AUSTRALIAN CHAMBER OF COMMERCE AND INDUSTRY

ACCI SERVICE INDUSTRIES BLUEPRINT

SERVICES: THE NEW ECONOMIC PARADIGM

ABN 85 008 391 795

Canberra Office
24 Brisbane Avenue
BARTON ACT 2600
PO Box 6005
KINGSTON ACT 2604

Telephone: (02) 6273 2311
Facsimile: (02) 6273 3286
Email: info@acci.asn.au

Melbourne Office
Level 3
486 Albert Street
EAST MELBOURNE VIC 3002
PO Box 18008
Collins Street East
MELBOURNE VIC 8003

Telephone: (03) 9668 9950
Facsimile: (03) 9668 9958
Email: melb@acci.asn.au

Web: www.acci.asn.au

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SERVICES: THE NEW ECONOMIC PARADIGM

This Blueprint is the work of ACCI Economics and Industry Policy Unit under the supervision of Greg Evans.

- Main Author: **Dr Siwei Goo**
- Editorial: **Cate Clunies-Ross**
- Graphic Design and layout : **Monica Mosmondor**

FOREWORD

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In recent decades, the relative importance of the services sector has increased significantly. This has been reflected in recent ministerial and administrative arrangements and structures by Australian governments, but at a slower pace in re-calibrating the policy framework.

Today, services account for more than 75 per cent of Australia's output; more than a quarter of the nation's total exports; and almost four in every five jobs created in the economy. Entrepreneurship characterises the services sectors as many of the businesses operating in the sector are small and medium sized enterprises (SMEs).

Despite the services sector dominating Australia's economic activity and job creation, the sector is not well understood nor has it been the subject of extensive study. For most of the past century, Australian economic and industrial policy was heavily framed around the manufacturing paradigm. The changing nature of the economic base requires adjustment in policy settings.

A Service Industries Blueprint can add impetus to this transition. In November 2009, the ACCI General Council resolved that the development of an ACCI Services Blueprint be one of ACCI's Strategic Policy Priorities.

The objectives of this Blueprint are to provide better understanding about the characteristics of the services sector and to ensure that Australia adopts the appropriate policy settings to deal with the challenges confronting service enterprises. The end result is this document.

This Blueprint assesses policy as it affects the services sector as a whole. It then focuses specifically on six service industries for more detailed analysis: Construction services; Business services; Tourism and event services; Accommodation, restaurant and catering services; Distributive (wholesale and retail) trades services; and Higher education services.

Many of these policy settings are embodied in the reforms undertaken or advocated by the ACCI to improve the economic efficiency in the areas of taxation, workplace relations, skills, investment, international trade and the regulatory environment. Consequently, this Blueprint not only provides a focus on the service industries, but also acts as a platform to prosecute and refresh the case for a broad cross-section of ACCI policy.

This Blueprint is the product of work done primarily by the ACCI Secretariat and endorsed by the ACCI Economics and Tax Committee, ACCI Industry Policy Committee and the ACCI General Council.

In the process of producing this document, ACCI also established a Services Working Party to act as a sounding board for the deliberations of challenges facing services industries as well as policy recommendations to improve the services sector's performance.

The members for the Services Working Party were:

- Business SA
- New South Wales Business Chamber
- Victorian Employers' Chamber of Commerce and Industry
- Australian Retailers Association
- Bus Industry Confederation
- Consult Australia
- Master Builders Australia
- National Retail Association Ltd
- Restaurant & Catering Australia
- Victorian Automobile Chamber of Commerce
- CPA Australia

I would like to warmly thank these organisations for their participation and note that the final views expressed in this document are those of ACCI collectively and not necessarily attributable, in part or in full, to any individual organisation or contributor.

Peter Anderson
Chief Executive

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EXECUTIVE SUMMARY

1. EXECUTIVE SUMMARY

Similar to many advanced economies, our services industries have become the most substantial sector in the Australian economy. Over the past few decades, the relative importance of the sector has increased significantly. Today, services account for more than 75 per cent of Australia's output; more than a quarter of the nation's total exports; and almost four in every five jobs created in the economy. Entrepreneurship characterises the services sector as many of the businesses operating in the sector are small and medium sized enterprises (SMEs).

Despite the services sector dominating Australia's economic activity and job creation, the sector has not been the subject of extensive study and has not received the attention it deserved. For most of the past century, Australian economic and industrial policy was heavily framed around the manufacturing paradigm. The changing nature of the economic base requires adjustment in policy settings. The perception and objective of government's decision-making, strategy, policy and programs should move away from priority consideration for traditional industries, i.e. the manufacturing and agriculture industries, to ensure that equal opportunities are given to services industries.

As the services sector contribution to the economy continues to grow and the linkages between the services sector and other sectors mature and deepen, the integral role of services will become even more embedded providing key intermediate inputs into other sectors in the Australian economy. Addressing the challenges and opportunities faced by the services sector will improve the economic efficiency and productivity of other industries.

> "Many of the policy settings that will assist the services sector are embodied in reforms undertaken or advocated by ACCI to improve economic efficiency"

ACCI considers that it is now time for stakeholders to better understand the characteristics of the services sectors and ensure that we adopt the appropriate policy settings to deal with the challenges confronting the services sector. Many of the policy settings that will assist the services sector are embodied in reforms undertaken or advocated by ACCI to improve economic efficiency in the areas of taxation, workplace relations, skills, investment, international trade and the regulatory environment.

Overview of Australia's Services Sector

The services sector has matured into the framework of Australian economic activity and is becoming increasingly important and representing a growing part of the Australian economy. The shift towards services in Australia, which is consistent with the experience of other advanced economies, reflects higher consumer and business demand as incomes grow, greater use of outsourcing of business services, technological advancement and productivity growth across different sectors.

Over the last three decades, the services sector output and employment have outpaced other sectors and the relative importance of the services sector has continued to grow. The share of industry value-added accounted for by the services sector has increased by 5.4 percentage points from 73.4 per cent in 1979 to 78.8 per cent in 2009, while the manufacturing sector's share fell from 16 per cent to 10.2 per cent over the same period. Growth in the services sector's share of employment has been even stronger – increasing 7.6 percentage points since the end of 1980s.

> "Services sector output and employment have outpaced other sectors"

In 2008-09, the services sector accounted for $798.9 billion of gross value-added, representing 78.8 per cent of total industry value-added. Over the period 1974-75 to 2008-09, the services sector value-added grew at an annual average rate of 3.5 per cent. This compares to 3.3 per cent for agriculture, 3.8 per cent for mining, 1.4 per cent for manufacturing and 3.2 per cent for all industries.

Over the last 25 years, the services sector has posted solid growth in employment. Over the period November 1984 to November 2009, services sector employment grew at an annual average rate of 2.6 per cent, much stronger than the pace in Australia's total employment growth (2.0 per cent). Over the same period, of the goods-producing sector, only the Mining sector posted a comparable growth in employment (2.5 per cent) while employment in Agriculture, forestry and fishing and Manufacturing recorded a negative annual average growth of -0.4 per cent and -0.3 per cent respectively. As at February 2010, the services sector employed nearly 9.4 million people, which accounted for around 86 per cent of Australia's total employment.

In contrast with common perception of low knowledge-intensity, Australia's services sector is highly innovative. In 2007-08, businesses in services industries spent $5.7 billion on R&D, 39.7 per cent of Australia's business expenditure on research and development (BERD).

It is important to note that R&D expenditure is not the only measure of a company's innovation efforts. Innovation not only covers R&D but also the non-technical and non-R&D innovation, which occurs every day in the way businesses operate, meet the needs of their customers, and organise their employees and processes. Implementation of new or improved operational processes, marketing method, organisation process in business practices, workplace organisations and external relations – all constitute business innovation efforts. These non-technical and non-R&D innovations are particularly prevalent in the services industry. In 2007-08, 39.1 per cent of Australian businesses reported the introduction or implementation of at least one type of innovation, with the proportion of innovating businesses in most service industries comparable, if not exceeding, the mining and manufacturing sector.

"Australia's services sector is highly innovative. In 2007-08, businesses in services industries spent $5.7 billion on R&D"

It is flawed to label all services industries as 'productivity laggards', although significant disparities exist amongst the services industries. In fact, some services industries had experienced a much higher productivity growth rate than that recorded by the manufacturing sector and the aggregate economy. Strong productivity growth for the Australian economy over the period 1993-94 to 1998-99, the Australian productivity boom cycle, was supported by a surge in productivity growth for a number of services industries, namely, the Wholesale trade industry, Communication services, Finance and insurance services and Construction services.

Over the last two decades, services trade has outpaced the growth in goods trade due to advances in information and communication technologies, and the deregulation of services industries in many countries. As the services sector has become increasingly important in the domestic economy, the share of services in total Australian exports has risen from 13.6 per cent in 1960-61 to around 21.6 per cent in 2008-09. Since 1980, services exports have grown at annual average rate of 6.6 per cent, outpacing the average growth rate of 5.0 per cent per annum for goods exports.

In Australia, small businesses account for a larger proportion of businesses in the services sector than in the mining and manufacturing industry. At the end of 2006-07, 96 per cent of services businesses were small businesses compared to 93 per cent of businesses in mining and 90 per cent of businesses in manufacturing.

Small businesses contributed around 35 per cent of private sector industry value-added in 2008-09. Approximately 80 per cent of the total small business contribution to the Australian economy can be attributed to the services sector. In 2008-09, small businesses contributed 38.9 per cent of private services sector value-added.

Taxation and Services

The capacity for Australian services sector businesses to improve their productivity performance, maintain investment plans and provide job opportunities relies on a competitive taxation system that delivers incentive and rewards entrepreneurship.

Taxation reform is just as important to the services sector as any other industries in the Australian economy. If Australia's services sector is to compete internationally it is vital that the Australian taxation regime does not disadvantage domestic services enterprises especially smaller services enterprises.

The objectives of Australia's future tax reform should be to reduce the overall burden of tax, eliminate economically damaging taxes, and generate greater incentives for workforce participation, productivity, investment, R&D and international competitiveness.

"Services trade has outpaced the growth in goods trade due to advances in information and communication technologies"

Therefore, ACCI proposes that:

Recommendation 1: The Government should continue to pursue the personal income tax reform agenda, and in particular, lower the top marginal tax rate to reduce the differential between personal income tax rates and company tax rates.

Recommendation 2: The Government should allow depreciating assets costing less than $10,000 to be immediately written-off for small businesses as suggested in the Henry Review.

Recommendation 3: The Government should allow companies to carry back a revenue loss to offset it against the prior years' taxable income. This mechanism can act as an automatic stabiliser during an economic downturn and provide much needed cash flow relief to businesses.

Recommendation 4: The Government should retain the four current small business capital gains tax concessions, i.e. the small business 15-year exemption, small business active business assets reduction, small business retirement exemption and small business rollover concessions. Further examination also needs to consider how to reduce the impost of CGT and its detrimental impact on investment and risk taking.

Recommendation 5: Proper consideration should be given to the introduction of a stepped rate CGT with diminishing rates of tax applying to longer held assets upon their disposals.

Recommendation 6: Conduct a comprehensive cost benefit analysis and undertake a regulatory impact statement to justify the proposed reforms recommended by the Board of Taxation on the personal services income tax rules.

Recommendation 7: The proposal to increase the rate of GST or broadening of the GST in order to reduce personal income tax rates and abolish inefficient state taxes should be the subject of a national taxation debate. Nonetheless, ACCI considers that an arbitrary increase in the rate of GST or broadening of GST should only be considered in a comprehensive tax reform package.

Recommendation 8: Beyond the GST reforms, state taxation reforms should remain in COAG's business deregulation objectives through:

- Harmonisation of tax bases and administrative practices across the states, particularly in relation to payroll tax, to reduce compliance costs;
- Abolition of payroll tax in the long run;
- Simplification of complicated tax rate scales to a single rate structure where possible; and
- Abolition of stamp-duties on business conveyances.

Recommendation 9: Reduce complexity of tax legislation, streamlining tax administrations and minimising compliance burden of taxpayers, particularly by better measurement of the regulatory costs of all tax measures (legislative and non-legislative).

Regulation and Services

Effective regulatory reform can significantly improve government performance and desired social and economic outcomes.

However unjustified, poorly designed and/or implemented regulation can unnecessarily increase costs and prices and hence reduce consumer choice, impede entrepreneurship, innovation and stifle productivity growth in the services sector. While these costs are not explicit, they nevertheless indirectly affect services providers and consumers and thus affect economic efficiency, investment decisions and opportunities for growth.

Ideally business related regulation should be carefully formulated, open to all stakeholders for consultation, elicit the most cost effective intervention from policymakers and include provisions for reviewing past regulations.

In order to achieve a situation where regulations are minimal and yet effective, ACCI recommends that:

Recommendation 10: The program of reform should proceed on the assumption that regulation may not be the most appropriate way in which to address issues of concern to the Government. It should be the last resort after all other options (education, publicity, industry self-regulation and other approaches) have been fully assessed and judged to be ineffective.

Recommendation 11: Policymakers should ensure that the regulatory decision-making process is transparent, leads to fair outcomes and involves consultation processes that are accessible and responsive to business and the community.

Recommendation 12: A new regulatory culture should be adopted to understand business processes and the burden created by regulatory compliance. There should be a commitment to provide a 'business friendly' operating environment.

Recommendation 13: No new business regulation should be contemplated without a thorough and independent cost benefit analysis (including the full cost of the proposed regulation to business) and no regulation should be introduced without full consultation with the business sector. The cost benefit analysis should be in the form of a *Regulation Impact Statement (RIS)* which assesses the total cost to business of compliance, fees and paperwork and compares this total cost to business with the estimated benefits of the proposed regulation. The process and the result should be made public.

Recommendation 14: The Australian Government should improve the transparency and accountability of its best practice regulation assessment processes by:

- Developing a central register of regulatory impact analysis;
- Ensuring the RIS is publically available at the time the regulation reaches the decision making stage;
- Providing greater scope for detailed consultation with stakeholders; and
- Incorporating a 'consultation' RIS in the regulation making process for use in public consultations where possible.

Recommendation 15: The Australian Government should commission an independent public review of its best practice regulation requirements no later than five years after the requirements come into effect.

Recommendation 16: Automatic revocation (through 'sunset clauses') should apply to all subordinate legislation after a period not exceeding 10 years and earlier if triggered by an appeal process. A RIS should apply to any attempt to renew 'sunset' regulation. Independent reviews of Acts of Parliament embodying business regulation (and associated programs) should be carried out at least every 10 years.

Recommendation 17: Implementation milestones for COAG's reform agenda should be clearly defined and subjected to regular review by the COAG Reform Council. The 27 reform hotspots identified under the *National Partnership Agreement to Deliver a Seamless National Economy* should proceed without further delay.

Recommendation 18: Conflicts, inconsistent rulings and overlaps between regulation and regulatory systems of different levels of government should be identified and addressed. Similarly, differing interpretations of national regulations by different State or Territory agencies must be addressed.

Recommendation 19: Similar to the Standard Business Reporting, all levels of government need to work cooperatively to reduce the burden associated with reporting obligations in other areas by:

- Eliminating unnecessary requests for information and reducing the frequency of requests where possible;
- With agreement from businesses, sharing information between regulators where appropriate;
- Standardising the taxonomy and forms used, and the type of data required and where possible aligning reporting obligations with existing company data gathering and reporting; and
- Facilitating on-line submissions of information.

Government Assistance and Services

Most of the Government assistance to date, either in the form of tariff assistance or budgetary assistance, is targeted to goods producing sectors.

Tariff assistance to other sectors in the economy negatively affects the services sector as it increases the cost impost in inputs. In 2008-09, the services sector received a negative net tariff assistance of $4.9 billion.

Although the services sector received 45 per cent of budgetary assistance in the same period, i.e. nearly $3.5 billion in identifiable support, such assistance was outweighed by the $4.9 billion in input tariff penalty, leaving a negative overall government assistance of $1.5 billion to service industries.

Given the growing contributions of the services sector to the Australian economy, it is important to ensure that government's policies and industry assistance programs provide equal opportunity to service industries. Therefore ACCI proposes that:

Recommendation 20: The Government should continue to support services sector export market development through an adequately funded, consistent, well-designed and targeted Export Market Development Grant Scheme, and restore the funding cuts to the scheme that were made in the 2010-11 Federal Budget.

Recommendation 21: In assessing the importance of industry assistance for the services sector, the Government should acknowledge that the sector currently bears the net costs of tariff assistance.

Recommendation 22: When considering innovation policy and assistance programs, the Government should take into account the difference in business or production processes between the services sector and primary and manufacturing sectors.

Recommendation 23: The government should ensure that any proposed changes to existing tax concessions and government assistance for the services sector are considered after comprehensive consultation with stakeholders and independent analyses have been conducted.

Recommendation 24: Information on government assistance programs should be easily available and reach its targeted audience more effectively. In this regard, government should work more closely with various industry organisations to assist the timely dissemination of information to businesses in the services sector.

Recommendation 25: The compliance burden and application of red tape should be monitored on a regular basis to ensure that paperwork and the red tape burden are minimised while maintaining the integrity of programs.

Recommendation 26: Broad-based tax reform and reductions of unnecessary costs of doing business should be the government's priority to further promote services sector growth and performance, instead of further reliance on specific budgetary assistance.

Recommendation 27: Regular and comprehensive review on the effectiveness and efficiency of government assistance programs should be conducted by independent agencies such as the Productivity Commission.

Workplace Regulations and Services

It is essential that labour market regulation is flexible and adaptable to changes in the domestic and global economy. In today's modern economy, these changes take place much more quickly and dramatically than previously was the case. Given the labour intensive nature in most service industries, firms operating within the services sector must be able to react with respect to their workforce in a more dynamic way than other industries.

It is vital that all forms of work arrangements are recognised by policy makers and regulators and that policy decisions seek to enhance rather than diminish workplace flexibility. Furthermore, the regulatory burden on firms must be reduced and consideration given by policy makers to increase productivity within and between services enterprises.

Therefore to preserve and improve productivity gains in the services sector, ACCI proposes that:

Recommendation 28: *(Fair Work System and Industrial awards)* The Government should direct the Productivity Commission to examine the effects of the Fair Work laws, particularly the operation of modern awards on firms in priority services sectors. Provisions that are too prescriptive, inflexible or do not assist in achieving productivity should be reviewed and changed following extensive consultation with industry. Awards should be a genuine minimum safety net only and not impede bargaining. The process of creating or varying industrial awards should not increase costs or introduce new inflexibilities on employers.

Recommendation 29: *(Enterprise Agreements)* Agreement making between employers and employees facilitated by bargaining agents should be truly voluntary. There should not be any capacity to frustrate formal agreement making where a majority of employees and the employer wish to bargain and make an agreement. Agreement making should be flexible to reflect both collectivist and non-collectivist workplaces in Australia. The content of agreements should be limited to employment matters only. Statutory agreements should have limited procedural requirements for approval. Agreements should pass a No-Disadvantage Test against a clear safety net of terms and conditions. Individual Flexibility Arrangements (IFAs) need to be able to flexibly deal with modifying the application of terms as originally intended.

Recommendation 30: *(Bargaining/Arbitration)* There should be limited scope for an industrial tribunal to arbitrate and impose a workplace determination or order on an employer. There should be no powers to coerce an employer into bargaining or prescriptive rules about bargaining which could lead to orders made against a business. Access to protected industrial action should only occur once bargaining commences and should be accessed only as a last resort.

Recommendation 31: *(Statutory Minima)* Statutory minimum standards are warranted but must be flexible and adaptable to suit a variety of workplace circumstances. They should be monitored to ensure sufficient flexibility and to identify any negative effects in a workplace. Modern awards and agreements should facilitate flexibility of the NES (for example, cashing out of annual leave).

Recommendation 32: *(Minimum wages)* Minimum wages should operate in conjunction with the tax transfer system and the primary focus should be on improving social inclusion through increased workforce participation. Minimum wages for juniors, apprentices and trainees need to be retained and assist in maximising employment and training opportunities for the most vulnerable in our labour market. Decisions by industrial tribunals should not price these workers out of the labour market. A primary consideration for an industrial tribunal should be how non-productivity based minimum wage decisions will impact individual businesses, including factors such as additional labour on-costs and its capacity to pay.

Recommendation 33: *(Transfer of business)* Rules on transmission of agreements should be flexible. Inflexible agreements should not apply indefinitely to an in-coming employer.

Recommendation 34: *(Employment Protection)* Unfair dismissal laws should not penalise an employer where they have terminated an employee based on a valid reason. Similarly, procedural deficiencies in termination or carrying out redundancies should not render an otherwise justified termination, unlawful. Appropriate exemptions should be considered after extensive consultation with industry. There should be low cost and fast track processes to exclude inappropriate or non-qualifying claims.

Recommendation 35: *(General Protections)* The general protection regime under Part 3-1 of the *Fair Work Act 2009* should be reviewed to ensure that the majority of laws are aimed at governing "freedom of association" as was historically the case under previous laws. Anti-discrimination provisions should be aligned with federal and state anti-discrimination legislation by removing *"reverse onus"* provisions which deem an employer liable unless they can demonstrate that their conduct was not for unlawful reasons. Laws should generally apply a *"dominant purpose"* test.

Recommendation 36: *(Independent Contractors)* Employment laws should not apply to genuine independent contractors who operate on a commercial basis (apart from special cases, such as the TCF industry).

Recommendation 37: *(Superannuation)* The overall regulatory burdens on firms should be decreased. Dual regulation of superannuation should be removed and only dealt with in the federal Superannuation Guarantee legislation (i.e. not in modern awards). There should be no additional costs to employers through higher Superannuation Guarantee levies without commensurate off-sets in other business costs.

Recommendation 38: *(Red Tape)* Red tape on business should be minimised. The existing 'employee records' exemption and 'small business' exemption in national privacy laws must be retained. The small business exemption threshold should be indexed and immediately extended from $3 million to $5 million (which is based on a firm's annual turnover). There should be no obligation on an employer to administer Government schemes and programs unless there is a real and equal benefit. Therefore, the Government's Paid Parental Leave scheme, whereby employers are forced to act as the "paymaster" (i.e. pass public monies to individuals on behalf of the Government) without any benefit to the employer or employee, should be modified.

Human Capital Development and Services

Employment in most services industries has experienced steady growth in the previous decade and many have reported significant wide spread skills shortages at entry level and higher skills levels both immediately prior to and emerging from the global financial crisis.

Competition from other sectors, the perception of many services sector jobs as low payed and low skilled and the transitory nature of many entry level service positions has caused considerable drain on the inflow of labour into the services sector.

Given the re-emergence of skills shortages as the economy recovers and projections that they will deepen across the labour market, skills development in the services sector is a crucial area of domestic policy worthy of further focus.

Therefore, ACCI proposes that:

Recommendation 39: The Australian Government, in conjunction with industry, should work to provide Australian businesses with support to access effective business planning and workforce development and diagnostic tools and Training Needs Analysis (TNA) assistance.

Recommendation 40: The Australian Government should consider introducing a tax discount on training to be given to employers who invest in the training of their employees. An initial figure of 30 per cent would provide a comparable benefit to that announced by the government in relation to capital expenditure.

Recommendation 41: The Australian Government, in conjunction with industry, should work to develop key strategies that will increase employers' knowledge base of the value of older workers and the benefits to be gained by their employment. Expansion and marketing of the *Commonwealth Government's Experience Plus* initiative along with consideration being given to training and employment incentives for employers who take on older workers, including through the apprenticeship system.

Recommendation 42: The Australian Government, in conjunction with industry, should work to develop a Skills Passport Model for use in the services sectors with the view to expanding to cover the breadth of Australian industry.

Recommendation 43: The Australian Government, in conjunction with industry, should work to develop a *Building Our Future Challenge* so that employers who show a strong commitment to building the future workforce can be publically recognised. The results of ACCI's National Skills Survey should be used to frame such a scheme.

Recommendation 44: The Australian Government should undertake a review of Apprentice and Trainee incentives and modify the incentives structure to more closely reflect the needs of employers and the productivity impositions that employing an apprentice or trainee can cause.

Recommendation 45: The Australian Government, in conjunction with industry, should work to develop strategies that will ultimately lead to sustainable increases in apprenticeship commencements for those young Australians currently outside the workforce.

Recommendation 46: The Australian Government, in consultation with industry, should introduce an Apprentice Mentoring Program for employers who have an onsite apprentice mentor to cover the non-productive time spent with apprentices instead of being on the job.

International Trade and Services

Trade in services has become an important part of the international trading system and has led to significant economic gains for both developed and developing economies over the past two decades. The services trade is the fastest growing international trade sector, accounting for around 20 per cent of total trade in the OECD countries, with the world exports of services valuing at US$3.9 trillion in 2008, up 11.7 per cent or US$404.1 billion on 2007 levels.

Despite Australia's services sector accounting for four fifths of Australia's GDP, services exports are relatively limited, accounting for only around 21 per cent of Australia's total trade in goods and services. Notwithstanding the strong performance of the services sector in the past two decades, Australia's services export do appear to be of a smaller magnitude than in the case for the other 29 OECD countries. In 2008, Australian services exports were equivalent to 4.6 per cent of Australia's GDP compared to 6.4 per cent in the case for other OECD countries.

