Australian Coalition of Service Industries

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by

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I have been asked to speak on the reform agenda in Australia and what needs to be done to provide an environment that will lift the performance and competitiveness of Australia's service industries.

The main points I want to make are these:

There are things that governments can do to encourage the development of service industries in ways that will improve the living standards of Australians in the next century. Chiefly, these involve winding back barriers to the competitiveness of service industries and indeed other industries as well.

But merely pointing out what governments can do is not sufficient. It will also require:

- groundwork to ensure that the community is prepared to accept worthwhile reform and
- effort from the service industries themselves to support the reform process and improve their own performance.

In the midst of the Asian 'meltdown' and the wash-up from the Queensland election, these points assume some significance.

The service sector

It would be a daunting task to attempt to cover with any authority all the activities that comprise the service sector. One of the features of the sector is its diversity. It includes such contrasting activities as telecommunications, cleaning, electricity generation, corner-store retailing, tourism and financial services. Services vary enormously in their application of technology, capital and skill requirements, orientation toward international trade and so on. While there are common elements, what is of concern to one service industry may not always be of concern to another service industry. And what may be a positive for one industry may be a negative for another.

Growth

But one thing that many service industries do share in common has been relatively rapid growth. As in other industrial countries, the service sector's growth in Australia has coincided with relative declines in manufacturing and agriculture. Services now account for around 79 per cent of GDP compared with 67 per cent in the 1970s. The shares for the OECD as a whole were 74 in the 1990s and 64 in the 1970s.

Also in common with other OECD countries, labour-intensive services such as finance and insurance, tourism, entertainment and personal services have grown in comparison with more capital-intensive activities: Construction and Electricity, gas and water and Transport and communications. It may also be relevant to note that the former have been private sector activities, and the latter predominantly public sector activities. That, of course, is changing.

With their relatively strong growth, services have also provided the bulk of new employment opportunities over the past few decades. Among other things, this growth has been a major factor in accommodating changes in female labour force participation.

Another key feature of many services is their role as major inputs to industries in other sectors as well as to service industries themselves. For example, transport and banking services are used throughout the economy. Overall, service inputs account for around one-fifth of the value of production in agriculture, mining and manufacturing; and about a quarter of the value of production of services.

Globalisation

Growth in services reflects not only well known demand-side influences in industrialised economies associated with rising incomes, but also powerful supply-side forces.

There has been a global increase in trade in services, driven by technological advances, goods trade liberalisation and deregulation in many economies. The range of services traded internationally has widened as the ease with which people can move and communicate across international borders has increased.

For Australia, exports of services now account for 23 percent of the total value of exports, compared with 17 per cent only 10 years ago. While services also account for around a quarter of Australia's imports, this share has remained fairly constant over the past decade.

Globalization, driven in part by market liberalisation, is a two-way street. It provides both opportunities and challenges. But it favours only the efficient and the innovative. This extends beyond firms' own actions to the regulatory environment in which they operate. Thus the performance of governments is increasingly being tested as well.

Technology

Technological developments are a major driver of change within the service sector and a contributor to its relative expansion. Communications and information technology are prime examples. The growth of the internet in particular is a spur to (new) service activities and is redefining how many existing service industries communicate and transact with their consumers and suppliers.

Internet commerce has the potential to open up international trade in new service markets, including information-based services which previously have not been traded.

Reassessment of public/private provision

Another important development in key service industries in recent years has been the reassessment of public vs private provision. Government operations in banking, air transport, electricity and telecommunications have been privatised. But there has also been a recognition of the need to regulate access to national monopoly components of infrastructure networks.

In government services such as acute care hospitals, employment services and prisons, the interface between the public and private sectors is being redrawn, with a clearer distinction being made between purchasers and providers of services. Many services provided by governments have been privatised or contracted out. Governments are increasingly questioning what is their core business and what is best left to private enterprise and the not-for-profit sector.

The reform agenda

So what does all this mean for the reform agenda — the thing I have been asked to talk about?

It is clear that the pressures and opportunities of globalisation, deregulation and privatisation — with rapid technology overlaying all of these — will demand flexibility and innovativeness in our service sector, as in the rest of the economy.

