK; and Tyler Cowen, 2007, 'Public Goods and Externalities', in David Henderson (ed.), *The Concise Encyclopaedia of Economics*, 2nd edition, Liberty Fund Inc, Indianapolis, IN [accessed at <http://www.econlib.org/library/Enc/PublicGoodsandExternalities.html> on 16 April 2008],

business innovation are disseminated throughout the economy the more quickly the potential benefits are realised.

The role of government in the process of creating and sustaining these institutions is not to displace the non-governmental organisations of civil society that provide education and training or conduct research and development. Rather it is to ensure that such organisations have access to the resources, which are necessary to operate effectively and efficiently. This may, and often does, require the provision of public funds for this purpose as well as the public setting of appropriate standards to be observed by the relevant organisations.

The other major role for government is to remove artificial impediments to international competitiveness. They include the impediments that are created, often incidentally, by public policy measures that impose excessive burdens on the cost of doing business for the export sector of the economy.

Such cost burdens generally inhibit the ability of those sectors of the economy, which are exposed to international trade — namely the export and the import-competing industries, to compete for resources within the domestic market. In Australia most of its trade-exposed industries are price takers in world markets so that their behaviour does not affect the prices that they receive for their output. In contrast, the behaviour of the non-trade sector does affect the prices that it receives from the domestic market where all of its output is sold.

The trade-exposed sectors cannot pass on such cost burdens as higher prices but the non-traded sector can. The cost burdens in question will tend to reduce the ability of the trade-exposed sectors to compete for inputs in the domestic market, so they tend to contract relative to the non-traded sector. This reduces the productivity of the economy and the living standards of the community.

The more prominent areas of public policy that are relevant in this regard are:

- fiscal and monetary policy;
- labour market participation and regulation;
- education and training;
- business regulation and taxation;
- economic infrastructure; and
- industry and trade policy.

The contributions of each of these areas of public policy to the international competitiveness of the export sector in Australia will be canvassed in Chapter 4 of this submission. Before doing so, however, Chapter 2 will highlight why the competitiveness of the sector is important to Australia and Chapter 3 the factors that have underlain its evolution over recent years.

2. Importance of International Competitiveness to Australia

The international competitiveness of its export and import competing sectors is important to Australia for two reasons.

- It facilitates greater specialisation. A country can increase the extent to which it concentrates on producing the goods and services it does best.
- The exposure to trade enhances competition in the domestic market and ensures that Australian businesses have access to the most competitively priced business inputs.

Both increased specialisation and enhanced competition in the domestic market will drive the economy towards greater economic efficiency, over both the short and the long run, thereby raising national productivity and living standards.

The benefits from each of these effects will be canvassed in turn.. The Chapter will conclude with a discussion of their implications for the different sectors of the Australian economy. In doing so it will highlight the sectors in which the members of the BCA have most of their business operations.

The benefits of greater specialisation

Specialisation allows an individual, a business or an industry to become more productive in a number of ways.

- Specialisation helps improve workplace skills — where tasks are performed more frequently there is scope for ‘learning by doing’.
- Specialisation reduces the time that would otherwise be lost by workers switching between tasks in the workplace.
- It provides the scope for developing specialised plant and equipment that is more productive.

Access to foreign markets represents an important opportunity to extend specialisation beyond the domestic market. This is particularly important for those countries, such as Australia, which have a relatively small population base and a relatively small economy compared to their prospective trading partners.

Export competitiveness means a country profitably produces some things in greater quantities than it needs for its own requirements, if any, and sells the excess on world markets. These exports provide the foreign exchange that the country then needs to purchase those goods and services in which it is not internationally competitive but which foreigners can produce more cheaply.

The strategy whereby each country specialises in producing only certain goods and services and relying on international trade to fulfill the balance of its domestic needs is more efficient than the alternative of self-sufficiency. Each country that

takes advantage of the opportunities for the greater specialisation that international trade offers is invariably better off as a consequence. After a shaky start Australia has finally started to fully embrace these opportunities.

Before Federation, Australia's comparative advantage was firmly based on its extensive natural resource endowments, including arable land and mineral deposits, and a very low population density. These endowments meant that the nation's economic development up to that point was dominated by rapidly expanding agricultural and mining sectors. These two sectors produced the vast bulk of the nation's export income which was used to import most of the plant and equipment and many of the manufactured goods that its population required.

The subsequent evolution of the Australian economy, however, was strongly conditioned by the new Federal Government's embrace of a policy package built around: centralised wage determination; comprehensive tariff protection for the emerging manufacturing sector; and extensive regulation of business.

By the early 1980s it was clear that Australia had missed out on many of the benefits of international specialisation. Its manufacturing sector was highly fragmented and mostly internationally uncompetitive. Its traditional export industries had been constrained by having to bear the bulk of the economic burden that public policy had created. Finally the hope of an economic transition to a future based on export manufacturing had been unfulfilled as the services sector had emerged as the dominant sector of the economy. Australia had been largely bypassed by the explosion in intra-industry trade that underlay much of the long term growth in global trade and its tendency to grow faster than global production.

Wide-ranging microeconomic reforms since the early 1980s have turned this around. They included floating of the Australian dollar, progressive dismantlement of tariff protection, the abolition of much industry assistance and extensive deregulation of key sectors of the economy, such as financial services. As a consequence, Australia has undergone a substantial structural transformation and has emerged with a much more internationally specialised industrial base that accounts for significant manufacturing and services exports.

Benefits of increased competition

Ultimately competition or the credible threat of competition is the spur that drives all economic progress. This includes the gains from realisation of opportunities for greater specialisation, as discussed previously.

- Competition means businesses constantly look for ways to save costs by producing each unit of output with the smallest quantity of inputs.
- Competition drives businesses to cut back on their less profitable products and expand their more profitable ones. The economy shifts to produce the mix of goods and services, which is most highly valued by consumers.
- Competition encourages the innovation that raises productivity and living standards. This focuses on the development of new products, variations of

existing products, applications for existing products, ways to produce and/or distribute products, and markets for existing products.

The Australian market for many products tends to be small relative to the minimum economic scale of the technologies that are used for the production and distribution of most goods and services. In turn this means that the local market cannot support more than a few domestic producers for many goods and services. Sometimes it means that only one producer will emerge.

When it comes to the strength of competition in a market, however, it is the extent of the barriers to entry to the market that counts most. The barriers to entry are generally much more significant than the number of producers in the market, and certainly over the longer run.

This underlines how important a credible threat of entry is to market performance and why the scope for international producers to supply a domestic market is generally the most powerful expression of such a competitive threat. In the case of countries, such as Australia, which have relatively small domestic markets and relatively few domestic producers the benefits of increased competition are most easily realised by reducing the barriers to international trade.

BCA & international competitiveness

The exposure of the BCA membership to international competition may be illustrated in terms of the Australian and New Zealand Standard Industrial Classification (ANZSIC) as published by the Australian Bureau of Statistics.

This involves allocating the BCA membership by the ANZSIC Sub-Division or Industry Group that captures their principal business operations conducted in or from Australia. In a small number of cases, such an allocation is not representative of the business as a whole as they have significant business operations in more than one ANZSIC Industry Division.

ANZSIC Divisions, Sub-Divisions and Industry Groups differ in the extent to which they are internationally competitive at the present time and the differences are substantial. This reflects the effects of both the natural and artificial barriers to international trade in the products that they produce. For example, other things being equal, the import competing Industry Groups will have a degree of natural protection in the Australian market that usually gets competed away in the case of the export sectors that supply local consumers. .

Even in the absence of man-made trade barriers, some Industry Groups are completely insulated from import competition. Such insulation is a consequence of the natural barriers to trade due to the effects of climate and geography.

The quarrying of stone aggregate for construction is a good example of a non-traded good. The high cost of transporting stone aggregate relative to its value in construction is so low that trading it internationally is generally highly uneconomic.

For other mineral products, such as coal and metal ores, the natural trade barriers are relatively low compared to their value in use so that they only have, at best, a modest influence on their extent to which they may be traded internationally.

In the case of most goods, the natural barriers to international trade are generally captured by the insurance and transport costs that are involved in getting them from the producer to the consumer.

Services are intangible by their very nature and therefore they generally have to be delivered to the end-user by the service provider. There are various ways in which delivery can be made — by way of a network of physical service outlets located close to the end-users and/or the use of extended transport or telecommunications networks to deliver the service.

The upshot of this characteristic is that international trade in services generally requires investment in some form of physical presence in the country where the potential end-users are located. This, in turn means, that the barriers to international investment can be as important to international trade in services as any barriers to the delivery of those services themselves.

Given the growth in the share of services with economic development and the proliferation of regulatory regimes for many services and much foreign investment, the extent of the regulatory barriers to trade in services and to foreign investment has assumed far greater importance than used to be the case. That said, it is reasonable to conclude that overall Australia maintains a very liberal foreign investment regime and has made significant progress in reducing its regulatory barriers to trade in services, especially in financial services, transport and telecommunications.

The ANZSIC Industry Divisions that are naturally exposed to international trade are Agriculture, forestry and fisheries, Mining, and Manufacturing. They account for most of the goods produced in Australia and virtually all of its merchandise exports. In the case of Agriculture, forestry and fisheries, and Mining the trade exposure is generally very high. Indeed, with the exception of quarrying, the Mining Division is the most internationally competitive sector of the economy. In Manufacturing the exposure is not as high due to the presence of tariffs barriers, which are generally low but variable.

The BCA membership is strongly in evidence across the Mining and Manufacturing Divisions but largely absent from Agriculture, forestry and fisheries, reflecting the fact that it is dominated by relatively small, family-run enterprises. The exception is in forestry.

International competitiveness varies considerably across the 15 Industry Divisions of the services sector, both within and between the Divisions. Transport and storage is at one extreme. The natural barriers to air and sea transport services are generally relatively low, although the regulatory barriers are often not insignificant. In both cases, however, the principal business activities of the relevant BCA members are conducted in international markets. At the other end of the scale there is virtually no scope for international competition, such as in electricity, gas and water supply.

3. External Performance of Australian Business

Australia remains a robust economy. Underpinned by structural reforms and sound macroeconomic management, the Australian economy has shown considerable resilience to economic shocks in recent years and has enjoyed a long period of strong and sustained economic growth.

Australia is an open economy with a transparent trade policy regime. It maintains relatively low tariff levels, few non-tariff barriers, an open services sector and a liberalised foreign investment regime. Australia's two-way international trade in goods and services was valued at \$443.6 billion in 2006-07.

Exports contribute significantly to the Australian economy, comprising around 20 per cent of the country's GDP. In 2007, Australia's exports of goods and services were valued at \$218 billion.

The largest exports are in minerals and fuels, accounting for 33 per cent of the total receipts, followed by services (22 per cent), manufactures (21 per cent) and rural products (11 per cent). Coal, iron ore, travel services (including education services), gold, crude oil, aluminum, natural gas and agricultural commodities are the top export earners.

Trends in total exports & investment

Over the last five years, Australia's total exports of goods and services have grown by an average of 7.5 per cent a year in value terms.⁷

Exports of Australian primary products have grown by an annual average of 9 per cent since 2001-02. They continue to be a major source of economic prosperity for the country. In 2006-07 the value of mineral and energy exports rose by 10 per cent to \$74.2 billion. Exports of elaborately transformed manufactures (ETMs) have grown at an average annual rate of 3.7 per cent since 1996-97.