Given the strength of Australia's services industries, the potential economic gains that can be made by promoting international trade in services are significant. By engaging in services trade liberalisation, Australia is estimated to achieve $155 billion (in 2010 dollars) real GDP gains over the 14 years from 2011 to 2025. This equates to Australian real GDP being higher by around $10.3 billion each year on average over 2011 to 2025.

In order to further encourage Australia's trade in services, ACCI proposes that:

Recommendation 47: The Australian Government should provide strong advocacy internationally on the benefits of services trade liberalisation and a concerted effort to ensure services trade liberalisation remains high on the global agenda.

Recommendation 48: The Australian Government should consult more widely with industry and seek business input into the services trade liberalisation agenda to ensure that Australian trade liberalisation negotiations deliver their potential benefits.

Recommendation 49: The Australian Government should give priority to those trade agreements, which practicably and cost-effectively reduce trade barriers faced by Australia's service exporters, avoid discriminatory terms and conditions and ultimately provide significant economic benefits to the domestic economy.

Recommendation 50: The Australian Government should develop and publish an overarching trade policy strategy to better coordinate and track the progress of Australia's trade policy initiatives and to ensure that limited resources and efforts are channelled to areas that provide the greatest prospective return.

Construction Services Industry

Construction services are closely related to the process of urbanisation and industrialisation. Through the component of fixed capital formation or investment, there is a strong link between construction and economic growth. In 2008-09, the Construction industry contributed 8.0 per cent of GDP or $81.6 billion in gross value-added to the Australian economy and employed over one million people or 9 per cent of total Australian employment.

Given the labour intensive nature of the Construction industry, flexible workplace policy will ensure that the industry continues to remain productive.

An efficient and productive construction industry remains the key to improve Australia's housing supply and affordability.

The Construction industry also has a leadership role in influencing the way in which the built environment is constructed and thus ensure environmental sustainability and improve energy efficiency, which will mitigate negative impacts on the environment.

Therefore to realise the potential gains from reform, ACCI advocates that:

Recommendation 51: The work of the Australian Building and Construction Commission (ABCC) should be preserved in its current form and continued. The existence of a well empowered regulator has been paramount in achieving a return to the rule of law in the industry. The continued existence of the industry regulator is essential to maintain labour and multi-factor productivity.

Recommendation 52: It is imperative that the ABCC continue its work with current statutory powers of investigation and current levels of funding retained, and that the work of the ABCC is able to continue as a "strong cop on the beat".

Recommendation 53: The modern award for the building and constructive sector should be re-written in plain English such that legal disputes are minimised.

Recommendation 54: The sub-contracting system in the building and construction industry should be retained and enhanced, including the retention and enhancement of the Independent Contractors legislation.

Recommendation 55: In order to ensure Australia's housing affordability, reforms are needed to:

- Reduce, with the aim of eventual abolition of, inefficient and costly infrastructure charges and levies;
- Increase land supply;
- Expedite planning and development processes to reduce costs and delays;
- Ensure mandatory minimum energy efficiency standards do not exceed six stars; and
- Secure provision of an appropriate level of public housing.

Recommendation 56: Statutory sustainable policies should be developed in full partnership with industry that are nationally consistent with the Building Code of Australia (BCA), while allowing for appropriate regional variations, ground and climatic conditions. It is also imperative that State and local variations not contradict the BCA's climate zones. All proposed regulations need to be supported by a rigorous cost benefit analysis.

Recommendation 57: Since new buildings replace only about 2 per cent of the stock each year, the Government's policy focus in relation to building energy efficiency should be on retrofitting the nearly $3 trillion worth of existing stock of buildings to make them more energy efficient and therefore less carbon intensive. A stronger focus on policies to ensure that existing buildings become more energy efficient is the most effective way of achieving carbon abatement in the short to medium term.

Recommendation 58: The construction of new, more energy efficient buildings and the retrofitting of existing buildings will require a more skilled workforce. Thus government assistance is needed to overcome structural skills shortages in the building industry and to train workers in the new green building techniques that will be required.

Recommendation 59: National environmental registration, regulation and reporting should be standardised.

Recommendation 60: The Government should aim to reduce barriers of entry to international markets in trade negotiations to promote the export of construction services.

Business Services Industry

Business or producer services are intermediate inputs to further production activities that are sold to other firms or businesses, although households are also important consumers in some cases. Business services industry covers two main industry divisions: Finance and insurance, and Property and business services.

In 2008-09, the Finance and insurance services contributed 11.7 per cent of GDP or $118.2 billion in gross value-added while Property and business services contributed the most to the Australian economy, contributing 13.3 per cent of GDP or $134.7 billion. Around 2.0 million people were employed in the Property and business services industry in 2008-09, representing around 18 per cent of the total number of people employed.

The business services sector plays an important role in the Australian economy as a whole due to its strong forward linkages with other sectors, i.e. it is an important supplier of inputs to other industries further along the value chain. Therefore, access to an efficient and innovative business services sector is essential for economy-wide productivity growth.

The Consulting engineering services and Accounting services are two of the key industries within the Business services sector. Both have experienced strong growth in recent years and the key challenge facing these industries is the issue of skills shortages. The recommendations that follow deal with these areas as well as the Business services sector in general.

ACCI recommends that:

Recommendation 61: The government should ensure a business enabling environment and ensure that the regulatory framework within the Business services sector is not overly restrictive. Instead it should be streamlined without jeopardising service quality.

Recommendation 62: Labour market regulation applying to the Business services sector should be flexible. Non-standard employment practices should be considered to enable the use of short term contract and agency staffing. This would have an immediate impact on the recruitment and contract staff services industry, and facilitate other business services outsourcing and contracting.

Recommendation 63: The Government's skilled migration policy should create a flexible and accessible skilled migration program and visa system that facilitates the fast processing of applications and both permanent and temporary migration of skilled workers, catering for a variety of situations and circumstances where gaps in domestic labour supply exist or are forecast.

Recommendation 64: Education in primary and secondary schools should focus more on maths and science outcomes to promote uptake of engineering and other technical disciplines as a rewarding career. Education resources must meet the contemporary needs of dynamic mathematics and science disciplines to help facilitate this objective.

Recommendation 65: Improved and continued funding for government supported engineering places in higher education institutions.

Recommendation 66: Governments at all levels should lead by example through their procurement processes and adopt existing standard model contract terms and conditions (developed through collaboration between industry and government) that are fair, reflect an appropriate allocation of risk, and that support competition.

Recommendation 67: The professional accounting bodies, government, employers, higher education providers and recruitment firms need to cooperate to develop a range of potential solutions to encourage experienced accountants to remain in the profession including:

- Encourage more flexible working arrangements;
- Increase pay and remuneration;
- The Australian Government establish a task force to consider ways to increase the participation rates of mature aged workers, including accountants; and
- Encourage outsourcing, particularly basic accounting work.

Recommendation 68: Additional investment in the higher education sector needs to be committed to ensure the higher education sector continues to play a pivotal role in the supply of accountants. This investment should be aimed at increasing the capacity of higher education providers to:

- Increase the number of funded accounting degree places available to domestic students;
- Increase support for international students in accounting degrees to improve their employment outcomes in Australia, including English language training;
- Develop innovative course curriculum to respond to the needs and requirements of employers, particularly the integration of generic skills into accounting curriculum;
- Support more accounting research activities, including increased support for PhD programs; and
- Increase the number of students able to participate in work integrated learning opportunities as part of the accounting curriculum.

Recommendation 69: In relation to regulation, the government needs to take a more holistic view of regulation impacting the accounting profession. Such a view would increase the government's understanding of the cumulative impact of regulation, so that they can better manage this impact.

Recommendation 70: The Australian Government should seek as part of bi-lateral free trade agreement negotiations, the removal of unnecessary restrictions (restrictions not related to quality) for Australian accountants to participate as accountants in those jurisdictions.

Tourism and Events Industry

Tourism is a sector made up of diverse industry participants. It is generally accepted that the tourism product, i.e. the visitor experience, is provided through a combination of services across a broad range of industry participants. They include, but are not limited to, accommodation, cafés and restaurants, transport, retail, business and major events, recreation, travel agencies and education and cultural services. Hospitality and events industries share many of the service providers in the tourism sector. Therefore tourism, hospitality and events industries are interconnected.

Tourism is a significant and vital industry to the Australian economy. In 2008-09, it contributed $32.8 billion to the Australian economy or 2.6 per cent of GDP. In addition to direct economic contribution to the Australian economy, the tourism and events industries also bring in significant indirect or intangible benefits to Australia, such as lifting Australia's profile in the international market, and providing networking and trade opportunities through major and business events.

Therefore to promote further growth in this industry, ACCI proposes that:

Recommendation 71: The government should establish an investment and regulatory reform working group to improve the efficiency and transparency in the planning and development process, and to implement and progress the tourism regulatory reform priorities. The Government should also ensure the alignment of tourism policy and planning schemes.

Recommendation 72: The government should ensure stronger alignment of aviation, transport and tourism policies and increase investment in new and existing rail and road networks, and continue the focus on increasing direct international flights to major cities.

Recommendation 73: There must be increased investment in the public transportation network, with greater private sector involvement, to meet existing and future demand, through increased service levels, improved connectivity between urban and regional areas, improved linkage between different modes of transport and wider transport choice.

Recommendation 74: The government should collaborate with industry to conduct relevant research and prepare updated visitor profiles to reflect new market information and trends. Industry networks can be used to distribute the new information as it becomes available in a user friendly format. Updated research and visitor profiles can be used to develop effective marketing strategies to promote the tourism and events industry.

Recommendation 75: The government should provide sufficient funding to ensure the ongoing maintenance of existing tourism and events infrastructure and assets. This is particularly the case in the wake of the 2010-11 floods and cyclone activity affecting parts of regional Australia, especially Queensland. Specific initiatives to promote regional tourism in flood and cyclone affected areas should be implemented jointly by industry and governments. Moreover the government should establish an investment development profile, outlining the top ten tourism and investment ready infrastructure opportunities across Australia to attract and assist potential private investors.

Accommodation, Restaurant and Catering Industries

In 2008-09, the Accommodation and food services sector contributed around 3.4 per cent of GDP or $26.8 billion in gross value-added. Within the sector, the accommodation services industry contributed $4.7 billion in industry value-added or 0.5 per cent of Australia's GDP in 2006-07; while Café, restaurant and catering services contributed $5.7 billion in industry value-added or 0.5 per cent of GDP in 2006-07.

The biggest challenge for the Accommodation, Restaurant and catering industries is the problem of skills and labour shortages. These industries have a high prevalence, of casual workers, around 50 per cent of the total number of people employed in the sector. Government regulation has also become a significant barrier to businesses operating in the industry.

Therefore to increase the productivity in the Accommodation, restaurant and catering industries, ACCI proposes that:

Recommendation 76: To address the severe skills shortages in the Accommodation and food services industry, the Government should utilise the training system to respond with:

- An employer responsive apprenticeship system that provides training where employer demand exists;
- Entry level training in occupations that are in demand; and
- Industry quality training.

Recommendation 77: The increase in the monthly income threshold of the superannuation guarantee levy should be considered and subject to periodic review.

Recommendation 78: Any amendment to existing regulations and legislation and new legislative proposals should go through the government's best practice regulation assessment processes. A corresponding Regulatory Impact Statements, which assess the total cost to business of compliance, fees and paperwork and compare this total cost to business with the estimated benefits of the proposed regulation, should be prepared. The process and the result should be made public.

Distributive Trades Industry

The Distributive trades industry corresponds to the Wholesale and Retail trade industry. The Distributive trades industry contributed 10.7 per cent to Australia's GDP (or $108 billion) in 2008-09, and employed more than 1.4 million people. Besides its economic contribution, the value of the sector to the Australian economy and community cannot be understated. The Distributive trades sector provides the first job for many Australians, either as a full time job or part-time job during studies. It provides the foundation for the basic work-related skills and knowledge of many individuals for their ongoing careers, whether in service industries or outside them.

Small businesses in the Distributive trade industry are facing numerous challenges including the dependence of sales and turnover on macroeconomic conditions and household disposable income; constant changes in the industry due to market trends and consumer preference; competition from major players in the industry; as well as issues on workplace regulations and skills shortages.

To ensure the efficiency in the Distributive trades industry, ACCI proposes that:

Recommendation 79: The government should maintain a flexible labour market framework and any regulated wage increases should correspond to productivity gains.

Recommendation 80: COAG should streamline and harmonise regulations across different jurisdictions, where possible. Any proposed regulatory changes should only be considered after comprehensive cost and benefit analyses and industry consultation.

Recommendation 81: The Government should streamline and improve the operation of the GST with the aim of reducing compliance costs.

Higher Education Industry

Higher education in Australia has changed significantly over the last three decades. Australia has developed an effective and efficient higher education system. There are now 37 public universities, two private universities and 150 or so other providers of higher education in Australia.

Australia has also been extremely successful as a world leader in international education and has developed education services as an important export industry.

Australia's international education services industry has grown dramatically over the last twenty years. In 1991-92, Australia's education exports were worth only about $1.2 billion to the Australian economy. However in 2008-09, international education services contributed $17.2 billion in export income to the Australian economy. In 2008-09, the education services industry was the fourth largest export industry behind coal, iron ore and gold. Education services had been ranked Australia's 3rd largest export since 2006 and the value of education exports has continued to grow strongly.

Over the last two decades, the public policy directions relating to financing universities and other higher education providers have changed significantly. There has been a major policy shift towards increasing the contribution students make to the costs of their tuition, although students have access to income contingents loans, HECS-HELP and FEE-HELP, to remove any up-front costs.

This shift in the sources of funding means that universities are less reliant on government and more able to determine their own future. However, financial risks have increased with their income increasingly contingent upon their ability to compete for private sources of revenue.

Thus to ensure sufficient funding to higher education institutions, ACCI proposes that:

Recommendation 82: There should be a balance between private and public funding for the Australian higher education system. The Government should consider student centred funding arrangements. Students should be able to purchase a course from any public or private provider (User Choice). Funding should be linked to student outcomes/achievements with prices determined by market forces. It is recognised that some transitional arrangements will be required to implement this arrangement.

Recommendation 83: University research funding should continue to be performance based. There should be greater linkages within the research and business community to encourage greater commercialisation of research.

CHAPTER 2

OVERVIEW OF AUSTRALIA´S SERVICES SECTOR

2. OVERVIEW OF AUSTRALIA'S SERVICES SECTOR

Despite strong and welcome growth in the resources sector in recent years, Australia is in fact a service-oriented economy. In 2007-08, the services sector accounted for more than 75 per cent of Australia's gross industry value-added and services exports accounted for around 23 per cent of Australia's total exports. Only 1 in every 5 members of Australia's workforce is not employed in the services sector.

Over the last three decades, services sector output and employment have outpaced other sectors and the relative importance of this sector has continued to grow. Figure 2-1 indicates that the share of industry value-added accounted for by the services sector has increased by 5.4 percentage points from 73.4 per cent in 1979 to 78.8 per cent in 2009, while manufacturing's share fell from 16 per cent to 10.2 per cent over the same period. Growth in the services sector's share of employment has been even stronger – increasing 7.6 percentage points since the end of the 1980s.

However despite its growth and dominance, the services sector is not well understood and it has not received the research and policy attention it deserves compared to agriculture, mining and manufacturing sectors.

2.1 What are Services?

There is no one agreed definition of the services sector due to its diversity. It is often defined as the 'residual sectors' or what they are not – i.e. all industries excluding agriculture, mining and manufacturing. In Australia, these industries are tracked by official statistics under the *Australian New Zealand Standard Industrial Classification* (ANZSIC). Those industries regarded as services in this report are listed in Table 2-1. It is important to note that recent publications by the Australian Bureau of Statistics (ABS) has used the ANZSIC 2006 classification, but older and more dated statistics tend to be grouped according to the ANZSIC 1993 classification[1].

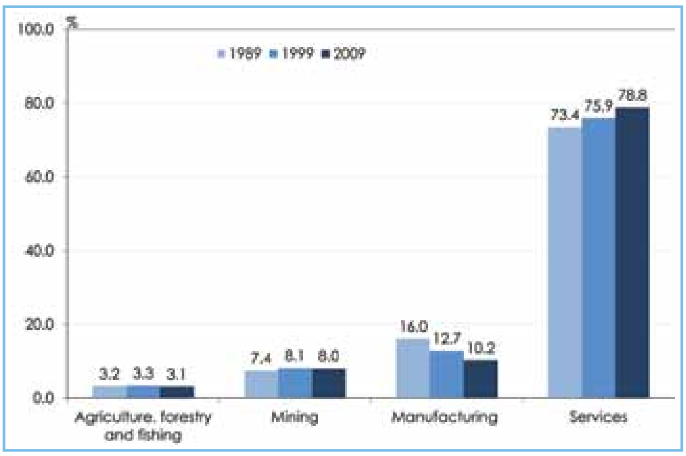
"Services sector is not well understood and it has not received the research and policy attention it deserves"

According to the Productivity Commission (PC), the description of services as the 'residual sector' may have contributed to some of the negative perceptions about the value of services:

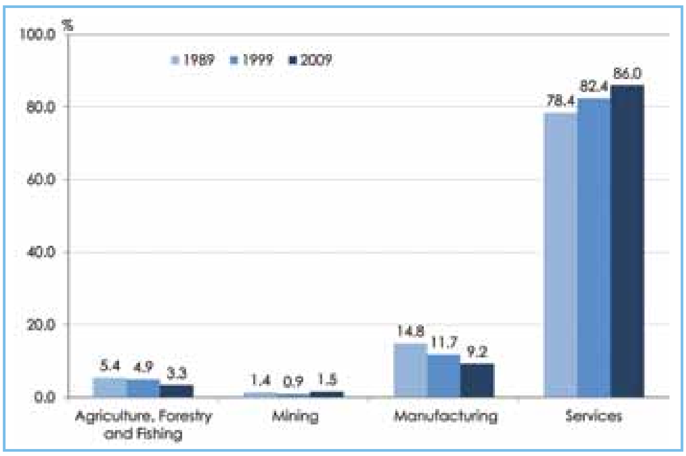
> "... the unintended implication that services are not important in their own right, but only in relation to the extractive and manufacturing processes. In addition, the term 'residual' is usually thought of as that little bit which is left over. Nothing could be further from the truth in the case of services sector".[2]

Figure 2-1: Sectoral shares of total industry value-added and employment

Value-added by Sector (per cent)



Employment by Sector (per cent)



Source: ABS Catalogue No. 5204.0 *Australian System of National Account,* Table 5. The calculations exclude ownership of dwellings. ABS Catalogue No. 6291.0.55.003 *Labour Force, Australia, Detailed, Quarterly,* Table 4.

1. In this report, we will use the 1993 ANZSIC and 2006 ANZSIC interchangeably.

2. PC 2002, *Australia's Services Sector: A Study in Diversity*, Staff Research Paper, p. XIII.

Table 2-1: Services sector classification

1993 ANZSIC	2006 ANZSIC
Electricity, gas and water supply	Electricity, gas, water and waste services
Construction	Construction
Wholesale trade	Wholesale trade
Retail trade	Retail trade
Accommodation, cafés and restaurants	Accommodation and food services
Transport and storage	Transport, postal and warehousing
Communication services	Information media and telecommunications
Finance and insurance	Financial and insurance services
Property and business services	Rental, hiring and real estate services
	Professional, scientific and technical services
	Administrative and support services
Government administration and defence	Public Administration and safety
Education	Education and training
Health and community services	Health care and social assistance
Cultural and recreational services	Arts and recreational services
Personal and other services	Other services

Table 2-2: Typical characteristics associated with services

	Characteristics typical of services
Service production	
Technology and plant	Low levels of capital equipment; heavy investment in buildings and structures.
Labour	Some services are highly professional or skilled; others are relatively unskilled and often involving casual or part-time labour.
Features of production	Production is often non-continuous and economies of scale are limited.
Organisation of industry	Often involve small-scale operations with a high prevalence of family firms and self-employment.
Service product	
Nature of product	Intangible, often information-intensive. Hard to store or transport. Production process and product are hard to distinguish.
Features of product	Often customised to consumer requirements.
Intellectual property	Hard to protect (can rarely be patented, though copyright or design rights may be possible), easy to copy many service innovations. Reputation and goodwill are often important.
Service consumption	
Delivery of product	Production and consumption coterminous in time and space; often client or supplier has to move to meet the other party.
Role of consumer	Services are 'consumer-intensive', requiring inputs from consumers in the design and production stage. Often hard to separate production from consumption

Source: Adapted from PC 2002, *Australia's Services Sector: A Study in Diversity*, Staff Research Paper, p.7.

An alternative way of defining services is to look for common features that made them different from goods and other types of economic activities including their non-storability, non-transferability, intangibility and the need for direct interaction between producers and consumers[3] . Table 2-2 provides a more extensive list of characteristics typically attributed to services industries.

Nonetheless, there are also many exceptions. For example, some services do have tangible outputs – restaurants produce meals; banking services can be performed without direct face-to-face interaction between bankers and customers through internet banking; software programs can be developed, boxed and transferred to client computers; and telecommunications and electricity, gas and water supply are highly capital intensive.

The Australian Services Roundtable defined services as:

> "Services deliver help, utility or care, an experience, information or other intellectual content. The majority of the value of that activity is intangible rather than residing in any physical products".[4]

Given the services sector is highly heterogeneous as indicated in Table 2-1, the PC has also divided services activities into five sub-groups:

- **Utilities and construction services** – Electricity, gas and water supply (EGW), and Construction;
- **Distribution services** – Wholesale and Retail trade, Transport and storage, and Communications;
- **Producer services** – Property and business services, and Finance and insurance;
- **Social services** – Health and community services, Education, and Government administration and defence; and
- **Personal services** – Accommodation, cafés and restaurants, Cultural and recreational services, and Personal and other services[5].

2.2 Contribution of Services to the Australian Economy

The services sector has matured into the framework of Australian economic activity and is becoming increasingly important and representing a growing part of the Australian economy. The shift towards services in Australia, which is consistent with the experience of other advanced economies, reflects higher consumer and business demand as income grows, greater use of outsourcing of business services, technological advancement and productivity growth across different sectors.

Before we discuss the contribution of services to the Australian economy, it is important to note that measuring services output and productivity presents a number of challenges. Unlike manufacturing, services typically do not produce tangible products that can be accurately counted. Thus defining and measuring services output can be conceptually difficult, if not impossible for some services, for example, the output of an opera or a concert. Nevertheless, output of some services are less abstract and are therefore easier to measure such as transport services and postal services, which can be easily estimated through the quantity of freight or passengers carried and number of mail items delivered.

"The shift towards services in Australia reflects higher consumer and business demand"

Improvements in the quality of services are often more difficult to observe and measure than quality changes for goods. For instance, it is difficult to measure the quality of medical advice given to patients. Usually an improvement in quality is reflected in price increases but such a relationship is not clear in the case of health services. If quality improvement were not taken into account, price increases would be considered as inflation, and real services output or productivity growth understated.

Thus, the measurement problem for services output and changes in quality suggest the need for some caution in interpreting services contributions to the economy in the remainder of this chapter.

2.2.1 Economic Contribution

In 2008-09, the services sector accounted for $798.9 billion of gross value-added, representing 78.8 per cent of total industry value-added[6]. Figure 2-2 shows the dollar value of each services industry contribution to the gross value-added between 1988-89 and 2008-09.

Within the services sectors, the largest contributions came from Property and business services, which include Rental, hiring and real estate services; Professional, scientific and technical services; and Administrative and support services. In 2008-09, it accounted for 16.9 per cent of services value-added (Figure 2-3) and 13.3 per cent of all industry value-added.

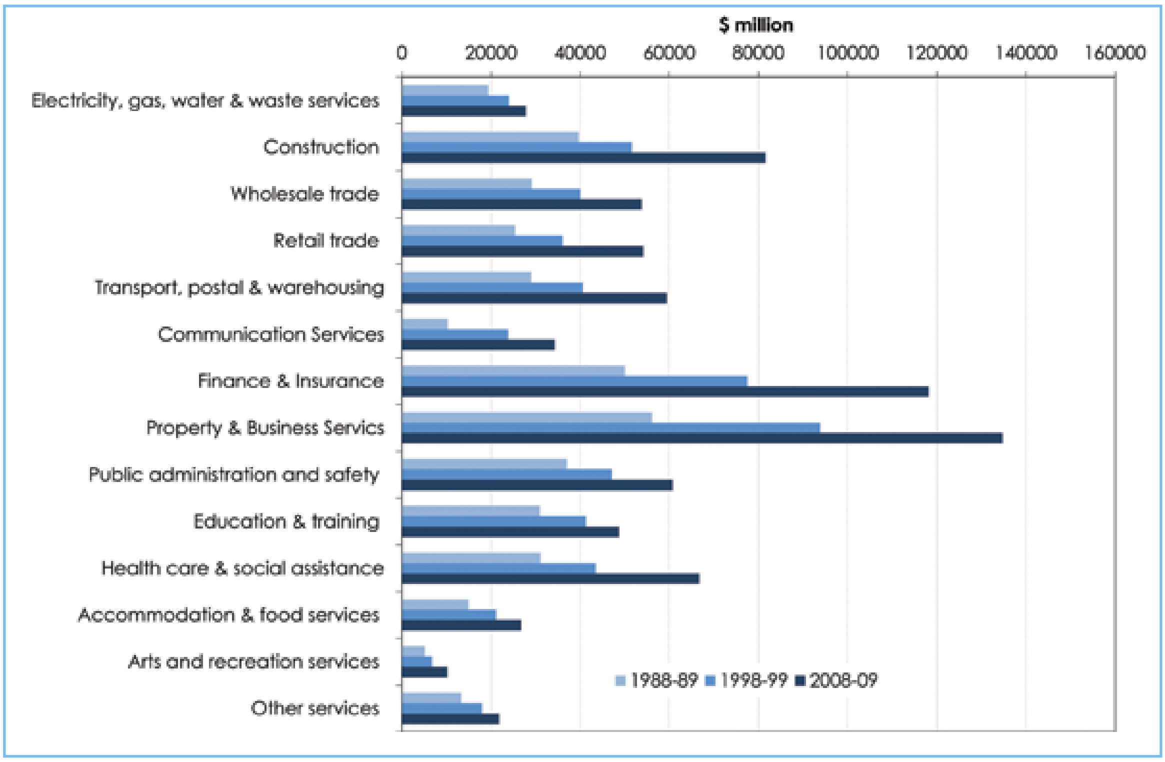
3. Ibid.