This was the context in which the nascent Productivity Commission approached its recent *Stocktake of Progress in Microeconomic Reform*, undertaken at the request of the incoming Government and which forms the basis for some of my remarks tonight.

The Commission's initial premise was that in a world of change, Australia's economy needs to be flexible and adaptable if we are to maintain and improve our living standards. If this point needed any reinforcement, it has been provided by the financial crisis in Asia. Australia's ability to withstand concerted pressure ultimately depends on the resilience of our own financial institutions and the extent to which earlier reforms throughout the economy have allowed us to respond more flexibly to global pressures.

A lot of past government intervention had the contrary effect of locking in a particular structure to our economy — a structure that was not internationally viable. Microeconomic reform has been targeted at removing such inhibitors and particularly the many obstacles to competition. In so doing, it has heightened the incentive for firms to be cost-conscious, innovative and productive.

A productivity dividend?

Australia's productivity record has traditionally been poor by international standards. But that is changing. Recent work by the Commission has shown that Australia's aggregate rate of productivity growth has increased from a long-term average of 1.5 per cent a year to over 2.0 per cent a year in the 1990s.

This improvement cannot be explained simply as a catch-up from recession, or even as a trend correction following the particularly poor productivity growth in the 1980s. Its appearance after a period of significant microeconomic reforms is more suggestive.

This is important, because a country's living standards are ultimately a function of its productivity performance. And the overriding objective of microeconomic reform is to enhance the living standards of Australians.

Productivity performance of service industries

While expanding their share of GDP, service industries have recorded a patchy productivity performance. Recent Commission work shows that over the past two decades the strongest contributions to measured national productivity growth have come from Manufacturing; Transport, storage and communications; and Electricity, gas and water.

Contributions from other major sectors such as Construction, Wholesale trade and Retail trade have been variable, though generally low. But not enough is known about the performance of these sectors to be judgmental. There may be measurement problems and other reasons (including more limited scope for technological advance) why their productivity appears lower.

The fact is that our ability to assess performance in the service sector is severely hampered by lack of data. Official productivity data exclude financial services, government administration, health, education and personal services. This is a major omission which the Coalition of Service Industries has identified as requiring remedy.

Our human resource potential

Making the best use of Australia's human resources was identified in the *Stocktake* as a priority for ensuring progress in a changing world. It is clearly a special priority for the service sector, which contains many activities that can almost be defined in terms of their need for skillful human interaction — whether across the counter or over a telecommunications network.

There are two policy areas that have a particular bearing on the ability of service (and other) industries to get the most out of their people.

One is the industrial relations system. Given our continuing struggle as a society to achieve change in this area, it is easy to forget how far we have come. When I returned to Australia in the mid 1980s, after nearly a decade overseas, I was struck by the vehement opposition by the Government and unions to the revolutionary concept of 'enterprise bargaining' — seen as the antithesis of the centrally prescriptive system which had prevailed to that point.

Since then, the industrial relations system has been evolving under all governments towards a more decentralised system that allows firms to negotiate directly with their own people to get outcomes that work best at individual workplaces. This brings added flexibility and adaptability within the firm. By allowing the introduction of more efficient work practices and new technologies it also promotes productivity.

A key remaining issue which Australians need to confront is whether it is sensible to maintain the vestiges of an award-based welfare system in our industrial relations framework, or simply let the welfare system proper perform that role. The 20 allowable matters that currently can exist in awards may need to be reviewed partly in that light.

While industrial relations legislation now provides greater scope than before for the development of more productive workplace arrangements, the extent to which this happens varies among firms and industries. One service industry that the Commission examined in some detail recently — container stevedoring — clearly had some way to go.

Education and training is the second policy area of importance to our human resource potential. It is also important to our economy's flexibility and adaptability. The development of skills brings with it a greater capacity to anticipate change, to develop strategies to deal with change and to adapt to change.

Education and training are important to service industries as both users and providers of education services. It is also an area with considerable export success and, by harnessing information technology, considerable further potential.

