



# Speech

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## Vision for a Competitive Australia

### Introduction

Thank you Michael.

And my thanks to both sponsor organisations, and to the Australia Israel Chamber of Commerce for inviting me to speak today.

I am also delighted to see so many of the BCA's CEO members here. Thank you all for coming.

The 2014 Global Innovation Index, released by Industry Minister Ian Macfarlane two weeks ago, saw Australia's ranking improve from 19th in the world to 17th.

The fact that this result was viewed as a success, rather than a call to arms, underscores the importance of the work being released today by the Business Council of Australia.

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It was former Treasury Secretary Ted Evans who said that a nation can choose the level of unemployment that it is willing to bear.

Extending this thought, we can also say that a nation chooses the living standards of its current and future generations.

It is a choice made through actions taken and actions avoided, or worse, actions side stepped.

In Australia, it is time to confront our complacency, and make the choices that will secure our nation's prosperity now, and for future generations.

The forces that are shaping our world – digital technology, significant demographic change and globalisation – are not benign.

Our degrees of freedom are rapidly running out. But we do still have time, just enough time, to imagine and fashion our future.

We need to choose now between a path of purposeful action or a path of painful adjustment.

The former requires a different, more nuanced approach to keeping our economy strong and growing the wealth of the nation.

It will be an approach characterised by four marked shifts from where we are today. They are:

1. Adopting a global mindset in everything we do and coming to terms with what it means to operate in a truly global marketplace

2. Returning to a more thoughtful role for government in facilitating and coordinating economic development and social progress
3. Dramatically increasing our competitiveness through innovation
4. Growing those sectors of our economy that can win on a global scale and make the greatest contribution to lifting our national wealth.

The use of the word 'wealth' is quite deliberate and we are unashamedly assuming that there is broad agreement on the need to create wealth: it reflects the longer-term value of economic growth and delivers the wherewithal to reinvest. That is:

- governments having the fiscal latitude to reinvest in skills and infrastructure
- companies having the means to reinvest in business model adaptation and transformation, and hence sustainable job creation.

So when policymakers talk about growth targets and structural reform, we need to hold them to account on two fronts:

- are they targeting the kind of growth that creates wealth?
- will the 'reform' they speak of actually help 'transform' the economy?

### **Three decades of growth**

As we hear repeatedly, Australia has enjoyed more than two decades of uninterrupted growth.

The first decade was driven by the reforms of the 1980s that opened our economy to the world.

These reforms were purposeful and thoughtful: the reformers of that time were encouraged in taking this active posture by a well-timed essay written by the former Department of Finance Secretary, Ian Castles.

Castles argued that reforms undertaken by 19th-century economists not only increased efficiency but, importantly, improved people's living standards.

His point was that difficult economic reform is not compelling as an end in itself. It must be designed and promoted as a vehicle for enhancing social well being.

The cautionary tale from the second decade of growth, a growth underpinned by record terms of trade, is what happens when a country is exposed to both the opportunities and the risks of global engagement, but fails to manage them strategically.

The resources sector recognised the need to be strategic, and did what it could to maximise the broader potential of the boom, through innovation – as evidenced for example in the investments in production processes, remote monitoring and robotics in the Pilbara.

Government, on the other hand, reacted opportunistically and the global financial crisis exposed the consequences of this policy short-sightedness, of a pattern of government behaviour that was not focused on the long term.

Had Australia been using the unprecedented terms of trade to invest in the future of the nation, when the GFC hit, we would have been prepared, and in a position to channel stimulus dollars into innovation infrastructure that would now be enabling a third decade of growth.

Instead, more than \$80 billion hard-earned dollars were spent or committed, with as yet little enduring positive legacy.

So notwithstanding the past decade of growth, where we are today? We have:

- stagnant multifactor productivity growth
- an estimated deficit, over the next 10 years, of \$700 billion of public and private investment in infrastructure. This is at a time when all government budgets are under enormous strain and fiscal repair is being stalled in the Senate

- an unemployment rate of 6 per cent
- a youth unemployment rate of 13.5 per cent, with regions where it exceeds 20 per cent
- literacy and numeracy levels which have fallen below the OECD average.

Clearly something was wrong with the way we managed the second decade of growth.

We now find ourselves having to reorientate our economy with the cupboard empty, the prospect of a worsening fiscal position if savings announced in the federal budget are not realised, and facing a conjunction of powerful global forces.

The dynamics of these global forces are strong, they are at scale and they're happening at speed. They were also reflected in much of the commentary at the recent B20 meeting in Sydney.

### **Forces shaping the future**

So what are they?