Services exports rose 10.5 per cent to \$46.2 billion in 2006-07, following growth of 5.4 per cent in 2005-06. This has been led by strong export growth in educated-related travel services, other personal travel services and other business services, which grew 16.1 per cent, 6.6 per cent and 21.7 per cent, respectively.⁸

Despite one of the longest resources boom in history, there has been a significant deterioration in Australia's export performance in recent years. Australia's exports growth, both in value and volume terms, have declined in recent years.

⁷ DFAT [Department of Foreign Affairs and Trade], 2008a, *Trade and Investment*, Australian Government, [accessed at http://www.dfat.gov.au/aib/trade_investment.html on 21 April 2008]

⁸ DFAT [Department of Foreign Affairs and Trade], 2008b, *Australia, Trade in Services Australia 2006-07*, Australian Government, March

The value of Australia's exports of goods and services rose by 3.4 per cent over the year to February 2008, while its imports rose by more than 11.6 per cent during the same period.⁹ In seasonally adjusted terms the value of total exports fell 4 per cent between January and February 2008 to \$18.3 billion.

Trends in net exports & foreign investment

Between 1997 and 2007, Australia encountered negative net exports in all but three years, with net exports, in seasonally adjusted terms, subtracting a full percentage point from GDP in the December quarter of 2007. Exports accounted for a little more than one-eighth of the GDP growth over the five-year period to 2007, while between 1980 and 2001 it had comprised nearly one-third the growth in GDP.

Australia has encountered trade deficits for more than five consecutive years now. The monthly trade deficit — in seasonally adjusted terms — reached \$3.3 billion in February 2008. This represented a 30 per cent increase over the previous month.¹⁰

The \$6.9 billion trade deficit recorded for the December 2007 quarter was the worst quarterly trade deficit on record thus far.¹¹ Current account deficit has soared to record levels of around 5.5 per cent of the GDP.¹²

Growth across most export sectors has slowed. Recently released statistics show that, seasonally adjusted non-rural exports fell 7 per cent to \$10.7 billion over the month to February 2008. Similarly exports of other goods fell 1 per cent, while exports of rural goods rose 1 per cent to \$2.2 billion over that same period. Services exports recorded a 1 per cent decline as well.¹³

Growth in the value of exports, particularly in the resources sector, has been driven primarily by price rises with volumes still lagging. In volume terms, total exports rose by a very modest 3.8 per cent from 2005-06 to 2006-07, while prices received for exports rose by 6 per cent.¹⁴

The stock of foreign investment in Australia — including portfolio, direct, financial derivatives and other investment — totaled \$1.6 trillion as at 30 June 2007. The stock of Australian investment abroad totaled \$921 billion.

Trends in agricultural exports

The output of the agricultural sector, measured at farm-gate, contributes approximately 3 per cent of Australia's GDP. In 2006-07, agricultural products accounted for more than 16 per cent of Australian merchandise exports.

⁹ ABS [Australian Bureau of Statistics], 2008a, *International Trade in Goods and Services, Australia*, Catalogue No. 5368.0, Canberra, February

¹⁰ ABS 2008a

¹¹ Minister for Trade, 2008, *Australia and the Multilateral Trade System – Seizing the Opportunities*, Address by the Hon. Simon Crean, the Minister for Trade to The Lowy Institute, Sydney 28 February [accessed at http://www.trademinister.gov.au/speeches/2008/080228_lowy.html]

¹² ABS [Australian Bureau of Statistics], 2008b, *Balance of Payments and International Investment Position, Australia, December 2007*, Catalogue No. 5302.0, Canberra, March

¹³ ABS 2008a

¹⁴ DFAT 2008b

Farm production has been severely reduced as a result of the widespread and prolonged drought. In 2006-07, the gross value of Australian farm production was estimated at \$34.4 billion, which was down by \$4 billion compared to 2005-06.

The strength of the Australian dollar has been flagged as a major impediment to the expansion of farm exports. Global supplies shortages have led to steep rise in costs of key farm inputs, such as fuel and fertilisers.

Trends in mineral exports

The minerals sector has contributed substantially to Australia's most recent economic boom. The value of Australian mineral resources exports — excluding exports of crude oil, LPG, LNG, bunker fuel and other petroleum products — increased 16 per cent to \$90.8 billion in 2006-07.¹⁵

While the value of Australian mineral resources exports almost doubled between 2002-03 and 2006-07, the growth has mainly been driven by price increases. The All Minerals and Metals Price Index published by the Mineral Council of Australia shows that prices increased approximately 91 per cent during the period from 2002-03 to 2006-07. In contrast, minerals output, as measured by the MCA's Mine Production Index, increased by only 4 per cent.¹⁶

Despite the bullish outlook for global demand in the minerals commodities produced in Australia and steady prices, Australia's minerals exports are forecast to increase by only 3 per cent to \$94 billion in the year to June 2008.¹⁷

In the 12-months to June 2007 the volume coal produced increased by only 2 per cent.¹⁸ Exports of coal as a result have been adversely affected, growing at a modest rate of 4 per cent a year over the past four years. Between the months of January and February in the current year, exports of coal, coke and briquettes were down by 21 per cent. This is in contrast to an average January to February fall of 14 per cent experienced over the last three years.¹⁹

Metallurgical coal exports were down 26 per cent in February 2008. Notwithstanding a 3 per cent increase in prices, the volume of metallurgical coal exports has fallen by 29 per cent, thus leading to a fall in the value of exports.²⁰ Exports of non-metallurgical coal were also down by 17 per cent with volumes having declined 19 per cent, despite a 2 per cent rise in prices for the product.²¹

Exports of metal ores and minerals fell by 15 per cent during January to February 2008. This compares poorly to an average January to February rise of 11 per cent in the previous three years.²² Exports of crude oil and condensate also fell at an average rate of 14 per cent a year.²³

¹⁵ MCA [Minerals Council of Australia], 2008a, *2008-09 Pre-Budget Submission*, Canberra, January

¹⁶ MCA 2008a

¹⁷ MCA 2008a

¹⁸ MCA 2008a

¹⁹ ABS 2008a

²⁰ ABS 2008a

²¹ ABS 2008a

²² ABS 2008a

²³ MCA 2008a

Trends in manufactured exports

Growth in Australian manufactured exports has slowed markedly in the current decade, with exports growing at an annual average rate of 2.7 per cent since 2000-01, well below its 20-year average of 10.5 per cent.

A large part of this fall is attributed to the decline in prices received for manufactured goods, which fell by 12 per cent, largely due to the steady appreciation in the Australian dollar over the period in question.

Over the 1990s the value of manufacturing exports grew by an average of 12.4 per cent a year, while the volume rose by an average of 12.7 per cent a year. Between 2001 and 2006, the value of manufacturing exports grew by only 4.4 per cent.

Trends in services exports

The services sector accounts for about three-quarters of Australia's GDP, and are an increasing component of Australia's total exports — representing more than a fifth of the total value of exports. This share is steadily increasing.

While there is a rapidly growing global demand for services and a greater focus on the sector's potential as a key driver of economic prosperity, it has not translated into optimum growth in services exports.

The value of global services exports grew by 10.7 per cent from 2005 to 2006²⁴. In contrast Australia's services exports only grew by 8 per cent over that period so its share of global services fell from 1.45 per cent in 1996 to 1.17 per cent in 2006.²⁵

The growth in Australia's services exports has slowed considerably. Between 1999-2000 and 2006-07 Australian services exports grew by an average 6.5 per cent a year. This was about half their average over the previous 16 year period that began with the floating of the Australian dollar in 1983.²⁶

Services exports, in seasonally adjusted terms, fell by 1 per cent between January and February of this year. The services that contributed to this fall included: travel services and freight services exports which fell by nearly 2 per cent each, and transportation services exports which were down by around 1 per cent.

Slower growth in transport services exports have been mainly driven by weak freight services exports. The decline in travel exports is estimated to be largely a consequence of weak growth in personal tourism and a slowdown in business travel.²⁷ Personal tourism exports valued at \$11.5 billion in 2006-07, has grown by an average of just 2.7 per cent per year since 2000-01, compared with rates of above 10 per cent per annum during the 1990s.²⁸

²⁴ The value of world exports of services are presented in US dollars (DFAT 2008b)

²⁵ DFAT 2008b

²⁶ ABS [Australian Bureau of Statistics], 2008c, *Australian Economic Indicators*, Catalogue No. 1350.0, Canberra, April

²⁷ Business Council of Australia, 2007a, *Underserved: Why Australia's Services Economy Deserves More Attention*, Discussion Paper, Melbourne, July

²⁸ ABS 2008b

The slowdown in the ‘other services’ exports, comprising largely business-related services exports, have also been particularly striking, with exports in this category growing by an average of just 5 per cent per annum over the past five years relative to the 12.2 per cent rise on average per year during the 1990s.²⁹

Factors driving external performance

Australia enjoys a highly stable economy with a low reliance on trade taxes, a fully floating exchange rate regime, and strong market-oriented policies. Its vast landmass along with a relatively small population has naturally led to Australia having strong comparative advantage in agricultural commodities, particularly in extensive livestock and crop production such as beef, sheep, wheat and sugar.

Australia also has had a strong comparative advantage in the extraction and refining of minerals and ores. The mining sector has evolved to the point where it is highly internationally competitive and is the largest export sector in the economy. Coal and iron ore were Australia’s two largest exports in 2007. Australia’s recent economic growth has been led to a large extent by a global boom in demand for minerals products, of which Australia is a major exporter.

Australia’s recent prosperity, while driven largely by external events — most notably China’s economic take-off and the related terms of trade improvements — may be attributed extensively to the benefits of the process of domestic economic reform that was begun in the mid-1980s. Without those domestic policy reforms, the Australian economy country would not have been able to capitalize on the external opportunities that have presented themselves. .

Wide-ranging reforms to monetary and fiscal policy, reductions in import protection and barriers to foreign capital, introduction of domestic competition laws, deregulation of the financial market, floating of the exchange rate, taxation reform and deregulation, particularly in the labour market, have been the basis for stable progress. Progressive liberalization led to a wider acknowledgement of comparative advantages and comprehensive restructuring in the various sectors.

The result has been increased specialization and innovation by Australian business, followed by improvements in productivity and international competitiveness of Australian produced goods and services. These gains have enabled real GDP to grow at an average of about 3.5 per cent a year over the past 15 years.³⁰

Strong business performance in recent years have been underpinned by extensive business innovation and research and development (R&D), aimed at increasing productivity, building new markets and boosting international competitiveness. Australian businesses spent more than \$10 billion on R&D in 2005-06, an increase of 11.8 per cent in real terms over the previous year.³¹ To encourage private sector

²⁹ ABS 2008b

³⁰ WTO [World Trade Organization], 2007, *Trade Policy Review- Australia: Report by the WTO Secretariat*, WT/TPR/S/178, January

³¹ DFAT [Department of Foreign Affairs and Trade], 2008c, *Research and Development*, Australian Government, Canberra, [accessed at http://www.dfat.gov.au/facts/research_development.html on 6 May 2008]

investment in R&D, the Australian Government provides tax concessions of up to 175 per cent for eligible expenditure on R&D.

