

Assessing Australia's Trade and Investment with Asia

Business Council of Australia
contribution to the development
of a strategy for Australia in the
Asian century



**Business Council
of Australia**

5 April 2012

Business
Council of
Australia

Dr Ken Henry AC
Special Adviser to the Prime Minister
Department of the Prime Minister and Cabinet
PO Box 6500
CANBERRA ACT 2600



Dear Dr Henry

ASSESSING AUSTRALIA'S TRADE AND INVESTMENT WITH ASIA: SUPPLEMENTARY INFORMATION

This letter, together with two attachments, provides supplementary information from the Business Council of Australia (BCA) for your consideration in preparing the Australia in the Asian Century White Paper for the federal government.

Our submission titled *Assessing Australia's Trade and Investment with Asia*, was provided in December 2011. Since that time we have, in conjunction with The Boston Consulting Group, undertaken some further specific work assessing Australia's competitiveness and identifying the opportunities and challenges for Australia in its engagement with Asia. The attachment to this letter includes the details of this work. Through this analysis the BCA has identified five priority areas for action:

- lifting Australia's competitiveness
- strengthening Australia's engagement in Asia through an increase in diplomatic and business resources to the most important bilateral relationships, while at the same time maintaining strong relationships throughout Asia
- building community support for increased levels of economic engagement with Asia, including foreign investment
- building the capabilities of Australia's workplaces to further improve the capacity of our organisations to develop effective relationships and do business in Asia
- recognising the importance of international education and the continuing work of the International Education Advisory Council.

Lifting Australia's competitiveness

Our work on the opportunities and challenges for Australia in its engagement with Asia shows there is the potential for further substantial benefits for all Australians. There are, however, three developments that have the potential to significantly erode Australia's competitive position.

Unless they are addressed, they will reduce our ability to harness the benefits of our geographic location, established relationships with Asia and historical trade patterns. These developments are:

- Asian economies are seeking alternative suppliers to Australia for inputs into the goods and services they produce, including new suppliers from within Asia

- businesses from competitor countries are increasingly focused on winning new and larger markets in Asia
- Australia's national competitiveness is being eroded by, amongst other factors, a lack of productivity growth extending back many years.

Our assessment of Australia's competitiveness compared to a sample of other countries, comprising Canada, the United States, Singapore and Japan indicates that:

- Australia's rankings on measures of competitiveness tend to be toward the middle rather than leading our peers
- in a number of important areas, including the ease of doing business, our rankings have been trending lower.

Our sectoral analyses of the coking coal sector and of higher education makes clear the need for sector specific policies to help maximise their competitiveness. For example infrastructure investment is critical to the efficient export of coking coal while policies that impact on student choice such as safety and housing are critical to the higher education sector.

These two sectoral examples demonstrate that in addition to policy settings and other factors that impact on competitiveness across the economy, there are also particular factors that affect the competitiveness of industry sectors that need to be taken into account.

Recommendations in relation to competitiveness

The attached analysis reinforces the importance of getting the economic fundamentals right. The certainty and credibility of sound monetary and fiscal policy are essential to enhancing efforts to lift productivity and workforce participation. Strong policy foundations are also essential to ensuring a stable environment for investment and innovation.

The BCA recommends that in parallel to pursuing sound macro policies, governments should concentrate on the fundamentals of good policy in the key areas of tax, labour market regulation, infrastructure and the broader regulatory environment. Further details about these priorities are contained in the BCA's 2012-13 Budget Submission, and in our previous submission to you, *Assessing Australia's Trade and Investment with Asia*.

It would also be beneficial for the government to undertake further sectoral analyses along the lines of the two examples provided in Attachment 1 (the sectoral illustrations on coking coal and education), to inform the preparation and the implementation of the Australia in the Asian Century White Paper.

The sectoral analyses should be informed by a realistic assessment of the opportunities available now and over the medium to longer term. We regard a realistic assessment as one that balances opportunities against current and emerging challenges.

Strengthening Australia's engagement in Asia

If the size and value of our economic engagement with Asia is to grow, then it will be necessary for governments, business and the academic and research community to increase both the

investment and the level of commitment to our bilateral relationships within Asia. This reflects the importance of building and maintaining relationships between people and organisations.

Australian government officials serving at diplomatic and trade missions make a vital contribution to building our economic engagement, especially in countries where the host government or governments play a major role in the economy.

The experience of BCA members is that representatives of the Australian Government overseas, most of whom are officials from the Department of Foreign Affairs and Trade and Austrade, are highly effective in assisting Australia's interests.

Notwithstanding the effectiveness of current missions, there could be a sharper focus on where and how Australia engages in Asia through improved cooperation and coordination between governments and business.

Strengthening key relationships should be undertaken in accordance with a clear set of priorities, with the greatest attention paid to the largest and most important relationships, including China and India. Attention also needs to be given to strategically important relationships where there is the potential for future growth in trade and investment, such as, for example, Indonesia and Vietnam.

At the same time, Australia has diverse economic interests with many nations in Asia, and it is in our interest to maintain and strengthen the diversity of our relationships.

These objectives require a careful balance and an increase in the resources committed to key economic relationships in Asia. Allocating government resources to strengthen Australia's relationships in Asia need not, however, require an overall increase in diplomatic and trade mission resources.

In May 2011 the federal government announced reforms to the structure and allocation of resources within Austrade. One of the reforms involved rationalising and redirecting resources away from where they were least utilised, into growing and emerging markets. The growing and emerging markets that are to be the focus of Austrade's reallocation of resources over time include Central Asia and western China.

The BCA supported the government's reforms to Austrade. We suggest that this approach could be considered in the context of Australia's wider diplomatic representation.

Business recognises that we have an important responsibility to increase the investment that we make to strengthening relationships. This includes the commitment that business leaders make to engage our counterparts in Asia through initiatives such as the Australia–China CEO Roundtable and the Australia-India CEO Forum.

In addition, the support that both governments and business provide to leadership development and exchange programs provided by universities and other education institutions makes an important contribution to strengthening relations with other nations.

Recommendations to strengthen engagement with Asia

In view of the importance to business of strengthening and sharpening the focus of Australia's key relationships on economic engagement, the BCA recommends:

- that governments and business give the highest priority to strengthening Australia's bilateral relationships with China and India, and to other relationships where there is potential for future growth, including Indonesia and Vietnam. In particular, consideration should be given to allocating additional diplomatic resources to these relationships by rationalising and reallocating resources from elsewhere
- that Australia's diplomatic engagement with Asia should have a sharper focus on current and emerging economic opportunities, informed by cooperation and a regular exchange of information between governments and business.

Building community support for increased levels of economic engagement with Asia

An equally important aspect of our preparedness for the challenges ahead will be community support for increased engagement with Asia.

In identifying this issue, the BCA is not suggesting that the mindset of Australians is currently a significant problem. In fact, it can be argued that there are many aspects of Australia's mindset towards Asia that are very positive. We have, after all, established extensive trade and investment relationships with most of the economies of Asia.

There are, however, some aspects to our mindset that have the potential to impede our economic relationships with Asia as these evolve. In recent years we have, for example, appeared to be inconsistent in our approach to new flows of foreign direct investment from Asia.

Australia should be demonstrating to the nations of Asia that we are serious about being an economy open to increased levels of investment and trade. Furthermore, we should aim to be an economic partner interested in generating mutual benefits over the medium to long term.

We also need to recognise that there is much to learn from our Asian neighbours about what is required to achieve success within the region. The economies of Asia are amongst the most dynamic in the world, and there are many ideas, new technologies and processes that offer potential benefits for Australia.

A further aspect to changing our mindset should involve a willingness to learn more about Asia, and to continue to enable increased opportunities for people from Asia to learn from Australia through education and formal and informal cultural exchange.

Recommendations to build community support

In view of the importance to Australia's prosperity of a strengthening relationship with Asia it is important that both business and government assist in building community understanding of this relationship.

The BCA recommends that both business and government better communicate the broad community benefits of Australia's engagement in Asia when particular initiatives and projects are proposed and implemented.

Improving our capabilities for engagement with Asia

The role played by our education and training system makes a vital contribution to increased levels of knowledge and understanding about Asia. This is also an area where investments by both government and business have strengthened the ability of organisations and individuals to engage with Asia over many decades.

The BCA recognises the importance of developing the capabilities of Australians to build relationships and to do business with the people of the diverse nations of Asia. The BCA is involved in an important piece of work in this area.

The Asia Capable Workplace Taskforce chaired by Mike Smith, Chief Executive Officer, ANZ, and initiated by Asialink, has already made a submission to the Australia in the Asian Century White Paper, which the BCA was very pleased to support. Importantly, the taskforce will be continuing to undertake work on the capabilities required for effective engagement with Asia.

Recommendation in relation to workplace capabilities

The BCA recommends that the development and implementation of the Australia in the Asian Century White Paper should be aligned with and informed by the ongoing work and any additional priorities and recommendations that are made by the Asia Capable Workplace Taskforce.

Recognising the importance of the work of the International Education Advisory Council

The education of international students in Australia has become one of the nation's most important export industries. The significance of this sector, however, extends well beyond the immediate economic and social benefits to include a major contribution to our diplomatic and cultural engagement with Asia. Importantly, Australian students have the opportunity to benefit their engagement with international students, including the opportunity develop their knowledge and understanding of other countries and cultures.

In addition, the sector is important to Australian business, with international graduates providing a valuable source of skills, especially for businesses engaged in Asia. This includes the employment of graduates in their home countries, recognising that they have been educated to Australian standards.

Although the education of international students by Australian universities, colleges and training institutions has grown into one of the nation's most valuable industries, it is now facing a number of challenges. These are identified in the sectoral analysis referred to above and outlined in Attachment 1.

As you would be aware, the federal government's International Education Advisory Council is currently considering these issues and will be developing a national strategy on international education on which it will prepare a report later this year.

Recommendation in relation to international education

In recognition of the significance of international education, the BCA recommends that the development and implementation of the Australia in the Asian Century White Paper should also be informed by the current work and the final report of the International Education Advisory Council.

Conclusion

We recognise the importance of developing an effective strategy to enable Australia to make the most of the opportunities and to meet the challenges of the Asian Century. Furthermore, such a strategy is timely given that, in our assessment, there is a significant risk to our future competitiveness in Asia.

The BCA looks forward to continuing to work with you and the members of your high-level advisory panel over the coming months.