#### ***Digital technology***

The first is the impact of digital technology which is making every sector tradeable, and the market for labour global.

As they say in Silicon Valley, 'software is eating the world' – and has democratised the tools of innovation.

The disruptive impact of the smartphone, first introduced in 2007, has been an accelerant in this process.

The speed of innovation in digital technology, particularly as a result of mobile broadband, means that apparently stable business models can be undermined and literally collapse.

Today, sectoral and national boundaries are no protection from competition. Global competition is coming on shore at a rapid rate: Aldi, Amazon, Google, PayPal – and consumers are going offshore on line.

In fact, consumers are increasingly in charge and Australian businesses need to be globally competitive, not just to participate in the global market, but to retain domestic customers and attract skilled employees.

#### ***Demographic shifts***

The second force is the impact of demographic change, in two key dimensions:

- the ageing of the population will lead to higher health care and social welfare costs. It will also escalate the demand on public finances as the growth in gross national income declines, with significant long-term consequences for the adequacy of tax revenues
- at the same time, we are seeing a worrying increase in youth unemployment as digital technology drives the phenomenon of jobless growth, and exposes a serious mismatch between the skills and capabilities of our youth and those demanded by business.

On both fronts, these demographic changes will make it increasingly difficult for governments to balance the books while maintaining social wellbeing.

#### ***The impact of global economic shifts on the strategies of countries***

Then there is global economic transformation – coupled with the strategic response of competitor nations.

The rise of global value chains now means that 70 per cent of global trade is in intermediate goods and services and capital goods, rather than end products and services.

We observe other countries taking a deliberate and purposeful policy approach, using areas of comparative advantage, to capitalise on the growth of middle-class demand in emerging economies and/or in the growth of these global value chains.

In New Zealand, for example, strategic policy intervention in the dairy industry has facilitated 12 per cent growth per annum in total dairy exports in the last decade, compared with Australia's 0.1 per cent. While we took a set-and-forget approach to the deregulation of our dairy industry, New Zealand was busy designing theirs for success.

Last year in China, the central government released a highly targeted strategy to increase the rate of growth in what it called 'Information Consumption' by an average 20 per cent annually, with a target sector value of \$500 million by 2015. In Australia, public funding of NICTA, our national ICT research institute, will cease after 2016.

In the United States, President Obama's Advanced Manufacturing Strategy is building on the shale gas revolution and the seeds of a turnaround in manufacturing, which has seen the creation of 600,000 jobs over the last four years, following decades of decline. In Australia, we have not yet been able to provide for the environmentally responsible development of our natural gas resources, risking the loss of a huge source of potential economic growth.

Speaking during the B20 a fortnight ago, UK Trade and Investment Minister, Lord Livingston, said that the economic resurgence in the UK could be explained, in part, by an Industrial Strategy that had invested in key sectors and key enabling technologies.

We would be naive in the extreme to think that Australia is the only country chasing the growth markets of Asia. We know that other countries are securing trade with China at a faster rate than we are in sectors where we have a presence.

We cannot afford to be complacent about the need to take control of our national destiny. If we don't take control, our future will unfold by default as a consequence of the actions being taken by other countries.

When people talk about "relying on the market to work it out", that market will be the global market, and it will be domestic jobs and domestic businesses at risk if we are not competitive at the global level.

### **Australia's starting position**

In response to this situation, and following on from our economic action plan last year, the BCA commissioned McKinsey to establish a baseline of Australia's comparative advantages, i.e. what we can do best, and our competitiveness in those and other sectors of the economy.

While this is a complex chart, in accordance with convention, green is good and red is not good:

## Competitiveness

■ Top or >0    ■ Bottom 6 or <0

Segment	Sector	X:M ratio		Export market share		Relative Competitiveness Score		Relative Input Cost Efficiency		Relative Labour Productivity	
		Index	2008-13 bps	%	2005-10 bps	Index	2005-12 bps	Index	2005-12 bps	Index	2005-12 bps
Advantaged performers	Agriculture	13.7	5.9	3.2	-0.4	0.8	0.0	0.0	-0.6	0.9	0.8
	Mining and extraction	5.6	1.7	11.4	5.4	0.2	0.1	-0.2	0.1	0.4	0.2
	Tourism	1.0	-0.0	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Latent potentials	Food & beverage manufacturing	1.6	-0.2	2.0	-0.7						
Transitionals	Basic manufacturing	0.2	-0.0	0.3	-0.1	-0.1	-0.0	0.1	-0.3	-0.2	0.1
	Advanced manufacturing	0.2	-0.0	0.2	-0.0						
	Commodities processing	0.7	-0.2	1.1	0.1						
Enabling industries	Construction	N/A	N/A	0.1	-0.1	-0.4	-0.1	-0.6	-0.3	0.4	0.5
	Utilities	N/A	N/A	1.2	0.3	-0.5	-0.5	0.1	-0.6	-0.5	-0.1
	Logistics	0.3	-0.0	0.6	-0.5	-0.2	0.0	-0.2	-0.2	-0.0	0.2
	Finance <sup>1</sup>	0.9	-0.0	0.3	-0.3	0.1	0.1	-0.1	-0.3	0.2	0.4
	Real estate services	N/A	N/A	N/A	N/A	-0.4	-0.2	-0.2	-0.4	-0.2	0.1
Domestic core	Professional services	0.7	-0.1	1.8	0.3	-0.4	-0.0	-0.3	-0.2	-0.2	0.2
	Communications	0.2	-0.0	1.1	0.1	-0.2	0.0	-0.2	-0.2	-0.0	0.2
	Wholesale and retail trade	N/A	N/A	N/A	N/A	-0.1	-0.0	-0.2	-0.5	0.0	0.4
	Domestic services	0.2	-0.3	2.3	0.4	-0.3	-0.1	-0.4	-0.4	0.1	0.4
	Public services	1.0	-0.2	0.5	-0.0	N/A	N/A	N/A	N/A	N/A	N/A

Source: McKinsey & Company

<sup>1</sup> Traditional productivity comparisons in the finance sector are difficult due to complexities measuring sector GVA

McKinsey found that Australia was only strongly competitive against the United States – still seen as the benchmark economy in terms of productivity and innovation – in one sector of comparative advantage: agriculture.

But they also found that we had a substantial comparative advantage, although flat or diminishing competitiveness, in other sectors:

- mining, including natural gas
- tourism
- international education, and potentially
- niche manufacturing, and food and beverage processing.

You can look at the McKinsey diagram and become very pessimistic about Australia’s prospects. The BCA looked at it and saw enormous opportunity.

But only if Australia changes its mindset and purposefully overcomes the barriers that McKinsey identified, which include:

- our lack of global orientation and technological capability
- regulation that is not fit for purpose in a globally competitive world
- limited access to skilled, highly capable people
- our substandard capacity for collaboration: we should be shocked that we rank only 15th in the WEF Collaboration Index, whereas the US ranks 2nd and the UK 5th.

While we know this analysis has limitations, as McKinsey has acknowledged, we are releasing it to start a conversation that will enhance national understanding of our industry competitiveness.

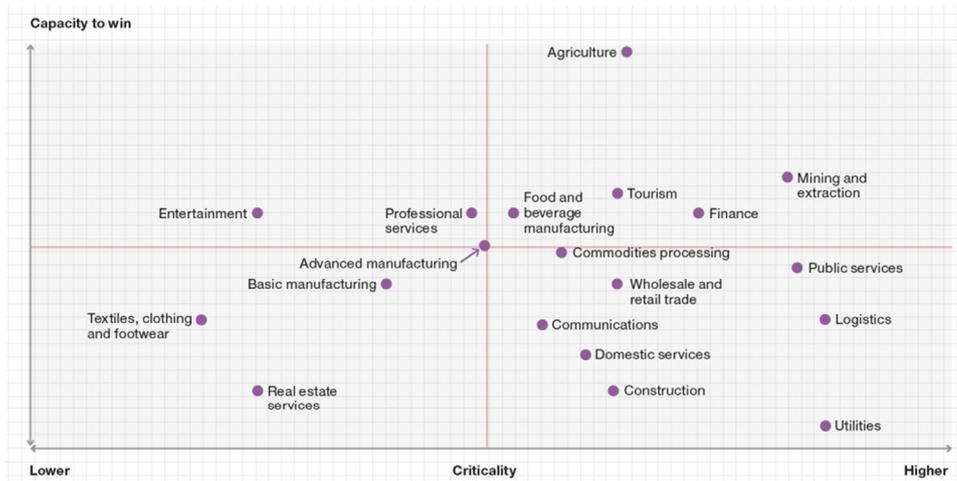
The BCA has taken the McKinsey research and prepared a discussion paper on why and, importantly, how, to play to our comparative advantages.

Our paper calls for a fundamental shift in mindset:

- from domestic to global
- from final products to high-value, highly differentiated, niche intermediate goods and services
- from qualifications and occupations, to skills and capabilities.

What the BCA is suggesting is a radical rethink of how Australia understands its economy, and plans for wealth creation.