The emerging challenges

Australia is, nevertheless, facing with numerous challenges. The long period of economic growth has fueled capacity constraints in the economy. Exports are underperforming. Infrastructure constraints have begun to surface as a result of dramatic increase in the demand for mineral products. Productivity growth has been particularly weak in the last couple of years.

The economy is currently running at almost full capacity, with record low unemployment. Inflationary pressures at home are leading to rising interest rates. The significant strengthening of the Australian dollar is also putting strong pressure on Australian exporters. Population ageing will significantly reduce workforce participation in the near future, adding further problems to the already tight labour market and the associated rise in health and social welfare costs.

In the face of these challenges the Australian Government must embark on a renewed program of economic reform. The program needs to build on the success of previous reforms by looking to eliminate the remaining impediments to international competitiveness of the Australian export sector and thereby secure further advances in prosperity for all Australians.

4. Impact of Policy on the External Performance of Australian Business

Australia's future prosperity is inextricably linked to its long-term productivity and the external performance of its businesses in global markets. The increasingly competitive nature of those global markets demands that our businesses must operate to the best of their ability to be successful. It is only through sustained productivity improvement and international success that standards of living can be raised by way of higher shareholder returns and real wages.

This Chapter addresses the need for comprehensive policy reforms to remove the impediments to international competitiveness and productivity growth for the export and import competing industries. It proposes specific changes to current policy measures to realise those reforms and translate gains in competitiveness into improved trade and investment performance. In doing so this Chapter draws heavily on the body of policy analysis recently published by the BCA.

The areas of public policy examined in the Chapter are the following:

- Macroeconomic policy;
- Productivity and business innovation;
- Workforce participation;
- Labour market regulation;
- Education and training;
- Business regulation;
- Economic infrastructure;
- Tariff and non-tariff barriers; and
- Trade facilitation programs.

Macroeconomic policy

The Australian economy is currently undergoing one of the longest periods of sustained economic expansions on record. It is in its 17th consecutive year of real GDP growth,³² and continues to ride high on the global commodities' boom driven primarily by rapid growth in China, India and other emerging economies.

This sustained economic growth reflects two decades of well-managed structural reforms that have helped transform Australia's economic performance. A wide-ranging program of domestic economic reform has helped to remove policy-related distortions and impediments facing the economy and improved its growth prospects. It has opened the domestic economy to global competition, deregulated domestic markets and liberalised domestic institutions.

The 1980s saw the floating of the dollar, financial liberalization, removal of foreign exchange and interest rate controls, as well as comprehensive trade liberalisation. In 1993 the Reserve Bank of Australia introduced an inflation

³² Kristy Laurie and Jason McDonald, 2008, 'A perspective on trends in Australian Government spending', *Economic Roundup*, The Treasury, Canberra, Summer [accessed at www.treasury.gov.au/documents/1352/PDF/03_spending_growth.pdf in May 2008]

targeting regime for monetary policy with the aim of keeping underlying rate of inflation between 2 and 3 per cent a year, on average, over the business cycle.

The challenges for macroeconomic management

Today Australia is a \$1 trillion economy that has enjoyed sustained growth of over 3 per cent a year since 1990. Its residents enjoy one of the highest standards of living in the world, ranking seventh among OECD countries in terms of GDP per capita; a marked improvement from its position in 1990.³³ It is one of the few OECD countries to have eliminated general government debt.

A strong economy has resulted in remarkable growth in government revenues. A total of \$87 billion has been added to Federal revenues since 2002,³⁴ with Federal tax revenues up by around 30 per cent since 2002-03. A substantial portion of this growth has been from corporate taxes. From 2001-02 to 2006-07, the share of corporate taxes in overall government revenue rose from 17.4 per cent to 24.4 per cent, making it one of the fastest growing sources of public revenue.³⁵

The underlying budget surplus has ranged between 1.0 and 1.6 per cent of GDP since 2001-02.³⁶ Sustained fiscal consolidation has meant that, with the exception of a small deficit in 2001-02, the Government has maintained an underlying budget surplus since 1996-97. The fiscal outlook for Australia remains strong. The Federal Government is forecasting another budget surplus for 2007-8.

Over the past decade the budget surpluses have been accompanied by significant increases in spending. In real terms, Federal spending has grown by over 51 per cent since 1997-98, from \$175 billion to an estimated \$264 billion in 2007-08, and is projected to reach \$282 billion by 2010-11.³⁷

Tax expenditures³⁸ (i.e. 'tax concessions') have also grown strongly since 1997-98. Real tax expenditures have grown by 51 per cent, from \$33.1 billion in 1997-98 to \$49.9 billion in 2007-08, and are expected to grow further by 2010-11.³⁹

On the other hand, the length and extent of the most recent economic expansion means that growth is now running up against supply-side constraints. The unemployment rate is a 33-year low, having fallen to 4.1 per cent in January 2008. Workforce participation is at a record high; the market for skilled labour is extremely tight. Capacity utilisation is high. The cost of business inputs is accelerating; for instance, over 2007 the real cost of Australian minerals exploration increased 9 per cent to \$139 per metre drilled.⁴⁰

³³ BCA [Business Council of Australia], 2008a, *BCA Budget Submission 2008-09: Budgeting for prosperity*, Melbourne, February

³⁴ BCA 2008a

³⁵ BCA 2008a

³⁶ DFAT [Department of Foreign Affairs and Trade], 2008, *Australia: A competitive Economy*, Australian Government, Canberra [accessed at http://www.dfat.gov.au/aib/competitive_economy.html in May 2008]

³⁷ Laurie & McDonald 2008

³⁸ Tax expenditures are concessions, benefits and incentives paid through the tax system

³⁹ Laurie & McDonald 2008

⁴⁰ MCA [Minerals Council of Australia], 2008b, *MCA Economic Activity Brief for the period ending December 2007*, Canberra, 6 March

Domestic demand expanded by 5.3 per cent over 2007, well in excess of the trend rate of growth in productive capacity.⁴¹ In the same period, the rate of change in prices of non-tradable goods and services, which measure domestic inflationary pressure, was estimated at 4.1 per cent.⁴²

Inflation is at a 16-year high. A combination of strong and sustained economic growth and loose fiscal policy has helped domestic demand to outpace domestic production, thus creating inflationary pressures in the economy. Much of Australia's price pressures are home-grown as the economy booms.

This has warranted a tightening of the monetary policy, in turn leading to higher interest rates. As noted by Treasury Secretary Ken Henry

‘...expansionary fiscal policy tends to crowd-out private activity: it puts upward pressure on prices which, all things being equal, puts upward pressure on interest rates.’⁴³

The Reserve Bank raised its benchmark-lending rate by 25 basis points, to 7.25 per cent on 12 March 2008. This was the 12th consecutive increase, and the second this year.

Escalating world commodity prices and rising interest rates due to a strong domestic economy, have led to significant exchange rate appreciation. The Australian dollar has reached a 20-year high against the United States dollar, trading at just over 92 US cents in mid-April 2008. Over the last five years the Australian dollar has risen by around 35 per cent against the currencies of Australia's major trading partners.

The export sector is a key contributor to the Australian economy, representing around 20 per cent of GDP. Export markets are crucial for Australian businesses, both in terms of revenue as well as scale for capital investment and innovation. The relative value of the Australian dollar is therefore an important determinant of international competitiveness of Australian exporters.

The strengthening of the Australian dollar has restrained the export sector by reducing its international competitiveness. If unaddressed it threatens further losses of export market share. In the manufacturing sector the appreciation stands to reduce the annual value of Australia's manufactured exports by about \$1.7 billion in the short term.⁴⁴ In a recent Australian Industry Group survey, over 65 per cent of Australia's manufacturers responded that the appreciation

⁴¹ Reserve Bank of Australia, 2008, *Statement on Monetary Policy*, Sydney, 11 February, [accessed at http://www.rba.gov.au/PublicationsAndResearch/StatementsOnMonetaryPolicy/Statements/statement_on_monetary_0208.pdf in May 2008]

⁴² The Economist Newspaper Ltd, 2008, 'Australian Economy: Hawks in the outback', *The Economist*, 6 March [accessed at http://www.economist.com/finance/displaystory.cfm?story_id=10809492 in May 2008]

⁴³ Ken Henry, 2007, *Treasury's Effectiveness in the Current Environment: Address to Staff*, Secretary to the Australian Treasury, Canberra, 14 March, p. 9

⁴⁴ Australian Industry Group, 2007, *The Australian Dollar and Manufacturing Exports: Shaping earnings and prospects*, June

had adversely affected their export activities.⁴⁵ The outlook indicates that the dollar will remain fairly strong over the medium terms.

The rapid expansion in demand and subsequent growth in output and employment in recent years has reduced excess capacity in the economy. Capacity utilisation is 83 per cent, which is high in seasonally adjusted terms.⁴⁶ The evidence of capacity constraints is pronounced. The job vacancy rate has increased, signaling a tight labour market and fuelling strong wages growth. There is a wide-spread shortage of skilled labour. Job vacancies in the minerals sector, one of the hardest hit, have grown five-fold since 2002.⁴⁷

Real GDP is forecast to grow by 3¾ per cent in 2007-08, up from 2½ per cent in 2006-07,⁴⁸ reflecting a partial recovery from the drought and the prospects of a further rise in commodity prices. The prices for coal and iron ore, two of Australia's main exports, are likely to increase sharply when the latest contract negotiations are finalised. These factors are likely to exert further pressure on the already supply constrained Australian economy.

Despite the slowdown in global activity due to the weakening US economy, high oil prices and the sub-prime financial crisis, higher commodity prices and a rebound in farm output should sustain reasonable growth in Australia over the next couple of years. Continued economic expansion in China and India should continue to provide momentum to the global economy, which should translate into large commodity price increases. Australia's terms of trade will further improve, at least in the short-run, exacerbating its supply constraints.

The IMF has warned about the near term challenge of avoiding any further economic stimulus.⁴⁹ The new Federal Treasurer has called for an end to using budget surpluses to provide tax cuts. The Government has signaled that it is aiming at a surplus of at least 1.5 per cent of the GDP.⁵⁰

Recommendations for reform

A renewed commitment to reform is required for Australia to prosper in the face of these challenges and to sustain its rate of growth beyond the current boom. The key to boosting prosperity lies in enhancing the economy's productive capacity and increasing the international competitiveness of its export sector.

⁴⁵ Australian Industry Group, 2007

⁴⁶ National Australia Bank, 2008, *National Monthly Business Survey & Economic Outlook*, Melbourne, March

⁴⁷ MCA 2008a

⁴⁸ The Australian Government, 2007, *Budget Paper No. 1: Budget Strategy and Outlook 2007-08*, Canberra, May

⁴⁹ IMF [International Monetary Fund], 2007, *Australia: 2007 Article IV Consultation—Staff Report; Staff Supplement; and Public Information Notice on the Executive Board Discussion*, IMF Country Report No. 07/314, Washington, DC, September

⁵⁰ David Uren, 2008, 'We'll hoard budget surplus - Wayne Swan', *The Australian*, 8 February, [accessed at <http://www.news.com.au/story/0,23599,23179313-2,00.html> in May 2008]

Policy makers must focus on prudent macroeconomic management with a view to raising the long-term capacity of the economy. Fiscal policy needs to reduce the excessive pressure it is placing on monetary policy, which in turn means that the exchange rate is higher than it would otherwise be.