4. Australian Services Roundtable 2006, *Submission to the House of Representatives Inquiry into the Current and Future Directions of Australia's Services Export Sector*, p.5.

5. Op. Cit., p. XIV.

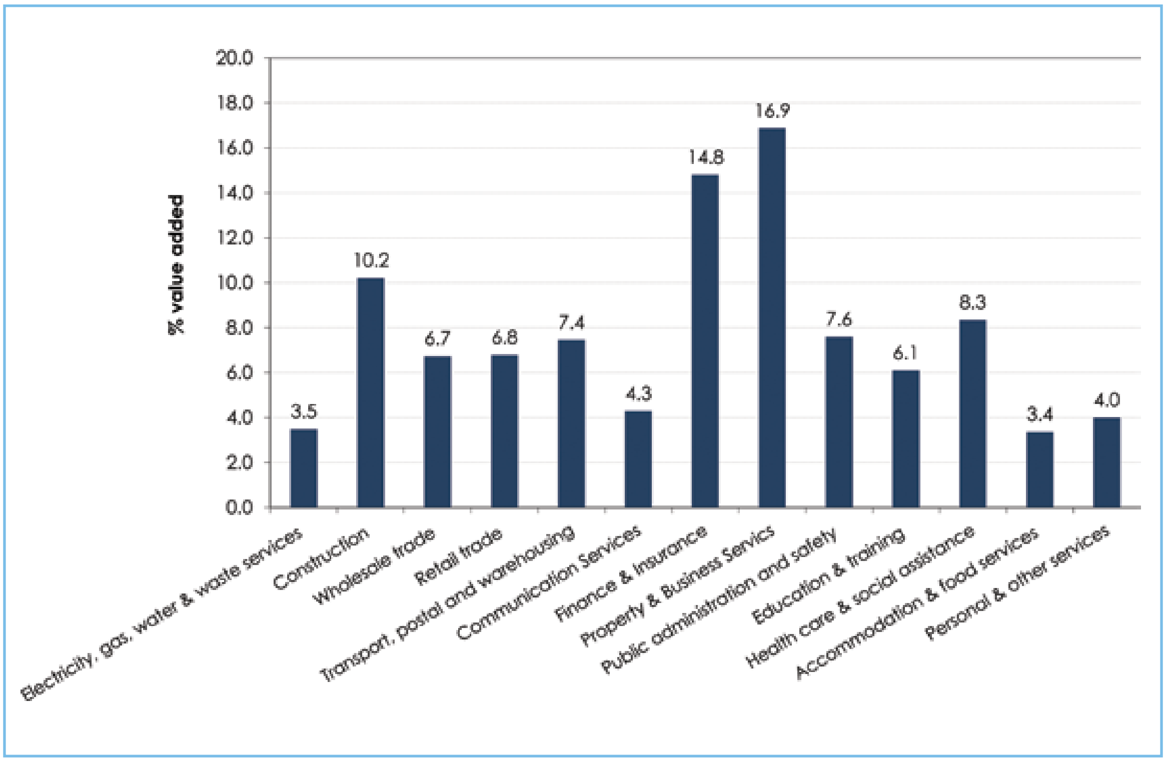
6. The calculations exclude ownership of dwellings.

Figure 2-2: Industry gross value-added 1988-89 to 2008-09 (chain volumes)



Source: ABS Catalogue No. 5204.0, Table 5. The calculations exclude ownership of dwellings.

Figure 2-3: Contribution to services sector gross value-added 2008-09



Source: See Figure 2-2.

Other major contributions to total services sector value-added came from Finance and insurance (14.8 per cent), Construction (10.2 per cent), Health care and social assistance (8.3 per cent), Public administration and safety (7.6 per cent), and Transport and storage (7.4 per cent). The smallest contributions came from Arts and recreation services (3.4 per cent).

Most services industries experienced solid growth in value-added over the last three decades. Over the period 1974-75 to 2008-09, services sector value-added grew at an annual average rate of 3.5 per cent. This compares to 3.3 per cent for agriculture, 3.8 per cent for mining, 1.4 per cent for manufacturing and 3.2 per cent for all industries (Figure 2-4).

All services industries grew over this period, although there were considerable variations in the growth rates. In terms of the value-added growth rates for the 14 services industries, three broad groups can be identified:

- A high growth group of services industries. Four services industries recorded average annual growth rate of around 4 per cent or higher, with Information media and telecommunication services recording the fastest annual growth at 6.4 per cent. Other high growth services industries include Financial and insurance services (4.9 per cent), Property and business services (4.6 per cent) and Health care and social assistance (4.1 per cent);
- A group that recorded growth rates broadly in line with all industries averages (3.2 per cent), including Transport, postal and warehousing (3.9 per cent), Art and recreation services (3.6 per cent), Construction (3.5 per cent), Retail trade (3.3 per cent) and Education and training (3.1 per cent); and
- A group of slower growth industries including Electricity, gas, water and waste services (2.9 per cent), Accommodation and food services (2.8 per cent), Wholesale trade and Public administration and safety (both 2.7 per cent) and Other services (2.4 per cent).

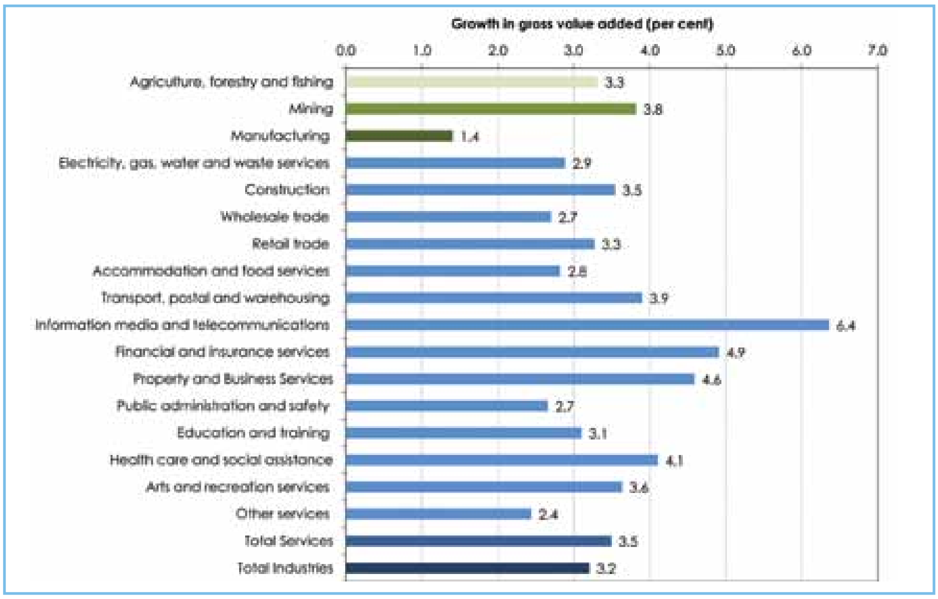
2.2.2 Employment in Services

As at February 2010, the services sector employed nearly 9.4 million people, which accounted for around 86 per cent of Australia's total employment. Figure 2-5 indicates that the biggest employer within the services industry is Property and business services (12.9 per cent of total employment), followed by Health care and social assistance (11.0 per cent of total employment) and Retail trade (10.8 per cent of total employment). Other important services industries contributing to total employment are Construction (9.0 per cent of total employment) and Education and training (7.6 per cent of total employment).

> "Over the last 25 years, the services sector has posted solid growth in employment"

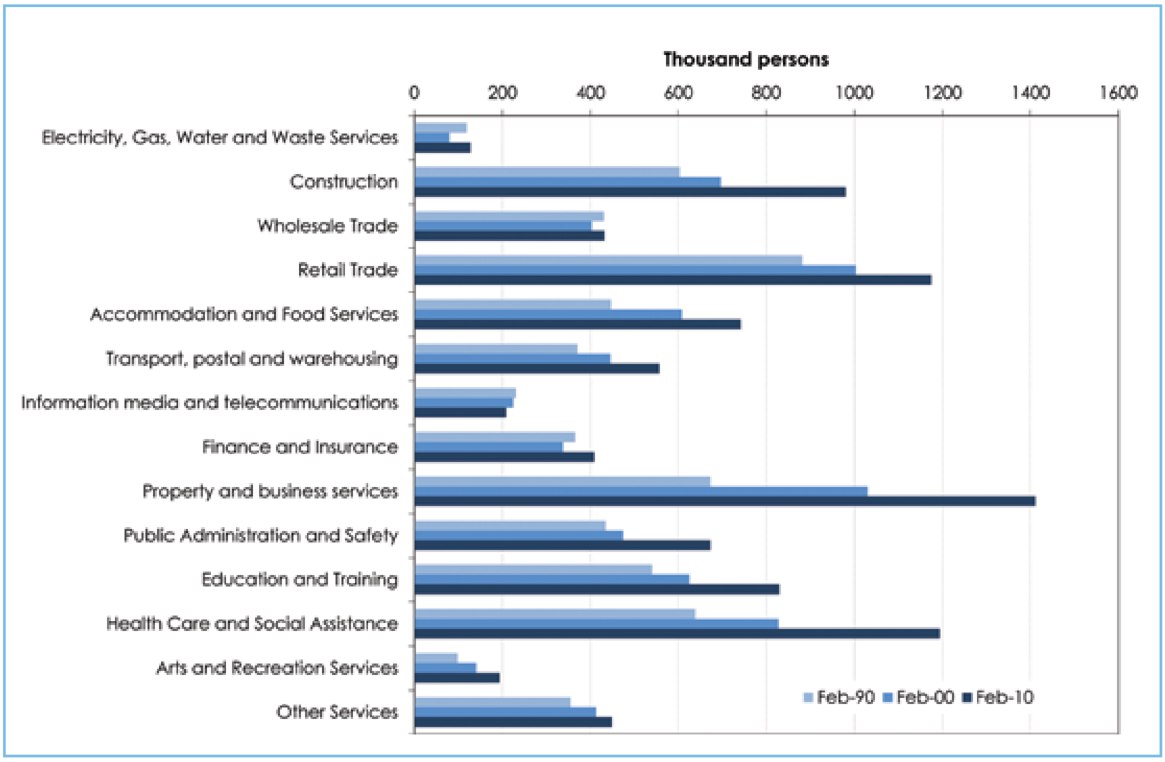
Over the last 25 years, the services sector has posted solid growth in employment. Over the period November 1984 to November 2009, services sector employment grew at an annual average rate of 2.6 per cent, much stronger than the pace in Australia's total employment growth (2.0 per cent). Over the same period, of the goods-producing sector, only the Mining sector posted a comparable growth in employment (2.5 per cent) while employment in Agriculture, forestry and fishing and

Figure 2-4: Annual average growth in Australian industries 1974-75 to 2008-09



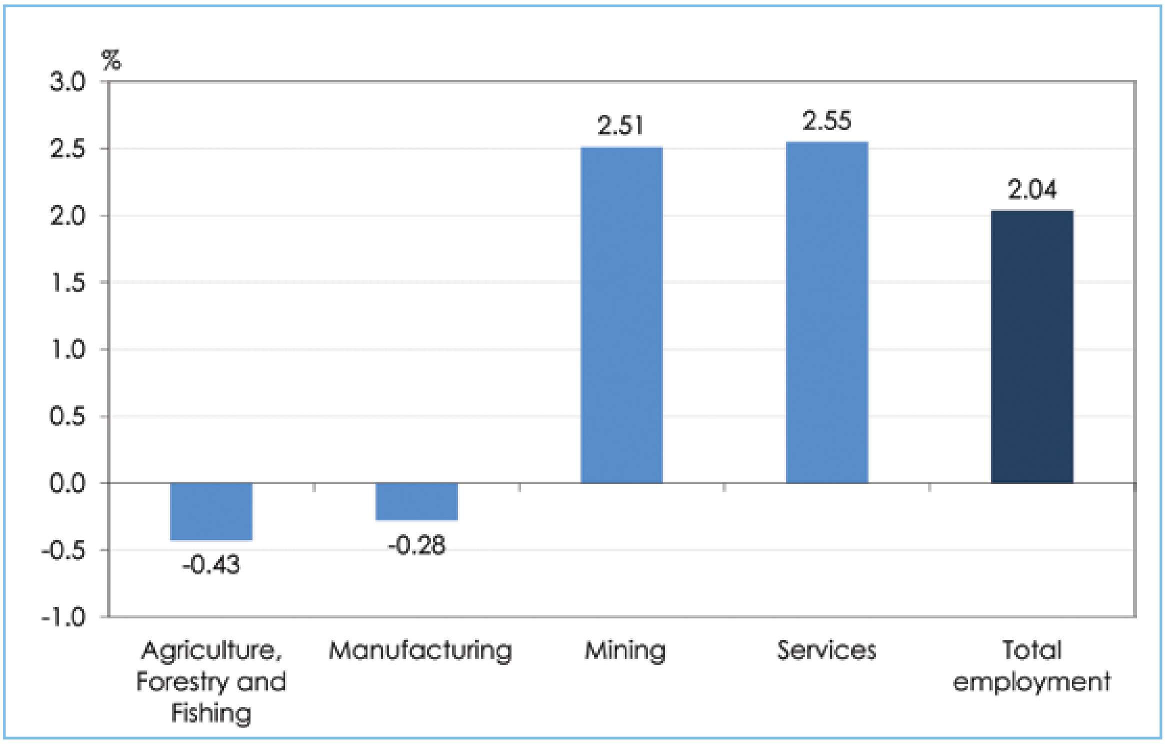
Source: See Figure 2-2 and author's calculations.

Figure 2-5: Services sector employment levels, 1990 to 2010



Source: ABS Catalogue No. 6291.0.55.003, Table 4, trend series.

Figure 2-6: Annual average employment growth, 1984 to 2009



Source: See Figure 2-5 and author's calculations.

Table 2-3: Industry contributions to employment growth, 1984 to 2009

	Employment level (Nov-2009)	Absolute change over period (Nov-1984 to Nov-2009)	Contribution to growth in total employment	Annual average growth
	Thousand of people		Per cent	
Distribution services	**2379.0**	**790.4**	**18.5**	**1.7**
Retail trade	1177.9	488.5	11.4	2.2
Wholesale trade	422.7	72.4	1.7	0.7
Transport, postal and warehousing	567.3	233.5	5.5	2.3
Information media and telecommunications	211.1	-4.1	-0.1	0.1
Producer services	**1769.9**	**1044.2**	**24.4**	**3.5**
Property and business services	1368.8	906.7	21.2	4.4
Finance and insurance	401.1	137.6	3.2	1.6
Social services	**2686.7**	**1313.6**	**30.7**	**2.8**
Health and social assistance	1198.9	658.9	15.4	3.3
Education and Training	821.2	371.2	8.7	2.4
Public administration and safety	666.5	283.5	6.6	2.4
Personal services	**1374.2**	**703.3**	**16.4**	**3.0**
Accommodation and food services	738.8	411.6	9.6	3.4
Arts and recreation services	194.3	123.5	2.9	4.4
Other services	441.1	168.2	3.9	2.0
Utilities and construction services	**1106.2**	**500.1**	**11.7**	**2.6**
Electricity, gas, water and waste services	126.7	-10.4	-0.2	0.0
Construction	979.5	510.5	11.9	3.2
Services	**9316.0**	**4351.6**	**101.8**	**2.5**
Agriculture, forestry and fishing	**357.1**	**-44.1**	**-1.0**	**-0.4**
Mining	**165.9**	**72.4**	**1.7**	**2.5**
Manufacturing	**997.7**	**-104.5**	**-2.4**	**-0.3**
ALL INDUSTRIES	**10836.8**	**4275.4**	**100.0**	**2.0**

Source: See Figure 2-6.

Manufacturing recorded a negative annual average growth of -0.4 per cent and -0.3 per cent respectively.

While Table 2-3 indicates that new jobs have been created in all five service industry groups since the mid-1980s, employment growth was most rapid for producer services. This group accounted for almost a quarter of Australia's employment growth over the period, mainly driven by strong growth in Property and business services – around 4.4 per cent a year or more than twice the national average (2.0 per cent).

Personal services also expanded rapidly at an annual average rate of 3.0 per cent over the period. This was driven by strong growth in Arts and recreation services (4.4 per cent per year) and Accommodation and food services (3.4 per cent per year). Social services also recorded an above average employment growth and accounted for almost one-third of Australia's employment growth over the period.

Distribution services was the only service industry group that recorded a below average employment growth at 1.7 per cent per year, due to weak growth in Wholesale trade and Information media and telecommunications.

Only Information media and telecommunications and Electricity, gas, water and waste services experienced an absolute fall in employment of -4,100 jobs and -10,400 jobs respectively over the last 25 years. All other services industries had experienced an increase in employment, with Property and business services recording the largest increase (+906,700 jobs).

It is often perceived that services sector jobs are low paid. However, in reality, Table 2-4 indicated that services sector jobs are more highly paid than jobs in the manufacturing sector. As at November 2009, average adult full time earnings in the service sector were around 5.9 per cent or $70 per week higher than average earnings in manufacturing sectors.

However, average earnings do vary considerably across service industries. The highest paid services sector jobs are in the Electricity, gas, water and waste services – 16 per cent or $206 per week higher than the national average wage of $1,277 in November 2009. Other highly paid service jobs include those in Information media and telecommunications, Finance and insurance, Construction and Public administration and safety. On the other hand, the lowest paid service sector jobs are located in Retail trade and Accommodation and food services.

Table 2-4: Comparison of average adult weekly full time earnings by industry, November 2009

	$ per week	% of national average wage
Distribution services	**1219.3**	**95.5**
Retail trade	950.0	74.4
Wholesale trade	1213.1	95.0
Transport, postal and warehousing	1237.8	97.0
Information media and telecommunications	1476.4	115.6
Producer services	**1376.0**	**107.8**
Property and business services	1318.9	103.3
Finance and insurance	1433.1	112.3
Social services	**1287.2**	**100.8**
Health and social assistance	1235.7	96.8
Education and Training	1287.6	100.9
Public administration and safety	1338.4	104.8
Personal services	**1031.7**	**80.8**
Accommodation and food services	950.0	74.4
Arts and recreation services	1107.0	86.7
Other services	1038.1	81.3
Utilities and construction services	**1431.3**	**112.1**
Electricity, gas, water and waste services	1482.3	116.1
Construction	1380.2	108.1
Services total	**1269.1**	**99.4**
Mining	**1999.0**	**156.6**
Manufacturing	**1198.8**	**93.9**
ALL INDUSTRIES	**1276.7**	**100**

Source: ABS Catalogue No. 6302, Table 10H.

Table 2-5: Educational attainment of employed persons, May 2009

Share of workforce with:	Higher degree	Graduate diploma / certificate	Bachelor degree	Advanced diploma / diploma	Skilled vocational qualification: Cert III/IV	Basic vocational qualification: Cert I/II	Certificate not further defined	Total without post-school qualifications
Distribution services	**2.4**	**1.2**	**12.1**	**8.4**	**15.0**	**4.7**	**1.7**	**53.4**
Retail trade	1.7	0.8	9.7	7.5	13.6	4.8	1.8	59.1
Wholesale trade	1.7	1.4	11.9	10.8	15.9	5.8	1.0	49.8
Transport, postal and warehousing	1.9	1.3	10.4	8.1	18.2	4.3	2.0	52.1
Information media and telecommunications	8.6	2.3	29.9	9.0	12.1	3.3	1.5	32.6
Producer services	**7.2**	**3.3**	**29.2**	**11.8**	**11.1**	**3.9**	**1.3**	**31.2**
Property and business services	6.7	3.5	29.4	11.6	11.6	4.0	1.3	30.7
Finance and insurance	8.6	2.4	28.7	12.6	9.4	3.7	1.2	32.7
Social services	**9.2**	**7.0**	**30.2**	**12.9**	**13.2**	**3.3**	**1.2**	**21.6**
Health and social assistance	6.3	5.2	28.6	15.1	15.3	4.1	1.2	22.9
Education and Training	13.5	11.3	37.1	10.3	8.9	2.1	1.0	14.6
Public administration and safety	9.1	5.2	24.7	12.2	14.8	3.3	1.6	27.8
Personal services	**1.9**	**1.3**	**10.7**	**7.5**	**21.8**	**4.9**	**1.9**	**48.7**
Accommodation and food services	1.8	0.6	8.6	7.1	13.9	4.8	1.5	60.9
Arts and recreation services	3.1	4.5	18.4	6.7	19.0	4.5	2.8	39.6
Other services	1.5	1.1	10.5	8.6	36.2	5.4	2.1	32.6
Utilities and construction services	**1.4**	**0.8**	**7.5**	**7.1**	**37.6**	**5.1**	**1.8**	**37.0**
Electricity, gas, water and waste services	3.8	1.4	17.4	9.2	26.5	4.7	2.6	32.1
Construction	1.1	0.7	6.2	6.8	39.1	5.1	1.7	37.7
Services total	**5.0**	**3.2**	**19.7**	**10.0**	**17.5**	**4.2**	**1.5**	**37.5**
Mining	**4.2**	**2.0**	**14.8**	**4.2**	**33.5**	**1.8**	**1.0**	**36.9**
Manufacturing	**2.6**	**0.6**	**11.2**	**7.0**	**25.0**	**4.8**	**2.1**	**45.4**
ALL INDUSTRIES	**4.7**	**2.9**	**18.5**	**9.6**	**18.4**	**4.4**	**1.6**	**38.7**

Source: ABS Catalogue No. 6227.0, Table 11.

Looking across five service industry groups, only employees in Personal services and Distribution services groups were paid below national average wage. Personal services jobs were the lowest paid jobs with its earnings only amounting to 80.8 per cent of national average wage in November 2009.

Following the recent resources sector boom, the mining sector was the highest paid industry – 57.5 per cent higher than average earnings in the services sector and 66.8 per cent higher than the manufacturing sector.

Data on educational attainment also shows that it is inaccurate to characterise services sector jobs as low-skilled. In May 2009, 62.5 per cent of workers in the services sector had post-secondary qualifications, compared with 54.5 per cent of manufacturing workers (Table 2-5); and the average services sector workers were twice as likely to have a bachelor degree or higher compared to manufacturing workers (28 per cent compared with 14 per cent). In contrast, the manufacturing sector had more workers with vocational qualifications than the services sector.

Nonetheless, there are considerable variations in the education profiles amongst the services industry groups. Table 2-5 indicates that Social services and Producer services had the highest proportion of degree holders (46.4 and 39.7 per cent respectively); while Personal services and Utilities and construction services had the lowest shares (9.7 and 13.9 per cent respectively). Distribution services and Personal services had the highest percentage of workers without post-secondary qualifications (53.4 and 48.7 per cent); while Utilities and Construction services had the highest share of employees with skilled-vocational qualifications (37.6 per cent).