Australia has done reasonably well in the education field. But tensions are evident now as a major growth phase ends and attention turns to reallocation and adjustment within the system. The system does not appear to be responding well to changing needs and greater parsimony in government funding.

The West Committee review of the higher education system — of which I was a member — was seized by the need to bring about a more responsive and diverse system into the next century. The main thrust of its recommendations were to:

- increase the responsiveness of higher education research to the needs of students and their (future) employers; and
- develop a world-class, well-resourced higher education industry.

But the recommendations have been resisted by many within the sector. And indeed a recent IRC judgement on tenure for university staff has gone in the opposite direction.

Competition policy and economic infrastructure

The next two areas on the Commission's reform agenda — competition policy and economic infrastructure — are essentially about getting better use out of our nation's resources.

Increased competition in product and service markets is a crucial factor in stimulating better performance and shining light on further barriers to improved performance that need to be addressed. We pointed to the importance of applying competition policy principles across the board, unless there was an independent assessment that some industries should be excluded on public interest grounds. Whether such politically sensitive areas as newsagencies and pharmacies would meet that requirement remains untested.

Economic infrastructure underpins all areas of the economy. In a large and remote country its efficient provision and operation is especially important. As reforms in manufacturing and agriculture have been implemented, attention has been drawn to the need for reform in such key service areas as transport, energy and communications, in order to lower firms' costs and improve service quality.

This has brought issues of public ownership, competition, regulation of pricing and access to natural monopoly networks to the fore. And some important reforms have been initiated.

We made a number of further recommendations in regard to specific infrastructure areas and, reflecting a concern that the most important thing was now the implementation of agreed reforms, saw benefit in rolling reviews of developments in each area. (The NCC has already conducted a review of postal services reforms and a Productivity Commission review of progress in rail reform has recently been signalled by the Treasurer.)

Social infrastructure

While our concern with economic infrastructure has been to push on with implementing identified reforms, the Commission sees a more basic need to get the reform process started in social infrastructure. Health, education and community services account for just over 10 per cent of GDP. They are vital to the welfare of Australians. As the population ages, current stresses will escalate.

The fact that these industries serve a vital social role does not reduce the need to ensure that they face incentives to meet such needs in cost effective way.

There is a need to define objectives more clearly, explore the scope for price signals to better discipline demand, improve coordination among programs and determine whether more competition in service delivery would benefit users.

The Industry Commission's inquiry into Private Health Insurance demonstrated some of the perverse incentives in the health system and the need to review the system as a whole.

Taxation

Any stocktake of reform needs could not ignore the deficiencies of our taxation system. The Commission has drawn attention to the merits of introducing not only a broad-based consumption tax — now of course being strongly debated once more — but also of reducing State government reliance on distortionary taxes — the subject of a recent Commission staff paper — and reducing the compliance cost of taxation.

Tax reform will have implications for service industries. A particular concern of those service industries involving hi-tech start-ups has been the operation of the capital gains tax and its effects on venture capital availability. It is important that these issues be analysed and debated. Ultimately what must be achieved, however, is a tax system in which the constituent parts operate together such as to minimise distortions in investment and production decisions. That is a major challenge which encompasses both the Commonwealth and the States.

Trade and assistance

On trade and assistance, our *Stocktake* recommended — some would say predictably — further action to wind back unnecessary government support, including remaining tariff protection.

I outlined earlier how trade has become increasingly important to service industries. Access to foreign markets is a factor affecting further development. For a number of services, the most effective way of extending markets overseas is through direct foreign investment.

Recent work at the Commission examining 15 APEC countries, found that FDI is most restricted in communications, financial services and transport services.

Barriers to FDI have come under increasing attention as OECD economies have attempted with some difficulty to negotiate a Multilateral Agreement on Investment. Trade and investment barriers will also need to be addressed over the next few years as WTO member countries prepare for the next ('Millenium') round of negotiations on the GATS and as APEC economies begin to implement their commitments to more open trade and investment.

Innovation policy

One form of industry assistance which the Commission has strongly supported is innovation policy. Innovation is critical to the success of service and other industries in responding to pressures and opportunities. Innovation covers not only technology, but also how firms organise their people and deal with their suppliers and consumers.