This requires the Federal Government must to apply greater fiscal discipline and to reprioritize public spending. This means a thorough review of all government expenditures and spending priorities, tighter spending controls, and restoring greater accountability for and transparency in policy outcomes.

In particular, fiscal policy needs to reduce the burden it is placing on the international competitiveness of the export sector. Accordingly, a concerted effort is required to:

- reduce aggregate public spending;
- shift public spending towards workforce skills and export infrastructure;
- maintain the focus of monetary policy on containing price inflation;
- reform federal-state financial relations; and
- reduce red tape.

Productivity & business innovation

Productivity is an important determinant of the long-run economic growth. Australia's current economic expansion has been largely attributable to very strong productivity growth. Macro- and microeconomic reforms laid the foundations for the strong productivity performance of the 1990s.

Market sector productivity, in terms of output produced per hour worked, grew at 3.2 per cent per annum over the five years to 1998-99. This was the fastest five-year growth period in the last 30 years.⁵¹

Since the late 1990s productivity growth has added around half a per cent a year to average income levels.⁵² This explains around 80 per cent of the growth in GDP per person in Australia over the past twenty-five years.⁵³ Australia's multi-factor productivity (MFP) performance was ranked among one of the best in the OECD, with Australian labour productivity exceeding that of the US.

The slowdown in productivity growth

Since 2000 Australia's productivity performance has not fared as well, raising concerns about the economy's growth prospects. According to recent national accounts, Australia recorded a 0.7 per cent growth in its market sector productivity⁵⁴ over 2007.⁵⁵ In the five years to 2006-07, labour productivity

⁵¹ Ben Dolman, Lan Lu and Jyoti Rahman, 2006, 'Understanding productivity trends', *Treasury Economic Round-up*, The Treasury, Canberra, Summer

⁵² Department of Industry, Tourism and Resources, 2007, *Background Paper 1: Overview of Australian Industry*, Australian Government, Canberra, May

⁵³ Robert Ewing, Sian Fenner, Steven Kennedy and Jyoti Rhaman, 2007, 'Recent productivity outcomes and Australia's potential growth', *Economic Roundup*, The Treasury, Canberra, Winter

⁵⁴ GDP per hour worked has been taken as a measure of changes in labour productivity since estimates of GDP per hour worked are commonly interpreted as changes in labour productivity. However, it should be noted that these measures reflect not only the contribution of labour to

growth eased to an average of 1.6 per cent a year, as compared to 2.7 per cent a year from 1990-91 to 1999-00.

Although Australia and the US have very similar labour utilisation rates, there is a sizable productivity gap between Australian and the US — Australian workers are 20 per cent less productive than US ones on average. Australia's market sector productivity is 25 per cent below leading European economies. This indicates there is considerable scope for productivity improvements in Australia.

Over the last five years the mining sector has suffered one of the biggest slowdowns in productivity growth. Despite a 40 per cent rise in mineral prices since 2000-01⁵⁶, there has been no significant increase in mining output.

In 2006-07 the multi-factor productivity (MFP) index for mining was at a 17-year low.⁵⁷ The index had dropped by 12 per cent over the previous 12 months⁵⁸ and by over 26 per cent since 2000-01. This fall has translated into a reduction of 3.6 percentage points in the economy-wide productivity growth.⁵⁹

The services sector has also experienced a significant slowdown in productivity growth and it has affected most service industries. Those industries which had done particularly well during the 1990s were not immune: productivity in communications now stands at 83 per cent of the US level, compared to 114 per cent of that level in 1998. Similarly, productivity in finance and insurance has fallen to 67 per cent of the US level, down from 73 per cent in 1998.⁶⁰

Recommendations for reform

Productivity growth, along with increased workforce participation, is the key to meeting the challenge of sustaining and accelerating economic growth. In the absence of productivity improvements, businesses are unable to compete successfully, sustain increases in real wage or create new jobs as they grow.⁶¹

Strong productivity growth is essential for the export sector to be able to compete in international markets. A weak performance jeopardises its capacity to exploit opportunities overseas and to compete for resources domestically. As the ACCI has noted,

changes in production per hour worked, but also the contribution of capital and other factors, such as managerial efficiency, economies of scale, etc. (ABS [Australian Bureau of Statistics], 2008d, *Australian National Accounts: National Income, Expenditure and Product December 2007*, Catalogue No. 5206.0, Canberra, March)

⁵⁵ ABS 2008d

⁵⁶ Vernon Topp, Harry Bloch and Dean Parham, 2007, *Mining productivity: The case of the missing input?*, Productivity Perspectives 2007, December

⁵⁷ MCA [Minerals Council of Australia], 2007, *MCA Economic Activity Brief*, June

⁵⁸ MCA 2008b

⁵⁹ Topp et al 2007

⁶⁰ Business Council of Australia, 2007a

⁶¹ Business Council of Australia, 2008b, *Submission to the Senate Standing Committee on Education, Employment and Workplace Relations- Inquiry into the Workplace Relations Amendment (Transition to Forward with Fairness) Bill 2008*, Melbourne, February

‘A slowdown in productivity growth makes it significantly harder for Australia to maintain non-inflationary growth.’⁶²

The National Reform Agenda emphasises the importance of long-term productivity growth and the policy reforms required to sustain it. Most of the issues and policy solution are canvassed in detail later in this Chapter.

Business innovation is also an important source of productivity growth and generates substantial economic spillovers for the rest of the economy. A key driver of innovation is the demands of customers and clients in open and competitive markets.

The knowledge and skills of employees make a vital contribution to business innovation, as does the research and development that is conducted by government, the universities and business.

One of the key determinants of whether businesses invest in R&D is the strength of the business case for conducting research in Australia. This needs to be considered against the location of research facilities and researchers throughout the world and the research currently being conducted by others, if this can be determined. Other factors influencing R&D decisions include proximity to markets and key productive inputs.

The R&D tax concession can make a contribution to improving the business case for companies to invest in R&D. But it is important that the measures such as the R&D tax concession result in a net positive economic benefit by supporting R&D activity that has positive spill-over benefits and which would not have occurred otherwise. These are issues that should be carefully considered in the current review of Australia’s tax system.

In addition, infrastructure bottlenecks and regulatory burdens need to be addressed. These are addressed later in this Chapter.

Workforce participation

Increases in labour market participation have been important to Australia’s recent economic growth. It has brought the benefits of a larger workforce, including a major improvement in living standards and reduced demands on welfare services.

The demand for labour has grown rapidly in recent years. This has led to the rate of unemployment falling to a 33-year low, job vacancy rates rising to levels not seen in nearly three decades, and the workforce participation rate reaching record highs. The latter has risen from 61.3 per cent in 1980 to 65.2 in early 2008.⁶³

⁶² ACCI [Australian Chamber of Commerce and Industry], 2008, *ACCI 2008-09 Pre-budget submission to the Department of Treasury: Prosperity through productivity*, Canberra, p. 23

⁶³ ABS [Australian Bureau of Statistics], 2008e, *Australian Labour Market Statistics*, Catalogue No. 6150.0, Canberra, April

Labour and skills shortages pose major constraints for economic growth over the coming decade. Projections indicate that demand for labour at current wage rates will exceed the supply of labour. The resources sector alone is projected to require an additional 70,000 workers by 2015.⁶⁴

The overall workforce participation rate is projected to fall with population ageing. Australia is expected to have fewer people in the workforce over the next 30 to 40 years. The decline in participation rate will adversely affect growth in income per capita. The Productivity Commission projects GDP growth to fall to half the current rate, which would represent around \$4.1 trillion in GDP foregone to 2045.⁶⁵

Despite the strong growth in workforce participation to date, there is significant scope for improvement. A large proportion of the working age population remains outside the work force. As at 30 September 2006, there were 5.4 million people aged 15 years who were not in the workforce⁶⁶ and therefore represented a potential burden on the welfare system. At present, for every person who is wholly or mainly reliant on welfare there are just five workers paying income tax. This compares to 22 workers per welfare recipient in the mid-1960s.

Recommendations for reform

It is imperative for the Government to address comprehensively the barriers to workforce participation and employment with a view to reducing the chronic shortages of labour that are in prospect.

- Reforms are needed in the provision of education and training, and infrastructure. These are outlined below.
- The Federal Government must continue to support access by business to appropriate labour from overseas to address skills shortages.

A more responsive and more streamlined visa system is needed for managing temporary skilled migration. As competition for skilled labour intensifies globally, the Government must be at the forefront in dealing with the issues that adversely affect the attractiveness of Australia as a destination for permanent or temporary workers. These include tax barriers and regulatory procedures.

Labour market regulation

Effective labour market regulation is at the core of strong productivity growth across the economy.⁶⁷ This includes the realisation of continual improvements in the international competitiveness of the export sector.

⁶⁴ Diannah Lowry, Simon Molloy and Yan Tan, 2006, *The labour force outlook in the Minerals Resources sector: 2005 to 2015*, National Institute of Labour Studies, Flinders University, Adelaide, May

⁶⁵ Productivity Commission, 2005, *Economic Implications of an Ageing Australia*, Research Report, Canberra

⁶⁶ ABS [Australian Bureau of Statistics], 2008f, *Yearbook Australia 2008*, Catalogue No. 1301.0, Canberra, February

⁶⁷ Business Council of Australia, 2008b

Amongst other things, strong productivity growth depends on a business' hiring and training practices, the structure of its operations, and its systems for rewarding their employees for their contributions and efforts.⁶⁸ Increasing the flexibility of the labour market flexibility and promoting greater understanding between employers and employees are therefore critical to improved long-term productivity performance and workforce participation.

The Federal regime for regulating workplace relations has a direct impact on labour productivity and workforce participation. A quality regulatory regime would enhance job opportunities and provide employees with appropriate rewards for effort, skill development, and contributions to business innovation.⁶⁹

Reforms to the Federal regime have been a critical feature of the overall process of microeconomic reform over the past two decades, and have supported Australia's transition to a more productive economy. The challenge is now to build on past workplace reforms so as to maintain productivity growth and enhance the international competitiveness of the export sector.

Workplace regulation needs to allow a direct link between productivity and rewards. Where real unit labour costs exceed labour productivity there is the very real risk of inflationary wage breakouts and disincentives to job creation.

In the interests of economic prosperity and social harmony, labour market policy has to strike the right balance between productivity and labour costs. The ability of the export sector to align its unit labour costs and productivity is essential for its international competitiveness.⁷⁰

Recommendations for reform

The BCA supports a national regime for regulating workplace relations. Within such a regime, the BCA believes that regulation should maintain a safety net under the labour market and promote fairness in workplace relations.

The BCA recommends that the regulatory regime should allow businesses flexibility in relation to how they employ their workers, structure their operations and reward employees for their contribution, effort and performance. In doing so, the regime should allow for a wide range of options for agreeing employment terms and conditions. Enterprise-based agreements should continue to be at the core of the workplace relations system.