Yours sincerely

[signature removed]

Jennifer Westacott
Chief Executive

ASSESSING AUSTRALIA'S TRADE AND INVESTMENT WITH ASIA: SUPPLEMENTARY INFORMATION

CONTENTS

| | |
|--|-----------|
| Lifting Australia's competitiveness..... | 1 |
| Recommendations in relation to competitiveness | 2 |
| Strengthening Australia's engagement in Asia..... | 2 |
| Recommendations to strengthen engagement with Asia | 3 |
| Building community support for increased levels of economic engagement with Asia | 4 |
| Recommendations to build community support | 4 |
| Improving our capabilities for engagement with Asia | 5 |
| Recommendation in relation to workplace capabilities..... | 5 |
| Recognising the importance of the work of the International Education Advisory Council | 5 |
| Recommendation in relation to international education | 6 |
| Conclusion | 6 |
| ATTACHMENT 1: ASSESSING AUSTRALIA'S COMPETITIVENESS..... | 1 |
| Purpose of this attachment..... | 1 |
| What is meant by competitiveness | 1 |
| A framework for Australia's competitiveness..... | 2 |
| How Australia compares..... | 5 |
| Ease of doing business..... | 6 |
| Impediments to Australian competitiveness | 7 |
| Sectoral illustrations: coking coal and education..... | 8 |
| Australian metallurgical coal exports | 8 |
| ATTACHMENT 2: AUSTRALIA'S ECONOMIC ENGAGEMENT WITH ASIA: OPPORTUNITIES AND CHALLENGES | 15 |
| What is the extent of the economic opportunities available from engagement with Asia? | 15 |
| The challenges | 17 |
| Australia's current economic engagement with Asia..... | 19 |
| Conclusion | 22 |

ATTACHMENT 1: ASSESSING AUSTRALIA'S COMPETITIVENESS

Purpose of this attachment

This attachment addresses four aspects of Australia's competitiveness, which are as follows:

- a summary of what is meant by competitiveness
- an outline of a competitiveness framework for Australia
- comparisons of competitiveness involving Australia and four other nations
- sectoral illustrations of competitiveness for the coking coal and education export sectors.

What is meant by competitiveness

Australia's competitiveness is fundamental to attracting finance and investment and enabling Australia's businesses to continue to compete effectively in markets in Asia and elsewhere in the world. This is the case whether businesses are exporting from Australia, whether they have made offshore investments and operations, or whether they are integrated with regional supply chains and regional markets, or a combination of these approaches.

Actions by governments, business and industry to lift Australia's competitiveness must be informed by a common and clear understanding of what is meant by the term when used in the context of a national economy.

Michael Porter and Jan Rivkin have proposed a definition for the competitiveness of the United States of America that is equally applicable to Australia or to any other nation. Under the Porter and Rivkin definition, Australia is a competitive location to the extent that businesses operating here under free and fair market conditions, are able to compete successfully in the global economy while supporting high and rising living standards for the average Australian. A fall in our national competitiveness will mean that it is more difficult to find buyers both in foreign and domestic markets for Australian goods and services.

A competitive location produces prosperity for both businesses and citizens. Furthermore, it is a nation's ability to generate high output per employable person, rather than high output per currently employed person, that reveals its true competitiveness.¹

This definition has also been informed by a similar definition provided by the Organisation for Economic Cooperation and Development (OECD). In particular, we support the emphasis that the OECD definition places on free and fair market conditions.²

Competitiveness is closely linked to both openness and productivity. Porter and Rivkin have also pointed out that whether a nation is competitive hinges on its long-run productivity. Furthermore, while macro foundations create the potential for long term productivity, actual productivity depends on the microeconomic conditions that affect business itself. It is only through businesses improving

¹ Porter M, and Rivkin J, *The Looming Challenge to US Competitiveness*, Harvard Business Review, March 2012, p. 56.

² OECD 1996, cited in Budd & Hermis 2004, p. 1016.

their ability to turn inputs into valuable products and services that countries can prosper while supporting rising wages for their citizens.

More competitive locations are more successful in attracting foreign capital and labour, and are more able to sustain continuing growth in productivity and, ultimately, living standards. This can create a very strong feedback loop with international flows of capital and labour tending to move in the same direction.

Our openness to the global economy means that Australians have access to a wider range of goods and services at competitive prices. Moreover, increased trade and investment flows give businesses access to new ideas and technologies.

We also agree with Porter and Rivkin that competitiveness is not a zero sum game.³ Greater productivity in other countries leads to higher wages and profits, and increased demand for what is produced in other countries.

Competitiveness can be seen as an important benchmark not just of Australia's ability to take advantage of global opportunities but also of our ability to address domestic economic challenges and sustain future economic growth.

Competitiveness is influenced by a range of factors but most commonly by movements in labour costs, labour productivity and the Australian dollar relative to other currencies. Australia's competitiveness is at risk of being eroded in each of these areas:

- Through 2011, nominal unit labour costs rose by 5½ per cent, well above their historical average rate of 3 per cent per year.
- Labour productivity growth has weakened markedly in recent years, with an outright decline recorded in 2010–11 of minus 1.1 per cent.
- The Australian dollar has appreciated substantially in recent years – by more than 40 per cent against the US dollar since late 2005 and by 24 per cent against the Trade Weighted Index.

These developments point to an environment that is challenging for business and where economic policy settings will be vital in addressing the encroaching risks to competitiveness. The most important policy settings are described in the section below which outlines a framework for competitiveness.

A framework for Australia's competitiveness

Australia needs to focus on improving its competitiveness in engaging with Asia. Countries in and around Asia are continuing to increase their competitiveness as locations to do business, are attracting and developing industries and organisations, are tapping into sources of intellectual property, and are accessing attractive and growing markets. This offers many opportunities for Australia to participate in what can be a positive sum game for the future, but only if we are also improving our competitiveness as a place to do business and enabling our industries to grow their engagement through trade and investment with the nations of Asia.

³ *ibid.*, p. 56.

In this environment, there are three mutually reinforcing foundations of Australia's competitiveness which are illustrated in Figure 1 below. The BCA acknowledges and appreciates the contribution of the Boston Consulting Group in the development of this framework, including information provided as figures within the document.

Figure 1



The first of these foundation components are outward oriented businesses and people. Competitiveness, much like productivity, begins at the firm level, while recognising that external factors that affect the overall business environment also play a critical role.

Australia's ability to lift the competitiveness of our industries will, in large part, be reflected in our capacity to increase productivity. Productivity is best enabled through business investment in technology, human and physical capital, and continual innovation in management practices, industrial organisation and work arrangements. Essentially, many productivity improvements flow from working smarter, not harder. These investments and the practices and innovation processes that they support are driven by outward oriented firms that use them to deliver increased value to their customers. In this way the many steps taken by businesses to increase productivity actively promote Australia's competitiveness.

The steps that are taken by outward oriented businesses include building strong commercial relationships in the region, linking with global businesses, gaining access to valuable intellectual property, and participating in industry clusters and value networks. It also involves the development

of highly skilled people, an ethical and high-trust culture, and strong mutual relationships through migration of Australian and Asian expatriates.

The second component involves making sure that Australia has a hard working asset base. This means the development and maintenance of built infrastructure that permits industries to derive the most value from our natural resource endowments. The capacity and effectiveness of Australia's asset base requires the participation of the private sector, competition and effective regulation to enable the efficient construction, operation and utilisation of infrastructure. As a consequence, there is a critical link with government policy settings.

The third component of the foundation, on which the other two components depend, comprises efficient policies and accountable institutions. In particular, competitiveness is underpinned by effective and attractive taxation policy, labour market policies, infrastructure, regulation, delivery of government services to the tradeable sector and quality higher education and research systems.

Taxation reform

Australia requires taxation policy settings that do the least harm to economic growth and help Australia to continue to be an attractive destination for investment not only in the resources and energy sectors, but also in other sectors where investment, including foreign investment is required. Continuing investment in Australia's productive capacity will underpin the future competitiveness of our economy.

Labour market

Australia requires policies that provide high quality education and training, and improve the alignment of the education and training provided with current and emerging labour market needs.

At the same time, maintaining skilled migration levels, and facilitating the movement of skilled workers from low-growth to high-growth sectors and regions to fill genuine industry needs is important.

Furthermore, Australia needs a workplace relations system that reflects the changing nature of our economy, our workers and our workplaces. It needs to support Australia in taking advantage of the opportunities available to us and in staying ahead of unfolding challenges.

Employment creation and satisfaction are best achieved by building a strong capacity for innovation, adaptation, mobility and resilience. This is because these characteristics within our workplaces support the capacity of both individuals and businesses to cope with the inevitable transitions from a changing economy.

Infrastructure planning and financing

In relation to infrastructure, it is vital that policy settings enable effective long-term planning, and that financing is linked to long term planning. In the Australian context, effective infrastructure development also depends on the different levels of government working together to establish a prioritised list of economic and strategic infrastructure requiring public funding.

Regulation and government service delivery

The business community accepts that there is a rightful role for regulation in the economy. The entire community benefits from good regulation that supports the effectiveness of markets needed to underpin economic growth. Good regulation achieves an effective balance, recognising the roles played by the formal device of the law and the informal device of reputation within competitive markets.

Competitiveness is also affected by the provision of government services. One important aspect is the trade transaction and processing times for Australia's international merchandise trade. There should be a focus on ensuring that port, shipping and customs regulations are the most efficient in the world. Australia's policy settings should ensure that international benchmarks are available for trade transaction costs and processing times, and that the costs to Australian business are reduced.

In addition, the quality and relevance to industry of higher education and research, and the institutions that support these activities, make a very important contribution to innovation and competitiveness. China, Singapore and many other countries are making major investments in these areas, recognising the value of these institutions as a source of national competitiveness.

Overall, the policy settings that are most important are those that enable Australia to develop, attract and retain mobile capital, talent and other inputs that will enable growth in our trade and investment with the countries of Asia.

Together, these drivers will determine whether we flourish in the Asian Century. If we get them right, we will release a 'positive feedback loop' whereby mobile factors are attracted to high-income generating industries that are strongly integrated into the world's most dynamic economic region. How Australia compares with other nations when it comes to the most important components of competitiveness can help to identify where the greatest attention needs to be directed, especially in relation to policy settings.