There is an important role for government in supporting technological innovation (or R&D) which has spillover benefits and which would otherwise not be undertaken. The Industry Commission's major report on R&D back in 1995 endorsed various forms of government support, targeted as specifically as possible to identified problems.

Government assistance — as well as exposure to international competition — have contributed to a dramatic rise in business research and development since the mid 1980s.

There has been ongoing concern, however, about changes to the tax concession, particularly the recent reduction in its rate. The main problem with the tax concession as it has operated is that it is not a very effective instrument for inducing *additional* R&D. Indeed, as the Commission has raised in a recent report, if this could be overcome, the rate of assistance could be increased again within current tax expenditures. This needs serious examination.

Reviewing Regulation

This brings me to the larger, over-riding issue of how policy-making processes can be most effectively structured to ensure a national pay-off from particular decisions.

Regulation review is part of this, and the Government has made important advances in requiring regulation impact statements to accompany both primary legislation and the many other regulations which do not get the same degree of parliamentary scrutiny. Such obligations involve no more than what governments should always want to do in formulating policy — assess the costs and benefits and consult those likely to be affected.

The absence of good process in the past has left a legacy of regulation which imposes unnecessary costs on business and impedes competition. The review of all State and Commonwealth legislation under the National Competition Policy framework is a major advance in efforts to amend or remove such legislation. In these reviews the onus is on those who wish to retain anti-competitive regulation to demonstrate that this would bring public benefit.

That said, it is important that review processes proceed on schedule and that they are conducted by appropriately objective reviewers — thus avoiding capture by the regulators or the beneficiaries of existing regulations. There are some concerns on both counts in some jurisdictions and no doubt the NCC will be examining these matters carefully in deliberating on the release of competition payments from the Commonwealth.

A broad approach to industry policy

What may not be evident from this run through of the reform agenda is the importance of tackling reform on as broad a front as possible. This can remove some resistance to reform, as at least some of the pain of introducing reform in individual industries may be offset by the gains from reform in other industries. As users as well as producers of services, the greatest gains to service industries — as well as to the community generally — are likely to come from including a range of service industries in the reform process.

The agenda that I have dipped into is an extensive one, involving fundamentals of good economic governance. For those who have decried the alleged lack of an industry policy in Australia it also provides an answer. Good industry policy amounts to a set of policies and processes directed at creating an environment for *all* Australian industries which is conducive to wealth creation, job generation and rising living standards. Getting the fundamentals right — in labour market regulation, education, taxation, infrastructure, innovation policy and the other areas I have mentioned — is the main game. Pursuit of selective industry assistance, including through special deals for particular foreign investors, is at best of second-order significance and at worst an impediment to the overriding need to improve the general economic environment for business.

Securing reform

It seems clear, by historical standards, that Australia *has* come a long way in creating a more outwardly oriented and productive economy. By current international standards, however, our progress looks less impressive. In a world of increasingly mobile financial (and human) capital, Australia must hasten to realise its productive potential. We still have some way to go.

Achieving further necessary reform will not be easy. The days when a Prime Minister could declare that every pet store parrot was advocating microeconomic reform seem somewhat distant, to say the least. Resistance to change is palpable. Indeed, some key reforms that seemed secure only a few years ago are facing a political backlash. This was manifest in the Queensland election : both in the heat of the campaign — in which commitment to the National Competition Policy was seemingly jettisoned — and in the polling results.

At such times, it becomes more important than ever that the wider benefits of reform are clearly articulated. It is an uncomfortable fact of political life that most of the reforms really worth having — those that can do most for the living standards of Australians in the long term — will involve losses to some groups within the economy in the short term. The problem we face as a nation is that preserving arrangements which favour such groups could end up impoverishing us all.

Achieving community understanding of why that is so is a big part of the solution. If the community is uncertain about or hostile to reform, the scope for Government to establish durable reforms is obviously limited.

As our Prime Minister observed after the APEC meeting in Manila in 1996, progress in implementing trade liberalisation — and by implication, any reforms with significant distributional effects — depends on achieving greater awareness of the national benefits, to counter the public influence of those facing adjustment.