Despite many reforms over the years, the existing regulatory regime continues to impose a very complex system of minimum wages and conditions.⁷¹ As the BCA has previously noted,

‘The degree of specificity in Australia’s awards limits the scope to differentiate employee arrangements to reflect roles, efforts or

⁶⁸ Business Council of Australia, 2008b

⁶⁹ Business Council of Australia, 2008b

⁷⁰ Business Council of Australia, 2008b

⁷¹ Business Council of Australia, 2008b

capabilities, undermining flexibility in employment arrangements and productivity.⁷²

Award modernisation is a crucial part of any reform. The BCA actively endorses rationalisation and simplification of the award system so as to:

- establish a simpler regime for regulating workplace relations;
- promote flexibility and productivity in the workplace;
- support agreements made between employers and their employees at the enterprise level; and
- ensure that awards provide a genuine safety-net.⁷³

Overall, the reform of the regime should streamline administrative processes, minimize costs for government, employers and employees, and enhance workforce participation. Reform must focus on minimising the barriers and disincentives to workforce participation, as well as on improving incentives for skill development.⁷⁴

Education & training

One of the key challenges Australia faces is to remove supply constraints and bottlenecks so as to position Australia as a competitive, innovative, knowledge-based economy that can compete in the global markets.

The rising demand for labour has brought to the fore acute skills shortages. Job vacancies in the minerals sector have grown five-fold since 2002. Skill shortages are increasing wage pressures and reducing growth prospects in the economy. Current trends indicate that the working age population will grow by just a tenth of its current rate for the entire decade of the 2020s.⁷⁵ According to industry estimates, at current wage rates Australia will face a shortfall of 240,000 workers with Vocational Education and Training (VET) qualifications by 2016.⁷⁶

Ageing of the population is another major challenge as it threatens to reduce workforce participation. This is against a backdrop where approximately one million people do not participate in the workforce but have the capacity to do so, if the barriers to their participation were to be relaxed.⁷⁷

Addressing these challenges calls for, among other things, increased education and skills development. A flexible and responsive education and training system that recognises the needs of the economy is crucial to enhancing the skills and abilities of the workforce and of those who hope to enter it.

⁷² Business Council of Australia, 2008b, p. 6

⁷³ Business Council of Australia, 2008b

⁷⁴ Business Council of Australia, 2008b

⁷⁵ Access Economics, 2005, *The Economic Benefit of Increased Participation in Education and Training*, May

⁷⁶ Australian Industry Group, 2008a, *Facing up to Australia's Skills Challenge: Setting Priorities and Delivering Results*, April

⁷⁷ Business Council of Australia, 2007b, *Engaging our Potential: The Economic and Social Necessity of Increasing Workforce Participation* Melbourne

The benefits of investments in human capital in terms of productivity growth and workforce participation are well recognised. The Productivity Commission has estimated that an increase in educational levels has increased the workforce participation rate by up to 0.69 percentage points and productivity by 1.16 percent.⁷⁸ Other estimates support this; they indicate that an increase of 0.15 years in the education level of the workforce will boost productivity by 0.62 per cent, workforce participation by 0.48 per cent, and economic growth by 1.1 per cent over the period to 2040.⁷⁹

Investments in human capital will help to relieve capacity constraints and increase productivity. Despite rising demand for skilled workers, Australia's total public spending on education is only 4.8 per cent of GDP, which is below the OECD average of 5.4 per cent,⁸⁰ and growth in spending has been modest. Since 1995, Australia's public expenditure on tertiary education has fallen by 7 per cent, compared with an average increase by other OECD countries of 48 per cent.

Recommendations for reform

A comprehensive and sustained response to the emerging labour shortages is required if the export sector is not to see its international competitiveness eroded by rising real labour costs. Clear goals and priorities that constitute real and sustained progress must drive the education reform agenda of the Government.

The Federal Government needs to accelerate efforts to tackle skills shortages, including reform of the vocational education and training (VET) system.

Efforts must focus at improving the quality and increasing the number of workers with VET qualifications. Lifting the rates of participation and completion in VET should be a priority. Australia's vocational education system must be more flexible, market-driven and responsive to the changing skills demands of the economy. Options to increase the level of investment should be considered, including income contingent loans to students to fund VET fees.

The higher education sector needs to be better resourced and more responsive to employment trends and industry requirements. In this, it is important that the Government collaborate with the business sector in national planning and priority setting.

Reform must provide for greater flexibility in training packages to cover mature aged workers, people re-entering the workforce, independent contractors, people with disabilities and Aboriginals.

The Government should continue and expand the Workplace English Language and Literacy (WELL) program to assist in training workers in literacy in English and numeracy.

⁷⁸ Productivity Commission, 2006, *Potential Benefits of the National Reform Agenda*, Australian Government, Melbourne

⁷⁹ Access Economics, May 2005

⁸⁰ Australian Industry Group 2008a

Business regulation

Regulation has an essential role to play in correcting market failures and achieving broader social objectives but excessive regulation distorts and impedes sound business decisions to the detriment of economic performance. This is particularly so where regulation is inconsistent or duplicated across jurisdictions.

Cost of excessive regulation

The cost of excessive regulation is felt throughout the economy. For consumers it means higher prices and less choice; for employees, fewer jobs and lower real wages; and for shareholders, lower returns on investment and fewer funds for retirement. While very real, these costs can be difficult to quantify.⁸¹

There are three types of costs associated with excessive and inefficient regulation:

- Government administration costs borne by taxpayers.
- Compliance costs borne by businesses and consumers.
- Economic costs borne by all.

The **administration costs** are mostly the cost of the additional staff to design, implement and enforce regulation. For its assessment of the economic benefit of the National Reform Agenda, the Productivity Commission identified:

- Sixty Commonwealth regulators and national standard-setting bodies.
- Forty Commonwealth-State Ministerial Councils
- Up to 1,300 regulators spread across three levels of government, involving six states, two territories and some 700 local government areas.⁸²

The Commission also pointed to cases where multiple agencies in a jurisdiction performed the same function. The cost of running these public agencies is a major impost on Australian taxpayers and there was clearly an opportunity to rationalise the number of regulatory agencies.

The **compliance costs** include the costs of:

- The staff and management time spent ensuring that they comply with, monitor changes to, and update their regulatory obligations.
- Maintaining and developing up-to-date information and reporting systems.
- Regular reporting to the regulator.
- Obtaining professional advice (legal, financial, strategic, etc.).
- Implementation of company-wide compliance programs and education of the broader workforce about the company's regulatory obligations.
- In some cases, the cost of multiple licence, inspection and audit fees.

⁸¹ Alexander J Brown and Jennifer A Bellamy (eds), 2007, *Federalism and Regionalism in Australia: New Approaches, New Institutions?*, ANU Press, Canberra, ACT

⁸² Productivity Commission, 2006, p. 134

These costs will grow with the stock of legislation, the extent of differences across jurisdictions, and the frequency of changes to regulation. Moreover, the 'regulatory risk' faced by business rises with the number of regulatory controls.

Although these costs affect the competitiveness of all businesses, the costs can be particularly high for small to medium sized businesses. Consumers also bear costs where a significant amount of time and effort is required to understand product legislation, including the cost of obtaining professional advice.

OECD has found that Australia fares poorly compared to ten OECD countries in terms of the quality of contacts with public agencies to obtain decisions or permissions.⁸³ An overwhelming number of businesses felt it was unclear who was responsible for decisions and thought the process inflexible and bureaucratic.

The *economic costs* of regulation include the opportunity costs of foregone business activity due to overlapping regulation (particularly between the Commonwealth and the States) and disincentives to invest, innovate or expand.

There are also opportunity costs for consumers. For instance, complex or difficult to understand consumer protection legislation might lead some to forego making purchases and others to being offered a choice.

The economic costs are generally the largest and least visible of the costs of regulation.⁸⁴ Regulation is often imposed with the best of intentions but imperfect information and inadequate assessment mean that regulators often end up enforcing less than optimal requirements.

The diffusion of technologies and new ideas, the key drivers of economic growth, can be distorted or impeded by regulatory barriers. Overly restrictive product regulation limits the flow of productivity gains across an economy, even in countries with less restrictive regimes. Researchers at the OECD have concluded that countries can benefit by aligning their regulatory regimes with those of less restrictive countries.⁸⁵

Recent IMF research attributes much of Australia's recent productivity growth to greater product and labour market flexibility since the 1990s.⁸⁶ Deregulation has allowed the diffusion of technologies faster than in other OECD countries. This gives weight to BCA's claim that further reform via removal of regulatory inconsistency and overlap will yield further economic gains.

⁸³ OECD [Organisation for Economic Co-operation and Development], 2001, *Businesses' Views on Red Tape*, OECD, Paris, p. 120

⁸⁴ Access Economics, 2005, 'Benefits and Costs of Regulation', in Business Council of Australia, 2005, *Business Regulation Action Plan*, Melbourne

⁸⁵ They found that, from 1995 to 2003, '...if OECD countries had aligned the form and operation of regulation in non-manufacturing sectors to that of the least restrictive OECD country, the increase in annual productivity growth due to faster catch-up is estimated to range from 0.2 percentage points in the United Kingdom, which has one of the least restrictive regulatory environments according to OECD indicators to 1.8 percentage points in Greece.' (OECD Working Paper No. 509, Regulation, Competition and Productivity Convergence, September 2006 [accessed at [http://www.oecd.org/dataoecd/1/1/38312222.pdf](#)])

⁸⁶ IMF [International Monetary Fund], 2008, *Does Technological Diffusion Explain Australia's Productivity Performance?*, IMF Working Paper 08/4, Washington, DC, January

The BCA has highlighted that the fact Australian companies' efforts to meet higher performance standards are not helped by additions to the existing stock of prescriptive and often dysfunctional regulation.⁸⁷ Firms have expressed increasing concern that the overall regulatory environment in Australia is working against entrepreneurial risk taking and business transformation.

Australia's strongest performing sectors are most affected by overlapping regulation. The number of businesses operating in every state and territory has risen by over 70 per cent since 2003. As they expand they are coming up against new and additional regulatory constraints. They cannot automatically apply the systems, knowledge and experience derived from their home jurisdictions.

These unnecessary regulatory imposts add costs and make it more difficult for companies to compete in international markets against companies from countries that have comparatively less onerous regulatory systems. Of greatest concern are those instances where the regulatory burden is sufficiently large to make businesses think twice and forego or defer expansion.

Recommendations for reform

With a new federal government indicating strong reform intentions and no state elections for twelve months, there is a window of opportunity to make concrete progress on previous reform commitments — see Exhibit 1 —before the political constraints once again come into play.

If COAG is to achieve the stated objectives of its newly formed Business Regulation and Competition Working Group and deliver significant improvements in Australia's competition, productivity and international competitiveness, then it must finally overcome past inertia and create a seamless economy for business regulation.

The BCA has consistently argued for eliminating regulatory overlap and duplication between different governments. They must be tackled by clarifying roles and responsibilities, institutionalising cooperation, and resolving any funding issues. With this in mind, the BCA reiterates its call for COAG and its member governments to commit to and complete the following two-stage reform process.

Step 1: Implement seamless regulation of all business by the end of 2010

Australia should have a business environment in which regulation is applied consistently across Australia. To this end Governments must:

- Avoid any further reviews and adopt the recommendations of the Taskforce on Reducing Regulatory Burdens on Business and use these as a basis for their forward work programs.

⁸⁷ Business Council of Australia, 2006a, *New Concepts in Innovation: The Keys to a Growing Australia*, Business Council of Australia, Melbourne, and Business Council of Australia, 2006b, *New Pathways to Prosperity, A National Innovation Framework for Australia*; Business Council of Australia, Melbourne.