How Australia compares

Australia is increasingly seen by internationally recognised institutions as middle ranking on competitive metrics compared to our peers. The World Economic Forum's latest Global Competitiveness Index indicates an erosion of Australia's competitive position:

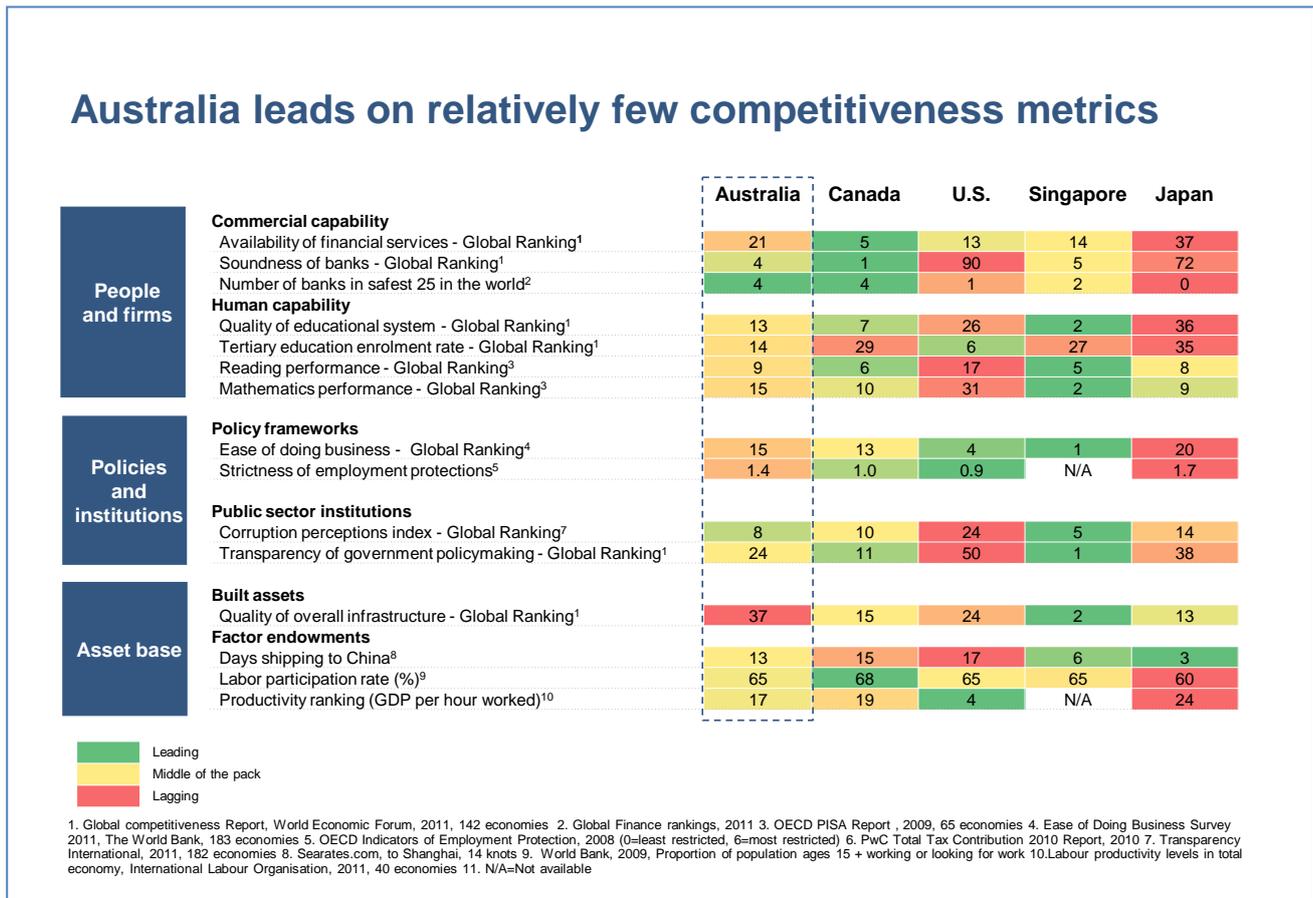
- On the World Economic Forum measure of competitiveness, Australia has dropped from 14th to 20th place in the last two years, its lowest ranking since the index commenced in 1980.
- The World Economic Forum identifies the most problematic factors for doing business in Australia as access to financing, restrictive labour regulations, tax rates, inadequate supply of infrastructure and inefficient government bureaucracy.

In relation to transport infrastructure in Australia, the Organisation for Economic Cooperation and Development (OECD) released the report *Strategic Transport Infrastructure Needs to 2030* in March 2012. The report concluded that some countries, such as Canada, are linking strategic infrastructure planning to long-term infrastructure funds. The report also found, however, that

Australia is one of a number of countries that should improve financing mechanisms so as to make sure that funding is consistent with strategic infrastructure needs.

Figure 2 below compares Australia to Canada, the United States, Singapore and Japan on a range of competitiveness metrics, including commercial capability, policy settings and built assets. The comparisons show that Australia tends to be ranked in the middle rather than as a leading country. These comparisons reinforce the BCA's position that there is scope for Australia to pursue domestic policy reforms to improve our competitiveness.

Figure 2

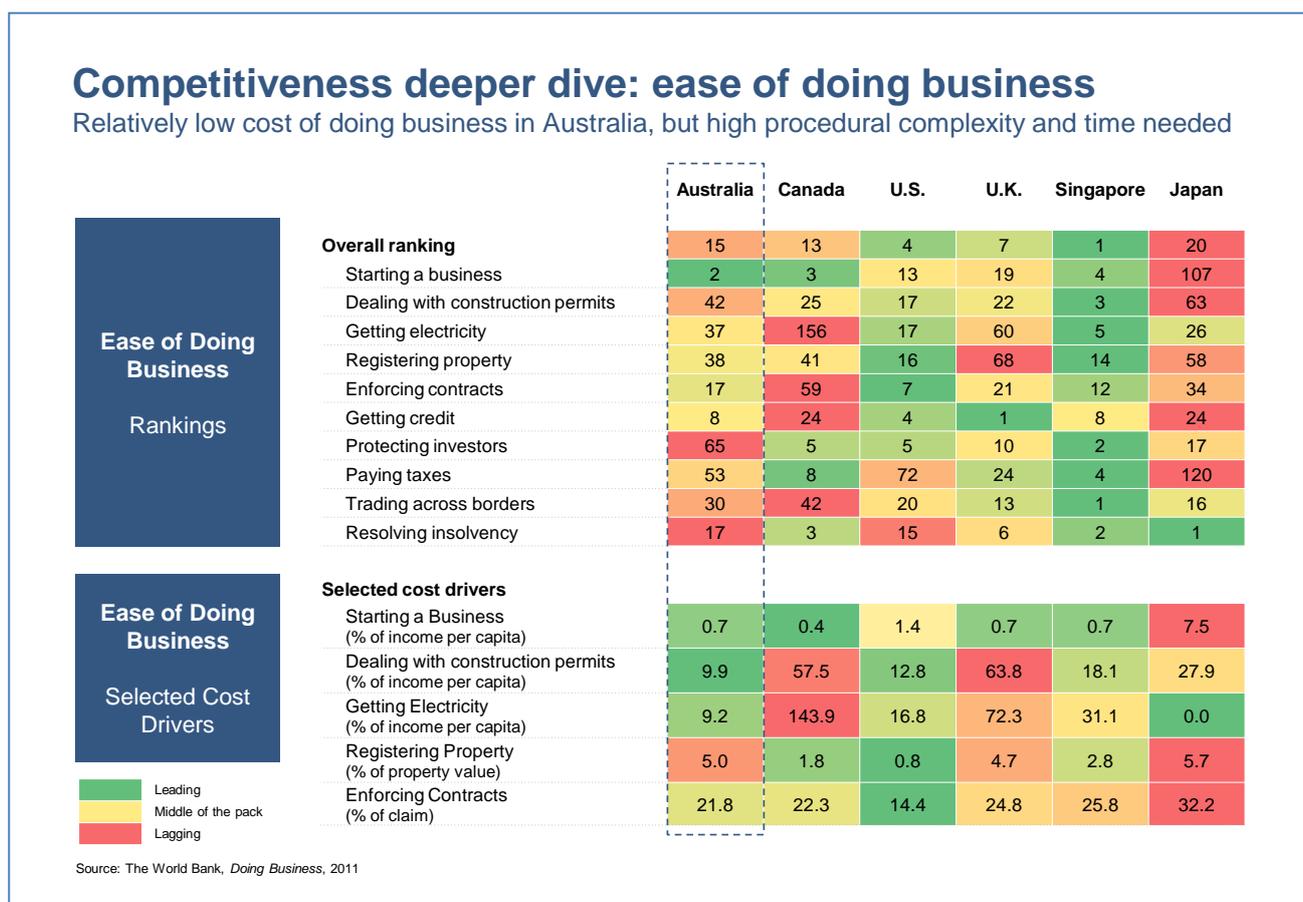


Ease of doing business

An important measure of whether Australia's policies and institutions are conducive to competitiveness is how easy they make doing business in Australia. Australia ranks behind many of its peers on the World Bank's ease of doing business rankings.

Figure 3 provides a breakdown of the ease of doing business rankings. Whilst transaction costs are relatively low in Australia, procedural complexity and processing time are high. These comparisons indicate the importance of domestic policy reforms and supporting actions to lift the competitiveness of our domestic economy.

Figure 3



Impediments to Australian competitiveness

The intense competition in the region is evident in the tax and regulatory environment:

- Almost half of the countries ranked in the top 10 by the World Bank for ease of doing business were from the Asia-Pacific region. Australia was not one of them.⁴
- As indicated in the BCA’s submission to the tax forum in 2011, Australia’s effective corporate tax rate of 26 per cent compares with an average of around 18 per cent across the Asia-Pacific.

Australia must place itself in a strong position to attract skills and investment if it is to be competitive in the region. Strong inflows of capital and labour will allow the resources sector to grow while putting less pressure on other sectors of the economy.

In seeking to be more competitive in the region, Australia’s poor productivity performance needs to be addressed. Productivity growth can be lifted through business investment in technology, human and physical capital, and innovations in management practices, industrial organisation and work arrangements.

Investment and innovation would be encouraged by having the most supportive business environment possible – flexible product and labour market regulation, competition, openness to

⁴ World Bank, *Doing Business 2012: Doing Business in a More Transparent World*, June 2011.

trade and investment for knowledge transfer as well as education and skills all play a part in shaping this environment. This suggests the need for continued attention on how various government policy settings impact on the business environment.

The BCA also proposes that particular sectors should be examined in detail. The following section provides two examples of how particular sectors might be examined.

Sectoral illustrations: coking coal and education

This section provides preliminary analyses of Australia's competitiveness in two industries: coking coal and education.

The two illustrations identify differing factors influencing the competitiveness of the Australian economy and Australia's engagement with Asia. They highlight the importance of examining different industries to form a complete picture of Australia's ability to compete in the Asian region and to identify how government policy settings and other public sector decisions can help Australians derive value from engaging with Asia.

The illustrations demonstrate that policy can be a significant influence on the competitiveness of Australian businesses in Asia. Vital areas, such as infrastructure for metallurgical coal and public safety for education, require a joint approach from the private sector, public sector institutions and government to solve problems with important 'public good' aspects. With the right cooperation and environment, these and other industries can build on Australia's strong platform to ensure continued and further success in the Asian market.

