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The services industries: unsung heroes of Western
Australia's economic growth story

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Service economy advocacy

For the entire history of Federation the Commonwealth Parliament has had ministers with responsibility for three important sectors of the Australian economy: agriculture, forestry and fisheries; mining; and manufacturing. But for 106 years, no portfolio had represented the service economy.

Yes, various services industries were represented by ministers, including transport, aviation, tourism, health and education. They still are.

But it seems ironic that by far the largest sector of the Australian economy – the services sector – had no overall representative in the Commonwealth government.

Indeed, the term 'service economy' had scarcely been uttered in the federal parliament until late in 2006 when the then opposition leader Kevin Rudd created a shadow portfolio of the service economy.

Now in government, Labor retains specific service industry portfolio ministers of the highest calibre, including Anthony Albanese in transport, Martin Ferguson in tourism, Nick Sherry in financial services, Nicola Roxon in health and Julia Gillard in education.

But Labor and the federal parliament now have, for the first time, a minister for the service economy and it is an honour for me to address this CEDA gathering today.

The Coalition, too, now has a shadow minister for the service economy in Steven Ciobo. Hopefully never again will the service economy be bereft of a portfolio of its own.

What should service economy advocacy entail?

An effective Minister for the Service Economy operating in the national interest advocates open competition within the service economy and with the other sectors of the economy.

In the old world of a sclerotic, uncompetitive Australian economy, service economy advocacy would have involved seeking subsidies and protective regulations. But in an open, competitive economy, service economy advocacy must entail:

1. Helping create the conditions for sustained, low-inflationary economic growth;
2. Removing government-imposed impediments to service economy success; and
3. Building industry capacity by correcting for genuine market failure.

In a moment I will elaborate on each of these. But before I do I want to set out what service economy advocacy must *not* entail. Fundamentally, it must not entail acceding to requests to protect service-based businesses from competition, either foreign or domestic.

Anti-competitive instincts are alive and well within sections of the Australian business community. Many of the visits I receive from individual businesses or from industry associations are for the purposes of persuading me that my responsibility is to protect them from competition. They are wasting their time.

It is against this reality that I welcome the pro-competitive attitude of representative organisations such as the Australian Services Roundtable chaired by Jane Drake-Brockman who is with us today, and also the Business Council of Australia and the Australian Chamber of Commerce and Industry.

A reading of Australia's history books will confirm that for the colonial period and most of the period since Federation, advocacy by ministers has entailed getting the best deal for the industries they represent, at the expense of other industries and of consumers, in what was at best a zero sum game and at worst a negative sum game. These contests were fought out in budget processes and in the arena of business regulation.

In the early years, agriculture ministers secured farm subsidies. They were taken on a little later by manufacturing ministers, who were able to lock in protective regulations in the form of tariffs and quotas against competition from imports. In a strange twist, Country Party leader and Deputy Prime Minister (Black Jack) McEwen successfully increased manufacturing protection to the detriment of the agricultural interests his party ostensibly represented.

Service industry interests were not always pure when it came to the protection racket, despite being clear losers from manufacturing protection. One of the last acts of the Fraser government was to renew the two-airline agreement that sustained a cosy duopoly for Ansett and TAA (later Australian Airlines). It all ended in tears – which is not unusual in the protection game, since protection ultimately usually turns out to be self-defeating.

Various service industry professions, too, managed to persuade state and federal governments to introduce licensing systems which, whatever their benefits in assuring quality, have had the effect of limiting competition by restricting entry. No-one wants

unqualified or incompetent doctors or surgeons, but strictly controlling the numbers of specialists and other professionals certainly smacks of the closed shops for which trade unions had been criticised for decades by conservative politicians and by business organisations.

Right now, 30 occupations in Australia are regulated by only one or two states. If the public benefits of regulating these professions are so great, why do the other states not also choose to regulate them? Or maybe the public benefits are not great at all, and they should be deregulated. Last month the Council of Australian Governments (COAG) ordered an assessment of the regulation of these 30 occupations to determine whether or not the public interest is served by maintaining these restrictions on entry.

