IMPROVING SERVICE SECTOR PRODUCTIVITY

KEY TO FUTURE ECONOMIC PROSPERITY

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Since the 1980s, Australia has experienced a record period of uninterrupted economic growth, underpinned by productivity improvements [1]. The economy has been one of just three OECD nations to enjoy strong productivity growth over this period, which has been attributed to solid macroeconomic management by the Reserve Bank, and to the significant microeconomic reforms that have been adopted, such as trade liberalisation in the 1980s and regulatory reforms in the 1990s. This has enabled the economy to thrive, despite turbulent global economic conditions, including the Asian Financial Crisis (1997), the Dot-com Bubble Crash (2000) and the Global Financial Crisis (2008), with household wealth increasing five-fold and output doubling since 1990 [1].

Declining Global Productivity Levels

Productivity refers to the ratio of economic output to one or more factors of production, such as labour, capital and intermediate inputs. Thus, there are many different measures of productivity, such as labour productivity, which measures output per hour worked, and total factor productivity, which measures output against the inputs of all production factors. Productivity growth is vital to ensure economic growth, and has been the key contributor to Australia's growth from the 1990s to 2000s.

However, growth in productivity has since waned across the developed world, with growth in GDP per hour worked lower in the decade to 2016 than in any other decade since 1950 [2]. Whilst this trend, dubbed "the new mediocre" by the IMF, has affected Australia, the domestic economy continued to grow in recent years, driven by the unprecedented mining boom [1]. Global demand for commodities grew rapidly and exceeded growth in supply, resulting in soaring commodity prices and a record terms of trade, which helped to offset and mask the declining productivity. However, with China's recent economic slowdown, iron ore prices have since fallen by 65% from its peak in 2011 [3], and the terms of trade is now projected to detract from income growth in the coming decades [4].

Increasing Dependence on Services

Australia can no longer rely on commodities to sustain future growth, and must address its declining productivity growth to ensure future economic prosperity and provide a long-term growth schedule. In particular, there must be a targeted emphasis on the services sector, because akin to most developed nations, Australia is a service-based economy. In 2015-16, services constituted the nation's four largest industry groups, and provided over 70% of total output, 87% of employment and 22% of exports [5]. Service sectors also provide significant intermediate inputs to other industries, and thus, contribute even more than suggested by these official statistics. Further, Australia is expected to grow increasingly more dependent on services for growth and trade in the coming years, with the mining boom transitioning away from the investment phase towards the production phase, and manufacturing migrating to low-cost developing nations.

In contrast, service sectors have significant growth potential, with technological advancements, lower transportation costs and increasing global integration enabling the provision of services across international borders. Further, the growing affluence of Asia's middle class is likely to yield sustained increased demand for service exports in the future, particularly health care, tourism and education, thereby causing services to become an increasingly larger component of trade [1]. Australia is well positioned to exploit these growing export markets, given its well-educated labour force, globally competitive service sectors and geographical proximity to South-East Asia. This will be aided by the development of free trade agreements, such as the China-Australia Free Trade Agreement (ChAFTA), which is expected to create a significant market for Australia's health care and education services [6].

However, to fully exploit these growing opportunities, Australia must address its declining productivity to ensure it positions itself as a world leader in services provision. Recent data reveals that service industries are among Australia's best productivity performers over the decade to 2016, with wholesale, retail, communications, finance and insurance, and real estate all outperforming the domestic market [5]. Whilst this may imply that the economy is well positioned to exploit the global service opportunities, it is paramount that Australian service industries do not rest on their laurels and strive to increase productivity and outperform their global counterparts [1]. This can be achieved by two methods: by increasing efficiency, which can take the economy as far as the current technological frontier permits, or through innovation, which pushes this frontier outwards. Thus, Australia must develop a long-term productivity plan that encourages firms to become more efficient and incentivises innovation, whilst also being flexible to digital disruption that is redefining the global business landscape, such as automation and artificial intelligence [1].