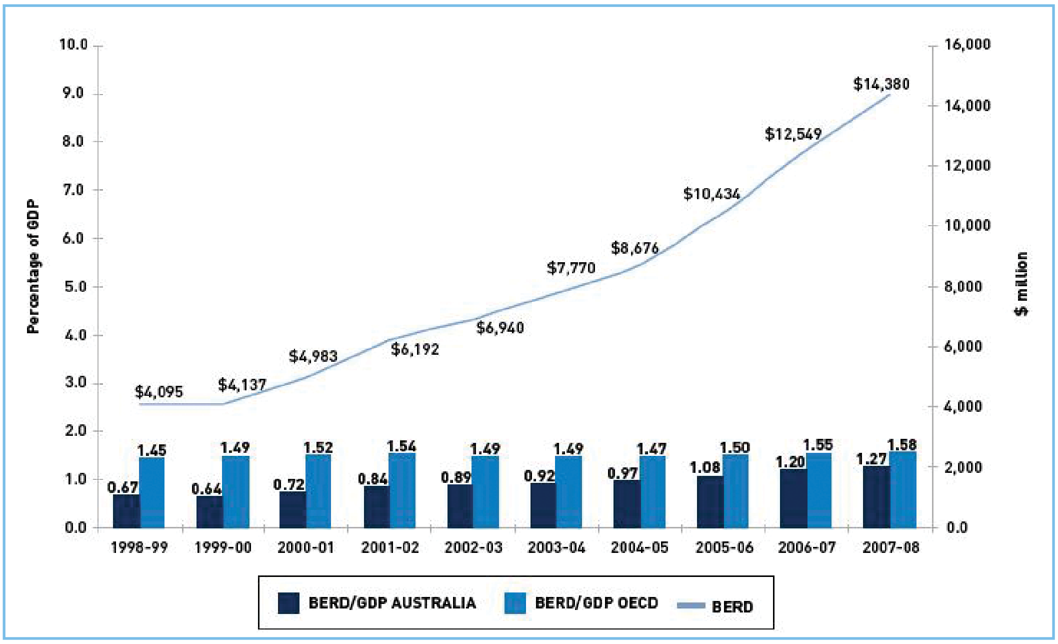
2.2.3 Innovation in Services

In 2007-08, Australian businesses reported $14.4 billion of expenditure on R&D, an increase of almost 15 per cent from 2006-07[7]. Over the last decade, business expenditure on R&D (BERD) has increased at an annual average rate of 13.4 per cent.

Figure 2-7 indicates that while Australia's BERD has increased significantly over the last five years, Australia's BERD to GDP ratio remains below the OECD average. While this gap is closing, with Australia's proportion improving from around 46 per cent of OECD average in 1998-99 to around 80 per cent in 2007-08, Australia continues to rank 14th on BERD to GDP ratio among the 30 OECD nations.

In contrast with the common perception of low knowledge-intensity, Australia's services sector is highly innovative. In 2007-08, businesses in services industries spent $5.7 billion on R&D, 39.7 per cent of Australia's BERD. Table 2-6 shows that the services industry as a whole had the largest share of business R&D expenditure in 2007-08, with Finance and insurance having the largest share (9.9 per cent) followed by Property and business services (9.7 per cent), Wholesale trade (5.9 per cent) and Information media and telecommunications (5.7 per cent).

Figure 2-7: BERD, 1998-99 to 2007-08



Source: DIISR 2010, Australia Innovation System Report 2010, p.17.

7. ABS 2009, *Research and Experimental Development, Businesses*, 2007-08, Catalogue No. 8104, Table 1.

Moreover, Australia's services industries have one of the highest shares of business R&D expenditure in the OECD[8].

"Non-technical and non-R&D innovations are particularly prevalent in services industries."

It is important to note that R&D expenditure is not the only measure of a company's innovation efforts. Innovation not only covers R&D but also the non-technical and non-R&D innovation, which occurs every day in the way businesses operate, meet the needs of their customers, and organise their employees and processes. Implementation of new or improved operational processes, marketing methods, organisation process in business practices, workplace organisations and external relations – all constitute businesses innovation efforts. These non-technical and non-R&D innovations are particularly prevalent in services industries.

Table 2-7 shows that 39.1 per cent of Australian businesses reported the introduction of implementation of at least one type of innovation, with the proportion of innovating businesses in most services industry comparable, if not exceeding, the mining and manufacturing sector.

The median percentage of innovating businesses surveyed by the ABS in 2007-08 is 40 per cent. Table 2-7 and Figure 2-8 indicate that wholesale trade and retail trade ranked at the top of innovating sectors, with 51.4 per cent and 50.9 per cent of innovating firms respectively; while each contributed about half as much gross value-added as manufacturing. Other frontrunners in innovating businesses include Information media and telecommunications; Professional, scientific and technical services; Financial and insurance services; Electricity, gas, water and waste services; and Rental hiring and real estate services. Construction, on the other hand, was the least innovative sector in Australia.

2.2.4 Productivity Growth in Services

Productivity is a measure of the rate at which output of goods and services are produced per unit of input such as labour, capital and raw materials. Thus improvement in productivity can be brought about by minimising input for a given unit of output or maximising output for a given amount of input. The two most commonly discussed measures of productivity are:

- **Labour productivity** measures the amount of real output that can be produced for a given labour input, that is, per hour of work; and
- **Multifactor productivity (MFP)** measures the amount of output that can be produced keeping all inputs (usually labour and capital) in fixed supply.

It is often perceived that services industries are 'unproductive' or 'productivity laggards'. Table 2-8 shows the annual average growth rates of Australia's labour, capital and multifactor productivity (MFP) by sector and industry for the period

Table 2-6: Industry shares of BERD, 2005-06 to 2007-08 (per cent)

	2005-06	2006-07	2007-08
Electricity, Gas, Water and Waste Services	1.1	1.2	1.3
Construction	3.9	3.6	4.3
Wholesale Trade	6.6	6.7	5.9
Retail Trade	0.5	0.7	0.5
Accommodation and Food Services	0.0	0.0	0.1
Transport, postal and warehousing	1.2	1.1	1.3
Information media and telecommunications	4.3	6.4	5.7
Finance and Insurance	9.1	8.8	9.9
Property and business services	10.4	9.8	9.7
Public Administration and Safety	0.1	0.0	0.0
Education and Training	0.0	0.1	0.0
Health Care and Social Assistance	0.4	0.3	0.4
Arts and Recreation Services	0.2	0.1	0.2
Other Servicecs	0.4	0.4	0.4
Services	**38.1**	**39.2**	**39.7**
Manufacturing	**35.7**	**30.6**	**29.9**
Mining	**17.3**	**22.1**	**22.8**
Agriculture, forestry and fishing	**1.0**	**1.0**	**0.8**

Source: ABS Catalogue No. 8104, Table 1.

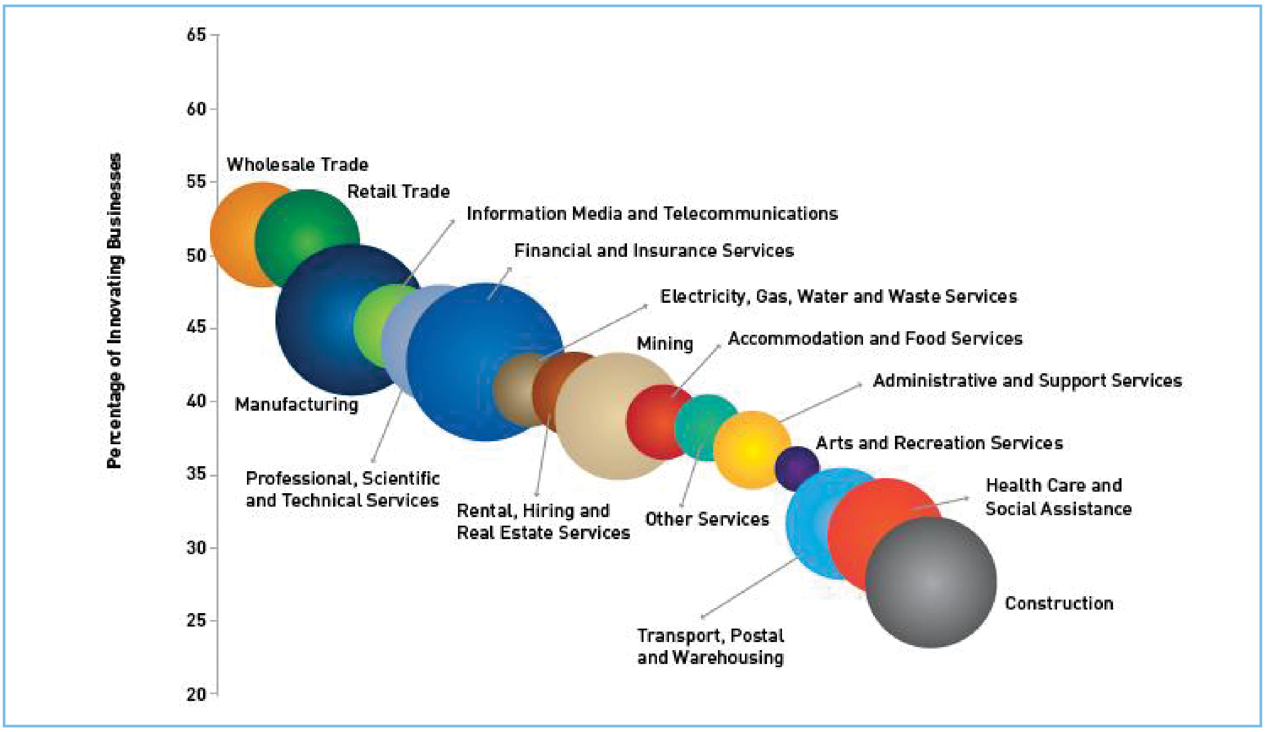
8. Wolfl, A. 2005, *The Services Economy in OECD Countries*, OECD STI Working Paper 2005/3, p.39.

Table 2-7: Proportion of businesses that introduced or implemented innovation by type and by industry, 2007-08

	Goods or services	Operational processes	Organisational /managerial processes	Marketing methods	Innovating businesses
Electricity, Gas, Water and Waste Services	20.8	26.6	16.1	11.4	40.8
Construction	13.2	13.7	14.3	7.0	27.3
Wholesale Trade	33.5	22.5	18.0	24.8	51.4
Retail Trade	32.7	17.2	19.3	19.8	50.9
Accommodation and Food Services	22.2	12.9	18.3	18.2	38.6
Transport, Postal and Warehousing	16.3	15.4	14.5	7.3	31.3
Information Media and Telecommunications	27.3	22.8	17.8	18.1	45.1
Financial and Insurance Services	16.7	20.5	24.9	17.9	42.7
Rental, Hiring and Real Estate Services	18.3	15.1	19.2	17.9	40.5
Professional, Scientific and Technical Services	23.0	21.9	26.2	17.9	43.9
Administrative and Support Services	20.1	17.9	21.7	9.7	36.7
Health Care and Social Assistance	19.5	14.9	17.0	9.4	30.4
Arts and Recreation Services	17.7	9.7	20.7	14.4	35.4
Other Services	25.1	12.0	15.1	14.7	38.2
Mining	**11.1**	**22.5**	**26.1**	**7.4**	**39.0**
Manufacturing	**24.8**	**28.7**	**20.8**	**17.7**	**45.6**
ALL INDUSTRIES	**21.9**	**17.6**	**19.0**	**14.6**	**39.1**

Source: ABS Catalogue No. 8166.0, Table 2.

Figure 2-8: Percentage of innovating businesses by industry sector and percentage of gross value-added (GVA), 2007-08



Note: The size of the bubbles represents how important the industry sector is to the Australian economy, measured as its proportion of GVA. The vertical axis of the bubble represents the proportion of innovating businesses in that industry sector. Thus large bubbles on the left hand side represent sector that are both economically important and have a high percentage of innovating firms.

Source: DIISR 2010, *Australia Innovation System Report 2010*, p.19.

between 1974-75 and 2007-08. It is evident from Table 2-8 that it is flawed to label all services industries as 'productivity laggards', although significant disparities do exist. In fact, some services industries experienced much higher productivity growth rates than that recorded by the Manufacturing sector and the market sector[9].

The three outstanding performers, in terms of both labour and multifactor productivity growth for the period 1974-75 to 2007-08, were the Agriculture, forestry and fishing industry; and the services industries – Communication services and Transport and storage. Over the period, average annual MFP growth for Communication services was 3.9 per cent and 2.1 per cent for Transport and storage. Over the same period, Electricity, gas and water supply and Construction also recorded growth in MFP comparable to that recorded for manufacturing (1.2 per cent).

The services industries that recorded low or negative MFP growth were Accommodation, cafés and restaurants (-0.6 per cent) and Cultural and recreational services (-0.5 per cent).

However, annual average growth estimates for the period between 1974-75 and 2007-08 reported in Table 2-8 hide the rapid productivity growth experienced by many service industries in the mid-1990s. Figure 2-9 shows that strong productivity growth for the market sector (2.3 per cent) over the period 1993-94 to 1998-99, the Australian productivity boom cycle, was supported by a surge in productivity growth for a number of services industries.

Wholesale trade was the standout performer during the period 1993-94 to 1998-99, with an annual average growth of 5.8 per cent and contributing 0.5 percentage points to overall productivity growth. Communication services also recorded high productivity growth over the period, with an annual average growth rate of 4.7 per cent and contributing 0.3 percentage points to overall productivity growth. Finance and insurance services (3.0 per cent) and Construction (2.7 per cent) also recorded productivity growth above the market sector average of 2.3 per cent. It is also evident from Figure 2-9 that other traditional contributors to productivity growth – mining and manufacturing sector, did not contribute to the productivity surge in the 1990s.

However in the recent productivity cycle of 1998-99 to 2003-04, Australia's overall productivity growth has slowed and returned to its long run average level of 1.1 per cent. During this period, MFP growth slowed sharply across all industries when compared to the 1993-94 to 1998-99 cycle, except for Manufacturing; Transport and storage; and Cultural and recreational services, which recorded a rise in MFP growth over the period.

"Australia's overall productivity growth has slowed and returned to its long run average level of 1.1 per cent"

The two main factors that contributed to productivity growth in services industries during the 1990s, were greater openness to trade and information and communication technology (ICT) advancement.

Given a small domestic market, openness to trade is one of the important drivers for Australia's productivity growth. Trade can assist technological transfer such as ICT advancement to domestic economy. Trade can also substitute the lack of a large domestic market to some extent in order to exploit economies of scale. Moreover, increased openness can encourage stronger international competition which can stimulate innovation and promote organisation transformation of inefficient domestic firms and activities. Openness can also encourage Australian firms to enter foreign markets and to seek access to global supply chains. Parham (2004) estimates that from the mid-1980s, Australia's annual productivity growth from increased openness of the economy was about 0.5 per cent[10].

Although many services are not easily traded internationally, the fall in prices for new ICT technologies has increased the uptake of ICT which has increased trade in sectors such as financial services. Local services providers have also become more efficient and innovative in delivering services to other sectors as they become more integrated into global supply chains and exposed to greater competition. Instead of producing non-core services in-house such as human resources, accounting and ICT services, businesses often source expertise for these services from local and international services providers. This has contributed to growth in business services and increased incentive for many domestic services providers to be more efficient and competitive than their foreign counterparts to increase their market shares.

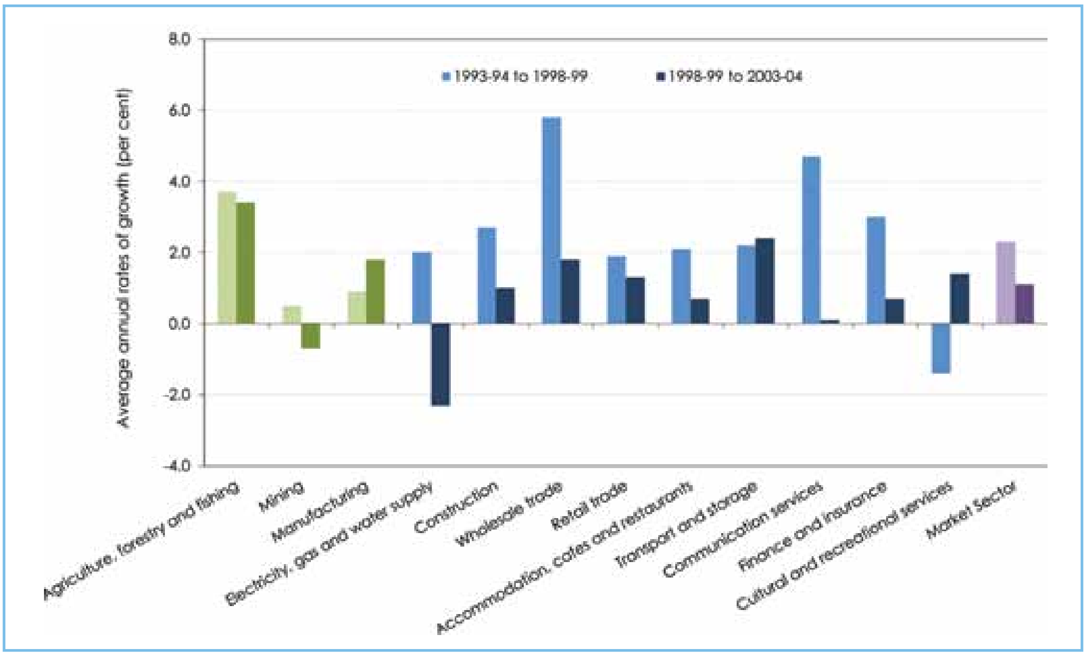
Much of the improvement in efficiency and productivity in services industries has been made possible through ICT advancement since the 1990s. As an importer of ICT, Australia has benefited from a sizable terms of trade gain through the rapidly declining prices of ICT. The Australian Treasury stated that ICT prices have fallen in Australian dollar terms by 9.5 per cent annually between 1985 and 2001[11]. ICT contributions to Australia's output growth increased from 0.27 percentage points during the period 1980-85 to 0.79 percentage points during the period 1995-2000[12]. Increases in ICT use contributed above-average MFP growth in the Finance and insurance, Wholesale trade, Retail trade and Construction industries during the 1990s.

Table 2-8: Labour, capital and multifactor productivity growth rates by sector and industry, 1974-75 to 2007-08

	Labour productivity	Capital productivity	Multifactor productivity
	Annual average growth (per cent)		
Agriculture, forestry and fishing	3.9	2.6	3.1
Mining	1.9	-0.9	-0.1
Manufacturing	2.4	-0.9	1.2
Services			
Electricity, gas and water supply	3.1	0.1	1.2
Construction	1.6	-1.2	1.2
Wholesale trade	2.1	-1.5	0.9
Retail trade	1.7	-1.3	1.0
Accommodation, cafes and restaurants	0.1	-2.9	-0.6
Transport and storage	2.8	0.9	2.1
Communication services	6.7	1.5	3.9
Finance and insurance	2.2	-1.6	1.0
Cultural and recreational services	-0.1	-1.6	-0.5
Market Sector	**2.1**	**-0.5**	**1.1**

Source: Productivity Commission http://www.pc.gov.au/__data/assets/file/0003/61266/industry-productivity-2009.xls accessed on 28 June 2010.

Figure 2-9: Multifactor productivity growth by Industry, 1993-94 to 2003-04



Source: Productivity Commission http://www.pc.gov.au/research/productivity/estimates-trends/trends accessed on 29 June 2010.

9. Five industries are excluded from the market sector: Property and business services; Government administration and defence; Education; Health and community services and Personal and other services. These industries are excluded because their outputs are not marketed and/or because their outputs are derived either wholly or primarily by using either deflated input cost data or hours worked as indicators of output (ABS, Cat. No. 5204.0).

10. Parham, D. 2004, *Sources of Australia's productivity revival,* Economic Record, Vol. 80, No. 249.

11. Parham, D. 2003, *Australia's 1990s productivity surge and its determinants*, in Ito, T. and Rose, A. (eds.), Productivity and Growth, East Asia Seminar on Economics, vol. 13, University of Chicago press.

12. Colecchia, A. & Schreyer, P. 2001, *ICT investment and economic growth* in the 1990s: Is the *United States a unique case?* OECD STI Working Papers, No. 2001/7.

The uptake in ICT has provided opportunities for businesses:

- To undertake existing tasks more efficiently, cheaply and effectively by substituting ICTs for other inputs, especially labour; and
- To develop and introduce new value-adding and efficiency-enhancing products and services, process and organisational structures.

For example, ICT development in Australia's wholesale and retail trade sector has contributed to rapid MFP growth during the 1990s through[13]:

- Widespread adoption of product numbering (i.e. barcode) and scanning devices;
- Enterprise Resource Planning (ERP) systems which integrate each department in an organisation, e.g. from marketing to accounts, ordering and finance forecasting; and
- Development of 'just-in-time' inventory management systems, including automatic replenishment orders based on stock levels.

International comparison of labour productivity growth rates and levels can provide a clearer assessment of Australia's productivity performance over time. However, it is important to note the significant measurements uncertainty due to differences in definition, scope and statistical methods across countries and business cycles in each economy.

For Australia, US productivity growth provides the most relevant 'frontier' or aggregate benchmark to use when examining Australia's productivity performance. The United States can still be broadly interpreted as the world productivity leader in technology and efficiency at an aggregate level, although some European countries, such as Norway, have reported higher labour productivity due to non-technological factors – policies constraining employment and industry mix, i.e. access to mining resources[14].

Although there has been a relatively stable and sizeable productivity gap at the aggregate productivity level, Australia's productivity performance relative to the US has varied widely at the industry level.

Table 2-9 shows a number of services industries that were the frontrunners during Australia's 1990s productivity surge have experienced significant slowdown in productivity growth in recent years. While Electricity, gas and water services, Retail trade and Finance and insurances services had partially caught up with the US in the 1990s, in recent years these industries' relative productivity performance has been slipping compared to the US. Wholesale trade service had not matched and has fallen further behind its counterparts in the US over 1979 to 2003. Only productivity in the Construction industry matched and exceeded the US's productivity levels and growth rates over the same period.

2.2.5 Recent Trends in Services Exports

Over the last two decades, services trade has outpaced the growth in goods trade due to advances in information and communication technologies, and the deregulation of services industries in many countries. As the services sector has become increasingly important in the domestic economy, the share of services in total Australian exports has risen from 13.6 per cent in 1960-61 to around 21.6 per cent in 2008-09[15]. Since 1980, services exports have grown at annual average rate of 6.6 per cent, outpacing the average growth rate of 5.0 per cent per annum for goods exports (Figure 2-10).

In 2008-09, Australia's services exports totalled $52.9 billion in nominal terms, an increase of 4.4 per cent on the level recorded in 2007-08. Figure 2-11 shows that the largest contributors to Australian services exports were Travel services[16], which accounted for $31.1 billion or 10.9 per cent of Australian total value of exports. Other business services were the second largest contributors to Australian services exports contributing 2.7 per cent, closely followed by Transports services, which contributed 2.6 per cent to Australian total exports. In 2008-09, Australia's services imports totalled $56.2 billion in nominal terms, an increase of 5.3 per cent on the total for 2007-08. As a result, the balance of services trade increased from a deficit of $2.7 billion in 2007-08 to a deficit of $3.3 billion in 2008-09.

"The share of services in total Australian exports has risen from 13.6 per cent in 1960-61 to around 21.6 per cent in 2008-09"

Although the above 'headline' figures show that Australia's services exports performances have been notable since the 1980s, a closer examination of the data indicates that Australia's services exports in recent years have been lacklustre compared to other OECD countries. Australia's services trade intensity, i.e. the ratio of exports and imports of services to total GDP, is very low compared to other OECD countries. Only Japan, the United States and Mexico have a lower services trade intensity ratio than Australia[17].

More importantly, the average five year trend growth in Australia's services exports (13.3 per cent) was much lower than those achieved by most emerging economies in the Asia Pacific region, such as China (25.5 per cent), India (33.2 per cent), Singapore (18.6 per cent) and Korea (17.1 per cent)[18].

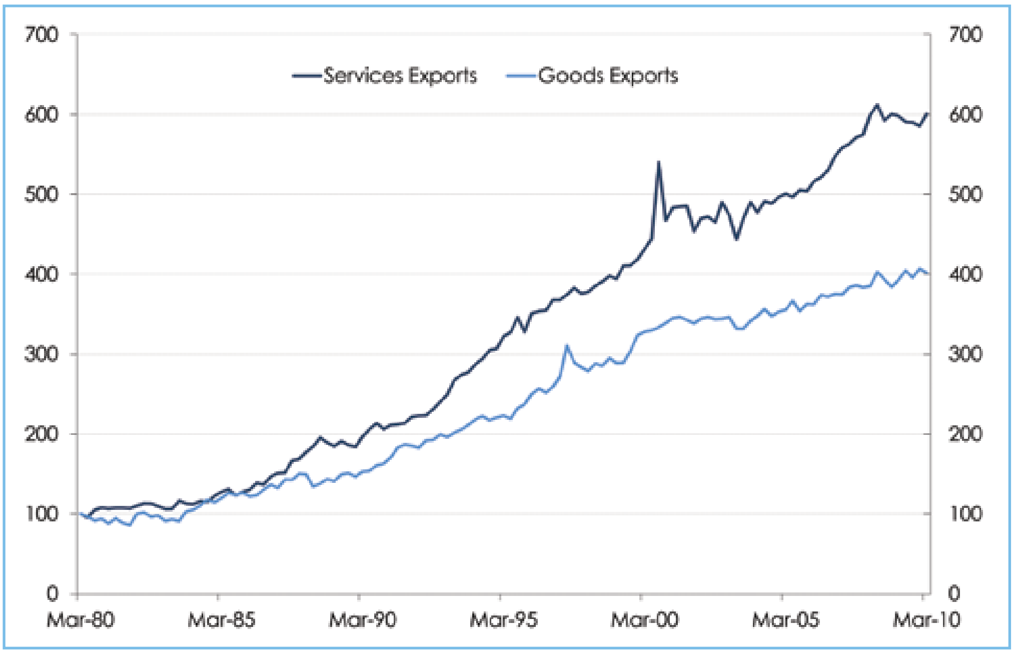
Table 2-9: Catch-up in Australia's productivity levels, 1979 to 2003

Industry	Per cent of US productivity level 1979	1998	2003
Electricity, gas and water	41	71	53
Construction services	74	111	124
Distributive Trades	62	60	60
Wholesale trade	55	33	43
Retail trade	60	73	63
Transport and Storage	179	95	98
Communications	41	114	83
Finance and Insurance	62	73	67

Source: Dolman, Parham and Zheng (2007).