This exercise will complement another bigger job – the rationalisation of some 850 licences for tradespeople. Here we are in the 21st century and tradespeople cannot move from one state to another without having to apply for and pay for a new licence. We hope this work will reduce the number of trade licences to less than 100, with a licence issued in one state being good in all others.

Service industry regulation can be in the public interest, but it needs to be assessed on a case-by-case basis and its effects on competition considered. Where regulation is warranted, it should be efficient and designed specifically to achieve its stated objective, not with the purpose of limiting competition.

Retail trade is one of Australia's biggest service industries and, according to the ACCC's grocery inquiry released last week, our grocery retailers have been less than enthusiastic in embracing competition. They like to use local government planning laws to keep competitors out. Although the so-called independents have a track record of complaining loudly about anti-competitive behaviour by Coles and Woolworths, they, too, have been found to have exploited the planning laws to limit competition.

In an otherwise fairly open, competitive economy, it seems incongruous that one of the reasons a retailer can give in objecting to a development application by a rival is that, if approved, the application would *increase* competition. The Minister for Competition and Consumer Affairs, Chris Bowen, has referred this regulation of retailing to COAG's Business Regulation and Competition Working Group for possible reform. As co-chairs of that working group, Lindsay Tanner and I will energetically pursue this matter.

So while the service economy as a whole does not have the same history of protectionism as the manufacturing sector, many parts of it have demonstrated and continue to display protectionist tendencies.

Others have taken the open, competitive model to heart. Take restaurants. They are the embodiment of competition. They take their chances in competitive markets, never expecting governments to limit the number of their competitors. New restaurateurs believe they can make a better fist of the business than their rivals. Some succeed, other fail, but few come to government for handouts. God bless their little cotton socks. They can truly take their place as unsung heroes of the Australian growth story.

And what about our financial services industries? They are seeking to compete on tough regional markets, determined to establish Australia as a financial hub on the doorstep of Asia at the dawning of the Asian century. Like restaurateurs, they do not seek government handouts or protection. They deserve to succeed and probably will. They are playing hard for Australia in the great tradition of an open, competitive industry.

The service economy as a generator of prosperity and jobs

Traditionally the service economy has been treated as what's left over after counting agriculture, mining and manufacturing. Yet the service economy is responsible for 77 per cent of Australia's total industry value added and 85 per cent of total employment. Some residual!

Here in Western Australia, the gun mining state, the service economy still contributes 57½ per cent of industry value added, compared with mining's 32 per cent. And service industries employ 79 per cent of Western Australian working people compared with mining's 6 per cent.

Of course a lot of service economy activity in this state springs from the great mining industry, but let's not continue consigning the Western Australian service economy to the status of a dependent child – it is fully grown and is making its own way in the state, the nation and the world. In fact, the Western Australian service economy, in the middle of a mining boom, has a bigger share of the state's employment than it did a decade ago, before the mining boom started. The same is true for Australia as a whole.

Some industry –based advocates of ongoing manufacturing protection complain that Australia's manufacturing sector is shrinking. They are wrong. Since 1975 (the earliest year for which comparative statistics are available) manufacturing sector real value-added has grown by an average of 1½ per cent a year to be more than 60 per cent greater than it was three decades ago. That's right: the manufacturing sector is more than three-fifths larger than it was in what protectionists would regard as the glory days of the 1970s. Australian manufacturing has expanded consistently over a period when protection has been phased down. Manufacturing would be even bigger if services that previously were performed in-house by manufacturing businesses (and therefore counted as manufacturing) had not been contracted out to appear now in the statistics as service industry activities.

But it's not the fault of the service economy that it has grown faster than manufacturing. Indeed, this is to be expected in an advanced economy like Australia's. Any argument that manufacturing must maintain a fixed historical share of the Australian economy and that somehow industry protection can and should be used to achieve this objective is so absurd that it deserves no attention.

The ongoing expansion of Australian manufacturing is testament to its strength – not its weakness – an affirmation of the truth that what doesn't kill you makes you stronger. Australian manufacturing has performed magnificently over the last couple

of decades, in the face of declining protection and more recently, a strong dollar associated with the mining boom.

Let's have faith in the ingenuity and entrepreneurial talent of Australian manufacturing, demonstrated over the last 20 years, to compete against imports and on the tough export market.