Australian metallurgical coal exports

In 2010, global consumption of metallurgical (coking) coal increased by 16%. The engine of this growth, the Asia-Pacific, took an estimated 66% of global exports.⁵ Demand for coking coal in China is predicted to increase by 65% between 2010 and 2016. In the same period, India's demand is expected to double.⁶ However, new streams of global supply and structural changes in the industry are expected to shift metallurgical coal prices downward over the next decades.⁷

Total cost, quality and reliability are key considerations for Asian buyers of metallurgical coal. As a result of Australia's natural mineral endowments, geographical location and export logistics assets, metallurgical coal producers are able to provide Asian buyers a quality product at a globally competitive landed price. Over the last decade the value of Australian exports in coking coal rose from \$5bn to \$34bn, driven by our large share of the Asian coking coal export market.⁸

Investments in export infrastructure by government and industry, especially from the mid-2000s, have been essential in ensuring the reliability and growth of Australian supply.⁹ Figure 4 illustrates

⁵ International Energy Association (IEA), *Coal Information 2011*, 2011, p. II.7

⁶ ABARES, *Australian Commodities March Quarter 2011*, available online from [http://adl.brs.gov.au/data/warehouse/pe_abares99001790/AC11.1_March_part_1_REPORT.pdf], p.178

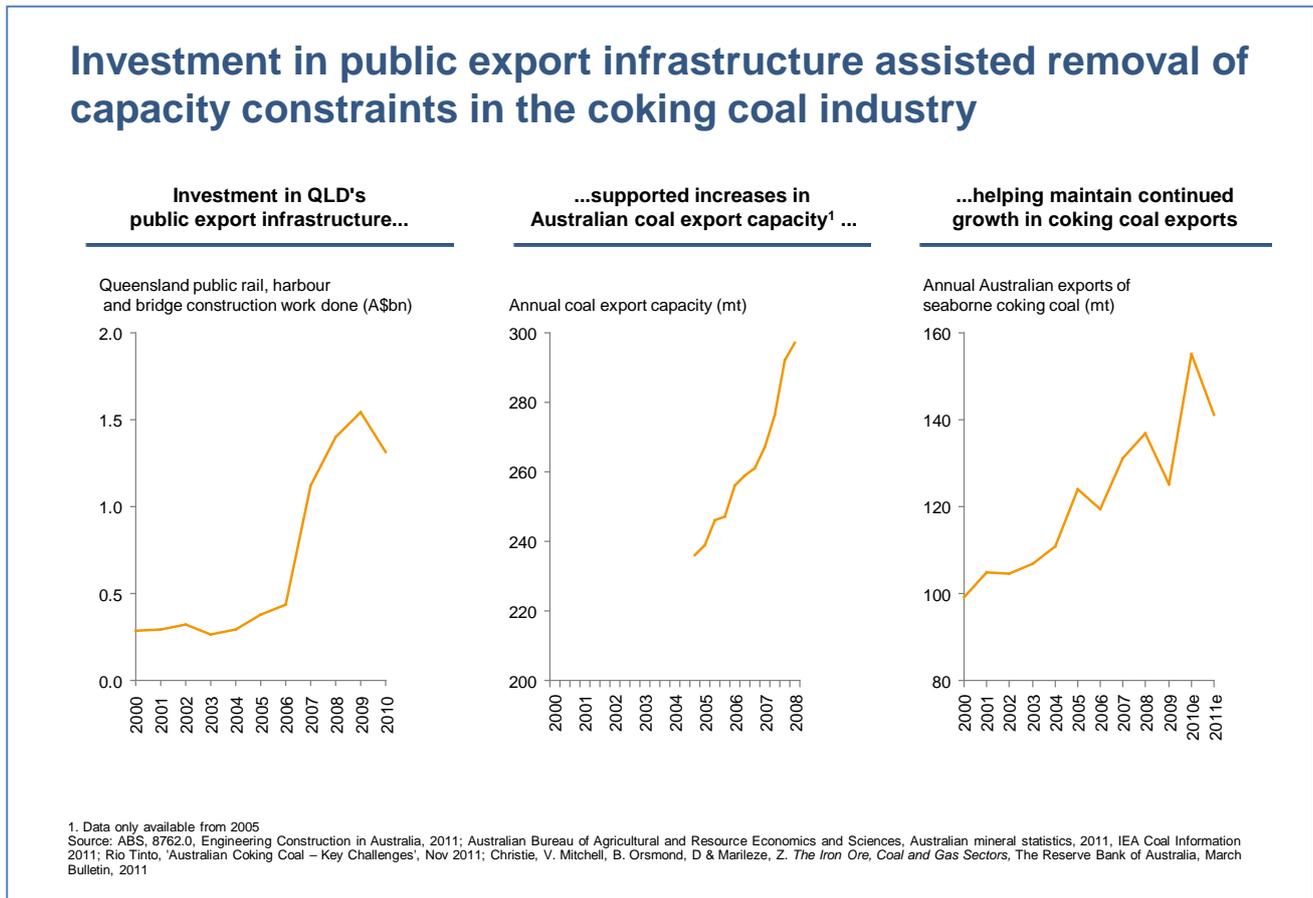
⁷ ABARES, p. 182

⁸ Non-adjusted, ABARES, p. 182; IEA, p. II.11 & p.III.30

⁹ Christie, V. Mitchell, B. Orsmond, D & Marileze, Z. *The Iron Ore, Coal and Gas Sectors*, The Reserve Bank of Australia, 2011, available online from [<http://www.rba.gov.au/publications/bulletin/2011/mar/pdf/bu-0311-1.pdf>]

how public infrastructure investment in Queensland increased in response to higher global prices for coking coal. The additional investment in public infrastructure seen in Queensland and elsewhere has increased the export capacity of Australia's coal corridors (Figure 4). The increase in export capacity has assisted Australia remain the world's largest exporter of seaborne metallurgical coal. In 2009, Australia exported 125 megatonnes (mt) of metallurgical coal. By comparison our closest competitor, the United States exported 34mt.¹⁰

Figure 4



As in the past, policymakers will remain central to addressing a range of challenges faced by the industry. Investments in port infrastructure during the mid-2000s to relax export capacity constraints were an achievement of government and industry co-operation. This should give confidence that future co-operation will bring continued success in addressing the new set of emerging challenges of the metallurgical coal industry.

Metallurgical coal producers have identified broad areas of engagement where policymakers and industry could work together to meet future challenges.¹¹ These include:

- human capital: availability of skilled workforce
- regulatory environment: delays in project approval, government taxation

¹⁰ IEA, p. III.39

¹¹ Rio Tinto, 'Australian Coking Coal – Key Challenges', November 2011, available online from www.coalservices.com/ICCCDownloads/malcom%20roberts.ppt; Association of Mining and Exploration Companies, 2012, available online from <http://amec.org.au/>

- exploration opportunities: access to land, co-funding options
- public infrastructure: timeliness and efficiency of public infrastructure projects, provision of community infrastructure in regional areas.

Australia's education exports

Asia is a large, vibrant and growing market for education. With Asian countries accounting for over 50% of the world's population, and their domestic education systems struggling to satisfy the burgeoning middle class, Asia's demand for education exports is likely to continue growing well into the future.

In the higher education sector alone, the number of students from Asian countries studying outside their home countries almost doubled to over 1 million in the decade to 2010. Asian students account for just over one third of the world's outbound tertiary students.¹²

Education-related travel services are Australia's third largest export, behind iron ore and coal. Australia's education exports in 2010-2011 totalled \$15.8 billion (including around \$6 billion in fees and \$9 billion in living expenditures), down from about \$18 billion in the previous year.¹³ In 2011, Asia accounted for 70% of Australia's enrolments by foreign students and education exports to Asia in 2011 are likely to be ~\$11 billion.¹⁴

Competition for students is likely to intensify, both from competitor 'host countries' like the US and from 'source countries' like China. Significant value is at stake: if Australia were able to attract an additional five percentage points of "market share" of Asia's outbound higher education students, that would result in an additional \$1.5b in education export revenue, and a resulting increase in Australians' incomes.¹⁵

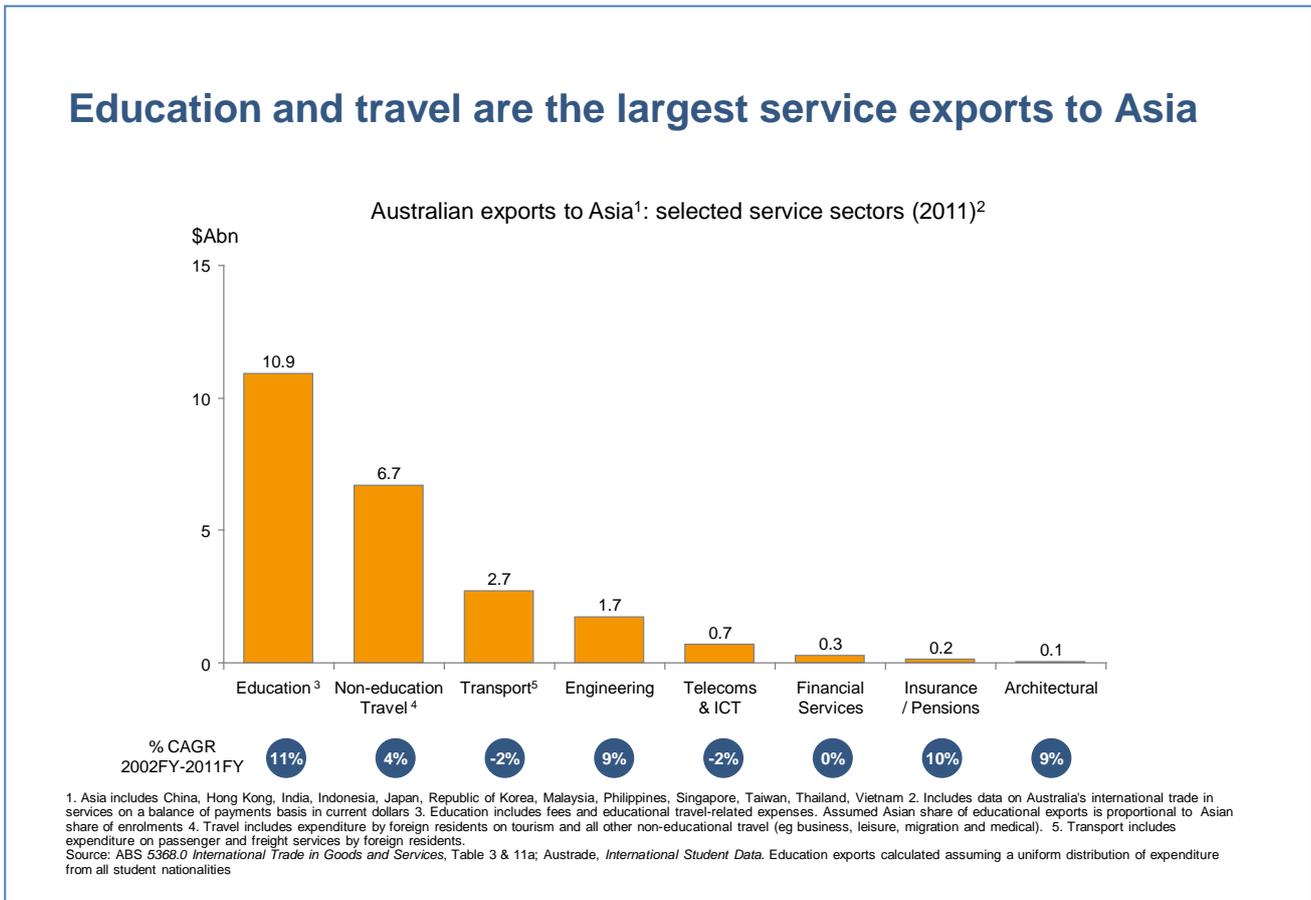
¹² UNdata, *Students from a Given Country Studying Abroad (Outbound Mobile Students)*. Note: Asia is defined here as China, Hong Kong, India, Indonesia, Japan, Korea (Republic of), Malaysia, Philippines, Singapore, Taiwan, Thailand, Vietnam.