Figure 2-10: Growth in Australian goods and services exports

Index March 1980 = 100 (Chain volumes)



Source: ABS Catalogue No. 5302.0, Table 6.

13. Johnston, A., Porter, D., Cobbold, T. & Dolamore, R. 2000, *Productivity in Australia's wholesale and retail trade,* Productivity Commission Staff Research Paper, Canberra.

14. Dolman, B., Parham, D. & Zheng, S. 2007, *Can Australia match US productivity performance,* PC Staff Working paper, March.

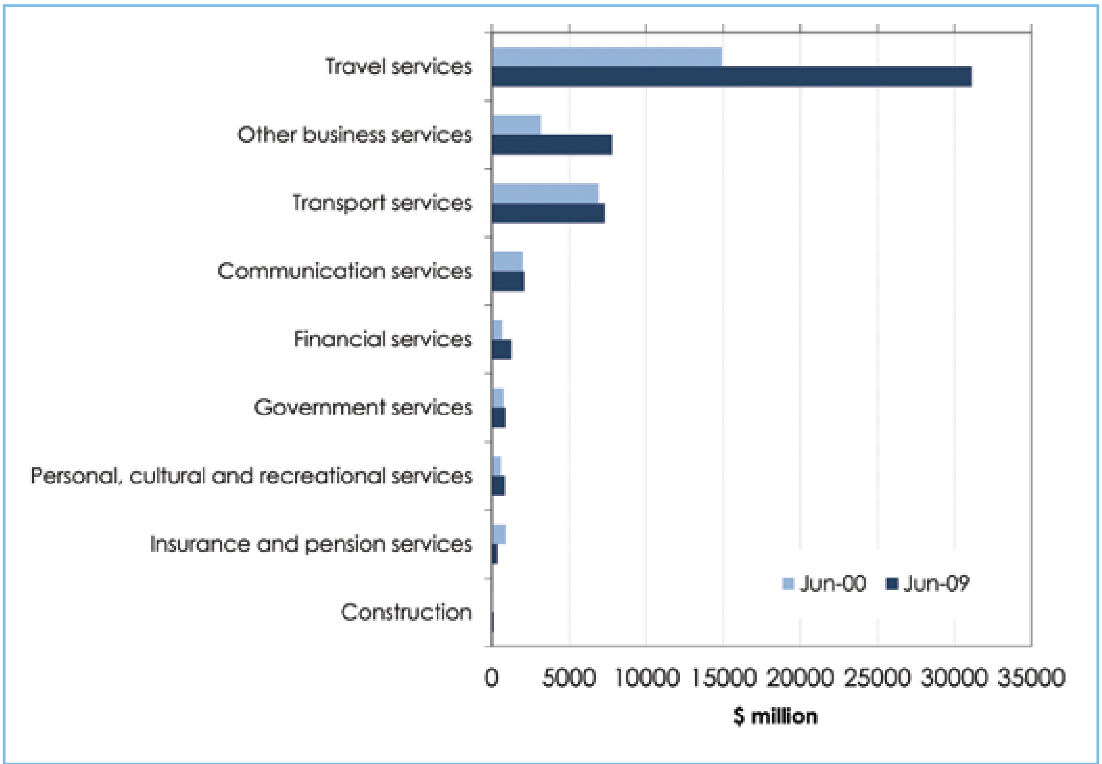
15. ABS Catalogue No. 5302.0, Table 18. The data is in chain volume measures terms.

16. Travel services include business, education-related and other personal travel.

17. Wolfl, A. 2005, *The Services Economy* in OECD Countries, OECD STI Working Paper 2005/3, p.39.

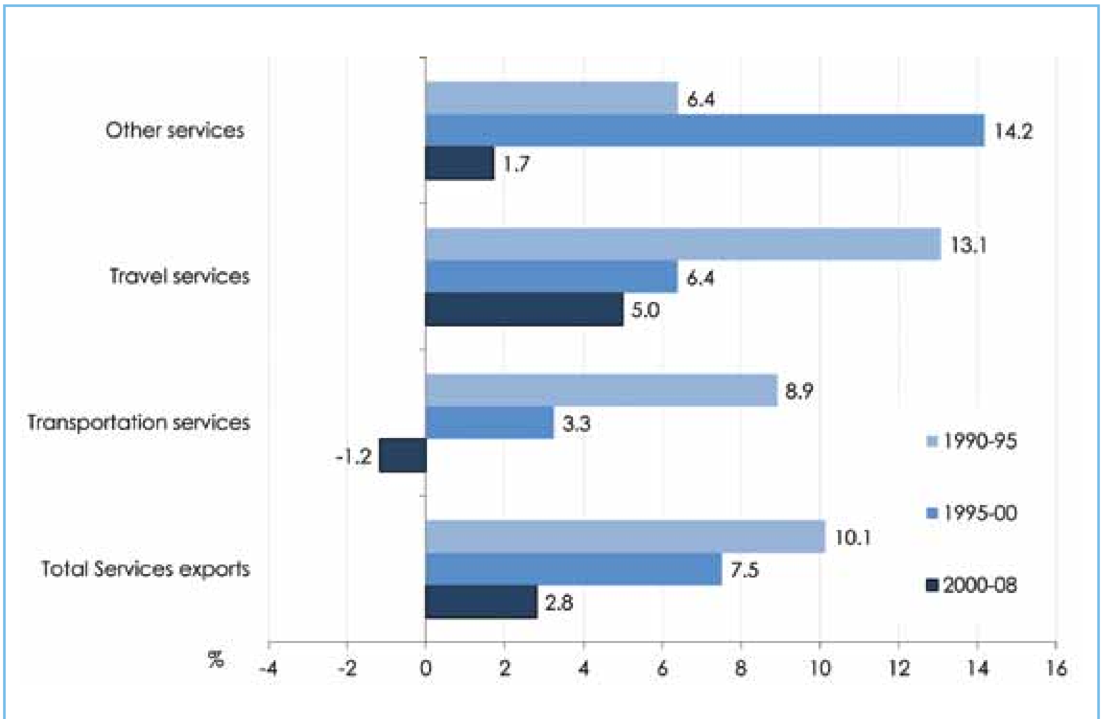
18. Department of Foreign Affairs and Trade (DFAT) 2010, *Trade in Services Australia 2008-09*, Canberra, p.119.

Figure 2-11: Services exports in nominal terms



Source: ABS Cat. No. 5302.0, Table 65.

Figure 2-12: Annual average growth in Australia's services exports



Source: ABS Cat. No. 5302.0, Table 18.

It is evident from Figure 2-12 that there has been a deterioration in the growth of services trade across all categories of services exports since the 1990s, i.e. Travel services, Transportation services and Other services.

Declining growth in Transportation services is due to weakness in exports of Freight services, which have declined from a strong average growth of 14.2 per cent per annum over 1990-95 to a negative growth of -4.2 per cent in 1995-2000 and a mere 1.9 per cent growth in 2000-08.

The weakness in Travel services exports is explained by a fall in Personal travel from an average growth of 17.3 per cent per annum in 1990-95 to 8.4 per cent in 2000-08.

"Between 2000 and 2008, the total value of world services exports grew by around 12 per cent per annum"

Slowdown in Other services category, which mainly includes business-related services exports, was particularly significant. Over the period between 1995 and 2000, exports for this group of services grew strongly from an annual growth of 6.4 per cent in the previous five years to 14.2 per cent. However, growth in Other services exports has slowed to a mere 1.7 per cent per annum since 2000. Most of the components within the Other services exports category have slowed since 2000, especially Communication services, Finance and insurance services and Other business services, which includes services commonly referred to as Professional and technical services such as accounting, legal, consulting, advertising, marketing, architectural and engineering services.

In addition, there is a lack of diversification in Australia's services exports. In 2008-09:

- 63 per cent of Australia's services exports were classified as Travel services, such as Tourism, Education and business-related travel;
- 12 per cent of total services exports were related to Transportation services; and
- The remaining 25 per cent were due to Other services exports, which are predominantly business-related or commercial services. The share of Other services exports has remained relatively unchanged since the mid-1980s.

However, global exports in commercial and business related services have increased significantly since the 1980s. The share of global Commercial services exports in total services exports increased from around 35 per cent in 1980 to around 51 per cent in 2008[19].

Moreover, slowdowns in Australia's services exports since the 1990s have occurred against a backdrop of rapidly growing global services exports. Between 2000 and 2008, the total value of world services exports grew by around 12 per cent per annum, the fastest pace since 1990[20]. In contrast,

Table 2-10: Number of businesses by industry, 2006-07

	Total businesses	Total small businesses	Small businesses as % of industry
Agriculture, forestry and fishing	**215,247**	**209,211**	**97.2**
Mining	**7,296**	**6,786**	**93.0**
Manufacturing	**105,702**	**95,097**	**90.0**
Services	**1,685,700**	**1,618,734**	**96.0**
Electricity, gas and water supply	1,962	1,812	92.4
Construction	323,238	316,539	97.9
Wholesale trade	85,518	79,221	92.6
Retail trade	219,273	205,131	93.6
Accommodation, cafés and restaurants	56,499	46,797	82.8
Transports and storage	117,756	114,333	97.1
Communication services	24,426	23,919	97.9
Finance and insurance	136,746	134,697	98.5
Property and business services	508,326	493,470	97.1
Education	16,452	15,489	94.1
Health and community services	92,163	87,807	95.3
Cultural and recreational services	46,713	44,250	94.7
Personal and other services	56,628	55,269	97.6
ALL INDUSTRIES	**2,013,945**	**1,929,828**	**95.8**

Source: Adapted from Department of Innovation, Industry, Science and Research 2009, Services Sector: *Overview of Structural Change, Industry Brief 2007-08*, Canberra, p. 94.

19. World Trade Organisation (WTO) 2009, *International Trade Statistics 2009*, Geneva.

20. Ibid, p.121, Table III.2.

Australia's services exports failed to keep pace with global growth in services exports. Over the same period, Australia's services exports only grew at an annual average rate of 2.8 per cent (Figure 2-12) indicating that Australia's share of the global services exports markets has been shrinking.

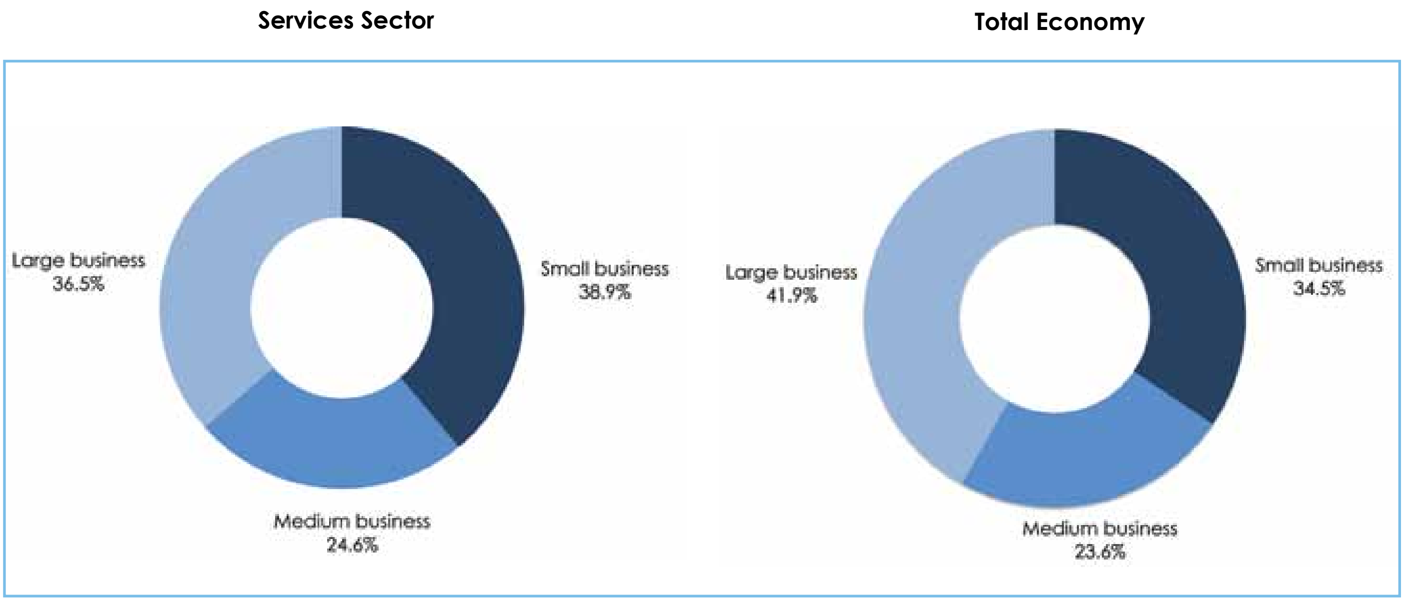
2.2.6 Small Businesses in Services

In Australia, small businesses account for a larger proportion of businesses in the services sector than in the mining and manufacturing industries. Table 2-10 indicates that at the end of 2006-07, 96 per cent of services businesses were small businesses compared to 93 per cent of businesses in mining and 90 per cent of businesses in manufacturing.

Small businesses contributed around 35 per cent of private sector industry value-added in 2008-09. Approximately 80 per cent of the total small business contribution to the Australian economy can be attributed to the services sector. In 2008-09, small businesses contributed 38.9 per cent of private services sector value-added (Figure 2-13).

"96 per cent of services businesses were small businesses"

Figure 2-13: Industry value-added contribution by business size, 2008-09



Source: Author's calculation based on ABS Cat. No. 8155.0., *Australian Industry*, 2008-09.

Note: Small businesses are businesses employing fewer than 20 employees; medium businesses are those employing 20 to fewer than 200 employees; and large businesses are those employing 200 or more employees.

CHAPTER 3

ISSUES AND CHALLENGES FOR THE SERVICES SECTOR IN GENERAL

3. ISSUES AND CHALLENGES FOR THE SERVICES SECTOR IN GENERAL

The rise of the services sector has been driven by the growth in income levels. As income levels increase, the demand for various kinds of services increases, such as demand for leisure activities, high quality health and care services, higher education and other personal services which contribute to an improved quality of life. Studies have found that the services sector has a higher income elasticity than goods or products.

In addition to final consumer demand, intermediate demand also plays a role in explaining the growth in services. The services sector is playing an increasing role as providers for intermediate inputs for other sectors, especially manufacturing. The share of services activities that is necessary for or complementary to manufacturing goods production has increased, such as market research, R&D and technical design, human resources management and business consulting etc. Coupled with technological advancement, especially in ICT, the past two decades have seen an increasing trend towards the outsourcing of business related services, such as financing, logistics and R&D. Technological advancement has also enabled the rise of knowledge-based services such as communications, business and financial services.

This chapter aims to address the issues and challenges currently confronting the services sector in general, including taxation policy, the regulatory environment, trade in services, government assistance, workplace relations and skills and labour shortages. Given the diverse range of individual service industries, we will discuss some of the industry-specific issues and challenges in the ensuing chapters.

3.1 Taxation and Services

In recent times, policymakers have become more aware of the benefits of competition, economic efficiency and globalisation. There has also been increased awareness of the drivers of economic growth such as skills development, innovation, research and development (R&D), investment and education. Australia's future tax policy must provide an environment conducive to encouraging each to flourish within an international context. The capacity for Australian services sector businesses to improve their productivity performance, maintain investment plans and provide job opportunities relies on a competitive taxation system that delivers incentive and rewards entrepreneurship.

Taxation reform is as important to the services sector as any other industry in the Australian economy. If Australia's services sector is to compete internationally it is vital that the Australian taxation regime does not disadvantage domestic service enterprises especially smaller businesses.

In the next decade Australia's economy will continue to experience the long process of intergenerational change, which has significant impacts for our future economic growth and living standards. Moreover, given the current era of globalisation with increasing mobility in capital and labour, there is an increasing pressure for the Australian economy to remain competitive. An important element in addressing the above challenges is through the creation of an efficient, simple and equitable tax and transfer system.

By addressing the challenges of tomorrow, today, through the creation of an efficient, simple and equitable tax regime, current policymakers will be able to build a strong foundation for productivity and economic growth in the services sector.

"Australia's competitiveness should be assisted and not impeded by the taxation system"

The Australian economy has become more dynamic, efficient, productive and open over recent decades. However, the taxation system has only adapted slowly to these structural changes. As a result, taxes have become one of the major impediments for the Australian economy to achieve its potential and be as internationally competitive as it can be. According to the *World Economic Forum – Global Competitiveness Report 2008-09*, Australia was ranked 18th out of 134 countries in terms of overall competitiveness. However looking into greater details, Australia was ranked 85th in terms of government regulation burden and 88th in terms of total tax burden. Thus, continuing tax reform remains key to enhancing Australia's competitiveness and economic growth.

ACCI believes Australia needs a taxation system that supports the achievement of important economic and social objectives. Australia's competitiveness should be assisted and not impeded by the taxation system.

Tax revenue should be adequate to meet elected governments' reasonable expenditure needs, consistent with the exercise of fiscal responsibility principles. The tax system should be such that all taxpayers feel confident and satisfied in complying with it.

A sustainable tax structure will only be achieved through an integrated package of reform across all significant Commonwealth and State tax bases in the form of a balanced package covering consumption, income and assets.

While changes over the last two decades to the Australian taxation regime have improved equity, sustainability and efficiency, there is still much room for improvement. The main reasons for further taxation reform include:

- Improving the efficiency and international competitiveness of the Australian economy by encouraging productive investment, risk taking and attracting capital and skilled labour;
- Continuing Australia's strong growth and promoting productivity growth;
- Ensuring Australia can meet long term structural challenges, particularly demographic changes, in the most cost effective way;
- Restoring incentive and promoting innovation, risk taking and entrepreneurship;
- Encouraging investment in human capital and the retention of skilled workers; and
- Reducing tax avoidance and evasion, to improve the perceived and actual fairness of the tax system.

The objectives of Australia's future tax reform should be to reduce the overall burden of tax, eliminate economically damaging taxes, and generate greater incentives for workforce participation, productivity, investment, R&D and international competitiveness.

3.1.1 Personal Income Tax Reform

Australia's personal income tax system has gone through limited changes over the last decade.

Prior to 2000, the tax-free threshold was $5400 and the marginal rates above that were 20, 34, 43 and 47 per cent. Since the Government's New Tax System in 2000, which centred on the Goods and Services Tax (GST), there have been two changes to the marginal rates:

- The first set of changes, as part of the package which introduced the GST, concentrated on the two lower rates, which were cut from 20 and 34 per cent respectively to 17 and 30 per cent. The only change to the two upper rates was a 1 percentage point cut to the 43 per cent rate; and
- The second set of changes has occurred since 2005. In 2005, the lowest rate was further reduced to 15 per cent. Apart from this, all the attention since 2005 has been on the two upper rates. The 42 per cent rate from the 2000 reforms was being cut in steps to 37 per cent from July 2010. In contrast, the top marginal rate has gone through minimal change. It had stood unchanged at 47 per cent since 1989 and has only been cut by 2 percentage points to 45 per cent, much less than any of the other three marginal rates.

It is important to note that much of the so called 'tax cuts' over the last 10 years have been the discretionary increases in the income thresholds at which the different marginal rates cut in. However, in the absence of automatic indexation of thresholds, the real benefits of these 'tax cuts' will be eroded over time due to inflation.

The simplicity and transparency of the above headline rates and thresholds have been compromised by the Low Income Tax Offset (LITO) and other selective income tax offsets that are withdrawn above specified income levels. The LITO mechanism is not widely understood, adds to complexity and detracts from the transparency of the tax system.

From July 2010, LITO is a maximum of $1,500 which begins to be phased out at a rate of 4 cents in the dollar of taxable incomes above $30,000. Thus, LITO is essentially a higher means-tested tax free threshold, whereby the benefit is clawed back from income earners above $30,000 through an increase in marginal rates applying up to $67,500.

Table 3-1 shows the difference between the statutory or headline marginal rates and the true marginal rates which take into account the 1.5 per cent Medicare levy and LITO. Both the Medicare levy and LITO raise the effective marginal rate over the income range from $30,000 to $37,000 from 15.0 per cent to 20.5 per cent, and from $37,000 to $67,500 the marginal rate will be 35.5 per cent, not the headline rate of 30 per cent. Thus the claw back mechanism increases the marginal rate for the majority of income earners. Above $67,500, marginal rates are not affected.

The above discussions on the personal income tax scale over the last decade suggest that marginal tax rates remain high and the operation of LITO and other tax offsets creates greater complexity in the taxation system.

High marginal tax rates create pressure for selective tax relief in the form of deductions, offsets and concessions, which erode the income tax base. Selective tax relief also makes the system more complex and opaque.

Table 3-1: Headline and true marginal rate scales from 1 July 2010

Headline Scale $	Per cent	True Scale (with 1.5% Medicare Levy and LITO) $	Per cent
0 to 6,000	0	0 to 16,000	0
6,001 to 37,000	15	16,000 to 17,794	15
37,001 to 80,000	30	17,795 to 20,934	25
80,001 to 180,000	37	20,935 to 30,000	16.5
More than 180,000	45	30,001 to 37,000	20.5
		37,001 to 67,500	35.5
		67,501 to 80,000	31.5
		80,001 to 180,000	38.5
		More than 180,000	46.5

Source: Carling, R. 2010, *The Unfinished Business of Australian Income Tax Reform*, Centre of Independent Studies, Policy Monographs, p. 9.

High personal income tax rates distort efficient resources allocation. It comes from workers choosing to stay out of the workforce, reducing their hours worked, foregoing investment in human capital, or devoting more of their income to consumption and less to saving and investment. Studies have shown that high income earners have more opportunities to adjust their behaviour in response to taxation. Moreover, a lowering of the top marginal tax rate and aligning it with the corporate tax rate would minimise tax avoidance incentives.

More importantly, although personal income tax is often perceived as a tax on wages and salaries, it is much more than that. Personal income includes individual income from saving and investment (interest, dividend, rent, capital gains) and from unincorporated businesses. Therefore, personal income tax is also a tax on capital. Given capital is more mobile than labour, saving, investment and entrepreneurial activity are more responsive to the level of tax than labour supply, which reinforce the case for lower marginal rates.

> "A focus on company tax reductions alone would leave the services sector short-changed"

Given many of the businesses operating in the services sector are unincorporated, a focus on company tax reductions alone would leave the services sector short-changed. Therefore, personal income tax reform should remain the top priority in the Government's tax reform agenda. The Government should:

- Ensure the elimination of bracket creep via the annual indexation of taxation thresholds;
- Gradually reduce the top marginal rate to the same level as the corporate tax rate; and
- Flatten marginal rates by increasing the tax free thresholds and reducing the number of thresholds.

The Henry Review, formally known as *Australia's Future Tax System Report*, which concluded in December 2009, recommends increasing the tax-free threshold and reducing the number of marginal tax rates in order to provide greater transparency and simplicity to the personal income tax system (Henry Review's Recommendation 2). However, ACCI is concerned that there is little change to the overall level and burden of personal income tax.

3.1.2 Company Tax – Further Reduction Required

At the international level Australia has a higher proportion of corporate tax to GDP compared to other comparable OECD economies. From 1982 to 2007, OECD average (unweighted) corporate tax to GDP ratio increased from around 2.5 per cent to 3.7 per cent. The increase in the corporate tax to GDP ratio has been more pronounced in Australia, with the company tax to GDP ratio rising from around 2.7 per cent in 1985 to 5.9 per cent in 2005, which reflects taxes on superannuation funds as well as increasing tax revenue from mining and minerals industries[21]. Henry Review also indicates that Australia has a relatively

21. Commonwealth of Australia 2010, *Australia's Future Tax System – Report to the Treasurer*, Part Two Detailed Analysis, Canberra, p.158.

broad based company income tax with limited concessional write-off arrangements compared to many OECD countries.

Over the past 30 years, company income tax rates have fallen across the OECD. The unweighted average company income tax rate fell from around 47 per cent in 1982 to around 28 per cent in 2007. Australia has until recently followed this trend with the company tax rate falling from 49 per cent in the mid-1980s to its current rate of 30 per cent in 2001. However, unlike in Australia where the company tax rate has remained stagnant at 30 per cent since 2001, the unweighted average rate across the OECD has continued to fall.

In 2001, Australia had the ninth lowest company tax rate in the OECD when it reduced its statutory company income tax rate to 30 per cent. However at present, Australia has the highest corporate rates amongst small to medium OECD countries, and at 30 per cent it is well above the average of around 25 per cent for small and medium OECD countries[22].

In light of the Henry Review's recommendation that Australia's company tax rate should be reduced to 25 per cent over the short to medium term (Henry Review's Recommendation 27), the Australian Government has committed to reduce the company tax rate to 29 per cent from 1 July 2013.