### A stylised framework for a competitive industry policy



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Source: BCA

Using the McKinsey findings, we have analysed the role of Australian industry sectors in the economy and their capacity to grow in a global marketplace by grouping industry sectors into four categories with clear goals for each sector:

1. Those that have a strong global growth outlook, where our goal should be to position the sector to achieve a globally significant presence.
2. Those whose global growth outlook is relatively lower but which are critical to the economy, where the goal should be to lower production costs, increase productivity and develop a platform for global growth.
3. Those that are less critical but nonetheless have a strong growth outlook, where the goal should be to remove impediments to progress
4. Those that are in transition, where the goal should be to manage and facilitate the structural adjustment of their business models and/or identify skills that can be re-deployed into more critical or competitive areas of the economy.

#### Directions for change

The BCA is acutely mindful of the role of business in responding to the forces shaping our competitiveness. Our member companies are living this reality every day.

But the idea that governments don't have a role in wealth creation, and can leave it all to business, ignores the reality that government controls key inputs into growth.

Governments regulate, they set trade and immigration policy and design markets; they plan and invest in infrastructure, and wield significant control over state and territory government decision making. They also have a major role in skills development.

The BCA is calling for a renewed understanding by government of its role and, for the next decade in particular, we are recommending that government focus on four key functions:

1. The first is direction-setting. It is a role of government to set a vision for the country. This is fundamental if we are to take the community on the difficult journey of change.

Balancing the budget is not a vision – it is a means to an end, a necessary step to enable other changes to be made.

Governments need to explain how decisions and policies will improve people's living standards over time.

2. Secondly, government needs to develop a sector lens on the economy.

This is not a matter of undertaking a one-off review. It is about developing and maintaining a deep understanding of the dynamics of the economy at the sector level, and of the differential impact of global forces.

This should be a core function of a highly empowered industry department that the federal government has rightly created.

3. Third, government should use what it learns from a sector analysis to move from an intervention and subsidisation role, to a facilitation and coordination role.

Every policy, every program, every incentive, every enabling action of government should take careful account of how it will impact at the sector level; and should be designed to support those sectors with a comparative advantage, and help others to transition with minimum disruption.

For example, government can pursue \$1 billion worth of red-tape reduction but if the reform program isn't substantive at the sector level, if it doesn't fundamentally improve our global competitiveness, it is a wasted opportunity.

4. The fourth responsibility of government is to build the innovation infrastructure needed to support the agility of the Australian economy.

The six key pillars of this infrastructure are:

- Physical infrastructure, where the recent budget confirmed the need for Australia to invest more strategically and made a helpful start.
- The financial system, where we have the Murray Review underway, and which we would urge to take account of the dynamics of the economy and different investment funding needs.
- Appropriate institutional underpinnings, in particular taxation and regulatory settings. Here we have the competition policy review underway, and the development of a white paper on tax reform has also been foreshadowed.

So, on these first three pillars, we are making progress. On the next three, we are not.

- We need to recognise the concept of our knowledge infrastructure, and its contribution to national competitiveness, through the rise of knowledge and design-intensive business models. This knowledge infrastructure resides in our governments, universities, national facilities and our companies and is refreshed through R&D and skilled and talented people.
- This leads to the next pillar: we must provide our people with skills needed to participate in the digital economy, and embrace entrepreneurship. This is another much longer conversation, but nothing short of a major intervention and reset is required on this issue.
- And the final key pillar of our innovation infrastructure is our industry-sector landscape and the ability of business to absorb knowledge, take risks and enter global supply chains.

When people talk about an innovation system, these are its key pillars. When they talk about structural reform, this is where it must focus, and particularly on the aspects of connectedness and collaboration among activities across these pillars.

In summary, government has a key role in enabling business to grow and create wealth. But it can no longer take a one-size-fits-all approach. It must be part of a strategic agenda that facilitates, enables and incentivises key sectors where Australia can succeed globally.

### Picking winners?

Let us be absolutely clear that the approach we describe is not about ‘picking winners’, nor delaying economic transition by propping up uncompetitive industries.

Nor is it about abandoning an economy-wide reform agenda.

It is about deliberate action to support those sectors where we can gain a competitive advantage, and taking a more sophisticated view of structural reform.

### Policy design

The approach we are putting forward today involves a very different model of policy design compared with the one we have observed in Australia over the last decade.

Policy design should be based on a deep understanding of the sector dynamics of the economy, including those where jobs are falling away and those where they are being created.

Effective policy is based on data and evidence, rather than ideology and anecdote.

It seeks to understand the problem that it is trying to solve, model second-order effects and have a mindset that consistently inquires into how policy will impact on the various elements, and on the whole, of a system.