¹³ ABS, *International Trade in Goods and Services*, cat. no. 5368.0.

¹⁴ Austrade, *International Student Data*. Note: Asia defined as per endnote 12. If all Asia is included, it would account for 77.4% of enrolments (Austrade).

¹⁵ UN data, *Students from a Given Country Studying Abroad (outbound mobile students)*; ABS, 5368.0 – *International Trade in Goods and Services*. Calculated assuming a uniform distribution of export revenue from all types of students.

Figure 5



International students from Asia provide a range of important benefits beyond earning export income. Educational links enhance Australia's cultural, diplomatic and commercial ties with Asia. Continued cultivation of educational links strengthens the network of Australian education alumni who occupy influential positions in Asian government and business, and promotes greater understanding between cultures.

Figure 6

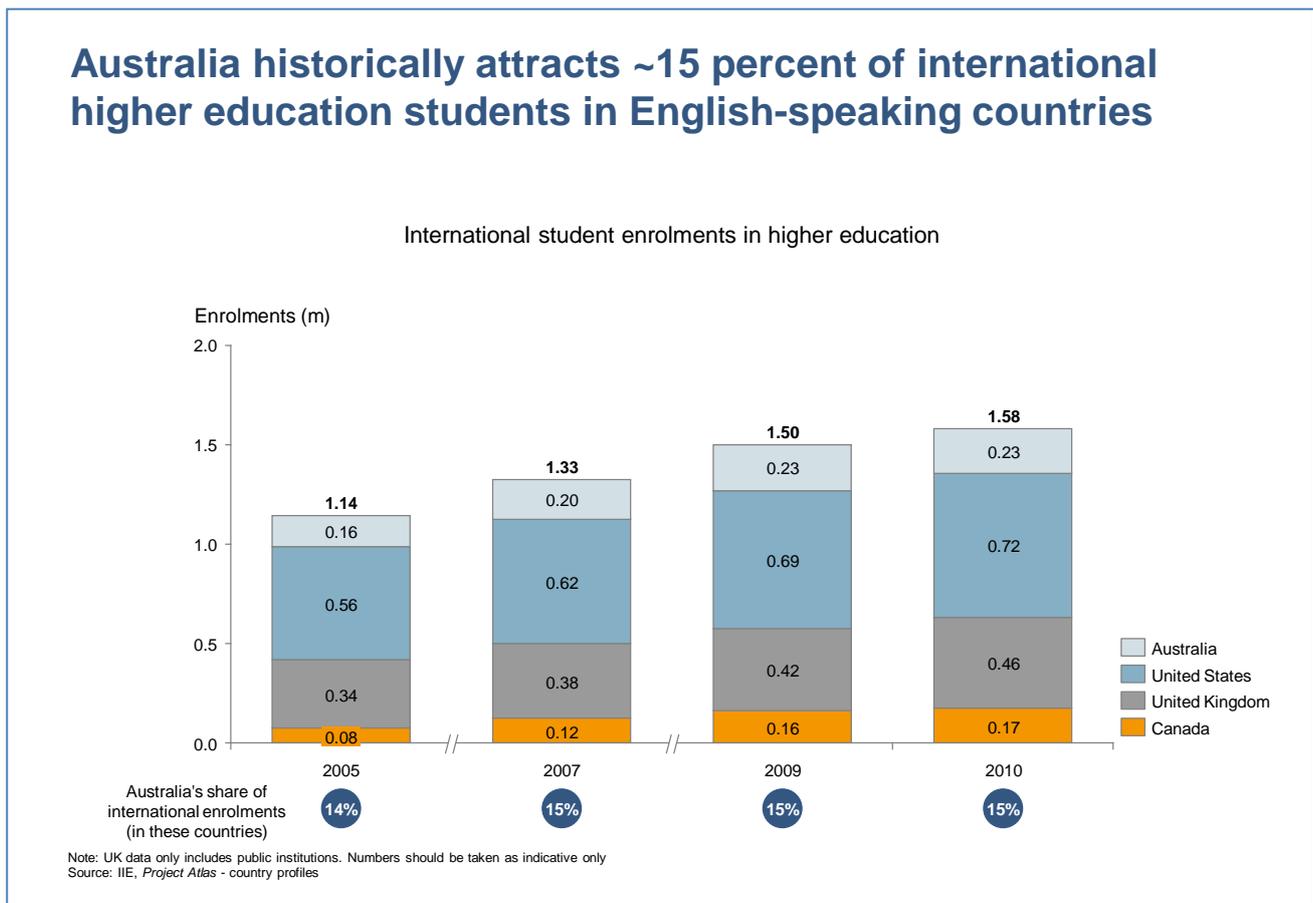
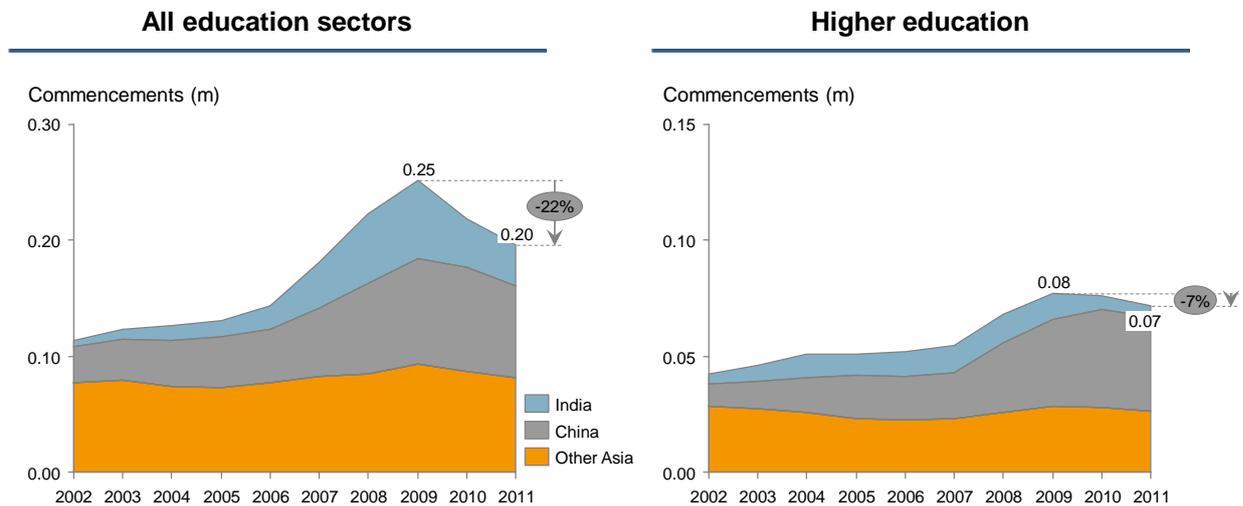


Figure 6 shows that Australia has consistently won around 15% of the international market for higher education in English-speaking countries. However, there are some grounds for concern about whether Australia is well positioned. There has been a significant decline in new students from Asia since 2009. Between 2009 and 2011, overall commencements (a leading indicator of future enrolments) from the region have declined by 22%, and by 7% in the Higher Education sector.

Figure 7

Australia's commencements from Asia have fallen since 2009

Commencements are a leading indicator of enrolments



Note: Asia here comprises of China, Hong Kong, India, Indonesia, Japan, Republic of Korea, Malaysia, Philippines, Singapore, Taiwan, Thailand, Vietnam. Education sectors include Higher Education, VET, ELICOS, Schools and Other (non-award and enabling courses)
Source: Austrade, International Student Data

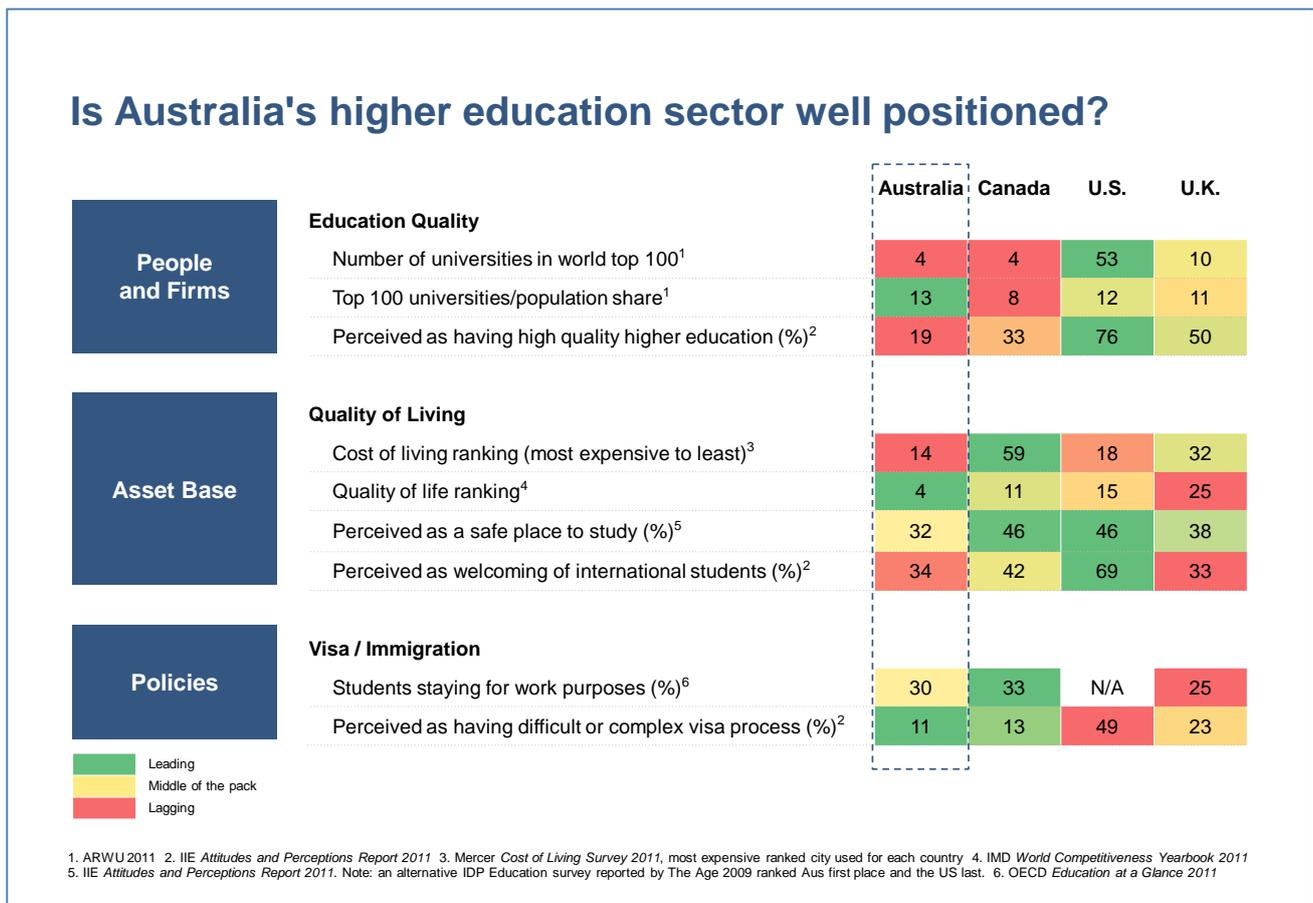
Three main factors drive a country's ability to attract international students:

- the quality of the education provided and recognition of this by the international education market
- the cost of education and the quality and cost of living; including safety
- employment opportunities in Australia post-graduation, which in turn are heavily influenced by visa arrangements.