While ACCI welcomes the reduction in the company tax rate, it is considered necessary to further reduce the current high rates of personal income tax to better align with the company tax rate and this should remain on the Government's agenda, since most service enterprises are small businesses and many are sole traders and unincorporated[23]. Thus any reduction in company tax may not encourage further investment or promote productivity in the services sector. While reducing the company tax rate is a move in the right direction, the scale of the announced reduction to date will not lead to any pronounced incentive effects.

Against the background of the Henry Review, Table 3-2 indicates that small businesses rated personal income tax reform as their number one priority.

3.1.3 Providing Capital Depreciation Benefits

Current depreciation arrangements in Australia's taxation system are complex and uncertain due to different arrangements for different assets and special or preferential arrangements. For example:

- Currently there are 40 different effective lives provided for 3,700 assets;
- Under the uniform capital allowance rules, low value assets (with a value of $1,000 or less) can be pooled together and depreciated at 37.5 per cent per year; and
- Small business may immediately write off assets costing less than $1,000 and depreciate assets costing $1,000 or more at accelerated rates under two pools. Assets with an effective life of less than 25 years are depreciated in a general pool at a rate of 30 per cent, while assets with an effective life of 25 years or more are depreciated in a long life pool at a rate of 5 per cent.

ACCI supports the following Henry Review recommendations to simplify and streamline existing depreciation arrangements which will provide more certainty and cash flow benefits to businesses in the services sector, in particular small businesses:

Table 3-2: Tax reforms priority by business size

Tax Reform Options	Small Business Ranking	Medium Business Ranking	Large Business Ranking	All Business Ranking
Personal income tax reform	1	2	1	1
Company tax reform	2	3	2	2
Capital gains tax reform	3	5	8	5
Other state taxes reform	4	4	4	4
Payroll tax reform	5	1	3	3
Depreciation allowance reform	6	7	6	6
Mining taxation reform	7	8	7	8
Fringe benefits tax reform	8	6	5	7

Source: 2010 ACCI Pre-Election Survey

Note: For ACCI surveys, small businesses are those employing fewer than 20 employees; medium businesses employ 20 to 99 employees; while large businesses employ 100 and more employees.

22. Ibid, p.160.

23. As of June 2009, there were 2,051,085 actively trading businesses in Australia; of which 32.7 per cent were Companies, 29.5 per cent were Sole proprietors, 20.2 per cent. were Trust and 17.6 per cent were Partnerships. (Source: ABS Cat. No. 8165.0 *Counts of Australian Businesses, Including Entries* and Exits, June 2007 to June 2009).

- Allowing low value assets (costing less than $1,000) to be immediately written-off (Henry Review's Recommendation 28)[24]; and
- For small businesses, allowing depreciating assets costing less than $10,000 to be immediately written-off and allowing all other depreciating assets (except buildings) to be pooled together, with the value of the pool depreciated at a single declining balance rate (Henry Review's Recommendation 29)[25].

As part of its initial response to the Henry Review, the Australian Government has announced in May 2010 that from the 2012-13 financial year small businesses with an annual turnover of less than $2 million may immediately write off in the year of purchase assets costing less than $5,000 and most other assets will be depreciated in a single pool at a rate of 30 per cent. ACCI has publically argued that this reform initiative has its own merit and should be decoupled from the proposed mineral resources rent tax.

ACCI also welcomes the Henry Review's consideration to increase the small business entity turnover threshold from the current $2 million to $5 million and to adjust the $6 million net asset value test (Henry Review's Recommendation 30).

In order to ensure that the real values of the immediate assets write-off and the $5 million small business entity turnover threshold do not erode over time due to inflation, ACCI considers that their values should be automatically indexed over time.

3.1.4 Carrying Back of Losses Can Help Economy in Downturn

During the global financial crisis and in its aftermath, ACCI has publically called for the Australian taxation system to allow carry back of revenue losses to offset it against the prior years' taxable income to provide much needed cash flow relief for business during the downturn. The current taxation system treats gains and losses asymmetrically, where gains are taxed as they accrue, while losses are not refunded but can be carried forward and used against future income, subject to continuity of ownership test and the same business test.

Current limitations on the use of tax losses discourage entrepreneurship and risk- taking as well as disadvantaging small businesses[26] and firms engaged in risky investment. Restrictions on loss utilisation also limit the ability of the tax system to serve as an automatic stabiliser during an economic downturn as the tax value of deductions is not recouped by businesses until they have income to offset losses against. The *American Recovery and Reinvestment Act of 2009* has used the carry back of the tax losses provision of the US taxation system to provide immediate relief for American businesses and act as an automatic stabiliser, by enabling small businesses with a net operating loss in 2008 to elect to offset this loss against income earned up to five years prior, instead of the typical two years.

Thus, ACCI welcomes and calls on the Government to implement the Henry Review's recommendation to allow companies to carry back a revenue loss to offset it against the prior year's taxable income (Henry Review's Recommendation 31).

3.1.5 Payroll Tax – Australia's Tax on Jobs

Australia's services sector is labour intensive and thus disproportionately impacted by payroll tax. Payroll tax is levied by all States on businesses with remunerations above certain thresholds. Payroll tax was originally levied by the Commonwealth Government to fund child endowment in 1941. Since the Australian Government passed control of the payroll tax to the States in 1971, every State and Territory has used this tax to meet a significant part of its revenue requirements. In 2009-10, all States and Territories are expected to collect $16.8 billion in payroll taxes, representing 32 per cent of their own-source tax revenues.

"The Henry Review found that payroll tax is the third most inefficient Australian tax"

Complexity and non-neutralities in the payroll tax regimes of Australian jurisdictions can have pervasive effects on competition through its effect on the locational decisions of firms. Payroll tax burden also negatively affects employers' decisions to expand business operations and increase wages and employment. Thus, payroll tax is not only one of the most punitive taxes on businesses, but also one of the most regressive taxes on workers, as workers bear the final burden of payroll tax. The Henry Review found that payroll tax is the third most inefficient Australian tax after royalties and crude oil excise and insurance taxes, which cause around 40 cents of welfare loss for each dollar of additional revenue raised[27].

24. Ibid, p.173.

25. Ibid.

26. In 2006-07, small businesses accounted for almost half of all carried forward tax losses in Australia (Ibid, p.174).

27. Commonwealth of Australia 2010, *Australia's Future Tax System – Report to the Treasurer,* Part One Overview, Canberra, p.13.

According to the 2002 survey conducted by CPA Australia, it estimated that 40 per cent of small businesses see payroll tax as an impediment to employment[28]:

- 40 per cent of small businesses and 45 per cent of CPAs believe payroll tax is a barrier to employment; and
- Of the small businesses that consider payroll tax a barrier, 80 per cent believe the rate is too high, 65 per cent believe the rate should be lower and applied to all businesses and 77 per cent believe the cost is passed on to consumers.

"Compliance and payroll tax costs provide an incentive for service businesses to remain small"

ACCI's *2010 Pre-Election Survey* found that Payroll tax ranked amongst the top five tax reform priorities for Australian business from different size groups. Businesses were also surveyed in relation to their views on the proposal to broaden the base or increase the rate of GST to fund the abolition of payroll tax. Those businesses with more than 19 staff are more likely to support the view that a higher GST rate should be considered to fund the abolition of payroll tax.

Businesses in the services sector face a number of complexities and high costs in complying with their payroll tax obligations. This is particularly the case for businesses that operate across different jurisdictions, where there are different definitions of wages for payroll tax purposes, direct rates of tax payable on wages and different small business exemptions. Moreover, the exemption threshold acts as a barrier to business growth as the compliance and payroll tax costs provide an incentive for service businesses to remain small.

Reform to reduce, harmonise and abolish both the complexity and burden of payroll taxes are necessary if Australian businesses including services enterprises are to remain competitive. ACCI has been publicly calling for the reduction and harmonisation of payroll tax towards its eventual abolition and therefore is supportive of Henry Review's recommendations to abolish state payroll tax and eventually replace it with revenue from more efficient broad-based taxes (Recommendation 55 and 57).

Other inefficient state taxes such as insurance taxes which cause individuals and businesses to be underinsured, and conveyancing stamp duties which induce businesses to minimise their transaction and investment in property, should also be abolished.

3.1.6 CGT – Discourages Risk Taking by Targeting Success

Australia has the highest reliance on capital taxation in the OECD, with around 35 per cent of all tax revenue derived from taxes on capital income, including capital gains tax (CGT). As a share of GDP, the total tax burden in Australia on capital is around 11 per cent, the fourth highest in the OECD. By contrast, the tax burden on labour is 12 per cent and the total burden on consumption tax is 9 per cent, the fourth lowest in the OECD[29].

In 2006-07, CGT raised $17.3 billion, 6.6 per cent share of total Commonwealth taxation revenue. There has been a significant increase on the $4.6 billion in CGT raised in 1998-99, the year before the Ralph reforms, when CGT amounted to only 3.3 per cent of Commonwealth taxation revenue[30].

Arguably, CGT is the most economically damaging tax for Australia's small business sector. It is an active disincentive to risk taking and entrepreneurship, which deters investment; and on the sale of an asset or business, it detracts from the amount of capital which may be used to invest in other productive assets generating much higher returns.

As capital becomes increasingly mobile internationally, it is imperative that Australia has a competitive CGT regime. Capital gains are taxed on a realisation basis giving an incentive for the owners of taxable assets to hold on to them to avoid paying the tax rather than selling them to those who value them more highly. This lock-in effect also means that investors do not shift their funds to other investments (such as higher growth investment) that offer the highest rate of return. Thus CGT decreases the efficiency of the capital market, results in capital asset misallocations and reduces productivity and economic growth.

Reducing the cost of capital through lower tax rates will increase capital investment and capital productivity. Experience of CGT abroad suggests that lowering tax rates on capital gains can encourage realisation of capital gains which not only increases market efficiency but also can have positive impact on CGT revenue. By contrast, higher capital gains taxes are self-defeating as a revenue raiser.

28. CPA Australia Media Release 13 March 2002.

29. Commonwealth Australia 2008, *Architecture of Australia's Tax and Transfer System*, Canberra, p. xvii.

30. Kirchner, S. 2009, *Reforming Capital Gains Tax*, Centre for Independent Studies Policy Monograph 103, p.5.

Currently small business is provided relief from CGT through a general 50 per cent CGT discount as well as a range of small business concessions as follow:

- The 15-year exemption where small business that has owned an asset for more than 15 years can disregard any capital gains;
- A further 50 per cent discount for the sale of active business assets;
- A retirement exemption for capital gains made on active assets up to a lifetime limit of $500,000 per individual; and
- A small business roll-over, which allows deferral of a capital gain made on an active assets if within two years the proceeds are reinvested in another business asset.

In 2007-08, 29,681 small business proprietors claimed the small business CGT concessions to the value of $4.4 billion, an increase of 29.4 per cent from 2006-07, demonstrating they are significant and widely utilised by taxpayers. Most small businesses claimed the small business active assets reduction which had the lowest average amount per claimant of $74,657. In contrast, the small business 15-year exemption was the least claimed concession, but had the highest average amount per claimant of $515,590 (Table 3-3).

"Many small business owners can have negligible superannuation savings and use the value built up in their business for post-retirement income"

ACCI is concerned that the Henry Review recommendation to remove the active assets 50 per cent reduction and 15-year exemption concessions (Recommendation 17) will increase the burden of CGT which in turn will have a wider and more serious impact on investment and diminish incentives for entrepreneurship and job creation. The proposed changes will particularly hit the services sector given 96 per cent of businesses in the sector are small businesses. Accordingly, ACCI is strongly opposed to the watering down of these measures as proposed in the Henry Review.

CGT has an economically detrimental 'lock-in' effect where an asset is retained to avoid realising a liability even though proceeds could be deployed elsewhere and achieve a higher return. Moreover, many small business owners can have negligible superannuation savings and use the value built up in their business for post-retirement income. The potential narrowing of the options available to reduce the impact of CGT will make achieving a reasonable retirement income more difficult.

3.1.7 Independent Contractors – PSI Rules

Over the last decade, there has been a growing number of independent contractors in the Australian economy. In November 2009, there were over 1 million people who worked as an independent contractor, representing 9.6 per cent of Australia's workforce. Most of the independent contractors worked in the services sector, with 33 per cent working in the Construction industry and 15 per cent working in Professional, scientific and technical services industries.

Given the increasingly important role of independent contractors in the Australian economy, particularly in the services sector, ACCI is concerned that the recent recommendations by the Board of Taxation[31] to reform the current alienation of personal services income (PSI) rules will stifle the growth of self-employment in the services sector and increase the small business compliance burden.

Under the existing legislation, an independent contractor (or their trading entity) will be considered as carrying on a personal services business and will be eligible to claim deductions

Table 3-3: Small business capital gains tax concessions, 2006-07 and 2007-08

	2006-07				2007-08			
	Individuals		Companies		Individuals		Companies	
	No.	$m	No.	$m	No.	$m	No.	$m
Small business 15 year exemption	764	221	207	118	707	321	191	142
Small business active asset reduction	24,220	1,141	2,746	423	23,755	1,489	2,659	483
Small business retirement exemption	10,057	715	1,264	352	9,968	891	1,150	361
Small business rollover	4,676	321	519	112	4,962	469	490	294
Total Small Business CGT Concessions	**26,548**	**2,398**	**3,772**	**1,005**	**26,512**	**3,169**	**3,517**	**1,280**

Source: ATO Taxation Statistics 2007-08, Table 7.11, p. 86.

31. Board of Taxation 2009, *Post Implementation Review into the Alienation of Personal Services Income Rules*, A Report to the Assistance Treasurer, Canberra.

for some of the business related expenses incurred by the contractor or their entity, if he/she satisfied any one of the following PSI tests:

- *Results test:* the contractor has to satisfy the following three questions: (i) if the contractor works to produce the result; (ii) if the contractor provides the tools and equipment necessary to produce the results; and (iii) if the contractor is liable for the cost of rectifying any defective work. The contractor will be treated as a personal services business if at least 75 per cent of his/her PSI meets all the three conditions;
- If the contractor fails the above Results test, he/she will have to pass any of the following tests:
  - The *80% Rule*, whereby the contractor cannot receive more than 80 per cent of his/her income from one client;
  - The *Unrelated Clients Test*, whereby the contractor must provide services to two or more unrelated clients;
  - The *Employment Test*, whereby the contractor must employ one or more employee(s); and
  - The *Business Premise Test*, where the contractor must have separate business premises.

The existing rules have provided a mechanism to limit deductions for contractors who provide personal services in an 'employee-like' manner, which were introduced following the Ralph Review. However, the recent Board of Taxation recommendations to reform the PSI rules include:

- The contractors will need to differentiate between the income attributed to their capital and the income attributed to their labour;
- The contractors must have two employees or more to qualify as a business; and
- The contractors must submit an annual report to the ATO so that the ATO can match the data with their clients to identify the number of clients the contractors have each year.

The proposed changes will increase the red tape and compliance burden of small services enterprises and will have a negative impact on services business productivity and competitiveness. Comprehensive cost and benefit analyses will need to be conducted to justify the proposed changes so that services businesses are not unfairly targeted. ACCI welcomes the recent announcement by the Government that it will not change the tax rules in the Personal Services Income space[32].

3.1.8 The Goods and Services Tax (GST)

Before July 2000, both Federal and State Governments relied on a raft of indirect taxes, which were narrowly based, cascading and inequitable. The introduction of the GST, a broad-based tax on consumption alleviated many problems inherent within Australia's indirect taxation system. The GST replaced a large number of different Wholesale Sales Taxes (WST) rates, which applied to a variety of goods and exempted others. Furthermore, other poorly designed state taxes were replaced by revenue from a far more efficient source.

The GST widened the tax base – with the removal of the WST and the worst of the state taxes. States and Territories were provided with a secure revenue source coupled with the removal of some highly inefficient State and Territory taxes. The introduction of the GST also paved the way for the removal of some indirect taxes levied on businesses as well as across the board personal tax cuts.

However, the tax package as implemented was different from the original proposals. Objections in the Senate led to negotiations between the Government and independents, which culminated in lower personal income tax cuts and fewer taxes being removed on business. The most serious tax not to be addressed was payroll tax.

In addition, the GST was not as broad based as best practice would dictate, adding unnecessary complexities and costs of compliance. Items excluded from the GST include fresh food, health, education, childcare, nursing homes and hostels, local government rates, water and sewerage charges and charitable activities. In many cases, the exemptions were broader than originally proposed.

Australia's existing GST is narrow compared to its potential base, taxing only 57 per cent of consumption. In 2009-10, total GST exemption is around $16.6 billion, with largest exemption for food ($5.5bn); Medical and health services ($2.7bn) and education ($2.6bn).

A narrower GST does not mean it is fairer instead it adds to complexity. Income redistribution role should not be the responsibility of the GST. A GST is an indirect tax, it is very difficult to target GST exemptions on some products to certain groups of people. For example, while the proportion of income spent on GST-free food does fall as income increases, absolute actual expenditure on GST-free food is almost six times greater for the highest than the lowest income groups. Hence, more than one third of the $5bn exemption for GST free food benefits households in the highest 20 per cent of income distribution[33].

32. Kehoe, J. (2010, 13 October), *Labor's contractor tax pledge*, The Australian Financial Review.

33. Commonwealth of Australia 2010, *Australia's Future Tax System – Report to the Treasurer*, Part Two Detailed Analysis, Canberra, p.286.

Moreover, GST compliance is costly especially for small business. While there has been no study on the cost of GST compliance in Australia, a US study on the VAT system indicates that small businesses with sales under US$50,000 face a cost of compliance of 2 per cent of annual sales, compared with 0.04 per cent for businesses with sales over US$1mn. In 2007-08, approximately 2.6 million entities were registered for GST, of which nearly 2 million lodged a Business Activity Statement (BAS). Of those taxpayers that had a net GST liability, less than one thousand were responsible for 40 per cent of ATO GST liabilities. Almost one million taxpayers had a positive GST liability of less than $10,000. This suggests that a large number of very small businesses bear the compliance costs of GST, while contributing very little to overall revenue collection.

ACCI is disappointed that the GST reform was excluded from the Henry Review's terms of reference which constrained the possibility of an ambitious and meaningful tax reform agenda.

> "It is important to ensure that any increases in the GST rate or base are not used to increase government revenue"

Therefore, ACCI argues that GST reform, either broadening the base or increasing the rate, should be canvassed in future Government's tax reform agenda, including the proposed 2011 taxation summit. However, it is important to ensure that any increases in the GST rate or base are not used to increase government revenue. Instead, greater reliance on consumption-based taxes should be debated in the context of providing for further significant reductions in personal income taxes and to allow the elimination of inefficient State taxes, such as payroll tax and stamp duties on business and other transactions.

3.1.9 Reforming State Taxation

The ability of States and Territories to raise adequate levels of revenue in order to meet service obligations is the central issue surrounding delegation of powers and Vertical Fiscal Imbalance (VFI). VFI is the difference between States and Territories' ability to raise revenue and its obligation to provide services. In 2006-07, the federal government transferred approximately $68 billion to the States and Territories in the form of GST revenue and specific purpose payments (SPPs), accounting for around 45 per cent of total state revenue. A recent publication noted that Australian States' own-source revenue accounted for approximately 40 per cent of own-purpose outlays[34].

34. Neil Warren (2006), Benchmarking *Australia's Intergovernmental Fiscal Arrangements*, Final Report, p. xxii.

The significant difference between State and Local Government taxing and spending powers creates a number of problems, including:

- The States have reduced accountability to electorates in relation to taxes. For example, the Australian Government is held accountable for the GST even though all the GST revenue goes to the States;
- There is reduced competitive pressures between States to cut taxes; and
- The States rely on inefficient taxes such as stamp duties, with limited ability for States to switch to more efficient taxes.

ACCI strongly advocates tax reform to restructure the most inefficient remaining State taxes. In particular, ACCI is calling for:

- The abolition of all taxes included in the *1999 Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*, including stamp duties on business conveyances;
- The reform of fire service levies so that they are based on property values and apply to all property; and
- Major reductions in payroll taxes as a step towards their eventual abolition.

Australia's tax structure should reflect and support the jurisdictional and spending powers and responsibilities Australians want from their different levels of government. The current Commonwealth-State responsibilities mean that the States are financially dependent on the Commonwealth to deliver their services. Such is the extent of dependence that it also limits the opportunity for the States to deliver meaningful taxation reform and abolish their most inefficient State taxes.

Further taxation reform therefore necessitates Commonwealth and State taxation systems being reviewed collectively. Central to this review would be to address the VFI. Moreover, we consider the allocation of responsibilities between State and Commonwealth government is critical to solving the VFI problem.

ACCI considers that State Governments should also undertake significant spending reductions to minimise this problem. In particular, the allocation or contracting out of functions to the private sector makes issues of federalism less relevant.

However, if this imbalance remains a concern, then the allocation of some taxing powers from the Commonwealth to State Governments may be worth examining, but only on the basis that this does not increase the total business tax burden.

In addition, States and Local Governments receive significant funding from the Commonwealth Government. This funding is allocated by a formula, called Horizontal Fiscal Equalisation (HFE), which attempts to redress any disadvantages that particular jurisdictions have in taxing or providing a standard level of service. Significant concerns have been raised over this formula, including:

- It is extremely complex and hard to understand;
- It may create perverse incentives, encouraging State Governments to 'game' the system; and
- It may not promote efficiency.

To address these concerns, ACCI considers the allocation formula should be reviewed in detail by the Productivity Commission.

3.1.10 Tax Compliance and Complexity

Raising revenue to fund government outlays must be done as efficiently as possible since inefficient collection and administration of taxes distort efficient decision making by taxpayers.

The Australian tax system is overly complex. The current income tax law extends to almost 6,000 pages, despite the repeal of more than 4,100 pages of inoperative income and other tax law in 2006[35]. Excessive levels of complexity in the taxation system impede the ability of taxpayers to make optimal decisions. More importantly, complexity tends to have the greatest impact on those with the least capacity to deal with it. It is widely acknowledged that compliance costs have a proportionately greater burden on small businesses than on larger businesses and these costs have been increasing over time. Resources devoted to comply with the complex taxation system could be channelled to more productive activities.

ACCI's *Tax Reform Blueprint* highlighted the cost of tax compliance and complexity in State taxation as two of the top five tax issues. It drew attention to the ad hoc manner in which state taxes are applied — 'with different rates, exemptions and definitions applying in different States to economically identical transactions and assets' — and the increased compliance costs that result for businesses operating across multiple jurisdictions. *ACCI Survey of Investor Confidence* and *ACCI Small Business Survey* continued to show that business tax is consistently identified as a major impediment to business investment.

3.1.11 Taxation and Compliance Burden for SMEs

The 2009 PricewaterhouseCoopers (PWC) report on *Small Medium Enterprises Total Tax Contribution Report* commissioned by the Department of Treasury has found that the impact of Australian taxation system differs significantly between small and medium sized enterprises[36] (SMEs) and larger businesses, with SMEs facing higher tax rates and compliance costs. The study found that:

- Payroll tax was a significant impost on SMEs, constituting 22 per cent of all taxes borne, compared with 8 per cent for larger businesses;
- In addition to taxes borne directly, SMEs also have a substantial obligation to collect a range of taxes, such as the pay-as-you-go (PAYG) withholding tax and the GST, from employees and customers on behalf of various governments. For every dollar of taxes borne by the SME, total taxes collected on behalf of governments were $1.29;
- The average employment taxes borne and collected per employee, including the payroll tax, fringe benefits tax (FBT) and PAYG withholding tax collected from employees, was $36,288 for the SME sample in the study;
- The average *Compliance Tax Rate Equivalent*, which measures the percentage of profit that is consumed by tax compliance costs, was 12.9 per cent for SMEs compared with 3.8 per cent for large business sample;
- There is an inverse correlation between business turnover and the *Compliance Tax Rate Equivalent*, whereby the smaller the businesses, the larger the *Compliance Tax Rate Equivalent*; and
- The average tax compliance costs for the SME sample in the study was $71,053.

3.1.12 Policy Recommendations

In order to promote the Australian services sector's competitiveness, the following are ACCI proposals:

Recommendation 1: The Government should continue to pursue the personal income tax reform agenda, and in particular, lower the top marginal tax rate to reduce the differential between personal income tax rates and company tax rates.

Recommendation 2: The Government should allow depreciating assets costing less than $10,000 to be immediately written-off for small businesses as suggested in the Henry Review.

35. Commonwealth of Australia 2010, *Australia's Future Tax System – Report to the Treasurer*, Part Two Detailed Analysis, Canberra, p. 651.

36. SMEs in the PWC report are defined as businesses with turnover of less than $100 million.

Recommendation 3: The Government should allow companies to carry back a revenue loss to offset it against the prior years' taxable income. This mechanism can act as an automatic stabiliser during an economic downturn and provide much needed cash flow relief to businesses.

Recommendation 4: The Government should retain the four current small business capital gains tax concessions, i.e. the small business 15-year exemption, small business active business assets reduction, small business retirement exemption and small business rollover concessions. Further examination also needs to consider how to reduce the impost of CGT and its detrimental impact on investment and risk taking.