Improving Economic Efficiency

According to Rohan Mead, exposing firms to heightened competition through free trade arrangements will stimulate greater efficiency and consumer welfare [5]. Thus, the government must start by reducing or eliminating unnecessary trade barriers, such as stringent regulations and institutional arrangements, which prevent foreign service providers and professionals from tapping into Australian markets [5]. This will allow both domestic consumers and firms to import goods and services from abroad that can be produced more efficiently in terms of price and quality, whilst also enabling knowledge spill-overs from the import of capital goods.

There will inevitably be significant challenges faced by newly trade-exposed domestic industries, however, this increased openness to trade is necessary to ensure the long-term prosperity of the nation [5]. By exposing our industries to fiercer competition, this will place greater pressure on firms to adjust by becoming more innovative and specialising in the production of niche goods and services in which they possess a comparative advantage. With this, there will be increased scope for specialisation and economies of scale, as domestic industries that do survive will be able to aggressively export to global markets, akin to the manufacturing sector in the 1980s and 1990s. After those tariff reforms, manufacturing exports actually increased, partially as a result of the depreciating real exchange rate, but also due to specialisation in the aspects of manufacturing that the nation had a comparative advantage, such as iron, steel and other metals [7].

Encouraging Innovation

To address the perceived decline in Australia’s innovative capacity, the government should continue to provide extensive funding to universities and industry driven research, such as the Turnbull Government’s recent Innovation and Science Australia Bill, which will invest approximately $10.1 billion in innovation, science and research in 2016–17 [8]. According to Greg Hunt, Minister for Industry, Innovation and Science, this “cements innovation and science at the heart of the nation’s long-term plan to secure Australia’s future economic prosperity”. Whilst this funding represents a positive step for the nation, it is vital that these programs engage with business and community leaders, and are continuously assessed using a scientific basis to ensure the optimal allocation of resources [8].

Further, whilst funding must be provided to universities or research groups, it must be noted that businesses are the ultimate drivers of innovation in the market. Fuelled by profit motive, firms constantly strive to improve the nature and efficiency of their operations, and face the risk of losing their customer base if they fail to adopt the latest technologies or provide goods and services that satisfy customer's growing needs [2]. Thus, it is entrepreneurship that is required to ensure that the knowledge and innovation that is created by research is implemented by firms to produce new goods and services and provide sustainable economic growth. Therefore, it is pivotal that the government strives to maintain an environment that encourages entrepreneurship, by shaping the regulatory framework and compliance costs borne by firms. In 2014, it was estimated that over a quarter of the compliance faced by firms was unnecessary, which may cost up to 5% of GDP per year, thereby discouraging entrepreneurs from creating new firms [9]. Whilst regulations are important to protect stakeholders and the stability of the economy, the government must simplify the regulatory environment as far as possible, whilst remaining commensurate with their policy objectives.

Infrastructure is another pivotal business input, which includes transport networks, energy distribution and communications networks. Investment in infrastructure can boost innovation and productivity within the economy, either directly by providing services more efficiently, or indirectly by allowing other firms to utilise the infrastructure to provide their goods and services [5]. For example, innovations such as just-in-time management systems and flexible manufacturing systems, have been borne from telecommunications infrastructures that have been implemented. Thus, to ensure a platform for sustained productivity growth, the government must ensure suitable investments in infrastructure, such the National Broadband Network and transportation links, based on comprehensive and transparent cost-benefit analyses.

Conclusion

Australia has reached the end of a once in a generation mining boom, and can no longer rely on commodities to sustain future prosperity. However, the long-run prospects for the nation appear promising, with the growing level of affluence in the Asian middle class and the increasing trend of globalisation, enabled by rapid technological advancement, likely to yield sustained demand for service exports. Given its abundance of skilled labour, robust economic institutions and geographical location, Australia is well positioned to exploit these opportunities and the economy is likely to oversee a shift towards providing high quality niche services [1]. However, this will require further reforms to address the economy's structural deficiencies and declining productivity, which will position the economy to capitalise on the global opportunities [1]. Australia has undergone significant reform in the past, which has underpinned the current level of prosperity, however, a further growth agenda is required to maximise the opportunities created by the growth of China, India and our other Asian trading partners and ensure the next wave of prosperity.

1812 Words

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