Exhibit 1: The Regulatory Hotspots

Australian Governments have repeatedly promised reform (see below) but delivered little. Any assessment of progress is hampered by a lack of transparency in reporting.

COAG February 2006: COAG identified hotspots where ‘overlapping and inconsistent regulation is impeding economic activity’. The nominated hotspots were:

- Occupational health and safety (OHS)
- Rail safety
- National trade measurement
- Chemicals and plastics
- Development assessment
- Building regulation

COAG July 2006: COAG recommitted to and added to the hotspots. Officials were to develop reform proposals by end 2006 in each of the above six areas together with a further four areas:

- Environmental assessment and approvals
- Business name registration
- Personal property securities
- Product safety

COAG April 2007: COAG committed to developing plans and proposals to address the ten hotspots, such as:

- A plan for rail safety implementation to be completed by mid-2008.
- Proposals for a more harmonised system of environmental assessment.
- Developing a plan for national business registration by the end of 2007.
- The adoption of a uniform approach to product safety within 12 months.

Three hotspots — rail safety, trade measurement, and building regulation — were referred to the COAG Reform Council for monitoring of progress and assessment.

Responsibility for trade measurement was referred to the Commonwealth with the transition to be completed by 2010. Subject to consideration of funding, the States agreed to refer personal property securities to the Commonwealth, with establishment of a national system by 2009.

COAG December 2007: The cycle recommenced under the new Federal Government. COAG committed itself to a broader reform agenda, including accelerating and delivering the agreed hotspots. It established a new regulation working group to oversee progress and identify the first tranche of reforms.

Source: BCA

- Cease the use of ‘opt out’ clauses from regulatory reforms and demonstrate a willingness to cooperate and achieve constructive outcomes.

Step 2: Complete the harmonisation of the ten COAG hotspots by the end 2009, with the remaining regulations harmonised by the end of 2010.

This means that Australian Governments must:

- Agree on clear reform targets in all areas and begin harmonisation by the end of 2008.
- Publish a work program with clear deadlines outlining the schedule of harmonisation in all areas and identifying the responsible agency for each task. Regular reporting of progress should be made publicly available.

The States have already had more than two years to progress work on the ten COAG hotspots. If they cannot agree on harmonisation of the ten hotspots by the end of 2008, the BCA reiterates its call for the Federal Government to step in and provide for businesses to be able to ‘opt in’ to national (Commonwealth) regulatory regimes by the end of 2009.⁸⁸

Business taxation

Taxation plays a fundamental role in shaping the international competitiveness of the export sector as well as the economic environment in which all business activity is conducted in Australia. This means the taxation system has the potential to have a significant impact – be it positive or negative – on the nation’s prosperity over both the short and the longer term.

In Australia taxation is levied by all three levels of government. The efficiency and effectiveness of the overall tax system hinges on an effective interrelationship between the tax regimes of what are often competing jurisdictions.

Unfortunately, the complexity of the overall system has increased substantially over the course of its evolution, thereby raising the economic burden that it imposes on the international competitiveness of the export sector, as well as on Australian business more generally. As a result, members of the BCA and the Corporate Tax Association (CTA) have repeatedly voiced concerns about the growing economic burden, complexity and compliance costs of the system.

These concerns notwithstanding, there has been significant tax reform in recent years by all levels of government. The reforms have included introduction of the goods and services tax (GST), capital gains tax, fringe benefits tax, and full dividend imputation, as well as reductions in personal and corporate income tax rates. They have helped to boost the international competitiveness of the export sector and have underpinned Australia’s most recent strong economic growth.

⁸⁸ Business Council of Australia, 2006c, *Reshaping Australia’s Federation: A New Contract for Federal–State Relations*, Business Council of Australia Melbourne, October, p. 27

As significant as the reforms, much remains to be done. For example the GST reform was the first serious attempt to address deficiencies in State taxation. The States have repeatedly delayed eliminating the taxes agreed to under the Intergovernmental Agreement on the GST. At the same time there is a sharpening focus on the dysfunctional elements of the Federal tax regime.

Unfortunately, in a country with nine sovereign governments each operating an independent tax regime, it is not easy to get a comprehensive view of the overall impact of tax on the international competitiveness of the export sector. The complexity of the regimes and difficulties in obtaining relevant data, mean that comprehensive analysis is rarely attempted, even though even a cursory glance at the current range of business taxes highlights the need for a holistic approach.

Business taxation & international competitiveness

The extent and distribution of the tax burden determines the efficiency and effectiveness of the tax system, as well as its implications for the international competitiveness of the export sector and Australia's attractiveness as a destination for international capital.

Other things being equal, the greater the tax burden and the extent of the compliance costs imposed on the export sector, the lower will be its international competitiveness. Similarly, the heavier the tax burden on business more generally, the less attractive Australia is to international investors.

At present, Australia's export sector is performing exceptionally well, underwritten by unprecedented world commodity prices and the strongest sustained growth in the global economy in two decades. Strong performance is by no means universal, however, and weaknesses are emerging. There are increasing differences in export performance between industries and regions.

If Australia is to sustain strong growth and prosperity, its economy must be underpinned by a tax system that does not excessively impede the international competitiveness of the export sector, the flow of inwards investment, and the realisation of productivity gains, while providing adequate, secure and effective funding to meet the needs of society over time.

A significant amount of time has now passed since the last major business tax reform program. In that time the pace of economic change has accelerated. Over the last decade, the international economy has become better integrated and world markets more competitive. Since 1977 the volume of global exports has grown by close to 7 per cent a year and the trade intensity of the global economy has dramatically increased as a consequence; the ratio of world exports to world GDP rising from 23 per cent in 1997 to over 30 per cent in 2006. In the last five years alone the stock of global foreign direct investment has nearly doubled to over \$US10 trillion.

In this environment governments around the world are continually reforming their business taxation systems to attract and maintain investment in their economies, and improve the international competitiveness of their export sectors. A recent BCA report found that, in 2006 alone, there were significant efforts to

reform business taxes in countries such as Singapore, Germany, New Zealand, Malaysia, the Netherlands, Denmark, Belgium, Greece and Turkey.⁸⁹

Maintaining a taxation system that is attractive to business is vital to Australia's economic health. In an age of internationally mobile capital, business taxation is an important determinant of a country's ability to attract and retain investment.⁹⁰ Globalisation is increasing the mobility of capital and Australia must remain competitive to attract foreign inflows of capital, particularly with the growing global significance and geographic proximity of countries in our region such as China, India, Hong Kong and Singapore.

The business tax system also influences business structure, production costs and investment decisions of domestic companies. For example, customs duties on imported inputs increase the cost of production for the users. Such costs cannot necessarily be passed on where the final output is exported or competes with imports on the domestic market. The need to remain internationally competitive is particularly important for the export sector given its strategic disadvantages including relative remoteness from major global markets and relatively small and geographically dispersed domestic markets.⁹¹

The credibility of Australian governments now rests firmly on their ability to deliver a world-class business environment, including a . A business taxation system that attracts international capital. Without it, Australia's ability to achieve high living standards, low unemployment and low inflation is undermined.

Against this background, the time is right for a thorough consideration of tax arrangements in Australia, with business tax being a priority element. Such reforms would enhance the efficiency of tax arrangements and support competitiveness, investment, higher rates of participation and economic growth.

Many of Australia's largest companies, represented by the BCA and CTA, have raised concerns about the burden, complexity and costs of operating in Australia, at both state and federal levels. These aspects of the tax system detract from Australia's ability to provide a world-class environment for its business sector.

⁸⁹ Business Council of Australia and KPMG, 2006, *Corporate Taxation: An International Comparison – 2006 Update*, Business Council of Australia, Melbourne

⁹⁰ Reint Gropp and Kristina Kostial, 2001, 'FDI and Corporate Tax Revenue: Tax Harmonization or Competition?' *Finance & Development*, 38(2), International Monetary Fund, Washington, DC, June [available at www.imf.org/external/pubs/ft/fandd/2001/06/gropp.htm]; Michael P Devereux and Rachel Griffith, 1998, 'Taxes and the Location of Production, Evidence From a Panel of US Multinationals', *Journal of Public Economics*, 68(3), pp. 335–67; Buettner & Ruff, 2007, 'Tax Incentives and the Location of FDI: Evidence from a Panel of German Multinationals', *International Tax and Public Finance*, 14 (2), pp. 151-164.; Ruud de Mooij and Ederveen Sjeff, 2003, 'Taxation and Foreign Direct Investment: A Synthesis of Empirical Research', *International Tax and Public Finance*, 10(6), pp. 673–693

⁹¹ Bryn Battersby, 2006, *Does Distance Matter? The Effect of Geographic Isolation on Productivity Levels*, Treasury Working Paper No. 2006–03, Australian Treasury, Canberra, April

Taxation burden on larger businesses

With a view to exploring these issues further and informing the policy debate, the BCA and Corporate Tax Association commissioned PricewaterhouseCoopers (PWC) to undertake a comprehensive survey of the total tax contributions of Australia's largest businesses to Federal, State and Local Government.⁹² It looked at the tax obligations of 92 large businesses and took account of all taxes.

The results of the survey indicate that:

- Australian businesses, and particularly large businesses, are contributing a significant portion of the nation's total tax revenues; and
- The business tax burden is far wider and heavier than generally assumed.

Australia's largest businesses are major contributors to revenue at both Federal and State levels. Most operate across multiple jurisdictions and have to pay dozens of different taxes. Consequently they confirm business concerns about the economic burden of and inefficiencies in the overall business tax system:

- The business tax system is far more complex than an examination of one level of government suggests;
- There are many taxes that raise very little revenue but considerably increase the complexity of the overall tax system;
- The increased complexity reduces its economic efficiency, thereby raising compliance costs for business and administration costs for government.

Australian businesses bear or collect a total of 56 separate taxes. This is more than double the number in the United Kingdom, an economy almost three times the size of the Australian economy. Further, the survey reveals the highly inefficient manner in which some revenues are raised. Of the 51 taxes directly borne by business, the corporate income tax alone accounted for two-thirds of all revenue. The other third was raised by a complex array of 50 additional taxes.

Australia's competitiveness as an investment destination has been diminishing. In 1990 Australia held 4.1 per cent of the world's stock of inward foreign direct investment (FDI), but by 2000 this share had decreased to 1.92 per cent.⁹³ Despite the reforms undertaken by the Ralph Review of Business Taxation, in 2005 Australia's share of the stock of global FDI stood at only 2.08 per cent.

Australia's ability to attract and retain investment should be a primary focus of policy makers. Investment is a driver of productivity, employment and growth in the economy. A corporate taxation system that inhibits investment is a brake on

⁹² Business Council of Australia and Corporate Tax Association, 2007, *Tax Nation: Business Taxes and the Federal-State Divide*, Business Council of Australia, Melbourne

⁹³ Business Council of Australia and KPMG 2006, p. 4

economic prosperity and wealth creation. Research confirms there is a negative relationship between the rate of economic growth and the corporate tax rate.⁹⁴

The complexity of the tax system exacerbates the economic losses from a given tax burden. It increases the compliance costs for business and the administration expenses for government. Inefficiencies that impact on the export and import-competing sectors need to be addressed given that businesses in question are operating in highly competitive, global markets. The losses, moreover, are not confined to big business; small- and medium-sized businesses are also affected.