As Minister for the Service Economy, I have a responsibility to argue against unwarranted imposts on services industries, including protection in non-service industries that would impose unjustified costs on the service economy. If it weren't for the reductions in industry protection initiated by the previous Labor government, Australians literally would be much the poorer, trying to find work in an uncompetitive economy and paying more than necessary for basic consumer goods.

Helping create the conditions for sustained growth

Above all else, national governments have a responsibility to contribute towards the conditions for strong, low-inflationary economic growth – for it is in these conditions that businesses can best survive and thrive, creating jobs and prosperity.

In market economies with independent, inflation-targeting central banks, the role of the national government is help keep inflation in the target range. When domestic consumption and investment is smashing up against capacity constraints, creating inflationary pressures, as has been the situation in Australia for the last several years, the task of government is to help ease back on aggregate spending and at the same time help relax the capacity constraints.

The Rudd government has been doing both. It has cut government spending growth from five per cent to one per cent and delivered the second-biggest surplus in 37 years. It has eased skill shortages by budgeting for 630,000 skilled training places and further increasing the skilled immigration intake by 31,000 this year. And the government has set aside \$20 billion for the Building Australia Fund for investment in much-needed infrastructure.

These policies have been in response to the highest underlying inflation rate in 16 years. Early in the life of the new government, Prime Minister Rudd and Treasurer Wayne Swan identified inflation as the number one enemy of business. These warnings of the dangers of inflationary expectations setting in and the inevitable consequences for interest rates have prompted the Opposition to claim that Wayne Swan has caused a slump in business confidence.

I have had a look at business confidence in Europe, the United States and Japan. It has slumped to 1992 levels. So it appears, by the Opposition's curious logic, that Wayne's warnings reverberated right around the Western world, causing a global economic slowdown. Oh, please! Such is the shallowness of the Opposition's contribution to the economic debate. Continuing to pretend that inflation is a fairytale is the Coalition's easy way out, but it is not Australia's way out.

Removing impediments to business success

Like all Australian businesses, service economy enterprises are hampered by productivity-stifling taxes and other types of business regulation. Taxation is necessary and Australia is a comparatively low-tax country by OECD standards. But we can do better than having 125 different taxes with their unnecessarily high compliance costs.

The May budget began the tax reform process, cutting rates and improving incentives for effort, risk-taking and entrepreneurship. But tax reform is a long and difficult journey. Labor has had the courage to open up the debate with the release of a Treasury paper last week.

Other forms of business regulation are pervasive. In many areas of regulation, Europe's 457 million residents face lower internal barriers than Australia's 21 million people. The Council of Australian Governments is taking on the ambitious task of reform in no less than 27 areas of business regulation.

The Rudd government's business regulation reform program will directly benefit the 32,000 businesses operating in more than one state, including the 4,300 businesses operating in every state and territory.

In the last four years, the number of businesses operating in every state and territory has increased by a stunning 70 per cent, most of them in the service economy – a welcome portent for the future of the Australian economy.

I would also like to note the contribution of the Productivity Commission to this work. The Commission has produced a substantial report on its Review of Australia's Consumer Policy Framework, which Chris Bowen is now in the process of implementing, and it has completed its work on Chemicals and Plastics Regulation. It is nearing completion of its review of the Regulatory Burden in the Manufacturing and Distributive Trades, and it has, or is about to receive, references to review oil and gas regulation, parallel import restrictions on books and anti-dumping legislation.

The Productivity Commission has a distinguished record in providing impartial, economically rigorous advice and continues to make an indispensable contribution to Australian public policy debate.

By removing regulatory impediments to business expansion, the government's regulatory reform program is advancing Australia towards a seamless national market as called for by the Business Council of Australia and the 2020 Summit.

Building industry capacity by correcting for market failure

In a market economy, government has a legitimate role in correcting for genuine market failure. Anti-competitive behaviour by businesses is a form of market failure. Well-designed competition policy can correct for this market failure, as long as it protects competition from business and not business from competition.