Australia compares well against our English-speaking peers on some dimensions driving student choice, but improvements are needed in several areas:

- Quality of education: Australia has a strong university sector, but survey evidence suggests that potential students do not perceive the quality of Australia's higher education sector as strong relative to competing offers.
- Education, living costs and safety: student fees and living expenses for international students have risen with the strong Australian dollar. In surveys, prospective students rate Australia as less safe and welcoming than competitors.
- Employment opportunities in Australia: survey evidence suggests that most prospective students regard Australia's visa process as relatively simple, and almost as many students stay for work after graduation as in Canada. However, recent changes to visa arrangements have made post-education employment in Australia more difficult in some categories.

Figure 8



Policy settings have been – and will remain – central to facilitating value creation for Australia in the education exports sector. Policy settings influence Australia’s long term competitiveness in the global education market in several ways, including:

- governance and investment to enable the further development of high quality education institutions
- policies to ensure that international students are safe and can access affordable accommodation, and to help host communities manage
- initiatives to ensure Australia’s target markets are aware of the Australian ‘value proposition’ and to protect the shared component of the Australian education “brand” (e.g. by continuing to refine the regulation of quality hurdles at each qualification level).

ATTACHMENT 2: AUSTRALIA'S ECONOMIC ENGAGEMENT WITH ASIA: OPPORTUNITIES AND CHALLENGES

This attachment provides an overview of the scale of the opportunities, while also identifying some of the major challenges for Australia's future economic engagement with Asia.

What is the extent of the economic opportunities available from engagement with Asia?

The opportunities being generated in the Asian Century are driven by relatively high levels of economic growth.

The economic re-emergence of Asia is projected to continue over the medium to long term, driven by ongoing economic growth in China, India and other newly industrialising countries across Asia.

Relatively strong economic growth is supported by continuing industrialisation, urbanisation and rapid growth in the size of Asia's middle class.

The rapid changes taking place in Asia are resulting in the continuing expansion of existing markets, notably demand for resources and energy. There are also new markets emerging in services. The World Bank has identified the growth in trade in services as a major global trend which is contributing to changes in the structure of Asia's economies.

There is the potential for continuing high levels of economic growth to continue to transform the size, structure and influence of the Asian region. Equally, however, there are many challenges that will need to be addressed.

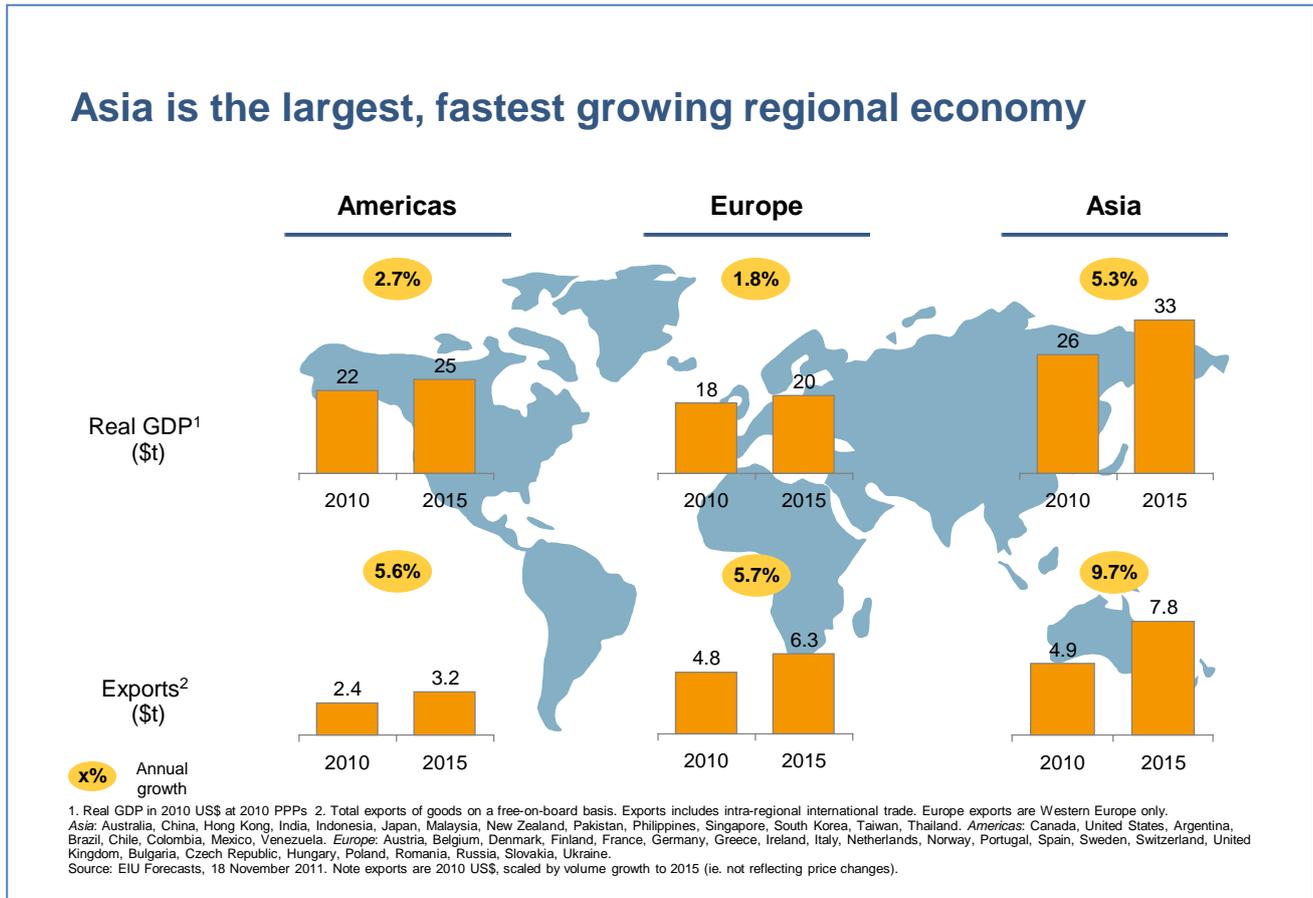
Asia already accounts for more than 26 per cent of global gross domestic product (GDP). The Asian Development Bank has forecast that, if the right policy decisions are taken by Asian governments, the region could account for more than 50 per cent of global GDP by 2050. If this were to occur, this share of global GDP would be similar to the proportion of the world's population living in Asia.

Asia's future growth prospects will, to a significant extent, be determined by internal factors. The Asian Development Bank points to important challenges such as governance problems and weak institutional capacity in a number of countries, concerns about rising income inequality, and the risk of a middle income trap.

At the same time, Asia's prospects are linked to economic engagement with markets in the wider Asia Pacific, Europe and in other regions.

In the nearer term, real GDP growth of the wider Asia Pacific region from 2010 to 2015 is expected to be double that of the Americas, and nearly triple that of Europe. Over the same period, the value of exports from Asian nations (including trade within the region) is also expected to grow by almost 10 per cent, compared to less than 6 per cent growth in other major economic regions.