Broader reforms to federal-state relations need to focus on revenue raising and sharing arrangements. The pressures and strains evident in the current arrangements are set to worsen as the fiscal impacts of an ageing population are increasingly felt. Business is concerned that as spending pressures intensify, the policy response will be to increase tax rates. The lack of transparency and the complexity of the current business taxation system across levels of government imply a creeping and debilitating increase in the economic burden on business.

An in-depth understanding of the strengths and weaknesses of the current business tax system, how it impacts on business costs, and how it might be reformed to maintain a competitive business sector and revenue security in the long run, will be integral to broader reform of federal–state relations.

Australia has implemented a number of business tax reforms over the last decade. Nevertheless, in some areas — notably abolition of economically inefficient State taxes under the GST Agreement — progress has been disappointing and some States have imposed new taxes in the meantime. The next wave of genuine business tax reform will only occur when both state and federal taxes are considered together.

Recommendations for reform

The BCA welcomes the Henry Review of the taxation system, which was announced by the Federal Government on 13 May 2008.⁹⁵ The BCA particularly welcomes the inclusion of state and local taxes in the review. Reforming the Commonwealth–State tax divide is vital to modernising Australia's federation.

As the BCA highlighted in its Budget Submission last February,⁹⁶ restructuring the taxation system will also require a careful look at Commonwealth–State financial arrangements as well as public expenditure levels and priorities.

To boost Australia's prosperity the tax system needs to encourage investment, business innovation and workforce participation, and will underpin more comprehensive reforms to infrastructure, education, and Commonwealth–State

⁹⁴ Young Lee and Roger H Gordon, 2005, 'Tax Structure and Economic Growth', *Journal of Public Economics*, 89(5-6), June, pp 1027–1043

⁹⁵ The Hon. Wayne Swan, 2008, 'Australia's Future Tax System', Press Release, Treasurer of the Commonwealth of Australia, Press Release No. 36, Canberra, 13 May, [accessed at <http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2008/036.htm&pageID=003&min=wms&Year=&DocType=0> on 19 June 2008]

⁹⁶ BCA 2008a

financial arrangements. However, the system also needs to be sustainable over the long term and this requires both the tax system and the level and composition of spending to be critically scrutinized

Accordingly the review needs to consider all business taxes and to focus on:

- The efficiency and effectiveness of current revenue raising and revenue sharing arrangements, including issues such as:
 - the amount of revenue raised;
 - the administrative and compliance costs of each tax for government and business respectively, with a particular focus on taxes other than the top four revenue-earning taxes; and
 - the economic costs imposed by individual taxes relative to the revenue they raise.

- The sustainability of current arrangements, including issues such as:
 - future demand on government spending relative to current revenue-sharing arrangements;
 - the drivers and sustainability of the current growth in corporate income tax receipts; and
 - the impact of population ageing and other structural changes on revenue trends and sources of revenue.

Economic infrastructure

Efficient infrastructure is fundamental to international competitiveness and economic growth. This is evident from the estimates of the economic benefits of the reforms to date⁹⁷ and of prospective reforms.⁹⁸ The BCA has estimated the reforms outlined here could boost GDP by 2 per cent or \$20 billion a year.⁹⁹

The situation and outlook for the nation's infrastructure suggests that further reforms are urgently required. The BCA highlighted the problems in 2005 and, since then, there has been a growing recognition of their significance. The Commonwealth launched a quick review of Australia's export infrastructure that reported in May 2005.¹⁰⁰ Among other things the review concluded that:

'...without action to remove impediments to efficient investment in infrastructure, Australia's export potential over the next five to ten years risks being compromised'.¹⁰¹

⁹⁷ In 2005 the Productivity Commission estimated that reforms in energy, water, transport, ports and telecommunications over the previous decade had boosted Australia's GDP by 2.5 per cent (Productivity Commission, 2005, *Review of National Competition Policy Reforms*, Australian Government, Canberra).

⁹⁸ In 2007 the Productivity Commission estimated that nominated reforms in energy and transport alone could increase GDP by a 0.43 per cent a year (Productivity Commission, 2007, *Potential Benefits of the National Reform Agenda*, February).

⁹⁹ Business Council of Australia, 2007, *Infrastructure: Road Map for Reform*, Melbourne

¹⁰⁰ Exports and Infrastructure Task Force, 2005, *Australia's Export Infrastructure*, Report to the Prime Minister by the Exports and Infrastructure Task Force, Canberra ACT

¹⁰¹ Exports and Infrastructure Task Force 2005,

Their diagnosis and prognosis has been confirmed by the OECD and the IMF. The OECD found that infrastructure was holding back export growth and that further reforms were needed.¹⁰² The IMF concluded that infrastructure reform could lift productivity and incomes, and saw the need for ambitious reforms covering export infrastructure, land transport, electricity and water.¹⁰³

The state of Australia's infrastructure

In the **electricity sector**, the National Electricity Market (NEM) is ineffective due investment barriers in generation and transmission, and distortion of prices.

The regional segmentation of the NEM does not reflect the needs of the market. Transmission investments do not fully take account of their competitive benefits and are state-based. In NSW and Queensland generation investment inevitably reflects parochial perspectives rather than those of the market participants. There are many barriers to and distortions of investment:

- All states cap the prices that may be charged to household consumers;
- Prices to households do not reflect the high opportunity cost of supplying the peaks in power demand;
- To respond to the greenhouse challenge, governments rather than the market increasingly determine the fuels to be used in generation; and
- Public ownership of generation distorts investment in a variety of ways.

These characteristics lead to poor locational decisions by electricity users and generators. Currently, for example, a large electricity user has insufficient incentive to locate close to a source of generation and the additional costs of transmission arising from a distant location are largely imposed on other users

All this is of great concern as the sector is facing investments totaling between \$45 billion and \$80 billion by 2030, depending on the technology used.¹⁰⁴ Without sound solutions Australia faces the prospect of major under-investment.

Until recently, there had been no new significant investment in **urban water supply** in two decades and none was contemplated, despite the fact shortages were foreseeable even before the effects of the recent drought became clear.

¹⁰² OECD [Organization for Economic Co-operation and Development], 2005, *Economic Survey of Australia*: 2004, OECD, Paris

¹⁰³ IMF [International Monetary Fund], 2006, *Australia: 2006 Article IV Consultation—Staff Report and Public Information Notice on the Executive Board Discussion*, IMF Country Report No. 06/374, Washington, DC, October

¹⁰⁴ Business Council of Australia, 2007, *Infrastructure: Road Map for Reform*, Business Council of Australia, Melbourne

Water pricing does not reflect the cost of the next increment in supply and discourages economic usage. Low prices, a lack of access to facilities, and poor regulation are barriers to investment in water recycling. There are different regulatory approaches — e.g. to water quality and access — among the states.

These problems are attributable to the ownership and structure of urban water supply. As urban water is generally a public monopoly, there is confusion between the goals of supply entities and politicians. A competitive market with private ownership would have seen much earlier action on the above problems.

With *rural water supply* the key concern is over-allocation of both surface and groundwater. This reflects poor planning in the past, which has been exacerbated by inadequate metering and accounting systems, and low prices which have encouraged excessive use. There has been slow progress on water trading. Many barriers to trade remain in the form of fixed trading limits, exit fees and local catchment structures and rules.

In *urban transport*, road congestion already imposes high costs and is expected to get worse. The Bureau of Transport and Regional Economics estimates that congestion costs — principally longer travel times — will double by 2020.¹⁰⁵

Freight transport suffers from bottlenecks and inappropriate policy. The Standing Committee on Transport and Regional Services of the House of Representatives has recorded many of the problems.¹⁰⁶ They include the lack of a national freight market due to state-based regulation and differing treatment of road and rail in terms of user charging, investment criteria and funding.

In *communications* the key problem is low penetration and speed of broadband compared to most other developed countries. Although there is debate over comparability of the measures, it is clear that the rest of the world is moving to high penetration of very high speed broadband but Australia lags behind.

Recent progress

Recently there has been progress on many of these issues. The most significant developments have been increased infrastructure expenditure by the Commonwealth and state governments to close the ‘capacity gap’, and the fact that many governments are streamlining their investment approval processes. One problem in closing the gap is that the investment has to compete for skilled labour in a highly buoyant labour market.

In February 2006 COAG announced a comprehensive National Reform Agenda covering, among other areas, aspects of energy and transport. Recently there have been subsequent announcements in water and high speed broadband.

¹⁰⁵ Bureau of Transport and Regional Economics, 2006, *Estimating Urban Traffic and Congestion Cost Trends for Australian Cities*, Canberra, December

¹⁰⁶ Standing Committee on Transport and Regional Services, 2007, *The Great Freight Task*, House of Representatives, Parliament of Australia, Canberra, July

Finally the Federal Government has decided to implement an emissions trading scheme from 2011 with measures to assist investment in research and development in low emissions technologies and adaptation, and a renewed emphasis on energy efficiency. This policy framework addresses one of the key risks to energy supply planning and investment.

Recommendations for reform

The BCA has formulated an approach to infrastructure reform based on a series of foundation strategies, which drive customized strategies in each sector.¹⁰⁷ Its approach identifies a key enabler and a mechanism to review progress.

There are six foundation strategies for the reform of Australia's infrastructure. They are quite specific, and reflect long experience in observing what does and does not work in relation to infrastructure policy and practice.

- The markets for infrastructure services need to be national in scope, rather than state-based. Among other things this requires national regulation.
- Prices for infrastructure services must be market-based, with appropriate internalization of any externalities that they generate.
- Public investment processes need to be transparent, well-coordinated by governments, forward-looking, based on a consideration of all feasible options, and to favour the options with the highest net economic benefits.
- There should be effective competition in all the contestable — i.e. non-network — segments of the market for infrastructure services.
- Private ownership of infrastructure is to be preferred in the contestable market segments.
- Regulation of infrastructure should not discourage investment to meet expected demand.

In the **electricity sector** there should be a fully national market by 2010, where investment barriers and distortions are removed, prices determine demand and supply decisions, and where overall outcomes are more market-driven and less government-driven. This requires:

- More appropriate and dynamic regional boundaries in the NEM reflecting key sources of generation and demand.
- A national rather than state approach to transmission investment.
- Full private ownership of the generation and retail sectors.

¹⁰⁷ Business Council of Australia, 2007, *Infrastructure: Roadmap for Reform*, Business Council of Australia, Melbourne

- Governments to avoid attempts to pick energy generation ‘winners’, be it through renewable energy or gas. Investment decisions should be made in the context of a comprehensive emissions trading system.
- The removal of all caps on household electricity prices.
- Significant progress in the rollout of smart meters for households.

In **urban water** the key to reform is to change the ownership and structure of the urban water industry so that markets and not governments determine water supply. This should involve the following changes:

- Disaggregate water utilities into their monopoly (pipes) and competitive (supply and retail) components in the major cities and regional centres;
- Establish appropriate regimes for access to water pipes and any other monopoly infrastructure;
- Introduce national regulation of water (on access, water quality);
- Introduce competition into water supply, particularly for usage above certain levels. Large users should also be able to trade their entitlements.
- Allow as much private ownership as possible in water supply;
- Ensure water prices are based on use and reflect the cost of new capacity;
- End ‘postage stamp’ pricing (one price across a state or a large region) as it discourages lower-cost supply options in outlying areas; and
- Remove all impediments to water recycling and the trading of water between urban and rural areas.
- Government should regulate supply but not be responsible for delivery.