Positive spillovers occur when businesses cannot successfully capture for themselves all of the community benefits of their activities. A business that trains an employee knows that the employee is free to leave the business and take on a job elsewhere. Left to their own devices, profit-maximising businesses therefore will tend to under-invest in training from the view-point of the wider community. Governments can correct for this market failure by investing in education and training, which the Rudd government is doing through the Education Revolution. Deputy Prime Minister Julia Gillard is doing a superb job in shaking the tree – abandoning failed traditions in favour of policies that can actually work in giving every boy and girl in Australia the opportunity of an excellent education.

The same applies to innovation. A private business cannot capture for itself all of the community benefits of its R&D activities. The private sector therefore will tend to under-invest in R&D from the community's perspective and governments have a legitimate role in supporting R&D. That's why Innovation Minister Kim Carr has initiated a national innovation review. Australia needs a coherent national innovation system in place of the plethora of separate and often unrelated innovation policy measures.

Not all spillovers are positive. Human-induced climate change is a major example of a negative spillover associated with the release of carbon into the atmosphere. That's why the Rudd government has committed to a market-based Carbon Pollution Reduction Scheme.

In both innovation policy and policies to limit carbon emissions, care will be needed to ensure that policy is designed to correct for the market failure and not to protect businesses from competition. Protectionist instincts within sections of Australian business have not died. As John Cleese would say, they are simply resting, pining for the fjords. Given half a chance, if life was breathed into them, they would be back up on the perch, displacing Paul Keating's pet-shop parrots who incessantly squawked micro-economic reform.

Protectionist businesses will want to be rewarded for R&D activities they would have undertaken anyway. Innovation policy should be directed at increasing national innovation, not at subsidising selected businesses at the expense of other, self-innovating businesses and the wider community.

Similarly, carbon reduction policies that favour existing businesses over new entrants would revive the special treatment of particular businesses, reversing the gains made over the last two and a half decades through opening up the economy to competition and ensuring greater transparency and openness in government policy.

The service economy's role in re-starting productivity growth

On its broad shoulders the service economy will carry much of the burden of re-starting Australia's productivity growth after it gradually slowed to a halt from the record-breaking decade of the 1990s. Around half of Australia's productivity slump this decade has been caused by a sharp decline in mining productivity associated with declining oil production and by negative agricultural productivity growth associated with the drought. In time, these declines may be reversed. We hope so. But if

Australia is to achieve productivity growth above its mediocre long-term trend rate, it will need the service economy – with more than three-quarters of total industry value-added – to step up to the plate once again. Of the nine services sub-sectors for which productivity can be measured, seven experienced lower productivity growth in the five years mid-2007 than over the five years to mid-1999.

A revival in service economy productivity growth to the levels of the late 1990s would go a long way in addressing the concerns expressed in the *Intergenerational Report* of 2002 and its update of 2007. The grim outlook in that report is for mediocre productivity growth to combine with the ageing of Australia's population to yield from 2010 onwards the slowest rate of growth in income per person since the decade of the Great Depression. Sure, the mining boom might prevent that sombre outcome from materialising, but relying on the boom to continue unabated is a pretty one-dimensional economic strategy.

Responding to *Servicing Our Future*

In 2006, the House of Representatives Standing Committee on Economics, Finance and Public Administration initiated two related inquiries: into the future of manufacturing and of the service economy. Both reports enjoyed bipartisan support. The latter, *Servicing Our Future*, was tabled last year before the election. The new government is preparing a considered, substantive response. While I cannot pre-empt that response, I can say that as one of the committee members who initiated and helped write the original report and now as minister responsible for co-ordinating the government's response, it will get a sympathetic hearing.

I know the Australian Services Roundtable is a strong supporter of the parliamentary report and I look forward to working with it in implementing the government's response to the report's recommendations.

Fundamentally, that response will be couched in terms of policies advocated in the report: creating the conditions for sustained, low-inflationary economic growth; removing unnecessary impediments to service economy success; and strengthening the capacity of business to compete. These policies will be designed to help lift the productivity of the service economy, boosting its capacity to expand further at home and into lucrative but challenging export markets. I will work with Trade Minister Simon Crean to help ensure the Australian government does everything in its power to open up access for Australian services to export markets.

The service economy truly is the unsung hero of Australia's economic success.