Figure 1

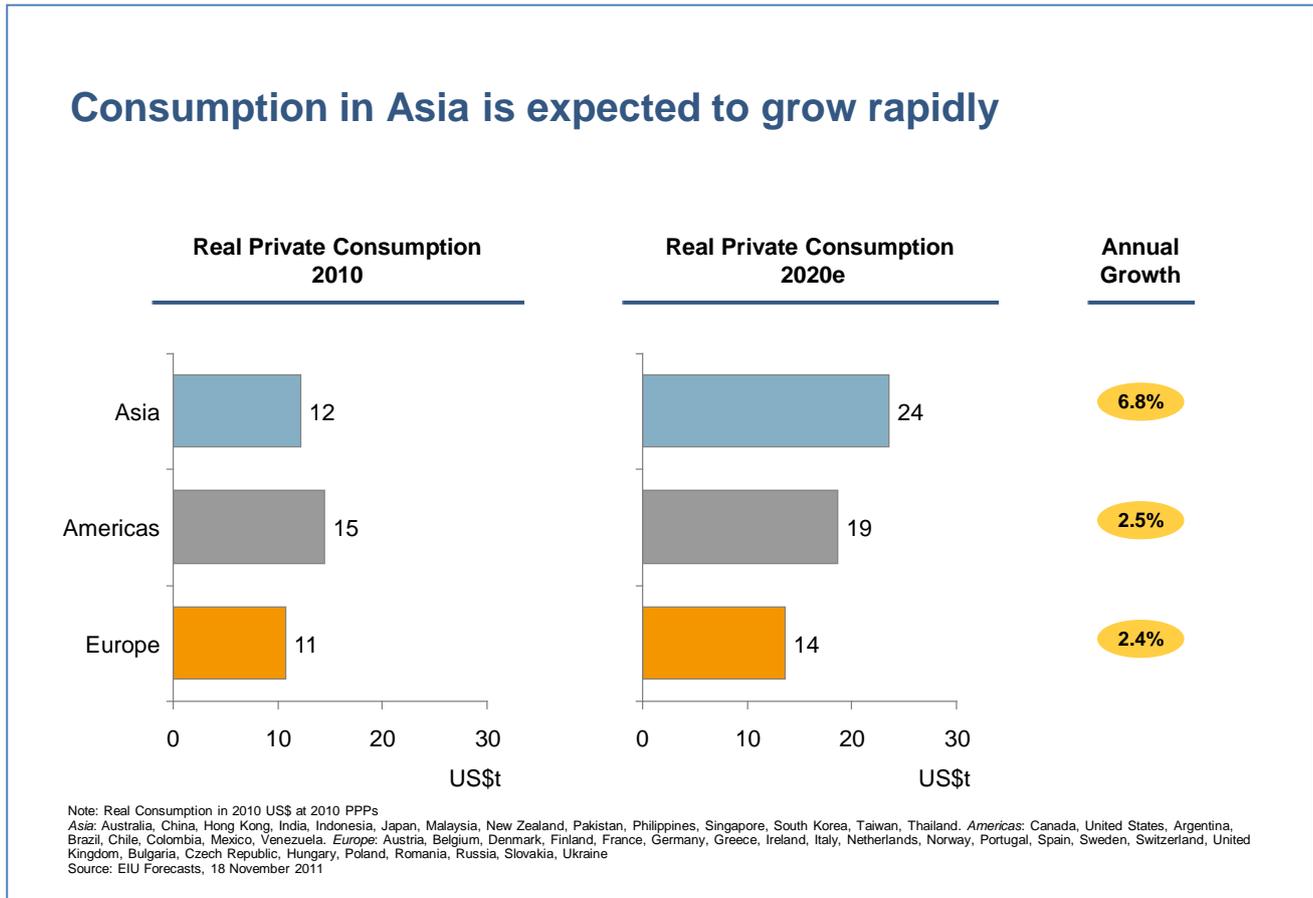


Asia's middle class is growing rapidly, and is amongst the fastest expanding middle class population group in the world. The World Bank has pointed to estimates that suggest the global middle class could go from 1.8 billion people in 2009, to 5 billion people by 2030.¹ It is further estimated that almost two thirds of the 5 billion members of the future global middle class will be living in Asia.

The growth of the middle class is expected to underpin future growth in demand for a wide range of commodities, agricultural products, manufactured goods and services. The World Bank and other agencies have emphasised the pressure that will be placed on supplies of energy, food (including foods with high protein content), housing and manufacturing goods. Securing supplies of energy and food are key priorities for Asian nations and represent important opportunities for Australia.

The growth in the middle class is forecast to result in a doubling of real private consumption in Asia between 2010 and 2020. This would mean that consumption in Asia would overtake both the Americas and Europe.

Figure 2



As the World Bank has stated, “perhaps the most important global megatrend is the rise of China itself”.² China’s continuing growth is likely to be the most important continuing influence on the future of Asia. The World Bank has also forecast that even if China’s growth rate slows over the coming decades, as expected, it would still replace the United States as the world’s largest economy by 2030, and its share of world trade could be twice as high as it is now.

The opportunities also extend across most of the nations of Asia, although once again there is a considerable difference in the scale between the different economies. As a result of rapid growth and industrialisation in countries such as China, India, Vietnam and Indonesia the economic structures of these economies are undergoing change. This includes the development of and growth of new markets in services, including financial services, education, professional and business services and information and communications technology.

Importantly, the scope of the economic opportunity extends to all major sectors of Australia’s economy, recognising that the scale of the opportunities for international commerce varies between the sectors. As well as resources and energy, there are very substantial opportunities in manufacturing, agriculture and services.

The challenges

While the opportunities are large, there are considerable challenges and impediments to overcome before the opportunities can be translated into viable transactions.

In a global context, there are two principal challenges confronting Australian industries competing in Asia:

- China, India and other resource and energy importers are seeking alternative suppliers – putting pressure on Australia
- businesses in North and South America, Europe and Africa want to win new markets in Asia. At the same time, our industries face new competition from within Asia as illustrated by projections for rapid growth in the number of large companies with sales of \$1 billion or more.

Figure 3

The number of large companies in Asia is expected to grow

| # of US\$1b Companies | 2000 | 2010 | 2020e | |
|-----------------------|-------|-------|--------|--------|
| | Total | Total | Low | High |
| Australia | 63 | 92 | ~120 | ~150 |
| China (including HK) | 51 | 465 | ~1,300 | ~4,200 |
| India | 19 | 141 | ~450 | ~1,000 |
| Indonesia | 6 | 40 | ~120 | ~180 |
| Japan | 604 | 853 | ~1,200 | ~1,250 |
| South Korea | 78 | 104 | ~140 | ~230 |
| Germany | 86 | 128 | ~180 | ~220 |
| US | 818 | 1,265 | ~1,850 | ~1,950 |

Note: Data is based on sales and pertains only to public companies. Number of companies in 2020 estimated using two approaches; 1) Using 2005-10 CAGR of current >\$50mn companies in sales and calculating how many fall in \$1bn+ category. 2) Growth rate of # of \$1bn+ companies in 2000-10 used to estimate # of companies in 2020
Source: The Boston Consulting Group, Thomson One Banker.

Both these challenges are directly concerned with the competitiveness of Australia’s industries. If we are not sufficiently competitive, we risk missing out on opportunities and losing ground in our existing markets.

Consideration also needs to be given to the potential for a slowing of economic growth and the impact that this would have on trade with countries in Asia.

Potential risks to continuing economic growth in the major economies in Asia include:

- the impact of the debt and financial crisis in Europe and continuing economic uncertainty in the United States on the emerging Asian economies
- whether governments in Asia, including China, will take the necessary next phase of economic reforms to support greater competition and continuing economic growth

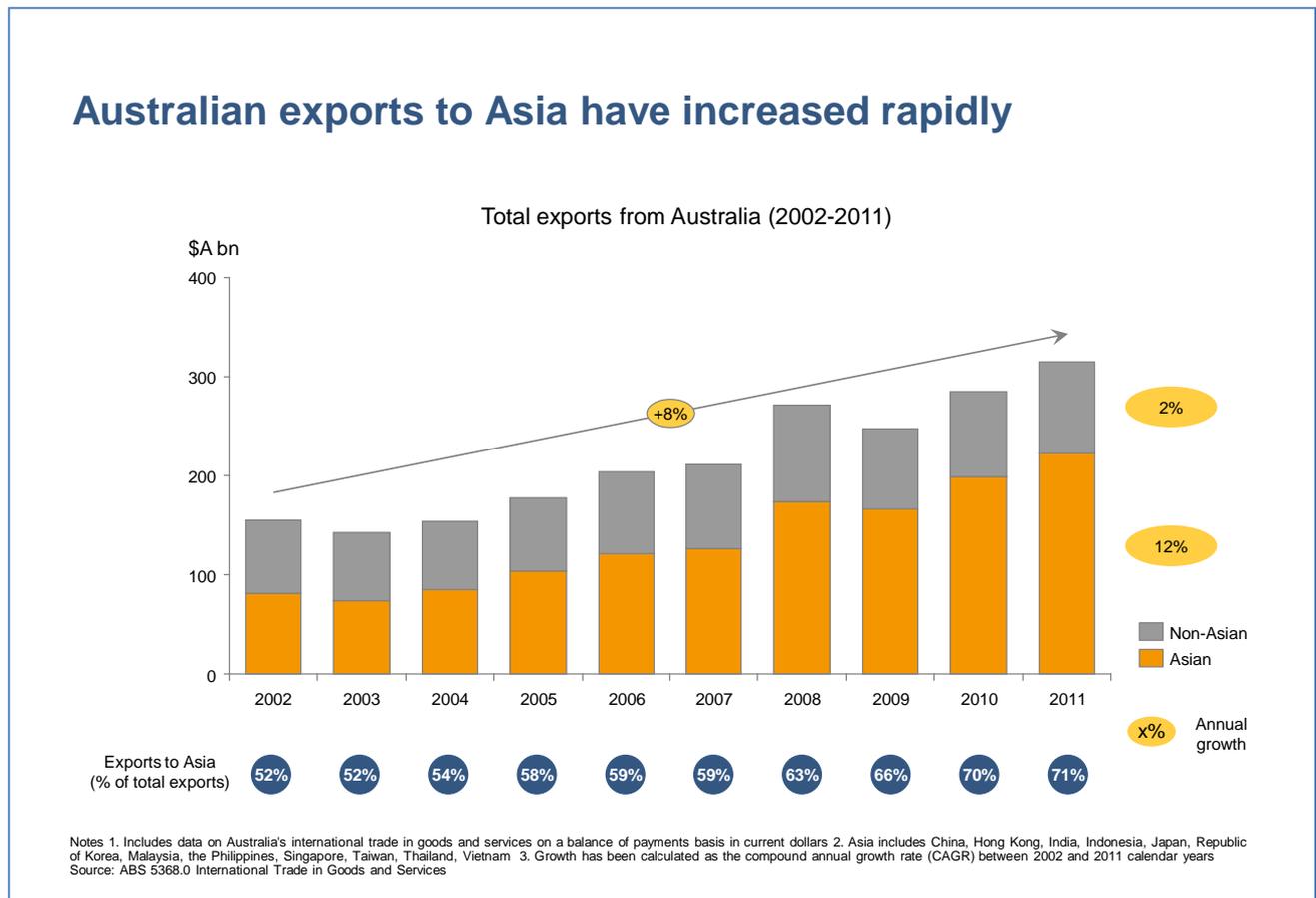
- whether the institutions, governance and policy settings required for sustained economic growth are in place in Asian countries
- whether strategic or security considerations might reduce economic growth prospects.