Fostering such public awareness is ultimately the responsibility of our political leaders. But their capacity to discharge this function depends on the quality of the information at their disposal.

This leads me to speak briefly about the role of my organisation — and of yours.

The Productivity Commission's contribution

Successive Australian governments have seen a role for an independent statutory agency that can collect information, test competing views and provide policy advice that is free of sectional interests and independent of day-to-day political pressures.

In forming the Productivity Commission out of the Industry Commission (which has a lineage back to the Tariff Board), the BIE and EPAC, the Government has built on the strengths of the three merging bodies and extended the Commission's statutory charter.

The Productivity Commission's role, as I see it, is essentially about helping governments make good policy decisions. As with its predecessors, it does this most directly through the information and recommendations in its reports. But it can also help governments through the educative function of its processes — which emphasise public interaction and the open exchange of ideas.

This is particularly true of the Commission's more traditional public inquiry stream of work. This, the Commission's core business, had its origins in Tariff Board inquiries into manufacturing tariffs, where it was rightly seen as important that both the potential beneficiaries and those who might be adversely affected from tariff decisions could have their say. But the same principle has been shown to have value in other areas of policy, and in other sectors, including services. Thus the forward work program for the new Commission includes inquiries into the Gambling industry (another rapidly growing service activity!) and the effects of national competition policy on regional Australia.

Such inquiries typify the Productivity Commission's special niche : policy or regulatory areas where there are significant distributional effects — including perceived ‘entitlements’ — coinciding with significant potential to enhance the welfare of Australians through policy reform. Such areas are inevitably controversial. In shining light on them, however, there is the prospect of also reducing the political heat, thereby paving the way for good policy outcomes. The fact that such policy areas can have important social dimensions only reinforces the value of having them examined through transparent and independent processes.

A thorough canvasing of issues in this way also gives Government an arm’s length opportunity to test public reactions to different policy approaches, and reduces the scope for unanticipated community reactions which could stymie policy implementation.

In addition to public inquiries and other research reports commissioned by the Government, the Commission is engaged in a number of complementary streams of work.

One is performance monitoring — to help identify the need for policy action, to assess progress in implementing agreed reforms and to evaluate their effects. One way we do this is via our secretariat role to COAG committees monitoring the comparative performance of government enterprises and service provision across the States and Territories of Australia. Another mechanism, following on from the Bureau of Industry Economics, is the international benchmarking of key infrastructure industries. Indeed the first reports issued by the Productivity Commission involved an assessment of the comparative performance of Australia’s waterfront. (We like to think that debate on this vexed topic has already been assisted by having some facts in the public domain.) Another forthcoming benchmarking report is concerned with telecommunications services.

One of our waterfront reports examined work arrangements in container stevedoring. It is part of a broader stream of work on labour markets requested by Government. We are currently engaged in similar research on work arrangements in meat processing, and in the building and construction industries.

The Commission also has an important systemic role in regulation-making through its Office of Regulation Review — which must now be consulted on the impacts of all new Commonwealth regulation — and through a newly created Competitive Neutrality Complaints Office, to provide independent advice to the Treasurer on this aspect of competition policy.

Finally, we have the capacity and the mandate for additional research of our own choosing. An important role of such research is to ‘fill in the gaps’ and to prepare the way for future inquiries. In developing research themes and topics for this discretionary research steam, we conduct annual consultations with key stakeholders, including the Coalition of Service Industries.

ACSI’s contribution

The Coalition of Service Industries has an important role to play in furthering the reform effort. Indeed it has already clearly had an impact in raising the collective profile of a sector that, despite its importance, has not always been adequately accounted for in industry policy decisions. As a *coalition*, covering a range of activities, it is particularly well placed to target fundamental policy issues of broad application. And, through its membership, it can marshall evidence on the detrimental effects of policy-related impediments to performance and provide necessary support to underpin governments' reform efforts.

ACSI's Strategic Business Plan for 1998-2000 is a promising indicator of the constructive contribution which it can make. The Productivity Commission looks forward to working with ACSI in the future to help realise its vision of Australia becoming one of 'the world's leading service economies'.