Recommendation 5: Proper consideration should be given to the introduction of a stepped rate CGT with diminishing rates of tax applying to longer held assets upon their disposals.

Recommendation 6: Conduct a comprehensive cost benefit analysis and undertake a regulatory impact statement to justify the proposed reforms recommended by the Board of Taxation on the personal services income tax rules.

Recommendation 7: The proposal to increase the rate of GST or broadening of the GST in order to reduce personal income tax rate and abolish inefficient state taxes should be the subject of a national taxation debate. Nonetheless, ACCI considers that an arbitrary increase in the rate of GST or broadening of GST should only be considered in a comprehensive tax reform package.

Recommendation 8: Beyond the GST reforms, state taxation reforms should remain in COAG's business deregulation objectives through:

- Harmonisation of tax bases and administrative practices across the states, particularly in relation to payroll tax, to reduce compliance costs;
- Abolition of payroll tax in the long run;
- Simplification of complicated tax rate scales to a single rate structure where possible; and
- Abolition of stamp-duties on business conveyances.

Recommendation 9: Reduce complexity of tax legislation, streamlining tax administrations and minimising compliance burden of taxpayers, particularly by better measurement of the regulatory costs of all tax measures (legislative and non-legislative).

3.2 Regulation and Services

Regulation is pervasive in modern societies. However, well targeted and designed regulation can generate significant benefits – delivering economic, social and environmental outcomes that may not have been achieved through a *laissez-faire* system. However, some of this regulatory burden may be unnecessary to achieve the outcome desired by government. This arises when regulation is overly complex, redundant, and duplicates the regulation of other jurisdictions or other regulatory bodies.

Unnecessary or poorly formulated and implemented regulation can expose business in services industries to excessive compliance costs, stifle market competition and distort resource allocation in the economy. Thus to ensure that regulation delivers the greatest net benefit to the economy, it needs to be properly justified, and well designed to avoid imposing unnecessary red-tape burden.

> "The services sector is heavily regulated especially in construction, distributive trade, and economic infrastructure and social services"

The services sector is heavily regulated especially in construction, distributive trade, and economic infrastructure and social services. Amongst the reasons for a heavy regulatory presence in the services sector are:

- There is an information asymmetry between services providers and consumers;
- Some services recipients are seen as vulnerable and requiring protection;
- Regulation is used to promote competition where natural monopolies exist, e.g. telecommunications and energy; and
- Many services enterprises operate across different jurisdictions.

Significant productivity gains have been made since the 1980s from regulatory reforms, directed at:

- Sharpening incentives to be more productive through increasing competition from domestic and overseas sources;
- Opening the domestic economy to trade, investment and technologies from overseas; and
- Providing greater flexibility e.g. more flexible labour market to adjust production processes and business operations to improve productive capabilities.

These reforms included deregulation of access to finance, floating the Australian dollar, establishing the independence of the Reserve Bank of Australia, marked reductions in trade barriers and restrictions on foreign direct investment, commercialisation and privatisation of government business enterprises, and increasing labour market flexibility[37].

Studies have found a positive link between Australia's structural reforms and productivity growth. Relative to the rates in the 1980s, microeconomic reforms during the 1990s including deregulation initiatives, have lifted Australia's trend total factor productivity by between 0.5 and 0.9 percentage points in the aggregate level during the 1990s productivity boom cycle[38].

However, more regulatory reforms are needed to further improve Australia's economic efficiency and productivity, especially in the services sector.

There are needs to examine the stock of existing regulation, the growth of new regulation and the associated compliance costs. According to the Productivity Commission, the compliance costs of regulation are significant and could be as high as 4 per cent of GDP per annum – up to $35 billion in 2005-06[39].

Regulation is also rarely reviewed. Instead in many circumstances ineffective regulation continues to be applied, reducing business flexibility, decision-making ability, investment, innovation, competitiveness, and productivity. While ineffective and overly intrusive regulation is an obvious problem, initially good regulation, in a dynamic market economy, can also evolve into stifling regulation. Clearly all regulation must be reviewed on a regular basis.

Developing effective processes for introducing regulation will significantly reduce the overall cost of regulation to the Australian economy. Implementing an agreed and transparent regulatory framework will ensure more considered and careful regulation. It will provide a barrier against knee jerk and reactionary legislation.

Action must also be taken to review, revise and reduce existing legislation.

3.2.1 What Businesses Tell Us

ACCI's triennial *Pre-Election Survey* provides a qualitative gauge of the effect that regulation has upon the business community. The complexity of government regulations and the cost of compliance with the regulatory burden head the list of concerns of Australian business in dealing with red-tape burden imposed by government.

In 2010, 86 per cent of Australian businesses expressed major or moderate concern at the complexity of government regulations, with 82 per cent complaining about the costs of compliance with government regulations. Penalties for failure to comply with government regulations attracted criticism, where the combined major plus moderate concern was 74 per cent. 68 per cent of respondents were concerned about the burden of compliance with health and safety regulations.

Compliance with environmental regulations was seen as a major or moderate problem by 59 per cent of businesses, followed by workplace occupational health and safety inspections (56 per cent), compliance with privacy requirements (47 per cent), corporations law requirement (44 per cent)and administration of the competition law – the *Trade Practices Act* (43 per cent).

Figure 3-1 shows that businesses have become increasingly concerned about the complexity and compliance with government regulations and requirements since the survey began in 2004.

The 2010 *ACCI Pre-Election Survey* also found taxation compliance is a particularly acute burden for small businesses, with 53 per cent of respondents describing overall complexity of the tax system as major concern for their business. The figure for large firms was 47 per cent.

At the same time, 48 per cent of small firms have major concern on the frequency of changes to tax laws and rules, compared to 37 per cent of large businesses.

Labour regulations and on-costs, rather than labour costs, dominate the concerns of Australian employers. The dominant issues of concern are the cost of worker compensation, transition to new industrial awards, and complying with Fair Work laws.

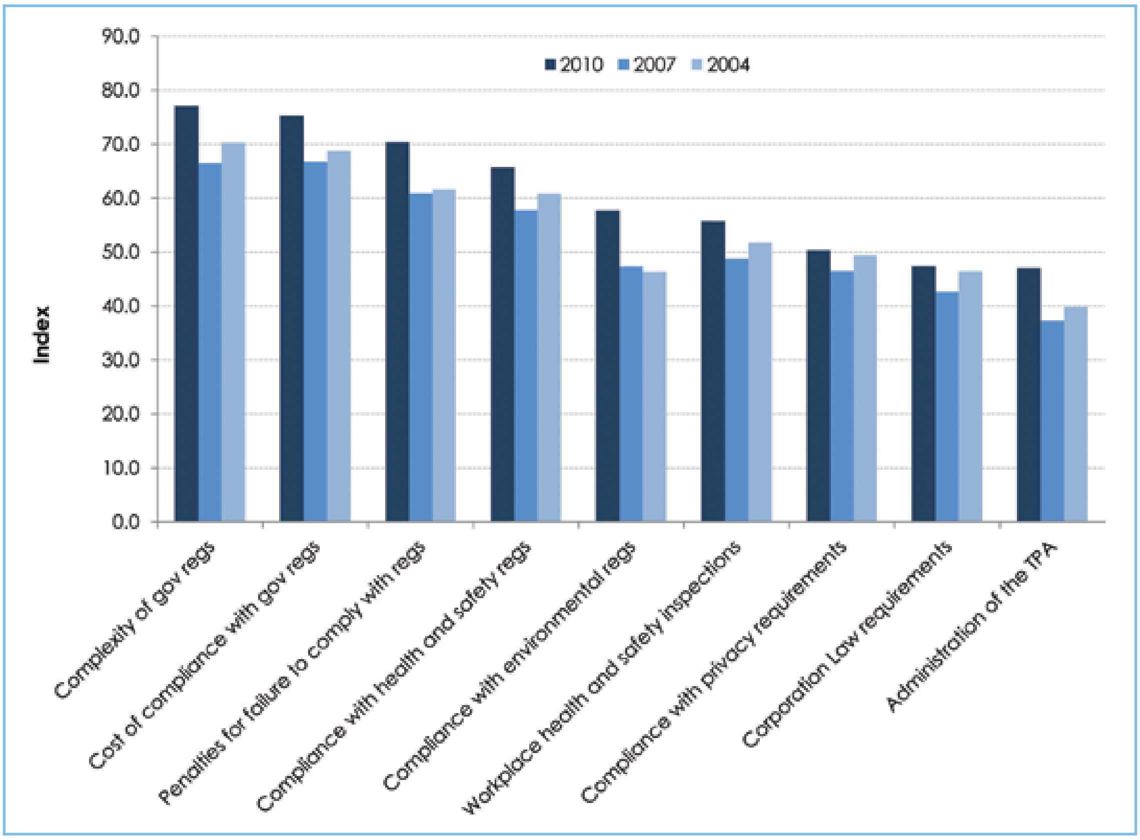
Government regulation, particularly federal and state, consistently rates in the *ACCI Survey of Investor Confidence* top ten out of the twenty major constraints to business investment in plant and equipment. In general, businesses are more likely to indicate that state government regulation is a major constraint on regulation followed by federal and local government regulation, as demonstrated by Figure 3-2.

37. Parham, D. 2003, *Australia's 1990s Productivity Surge and its Determinants*, in Ito, T. and Rose, A. (eds.) *Productivity and Growth*, East Asia Seminar on Economics, vol. 13, University of Chicago Press, Chicago.

38. Salgado, R. 2000, *Australia: Productivity Growth and Structural Reform*, in Australia: Selected Issues and Statistical Appendix, IMF Country Staff Report 00/24, p. 3-35.

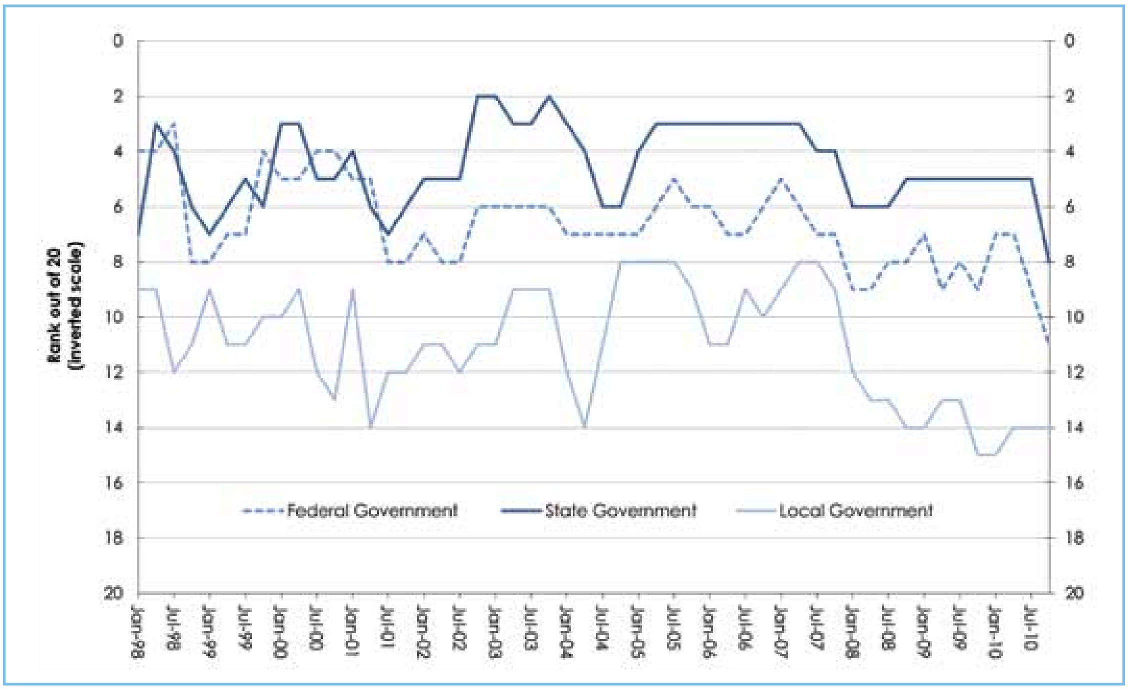
39. PC 2006, *Potential Benefits of the National Reform Agenda*, Report to the COAG, Canberra.

Figure 3-1: Government regulation, 2004-2010



Source: ACCI Pre-Election Survey, 2004, 2007 and 2010.

Figure 3-2: Regulation as a major constraint to business investment



Source: ACCI Survey of Investor Confidence, October 2010, trend data.

The *Red Tape Survey 2009* undertaken by the New South Wales Business Chamber is designed to quantify the hidden costs of regulations and understand the regulatory burdens faced by businesses. The survey found that:

> "Over one-half (52.1%) of respondents believe that complying with government regulatory requirements has a moderate to major impact on their business. Majority (62.0%) are spending between 1 and 10 hours per week complying with regulatory requirements and some more than 20 hours per week.
>
> In the last two years, around three-quarters of the businesses surveyed have noticed an increase in the cost of compliance and the time it takes to comply with regulatory requirements. This figure has not changed since the 2008 survey.
>
> Almost one-half (46.5%) of businesses consider that there is an opportunity to streamline reporting and reduce its on business operations.
>
> Key contributors to red tape are growth in the volume of regulation and the frequency of reporting requirements. Over one-fifth (21.8%) of surveyed businesses highlighted that reducing the frequency of reporting requirements would have the greatest impact in reducing the cost of compliance."[40]

Figure 3-3 shows that while fewer businesses spent more than 20 hours complying with regulatory requirement in 2009 compared with 2008 (10.9 per cent vs. 20 per cent), 62 per cent of businesses spent between 1 and 10 hours in regulatory compliance in 2009, compared with 56 per cent a year earlier.

Figure 3-4 indicates that the most costly stage of compliance is in preparing the information required (more than 50 per cent of respondents). The second most costly stage is understanding the obligations of compliance. It is alarming to see that the percentage of respondents rating *Understanding the Compliance Obligation* as the most costly stage of compliance has increased from 26.7 per cent in 2008 to 34.4 per cent in 2009.

3.2.2 Concern about Australia's Regulatory Development

Regulation not only includes the 'black-letter law' of legislation, statutory instruments and by-laws, but also 'quasi-regulation' and government instruments such as industry codes of conduct and mandatory rules. All of these regulations impose significant obligations and costs on business.

According to the Productivity Commission (PC):

> "…Between 2000 and 2004, <u>as many pages of Commonwealth Government legislation were passed as during the period 1901 to 1969</u>. This growth has added to the already 'large' stock of existing regulation. The Regulation Taskforce noted that there are more than 1500 commonwealth Acts of Parliament and around 1000 statutory rules in force, as well as unknown quantity of Commonwealth 'subordinate' legislation. This is in addition to State and local government regulation."[Emphasis added].[41]

The recent PC (2008) report on *Performance Benchmarking of Australian Business Regulation: Quality and Quantity* showed that despite significant differences across jurisdictions in the processes of developing and reviewing regulations, some commonality emerged:

- There are few mandatory requirements for consultation on regulatory proposals. Only Western Australia and COAG require stakeholder consultation for all types of proposals;
- The proportion of regulatory proposals actually subjected to regulatory impact analysis or compliance cost estimation is generally low. For example, in 2006-07, only 21 per cent of new Commonwealth Bills and 9 per cent of Victorian Bills were subject to analysis, while no information was available for new regulations proposed in New South Wales. Moreover, only the Commonwealth, Tasmania and Queensland require regulatory analysis to be made public;
- Few jurisdictions enable business to interact with regulatory bodies online. For example, few have facilities for online lodgement of forms, renewal of licences, and payment of fees and charges; and
- Few regulators will allow a business licensed in another jurisdiction to operate in their jurisdiction without obtaining a separate licence.

The Australian Government and COAG have endeavoured to improve the quality of regulation through the undertaking of a regulatory impact analysis.

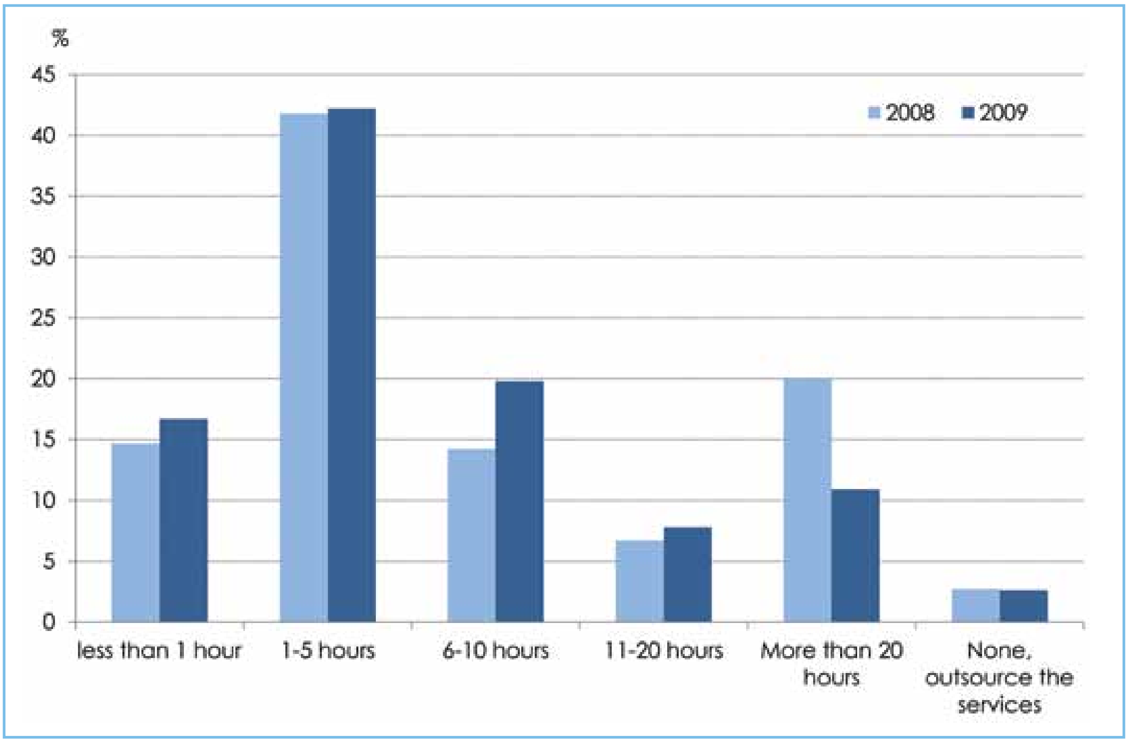
The Australian Government requires a Regulation Impact Statement (RIS) for Commonwealth regulatory proposals '*that are likely to have a significant impact on businesses and individuals or the economy*'.

Similarly, COAG requires a RIS for regulatory proposals put forward by ministerial councils and national standard-setting bodies that '*would encourage or force businesses or individuals to pursue their interests in ways they would not otherwise have done*'.

40. NSW Business Chamber 2009, *Red Tape Survey*, December 2009, p.3.

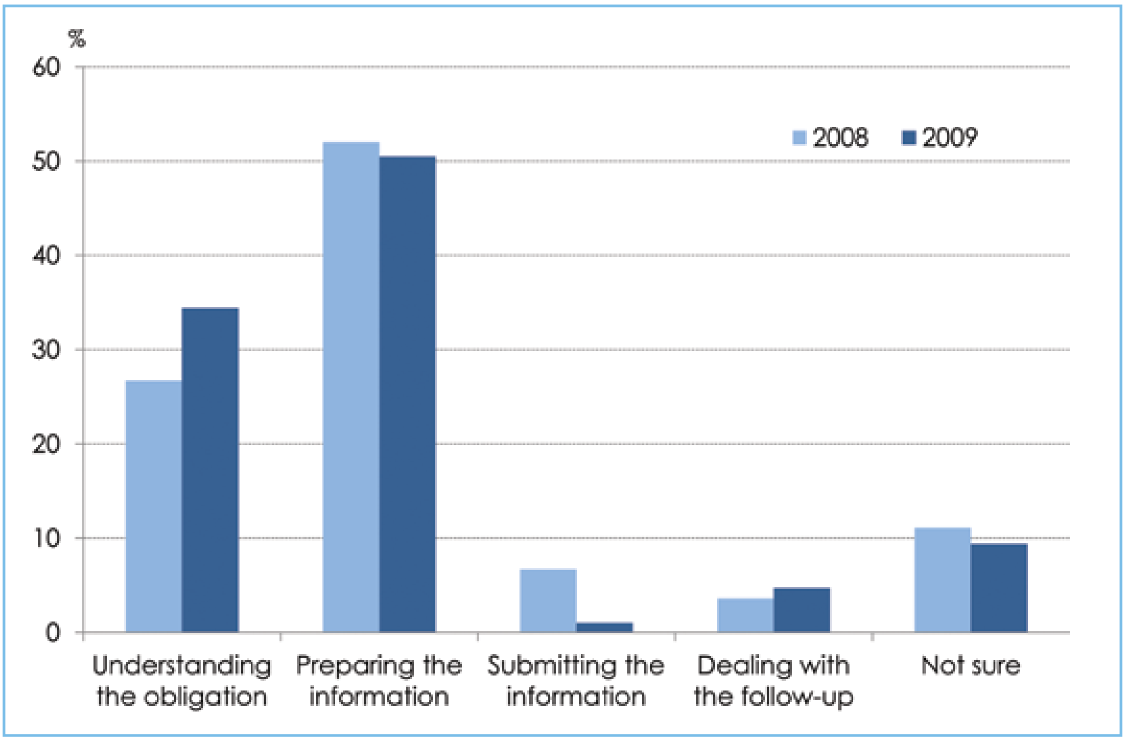
41. Op. cit., p. 136.

Figure 3-3: Time spent per week on compliance with regulatory requirements



Source: NSW Business Chamber Red Tape Survey 2008, 2009.

Figure 3-4: Most costly stage of compliance



Source: NSW Business Chamber Red Tape Survey 2008, 2009.

A RIS identifies the problem the regulation seeks to address, outlines the objectives of government action, and assesses the impacts of a range of feasible options for addressing the problem. The RIS then documents community consultation, proposes a recommended option and outlines implementation and review mechanisms. A well designed and implemented RIS process can improve the quality of new regulations.

"Service businesses continue to express concern and disappointment with RIS processes. They are often less than adequate and comprehensive"

Notwithstanding recent commitment by the Australian Government and COAG to enhance and strengthen their respective RIS processes, service businesses continue to express concern and disappointment with RIS processes. They are often less than adequate and comprehensive, even for major policy proposals, do not allow adequate consultation with stakeholders, and RIS documents are neither readily available nor easily accessible.

The vast majority of Commonwealth regulations recently tabled by the Australian Government underwent no more than a preliminary self-assessment by the departments and agencies responsible for the regulation. In 2007-08, only around 2 per cent of regulatory proposals tabled required a regulatory impact analysis[42].

For regulatory proposals tabled by the Australian Government in 2008-09, of the 59 RISs required at the decision making stage, 6 cases were granted 'exceptional circumstances' by the Prime Minister, i.e. a RIS was not required but a post-implementation review will be required within one to two years of the regulation being implemented. Consequently, for the 53 decisions requiring a RIS, 45 RISs were prepared and assessed as adequate, giving a compliance rate of 85 per cent.

Table 3-4 indicates that RIS compliance at the decision making stage fell from 94 per cent in 2006-07 to 85 per cent in 2008-09, while the publication of RISs (i.e. transparency stage) fell from 94 per cent in 2006-07 to 84 per cent in 2008-09.

In 2008-09, eight proposals proceeded to the decision makers without the support of an adequate RIS, including the proposal that requires unit pricing by grocery retailers, and the proposal that expands the Renewable Energy Target from 9500 GWh to 45000 GWH by 2020.

In late 2008 the Office of Best Practice Regulation (OBPR), in consultation with the COAG secretariat, aligned the reporting period for COAG with that of the Australian Government. Compliance with the COAG best practice regulation requirements fell at the consultation stage from 96 per cent in 2007-08 to 88 per cent in 2008 09. However, at the decision-making stage, compliance increased from 93 per cent in 2007-08 to 96 per cent in 2008-09.

As part of good regulatory design, it is important for government to regularly review the existing stock of regulations to ensure that they remain relevant and effective over time. All governments have committed to annually reviewing existing regulation with a view to encouraging competition and efficiency, streamlining the regulatory environment and reducing the regulatory burden on businesses arising from the stock of regulation.

Table 3-4: Regulatory impact analysis compliance, 2006-07 to 2008-09

Stage	Type of RIA	2006-07 ratio[a]	Per cent	2007-08 ratio[a]	Per cent	2008-09 ratio[a]	Per cent
Decision making stage	RISs	15/16	94	43/48	90	45/53	85
	BCC reports	2/2	100	7/7	100	4/4	100
Transparency stage[b]	RISs	15/16	94	41/45	91	41/49	84
	BCC reports	2/2	100	6/7	86	4/4	100
Exceptional circumstances		2		3		6	

Note: [a] Ratio of adequate RISs and Business Cost Calculator (BCC) reports to the total number of RISs and BCC reports required. [b] The number of RISs required at the transparency stage is lower than at decision making stage because some regulations were subject to multiple decision-making processes.