Australia’s current economic engagement with Asia

There are many areas where Australia’s economy is already well integrated with Asia:

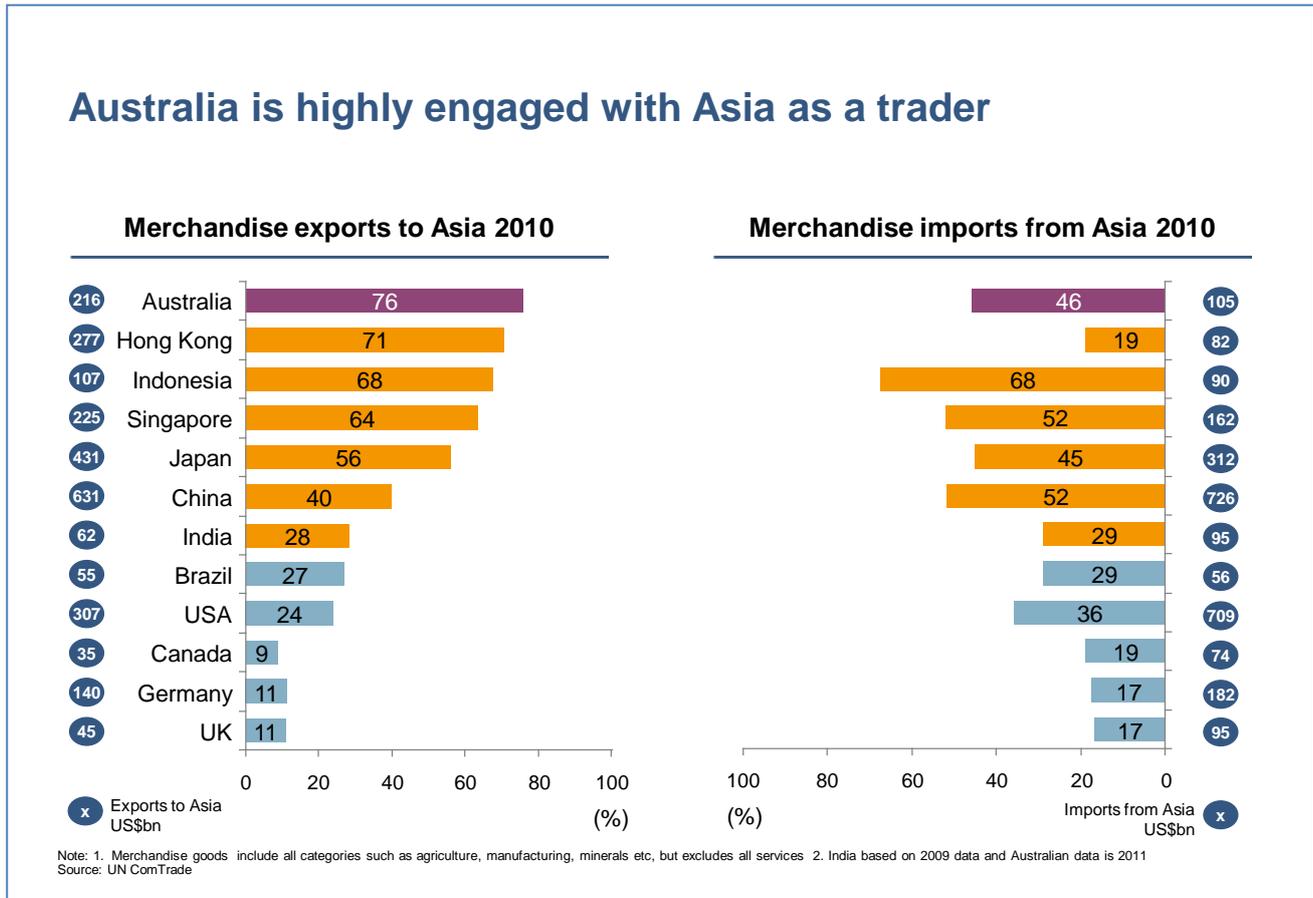
- Asian nations now purchase about 70 per cent of Australia’s exports. Only six years ago exports to Asia accounted for less than 60 per cent of our total exports. The rapid growth in exports to Asia, which are now worth more than \$200 billion per year, is shown in Figure 4.
- Asia is the major source of imported goods for Australian businesses and consumers.
- Foreign direct investment from Asian nations now accounts for 20 per cent of all foreign investment in Australia.

Figure 4



When it comes to trade with Asian countries, Australia’s level of integration is high compared with other economies in Asia. The Asian share of Australian merchandise exports, at 76%, is higher than the Asian shares of Hong Kong’s and Singapore’s merchandise exports. Similarly, Australia imports more of its merchandise from Asia than Japan does.

Figure 5



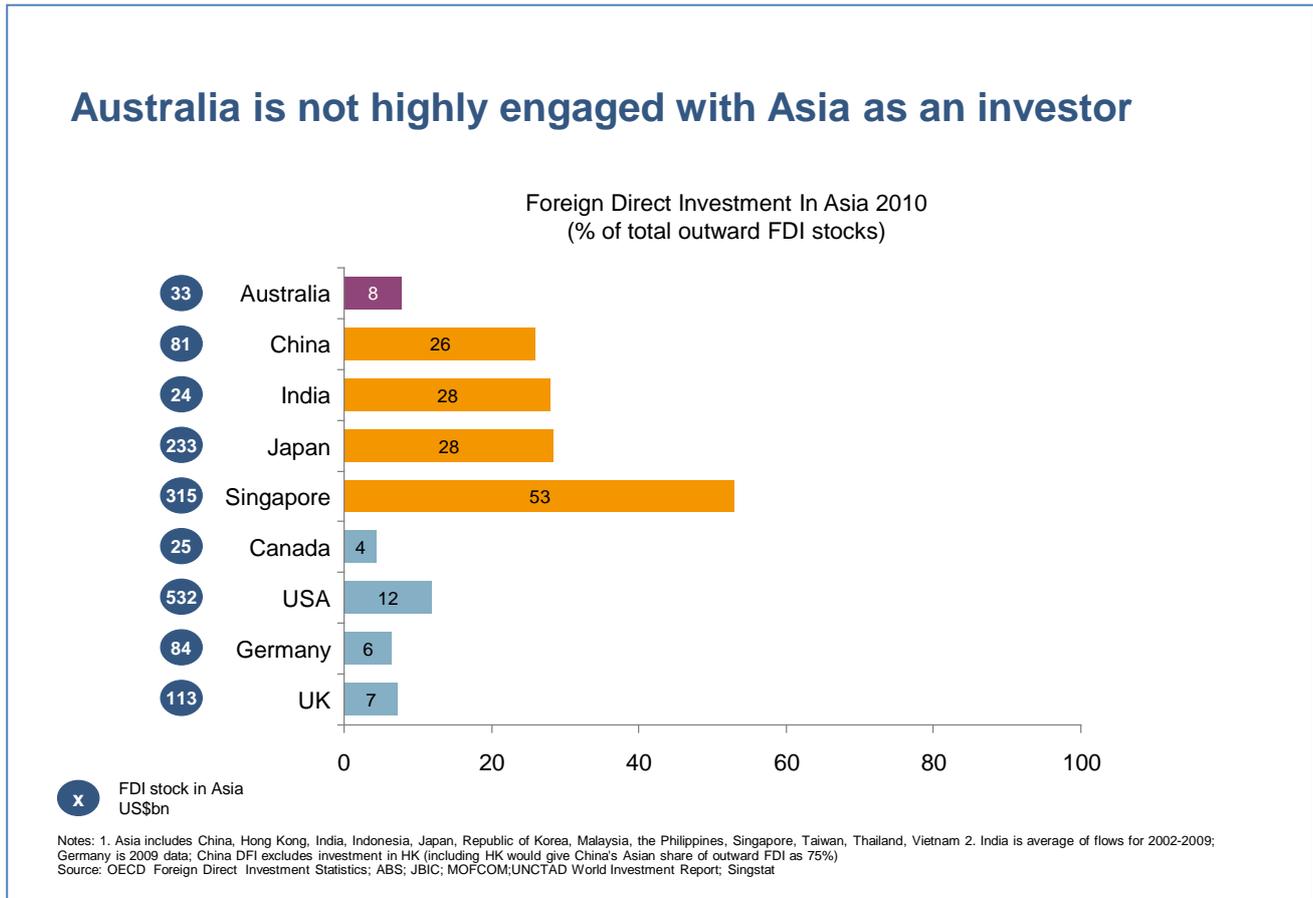
Despite Australia's strong trade relationships with the nations of Asia, there are some areas where the level of integration is relatively low. These include:

- relatively low levels of direct investment by Australian businesses in Asia;
- major exports to Asia are from a narrow base of energy, resources, agricultural and services exports. Therefore, in many sectors, Australia's exports to Asia are small.

Although Australia's exports of manufactured goods to Asia are relatively small, there has been significant growth in a number of areas, especially in high value manufactures.

In relation to outwards investment, the amount of Australian foreign direct investment (FDI) in Asia is relatively low. Only 8 per cent of Australia's outward FDI is in Asia, although this proportion is not much lower than that of the United States and is larger than Canada, as shown in Figure 6 below.

Figure 6



Although economic growth will drive increased demand across almost all industry sectors, the opportunities for trade and investment varies across different industries.

Resources and energy

Growing demand for minerals has led to strong increases in exports of minerals from Australia to Asia, particularly exports of iron ore, coal and gold to China, India and the Republic of Korea.

Australia's energy sector has also built major export markets for liquid natural gas (LNG) in China and Korea, as well as to countries such as Malaysia and Vietnam.

Continuing urbanisation in China, and continuing population and income growth in Asia is expected to underpin continuing growth in demand for resources and energy, with forecasts showing LNG and coal expected to be subject to strong growth in demand over the next 20 years.

Manufacturing

There are significant opportunities for Australia's manufacturing sector, although the value, location and how the opportunities can be taken up varies greatly between different manufacturing industries.

Although it is not well recognised, China has been Australia's largest market for manufacturing exports. The ITS Global report pointed to real growth of just over 4 per cent a year of manufactured exports from Australia to China.

The report also highlighted that there are some bright prospects in high valued added manufacturing, reflecting the fact that exports of certain elaborately transformed manufactured products grew in real terms over the last five year. In some cases the growth was rapid, although it was from a relatively modest base.

There are also opportunities for manufacturing more generally, by investing in Asia and either providing products to markets directly, or exporting from Asia to other countries.

Services

Australia's exports of education and tourism services are amongst the nation's largest exports to Asia. Both involve services delivered predominantly from Australia, and represent important industries for future economic engagement.

Education services provide important benefits beyond earning export income, including the contribution education makes to strengthening Australia's broader relationships with countries in Asia.

Australia's services sector has also developed significant cross-border trade, including financial and professional services, and in areas such as transport, logistics and in construction services. There has also been significant growth in specialised information services delivered from Australia using information and communications technology.

Furthermore, as a result of the strength of Australia's resources and energy sector, businesses providing services to these industries have the potential to further expand in international services markets in Asia and elsewhere.

Another important approach to exporting services is through the establishment of a commercial presence abroad. Sales of services by affiliates of Australian-based businesses in Asia are likely to be more significant than generally recognised. For example, ITS Global has estimated that global sales of services by foreign affiliates of Australian-based businesses in 2010–11 were about \$100 billion per year, compared to \$55 billion for cross-border services.

Agriculture

Agricultural exports including wool, meat, dairy products and grains comprise a substantial component of Australia's trade with Asia.

Population growth and higher incomes in Asia are expected to drive growing demand for a range of agricultural products, in particular high protein foods. It is expected that with food security already a high priority for the nations of Asia, Australia's agriculture and food processing sectors have the potential to develop very important markets over the coming decades.

Conclusion

The opportunities for growing Australia's economic engagement with Asia need to be weighed against the challenges.

Intense competition in the region is changing the landscape for Australian businesses. Added to this, some of Australia's major export markets are seeking to diversify their supply.

If we are to overcome these challenges and take up the opportunities available in Asia, it is most important that we pursue policies that will lift Australia's competitiveness and remove impediments to future engagement.

The economies of Asia have become among the most dynamic in the world, and there are many ideas, new technologies and business practices from which Australia can benefit. We need to take steps to strengthen our most important relationships, and to develop our capabilities to engage and to build effective partnerships.

¹ World Bank, *China 2030*, February 2012, p. 7

² *ibid.*, p. 6.