In **rural water** the aim should be to have addressed over-allocation by 2010 and to have established low cost regimes for water trading. The accounting systems and entitlement registers should operate in real time and be reliable, transparent and national in scope. Pricing should provide the right signals for the use of and investment in irrigation.

Urban transport needs an integrated strategy with COAG backing that includes congestion charges, a better integrated road network, increased investment in public transport, and private sector operation of public transport (as in Victoria).

Freight transport needs much better Commonwealth–state cooperation on investment planning and funding, better road user pricing for heavy vehicles, and a range of related policy improvements.

AusLink investments need to be funded and supported by both the Commonwealth and the States. The investments should be integrated with the requirements of individual container and bulk freight ports and more investment is needed in ports to improve supply chain efficiency.

Road user pricing should treat the different types of vehicles appropriately. This helps to promote competitive neutrality between road and rail transport and facilitate the use of high productivity vehicles.

Regulation should allow infrastructure owners to invest in anticipation of changes in demand and a single regime would help to create a national freight market, Finally, coastal shipping needs to be liberalized so that transport users are not forced into high cost Australian-crewed shipping services.

With ***communications***, the required steps are clear. The policy framework needs to stimulate the investment required for higher broadband speeds, provide a competitive regime for third party access to this infrastructure, and set out a statement on the timing of its implementation.

Further details are in the BCA's most recent report on the subject.¹⁰⁸

Significant reforms are not possible without a more effective working relationship between the Commonwealth and the States. The current arrangements do not guarantee a proper focus on issues of national importance. The Council of Australian Governments meets infrequently. Its agenda and timelines for action lack of transparency. Its decisions are characterized by a lack of attention to concrete outcomes.

There is a need for a mechanism to ensure that the reform program is proceeding as expected, its strategies being implemented in a timely way, the outcomes sought being achieved, and required adjustments to strategies being made.

The BCA believes that it is essential for Governments to provide for transparent independent and regular assessment, monitoring and reporting of the progress on agreed reforms, as well as on the condition and performance of the existing infrastructure. Such 'policy and condition' audits should be conducted by the Productivity Commission every two years.

Trade barriers

The Australian economy is based on a transparent trade policy regime, with tariffs the main policy instrument. Australia applies a low tariff rate, on average, and continues to reduce rates above 5 per cent.

Up to the late 1980s Australian applied relatively high tariffs to many manufactured goods, which severely compromised the international competitiveness of Australia's traditional export industries. Subsequently it progressively reduced tariffs across the board, enhancing the international

¹⁰⁸ Business Council of Australia, 2007, *Infrastructure: Roadmap for Reform*, Business Council of Australia, Melbourne

competitiveness of the traditional export sector and allowing the emergence of new export industries in manufacturing and services.

Since 1988, Australia's average tariff rate has fallen from 15 to 3 percent.¹⁰⁹ Today over 95 per cent of tariffs are bound. Australia grants at least most favoured nation (MFN) treatment to imports from all its trading partners. The average applied MFN tariff is below 5 per cent. The tariff rates applied to agricultural products are much lower at around 1 percent. However, some significant tariff and non-tariff barriers remain.

Tariffs are highest for passenger motor vehicles (PMV) and textiles, clothing, and footwear (TCF). In 2005 PMV tariffs were reduced to 10 per cent. That year TCF tariffs were cut to 17.5 per cent on apparel and certain finished textile articles, 10 per cent on cotton sheeting, woven fabrics, footwear, and carpets, and 7.5 per cent on sleeping bags, table linen, and footwear parts.¹¹⁰ PMV and TCF tariffs are scheduled to fall to 5 per cent by 2010 and 2015 respectively.

Australia's services sector is relatively open, with minimal regulation. The microeconomic reforms undertaken by the Federal Government in the 1990s, have improved the international competitiveness in many service industries, particularly financial services, transport and communications. In some, foreign equity restrictions have been retained, such as in real estate, banking, civil aviation, shipping and telecommunications.

Australia welcomes foreign investment. With some exceptions, in the majority of industries smaller investment proposals by foreign investors are exempt from prior notification to the Foreign Investment Review Board and larger proposals are approved unless judged to be contrary to the national interest. As noted previously, there are foreign equity restrictions in certain service industries.

The Government pursues free trade agreements (FTA) where liberalisation is comprehensive in scope and scale, and consistent with its WTO obligations. To date, Australia's FTAs have sought to improve access to key markets and broaden and deepen economic integration with them. Australia has concluded FTAs with New Zealand, Singapore, Thailand and the United States.

FTA negotiations are underway with China, Malaysia, Japan, Chile, the Gulf Cooperation Council, and, with New Zealand, the Association of South East Asia Nations (ASEAN). Feasibility studies on FTAs are being undertaken with Indonesia, the Republic of Korea and India. Pacific Island trade ministers have also agreed to consult on a way forward for a free trade area in the Pacific region.

Multilateral trade liberalisation through the World Trade Organisation (WTO) Doha Round remains the top priority of Australia's trade liberalisation efforts.

¹⁰⁹ DFAT [Department of Foreign Affairs and Trade], 2008d, *A Successful Global Trader*, Australian Government, Canberra [accessed at http://www.dfat.gov.au/facts/global_trader.html on 7 May 2008]

¹¹⁰ WTO 2007

Recommendations for reform

The BCA supports the Government's efforts to revitalise the stalled Doha Development Round of trade negotiations being conducted under the auspices of the WTO.

The BCA also support the Government's efforts to conclude regional and bilateral FTAs. The Government must work towards concluding FTAs that are comprehensive and support the country's multilateral stance.

Trade facilitation programs

Australian exporters today operate in a vastly different environment than 20 years ago. One of the greatest changes has been rapid globalization with emergence of China and India adding a further dimension to the shifts in the global scene.

Trade facilitation programs look to maximise opportunities for Australian companies to access overseas markets. The programs that assist Australian businesses in entering export markets include:

- the Export Market Development Grants (EMDG) Scheme;
- TradeStart;
- a range of state government programs; and
- overseas trade missions.

The EMDG Scheme is an important Federal Government Program for promoting exports by Australian companies. It focuses on small and medium-sized Australian businesses seeking to develop new export markets and provides financial assistance to current and prospective exporters who have spent \$15,000 over two years on eligible export marketing expenses.

The TradeStart program is built on a network of export assistance offices, partnerships between Austrade and a range of local private and public sector organisations throughout Australia. It promotes exports, international business and the Australian Government's trade agenda. Its main objectives are to provide assistance to established exporters to expand and/or enter new markets, and to assist potential and irregular exporters to develop their business overseas.

A recent survey commissioned by the Australian Industry Group indicates that there has been a relatively low uptake of these trade and export programs. Only 21 per cent of Australian manufacturing exporters confirmed using at least one of the four categories of the trade facilitation programs.¹¹¹

The EDMG Scheme had the highest take-up rate; nearly one in 10 Australian manufacturing exporters claim to have used it.¹¹² This was followed by trade missions, with 7.1 per cent of manufacturing exporters surveyed having taken part in a mission, State-based export promotion programs (4.7 per cent of exporters surveyed), and TradeStart (about 1 per cent of exporters surveyed).

¹¹¹ Australian Industry Group, 2008b, *How Fast Can Australia Grow? Mark III*, February

¹¹² Australian Industry Group, 2008b

Real EMDG funding has been declining due to narrowing of the eligibility criteria. The Australian Industry Group has proposed that a strengthened EMDG Scheme should be complemented by targeted efforts to assist Australian companies to begin exporting and to develop new export markets.¹¹³

A major concern for growing companies is getting access to sufficient credit for export. The Export Finance and Insurance Corporation (EFIC) *Headway* program provides assistance to growing export companies to access working capital. The Federal Government's recent decision to expand the mandate of this program, such as to broaden its role to support other export-related activities, including the establishment of off-shore distribution facilities, is a welcome initiative.¹¹⁴

The \$254 million Global Opportunities program will assist companies to access global supply chains and major projects.

In the 2008-09 Budget the Commonwealth Government announced a number of enhancements to some of its trade facilitation programs.¹¹⁵ The enhancements involved an increase of \$50 million in funding for the EMDG Scheme in 2009-10 as well as changes to the operation of the Scheme. The latter included changes to widen the eligibility for assistance by:

- increasing the maximum grant to \$200,000;
- increasing the turnover limit for eligible claimants to \$50 million;
- reducing the minimum threshold for eligible expenditure to \$10,000; and
- extending the limit on the number of annual grants from seven to eight.

As part of the Budget process, the Government's investment promotion and Global Opportunities programs will also be integrated into Austrade.

The BCA's views on the rest of the Government's trade facilitation programs are set out in a companion submission to the Review of Export Policies and Programs. That submission focuses on the trade policy issues before the Review.

¹¹³ Australian Industry Group, 2008b

¹¹⁴ Australian Industry Group, 2008b

¹¹⁵ Hon. Simon Crean, 2008, 'Government delivers on commitment to revitalise Export Market Development Grants (EMDG) scheme', *Media Release*, Canberra, 13 May [accessed at http://www.trademinister.gov.au/releases/2008/sc_080513_budget4.html on 19 June 2008]

Annex: International Competitiveness & Comparative Advantage

International competitiveness is a function of comparative advantage, which depends on differences in relative productivity between trading partners.

David Ricardo developed the concept of comparative advantage to explain trade between Portugal and England in the early 19th Century. He showed England had a comparative advantage in producing the cloth and Portugal in wine. This was so even if England was absolutely more productive than Portugal in both.

If England produced wine, its opportunity cost from doing so — its output of cloth foregone — would have been relatively high. This was because England was relatively more productive in producing cloth than wine, compared to Portugal.

For Portugal, the opportunity cost of producing cloth was high as it was relatively more productive in wine compared to England.

To put the same point in another way, England was internationally competitive in manufacturing cloth but not in producing wine. Moreover England would have remained internationally uncompetitive in wine production, even if it had been capable of producing more wine per unit of resource input than Portugal was. England's lack of competitiveness in wine was due to the fact that the opportunity cost of the resources that it would have used to produce it was greater than the value of the wine that those resources could have produced.

Portugal's position was the mirror image of England's. Portugal was internationally competitive in producing wine but uncompetitive in the manufacture of cloth.

David Ricardo's notion of comparative advantage is the foundation for all economic exchange. It applies regardless of whether we are talking of exchanges at the level of the individual, the region, the nation or, even, the empire.

Paul Samuelson has given us a memorable illustration of comparative advantage at the individual level.¹¹⁶ If a barrister can type faster than any secretary, should he do his own typing or hire a secretary? The answer, of course, depends upon the opportunity cost of the barrister's time.

At the present time, a secretary who types at 50 words a minute would cost around \$20 per hour to employ on a casual basis. A junior barrister would charge at least \$150 per hour for his services. Even if he can type at 200 words a minute — an extraordinary speed — the barrister is always better off doing legal work than typing. A secretary to replace what the barrister could have typed in an hour would cost him \$80 but he would be able to use the time saved to earn \$150 in legal fees. In other words, if the barrister were to employ a secretary for the hour he would be better off to the tune of \$70.

¹¹⁶ Paul A Samuelson and William D Nordhaus, 2004, *Economics*, 18th ed., McGraw-Hill/Irwin,

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