Importantly, effective policy recognises that people will change their behaviour in response to a policy. We can design for behavioural change, or be surprised by it.

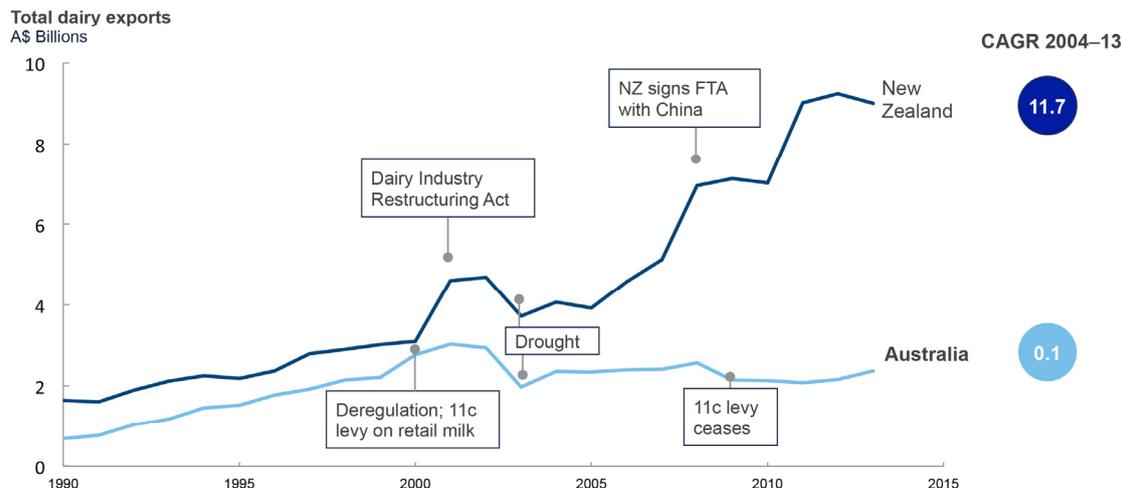
A good start is for policymakers to ask the right questions, for the right reasons, at the right time.

Looking back, if we had asked the question about the automotive industry in the 1980s, and acted purposefully as a consequence, we may have seen companies transition into niche suppliers participating in global supply chains, rather than having to close down.

If we look forward, in agriculture, we should be asking ourselves whether we could do better by differentiating our niche, high value-added products, and tapping into emerging market demand via global supply chains.

This would lead to a set of strategic questions about how we align industry regulation and trade policy to support a clear objective of growing this strong, globally competitive sector.

### New Zealand’s dairy exports have accelerated; Australia’s have flatlined



This slide illustrates the impact of what McKinsey describes as “intent and ambition” on the part of New Zealand in respect of the milk industry. In Australia’s case, McKinsey describes our lack of intent and ambition as “the story of squandered potential”.

We could also be asking questions now about our world-leading mining services sector. Is it adequately embracing data analytics – a capability that will determine its ongoing competitiveness? There is a view that it is not.

None of what we propose can happen without far deeper cross-sector collaboration, not via one-off consultation, but through permanent, continual structures.

While there is much room for improvement in the way businesses collaborate with each other and with the research sector, the first priority is to improve collaboration between business and government.

From today, I will be asking 20 of Australia’s leading companies to offer highly structured secondments for senior public servants with the aim of improving our mutual understanding of the forces impacting on business.

We have to close the gap between what government thinks and what business knows.

I will be making those calls over the next week and I hope that the Australian Government and state premiers will support the BCA in this important initiative.

## **Conclusion**

The forces that are shaping our world are very different from any that we have experienced before. They require different responses from government, from businesses and indeed from us as individuals.

Our time is running out. We need to act with a sense of urgency.

If we don’t, we are going to find ourselves slipping further behind, with the consequent loss of business capacity for growth and wealth creation, and an inevitable impact on living standards.

Ultimately, our core comparative advantage is our people. We must equip them with the skills they need and ensure that they have the opportunity for meaningful jobs.

The onus on our leaders is to understand the forces of change and Australia’s enormous potential to succeed.

Theirs is the responsibility of ensuring that the business model of our nation thrives in the global market, rather than falls victim to it.

Thank you.

## **For further information contact:**

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The Business Council of Australia (BCA) brings together the chief executives of 100 of Australia’s leading companies. For almost 30 years, the BCA has provided a unique forum for some of Australia’s most experienced corporate leaders to contribute to public policy reform that affects business and the community as a whole.

Our vision is for Australia to be the best place in the world in which to live, learn, work and do business.