Source: OBPR 2009, *Best Practice Regulation Report 2008-09*, p.15.

42. Office of Best Practice Regulation (OPBR) 2008, *Best Practice Regulation Report 2007-08*, p.15.

However, it is disappointing to note that none of the jurisdictions reported that sunset provisions were required in new primary legislation during 2006-07[43].

3.2.3 Regulatory Compliance Costs

Regulation imposes compliance costs on services sector business by requiring them to undertake activities and provide information to government and third parties. Compliance costs incurred by business often exceed the level necessary to achieve the policy objectives. Excessive compliance costs can often arise due to:

- An unnecessarily high frequency of reporting or providing similar information to a number of government organisations or levels of government;
- Overlaps and inconsistencies between jurisdictions;
- Inconsistencies in definitions and criteria; and
- Regulation that is redundant or not justified by policy intent.

While regulations apply throughout the economy, there are specific reasons why small services businesses suffer disproportionate regulatory costs. These include:

- Regulatory cost makes up a large proportion of overhead costs and net margin. At the firm level it often implies a direct reduction in profitability and retained earnings. This may affect investments and the return to shareholders;
- The nature of the compliance cost. Administrative costs tend to be fixed, so that changes in sales have no effect on the costs in the short-run. In other words, if sales go down but the costs remain unchanged this causes the break-even point to be raised; and
- Diversion of entrepreneurial attention. In small companies the owner, senior manager or director has to deal with the paperwork while they instead could focus their attention on business management.

As part of an international study, OECD estimated that Australian compliance costs for small and medium enterprises (SMEs) – covering tax, employment and environmental regulation to be approximately $17 billion (2.9 per cent of GDP) in 1998[44].

The report also noted the overall detrimental effect of regulation on business:

> "The cumulative effect of regulations from multiple institutions and jurisdictions is to slow down business responsiveness, divert resources away from productive investments, hamper entry into markets, reduce innovation and job creation, and generally discourage entrepreneurship".

A survey commissioned by the Small Business Taskforce reported that the compliance costs for average small businesses in 1996 were measured to be approximately $7,000 per year, covering local, State and Commonwealth Government regulations. The survey also suggested that approximately $3,000 per year was spent on external consultants[45].

3.2.4 COAG Reform Agenda

In 2008-09, COAG agreed to a *National Partnership Agreement to Deliver a Seamless National Economy*. The agreement seeks to improve Australia's productivity by reducing the cost and removing regulatory barriers to doing business across jurisdictional borders.

The agreement commits the Commonwealth to provide the states and territories with up to $550 million over five years to facilitate and reward the delivery of 27 priority reforms:

- National harmonisation of occupational health and safety laws is seen as a priority; with commitment to harmonisation reflected in a commitment to develop model legislation by September 2009;
- Early action in 2008 on a further 12 areas, covering environmental assessment and approvals process, payroll tax administration, trade licences, the Health Workforce Intergovernmental Agreement, national trade measurement, rail safety regulation reform, the consumer policy framework, product safety, trustee companies, mortgage credit and advice, margin lending, and non-deposit taking institutions;
- Significant progress to be made in accelerating the five remaining COAG hotspots – development assistance, building regulation, chemicals and plastics regulatory reform, Australian Business Number and business names registration, and Personal Property Securities reform; and
- Nine new areas to be added to COAG's regulation work program, covering standard business reporting, food regulation, a national mine safety framework, electronic conveyancing, upstream petroleum (oil and gas), maritime safety, wine labelling, directors' liabilities, and financial service delivery.

43. PC 2008, *Performance Benchmarking of Australian Business Regulation: Quantity and Quality*, Research Report, Canberra, p. 55.

44. OECD 2001, *Businesses' Views on Red Tape – Administrative and Regulatory Burdens on Small and Medium-Sized Enterprises*, OECD, Paris.

45. PC 2006, *Potential Benefits of the National Reform Agenda*, Report to the COAG, Canberra, p.147.

Reward payments to the states and territories are contingent upon jurisdictions meeting the key milestones set out in the agreement's implementation plan.

In the following sub-sections, we will discuss some of the COAG reform initiatives that could improve services sector performance.

3.2.4.1 Standard Business Reporting

The objective of standard business reporting is to reduce the reporting burden on businesses by streamlining and standardising government financial reporting requirements.

Led by the Australian Treasury, the agencies participating in SBR are the Australian Bureau of Statistics, Australian Prudential Regulation Authority, Australian Securities and Investments Commission (ASIC), Australian Taxation Office and all state and territory government revenue offices.

Once fully implemented the SBR is estimated to save Australian business $800 million per annum on an ongoing basis. SBR will reduce the regulatory reporting burden for business by:

- Removing unnecessary and duplicated information from government forms. The 9,648 information fields currently collected could be reduced to 2,838, a reduction of over 70 per cent in the number of data fields requested;
- Utilising business software to automatically pre-fill government forms;
- Adopting a common reporting language, based on international standards and best practice;
- Making financial reporting to government a by –product of natural business processes;
- Providing an electronic interface to enable business to report to government agencies directly from their accounting software, which will provide validation and conform receipt of reports; and
- Providing business with a single secure online sign-on to the agencies involved.

ACCI welcomes the commencement of SBR, which the government delivered within the scheduled time frame, on 1 July 2010. SBR now offers the opportunity of significant cost savings for business as the processes for dealing with government reporting requirements are streamlined.

SBR will not only assist a range of Australian services businesses but also accountants, tax agents and bookkeepers which will lower costs and improve efficiency. The greatest uptake of SBR by business will relate to Business Activity Statements, Tax File Number Declarations, PAYG, and payroll tax returns.

3.2.4.2 National System for Business Names Registration

The objective of this reform is to simplify business name registration by setting up a single, national system for business names registration.

Currently, each State and Territory maintains a business names register on which businesses that are sole traders, partnerships or trusts and do not trade under their own entity name, must register their name if they are to trade in the relevant State or Territory.

Companies registered with ASIC can conduct business throughout Australia without registering their business name in individual States and Territories. However, such companies are required to register a business name if they intend to trade under a name other than the registered company name.

Services businesses trading in more than one jurisdiction must register their business name separately in each jurisdiction.

Approximately 600,000 Australian Business Numbers (ABN)[46] and 250,000 business names are registered each year, making them the most common registrations required when starting a business.

Therefore, ACCI welcomes the COAG reform initiative to establish a national business name registration system that will allow businesses in the services sector to register for business names and an ABN in one transaction. The system will also deliver online business information services and improve ongoing interactions between government and businesses. This initiative will significantly reduce businesses' time and cost of compliance and further encourage entrepreneurial activity.

The Australian Government has provided $125.2 million over four years from 2010-11 for the Australian Business Number Business Names Registration Project, which is expected to commence in 2011. However, ACCI notes the COAG Reform Council's concern that the lack of a firm timeframe for the completion of a memorandum of understanding on collaboration by governments on the project may lead to future delays.

3.2.4.3 National Trade Licencing System

Licensing in many occupational and professional areas is undertaken by the States and Territories. Licensing systems have developed in different ways in each jurisdiction and, depending on the jurisdiction and occupation in question,

46. The ABN is single identifier for all business dealings with the ATO and for dealings with other government departments and agencies.

licensing may be focused on different objectives, including consumer protection, occupational health and safety or public safety. Licences issued for the same occupation by jurisdictions often have different eligibility requirements and scopes of work covered. There is also varying licence nomenclature, duration, licence structures and fee structures.

These separate licencing systems are a barrier to labour mobility especially in the construction services industry and will further exacerbate the problem of skills shortages in the resource states.

Thus, ACCI welcomes the COAG commitment to establish a national trade licensing system. The National Licensing System will be implemented in a phased approach, with:

- The first tranche of occupations—electrical, air conditioning and refrigeration, plumbing, gas fitting and property services—to be included by 1 July 2012; and
- The second tranche of occupations—building and building-related occupations, land transport (passenger vehicles and dangerous goods), maritime occupations, conveyancers and valuers—to be included by 1 July 2013.

However, ACCI is concerned that the *Intergovernmental Agreement for a National Licensing System for Specified Occupations* signed at the COAG on 30 April 2009 did not make provisions for the allocation of licence fees to the States and Territories. Therefore, potential difficulties in resolving the financial implications and allocation of fees in the national licensing system could contribute to a delay in the national system implementation.

3.2.4.4 Rationalisation of Occupational Licences

According to the Productivity Commission's 2008 Review of *Australia's Consumer Policy Framework*, there are currently several hundred State and Territory laws covering a range of activities including home building, retail energy supply, credit providers, vehicle sales, retirement villages, travel agents, pawnbrokers and second-hand dealers, and various professional occupations[47].

For the most part, this legislation is administered by fair trading authorities, but there are also industry specific regulators in many areas. Different occupational licences are provided for all of these occupations, imposing a range of conditions on service providers, such as:

- Educational and professional qualification requirements;
- Restrictions on the activities which a licensed provider can undertake;
- Proscribed forms of conduct; and
- Sanctions for non-compliance with any or all of these requirements.

While occupational licences can assist to overcome the problem of information asymmetries between service providers and users in some industries by imposing standards of behaviour on service providers, such benefits are not apparent in all regulated occupations.

In some cases, there are anti-competitive effects of occupational licensing as they form a barrier to market entry or imply a standard of services that is not delivered.

Moreover, occupational licensing mainly applies to small business operators. The removal of unnecessary licensing requirements could reduce red tape burden and provide savings to small businesses in the services sector.

Therefore, ACCI supports COAG's commitment to rationalise the number of occupational licenses in operation with particular reference to those occupations which are only licensed in one or two jurisdictions. However businesses are concerned that the milestone for COAG to agree options for occupational licensing reform was not completed within the reporting period[48].

3.2.5 Policy Recommendations

Effective regulatory reform can significantly improve government performance and desired social and economic outcomes.

However, justified, poorly designed and/or implemented regulation can unnecessarily increase costs and prices and hence reduce consumer choice, impede entrepreneurship, innovation and stifle productivity growth. While these costs are not explicit, they nevertheless indirectly affect service providers and consumers and thus affect economic efficiency (allocative, technical and dynamic efficiency[49]), investment decisions and opportunities for growth.

47. COAG Reform Council 2010, *National Partnership Agreement to Deliver a Seamless National Economy: Report on Performance 2008-09*, Sydney, p. 281.

48. Ibid, p. 288.

49. Allocative efficiency is the extent to which resources are used in way that maximise community wellbeing; technical efficiency is the extent to which goods and services are produced with the minimum required inputs; and *dynamic* efficiency is the extent to which limited resources can be used to produce more output over time and the extent to which production can be altered effectively and at a minimum cost in response to changes in economic conditions.

Ideally business related regulation should be carefully formulated, open to all stakeholders for consultation, elicit the most cost effective intervention from policymakers and include provisions for reviewing past regulations.

In order to achieve a situation where regulations are minimal and yet effective, ACCI recommends that:

Recommendation 10: The program of reform should proceed on the assumption that regulation may not be the most appropriate way in which to address issues of concern to the Government. It should be the last resort after all other options (education, publicity, industry self-regulation and other approaches) have been fully assessed and judged to be ineffective.

Recommendation 11: Policymakers should ensure that the regulatory decision-making process is transparent, leads to fair outcomes and involves consultation processes that are accessible and responsive to business and the community.

Recommendation 12: A new regulatory culture should be adopted to understand business processes and the burden created by regulatory compliance. There should be a commitment to provide a 'business friendly' operating environment.

Recommendation 13: No new business regulation should be contemplated without a thorough and independent cost benefit analysis (including the full cost of the proposed regulation to business) and no regulation should be introduced without full consultation with the business sector. The cost benefit analysis should be in the form of a *Regulation Impact Statement (RIS)* which assesses the total cost to business of compliance, fees and paperwork and compares this total cost to business with the estimated benefits of the proposed regulation. The process and the result should be made public.

Recommendation 14: The Australian Government should improve the transparency and accountability of its best practice regulation assessment processes by:

- Developing a central register of regulatory impact analysis;
- Ensuring the RIS is publically available at the time the regulation reaches the decision making stage;
- Providing greater scope for detailed consultation with stakeholders; and
- Incorporating a 'consultation' RIS in the regulation making process for use in public consultations where possible.

Recommendation 15: The Australian Government should commission an independent public review of its best practice regulation requirements no later than five years after the requirements come into effect.

Recommendation 16: Automatic revocation (through 'sunset clauses') should apply to all subordinate legislation after a period not exceeding 10 years and earlier if triggered by an appeal process. A RIS should apply to any attempt to renew 'sunset' regulation. Independent reviews of Acts of Parliament embodying business regulation (and associated programs) should be carried out at least every 10 years.

Recommendation 17: Implementation milestones for COAG's reform agenda should be clearly defined and subjected to regular review by the COAG Reform Council. The 27 reform hotspots identified under the National Partnership Agreement to Deliver a Seamless National Economy should proceed without further delay.

Recommendation 18: Conflicts, inconsistent rulings and overlaps between regulation and regulatory systems of different levels of government should be identified and addressed. Similarly, differing interpretations of national regulations by different State or Territory agencies must be addressed.

Recommendation 19: Similar to the Standard Business Reporting, all levels of government need to work cooperatively to reduce the burden associated with reporting obligations in other areas by:

- Eliminating unnecessary requests for information and reducing the frequency of requests where possible;
- With agreement from businesses, sharing information between regulators where appropriate;
- Standardising the taxonomy and forms used, and the type of data required and where possible aligning reporting obligations with existing company data gathering and reporting; and
- Facilitating on-line submissions of information.

3.3 Government Assistance and Services

The Australian Government assists Australian industries through various policy measures including selected import tariffs and restrictions, budgetary assistance, i.e. specific budgetary outlays and taxation concessions, and regulatory restrictions on competition. While government assistance typically benefits the targeted or receiving industry, it can penalise other industries, taxpayers as well as consumers.

Tariffs have direct effects on the returns received by Australian producers. In its annual report on Trade and Assistance, the Productivity Commission divides tariff assistance into three main categories:

- 'Output' assistance: Tariffs on imported goods increase the price at which those goods are sold on the Australian market and thus allow domestic producers of competing products to increase their prices;
- 'Input' assistance: Conversely, tariffs also increase the price of local and imported goods that are used as inputs and thus penalise local user industries; and
- Net assistance: Effective tariff assistance provided to industry is calculated as output tariff assistance less the input penalty (or input assistance) imposed by tariffs.

The agriculture or primary sector received the majority of its government assistance in the form of budgetary outlays; while manufacturing sector received the majority of its assistance through import tariffs.

However for the services sector, tariffs impose input-cost penalties which significantly exceed their measured budgetary assistance and thus the services sector receives negative net government assistance overall.

In 2008-09, the gross value of tariff assistance to domestic production was around $9.5 billion; while the estimated cost penalty on inputs to user industries arising from tariffs was estimated at around $8.1 billion, leaving an estimated $1.4 billion of net tariff assistance for the Australian economy (Table 3-5).

Although in aggregate net tariff assistance remains positive, the sectoral experience varies.

Most tariff assistance on output is directed towards the manufacturing sector and since the value of tariff assistance on outputs outweighs the cost impost of tariffs on inputs, the manufacturing sector received $6.5 billion in net tariff assistance.

"The services sector receives negative net government assistance overall"

Conversely, since tariffs are not levied on services, the services sector received a negative net tariff assistance of $4.9 billion (Table 3-5). Since 2003-04, the value of net tariff assistance for the manufacturing sector has increased by 5 per cent, reflecting the general growth in manufacturing output. At the same time, the net tariff penalty on the service sector has increased by 23 per cent to nearly $5 billion, reflecting the stronger growth of the services sector relative to the manufacturing industry.

Nonetheless, it is important to note that there has been a marked decline in measured industry assistance to the manufacturing sector over the last 35 years. According to the Productivity Commission estimates, the estimated effective rate of industry assistance for the manufacturing sector has declined from 35 per cent in 1970-71 to around 5 per cent in 2008-09, mainly due to the 25 per cent across-the-board tariff cut of 1973, the abolition of subsequent tariff quotas and the broad programs of tariff reductions that commenced in the late 1980s[50].

In 2008-09, the primary and manufacturing sector were estimated to have received 22 and 23 per cent of budgetary assistance. The services sector was the largest recipient of budgetary assistance and was estimated to have received around 45 per cent of estimated budgetary assistance. This figure was up from around 27 per cent in 2007-08 mainly due to the inclusion of various small business tax concessions, a large proportion of which primarily benefit the services sector, given 96 per cent of services businesses are small business.

Table 3-5 shows that Property and business services and Finance and insurance were two of the largest budgetary assistance recipients ($744 million and $613 million respectively), mainly through Small Business CGT concessions, the Offshore Banking Unit Tax Concession program and R&D tax concessions[51].

It is also evident from Table 3-5 that although the services sector received the most or 45 per cent of budgetary assistance, i.e. nearly $3.5 billion in identifiable support, such assistance was outweighed by the $4.9 billion in input tariff penalty, leaving a negative overall government assistance of $1.5 billion.

Moreover, ACCI notes that government's innovation policy and assistance program have traditionally focused on goods and associated production processes. However, the growing role of the services sector requires appropriate consideration for government assistance tailored specifically for services industries.

In contrast to the primary and manufacturing industries, services provision takes place at the point of interaction with the client. As there is less opportunity to improve economies of scale, services providers tend to differentiate on intangible assets and the ability to produce a customised solution. Innovation in the services sector tends to be user-driven, frequently non-technological in nature, and often occurs across the whole company as part of the day-to-day activities. Skills such as teamwork, customer services, cooperation, negotiation, and communication are an important part of services sector innovation.

Due to the complexity of supply chains and the level of goods embedded in the provision of services, an increased focus on the services sector is likely to also have flow-on benefits to the

50. PC 2010, *Trade & Assistance Review 2008-09*, Annual Report Series, Canberra, June, p. 21-22.

51. PC 2010, *Trade & Assistance Review 2008-09*, Annual Report Series, Canberra, June, p. 14.

Table 3-5: Government assistance by industry, 2008-09 $ Million (nominal)

	Tariffs			Budgetary		Net
Industry grouping	Output	Input penalty	Net tariff assistance	Outlays	Tax concessions	combined assistance
Primary production[a]	**158.8**	**-71.9**	**86.9**	**1440.0**	**228.8**	**1755.7**
Dairy cattle farming[a]	0.0	-3.8	-3.8	104.9	19.1	120.5
Grain, sheep & beef cattle farming	0.0	-23.2	-23.2	741.8	181.4	900.1
Horticulture & fruit growing	117.2	-7.4	109.9	133.8	44.5	288.1
Other crop growing	0.0	-5.0	-5.0	40.0	27.6	62.6
Other livestock farming	0.0	-1.8	-1.8	19.7	9.6	27.5
Fisheries	0.0	-15.4	-15.4	71.5	25.9	82.0
Forestry & logging	41.5	-7.4	34.1	17.3	-87.6	-36.2
Other primary production	0.0	-7.8	-7.8	14.8	8.3	15.3
Unallocated primary production	0.0	0.0	0.0	296.1	0.0	296.1
Mining	**1.4**	**-287.2**	**-285.8**	**109.3**	**310.8**	**134.3**
Manufacturing	**9374.5**	**-2844.7**	**6529.8**	**723.8**	**1041.7**	**8295.4**
Food, beverages & tobacco	1568.9	-447.8	1121.1	65.5	58.5	1245.1
Textiles, clothing, footwear & leather	636.8	-127.0	509.7	112.4	16.4	638.6
Wood & paper products	552.0	-145.8	406.2	69.5	13.7	489.5
Printing, publishing & recorded media	323.3	-132.0	191.3	5.5	7.6	204.3
Petroleum, coal, chemical & ass. products	1074.1	-304.3	769.7	140.1	52.9	962.8
Non-metallic mineral products	290.2	-79.1	211.2	8.5	14.2	233.8
Metal product manufacturing	1923.4	-513.0	1410.4	55.8	110.1	1576.3
Motor vehicles & parts	1530.6	-507.4	1023.2	24.6	548.7	1596.5
Other transport equipment	159.1	-110.8	48.3	20.7	18.9	88.0
Other machinery & equipment	885.9	-312.0	573.8	122.7	73.8	770.3
Other manufacturing	430.2	-165.4	264.7	19.9	8.6	293.2
Unallocated manufacturing				78.5	118.4	196.9
Services	**0.0**	**-4938.8**	**-4938.8**	**1181.2**	**2285.7**	**-1471.9**
Electricity, gas & water supply	0.0	-87.4	-87.4	77.5	15.7	5.8
Construction	0.0	-1574.9	-1574.9	21.7	192.6	-1360.7
Wholesale trade	0.0	-376.8	-376.8	58.6	162.3	-155.9
Retail trade	0.0	-710.2	-710.2	199.6	192.0	-318.6
Accommodation, cafes & restaurants	0.0	-423.9	-423.9	5.7	162.1	-256.1
Transport & storage	0.0	-338.5	-338.5	48.3	89.8	-200.4
Communication services	0.0	-162.8	-162.8	109.8	45.7	-7.3
Finance & insurance	0.0	-25.1	-25.1	46.1	566.7	587.7
Property & business services	0.0	-467.1	-467.1	181.0	563.3	277.2
Government administration & defence	0.0	-331.3	-331.3	27.3	4.9	-299.1
Education	0.0	-89.2	-89.2	20.2	11.6	-57.4
Health & community services	0.0	-130.1	-130.1	97.3	127.2	94.4
Cultural & recreational services	0.0	-134.4	-134.4	115.6	77.9	59.1
Personal & other services	0.0	-87.0	-87.0	14.4	73.8	1.3
Unallocated services	0.0	0.0	0.0	158.2	0.0	158.2
Unallocated other	**0.0**	**0.0**	**0.0**	**215.2**	**118.8**	**334.0**
TOTAL[a]	**9534.7**	**-8142.7**	**1392.1**	**3669.5**	**3985.8**	**9047.6**

Source: PC 2010, *Trade & Assistance Review 2008-09*, Annual Report Series, Canberra, June, p. 18.

Notes: [a] Include $0.2 million agricultural pricing and regulatory assistance. Totals may not add up due to rounding.

Table 3-6: Australian Government assistance to services industry, 2008-09

$ Million (nominal)

	Export Market Development Grant	R&D Tax Concession	R&D Tax offset for small business	Small Business CGT Concessions	Small Business Programs
Electricity, gas and water supply	0.6	4.1	4.3	5.6	0.0
Construction	1.6	15.1	15.1	112.1	0.2
Wholesale trade	14.1	30.8	40.8	112.6	0.0
Retail trade	2.1	6.7	16.3	175.2	0.0
Accommodation, cafes and restaurants	4.9	1.5	0.8	159.6	0.0
Transport and Storage	5.9	10.7	5.9	54.4	0.0
Communication services	27.4	28.9	27.3	12.0	0.0
Finance and insurance	0.9	54.4	22.6	148.3	0.0
Property and business services	35.3	113.3	69.9	364.3	1.5
Government administration and defence	0.4	1.2	0.0	2.5	0.9
Education	12.1	0.6	5.7	5.3	0.6
Health and community services	1.8	2.5	7.8	111.7	0.0
Cultural and recreational services	5.8	0.2	2.1	26.0	0.2
Personal and other services	2.4	4.1	9.3	41.7	0.3
TOTAL SERVICES	**115.5**	**274.3**	**227.9**	**1331.3**	**3.7**
ALL INDUSTRIES	**183.9**	**620.0**	**428.0**	**1575.0**	**3.8**

Source: Author's calculations based on PC 2010, *Trade & Assistance Review 2008-09*, Annual Report Series, Canberra, June, p. 124-138.

goods producing sector. Therefore, government should support the services sector by providing supporting infrastructure, leadership and marketing, minimise growth impediments by ensuring efficient and transparent regulation and complementary policy framework. This in turn will spur private sector investment in innovative products, services and processes.

The following subsections discuss some of the existing government assistance programs to assist services sector in general, particularly small services enterprises.

3.3.1 Small Business Capital Gains Tax Concessions

Table 3-6 shows that one of the largest budgetary assistance measures to the services sector was the small business capital gains tax (CGT)concessions, costing around $1.3 billion in 2008-09 or almost 85 per cent of the overall amounts claimed by all sectors. There are four different small business CGT concessions: the small business 15-year asset exemption, the small business 50 per cent reduction for the sale of active business assets, the small business retirement exemption and the small business rollover deferral. These small business concessions have provided significant cash flow benefits and retirement income to small services proprietors.

In 2008-09, small business CGT concessions were the largest for Property and business services ($364.3 million), followed by Retail trade ($175.2 million) and Accommodation, cafés and restaurants ($159.6 million).

As discussed in Section 3.1, ACCI is concerned that any changes to the current small business capital gains tax concessions would negatively affect risk-taking and entrepreneurial activity in the services sector.

3.3.2 R&D Tax Concessions

The R&D tax concession is an ongoing scheme designed to increase the level of R&D being conducted by Australian companies. It is broad-based, not industry specific, and market-driven with the applicant entity deciding upon the scope and timing of the R&D.

It enables companies to deduct up to 125 per cent of eligible expenditure incurred on R&D activities from assessable income when lodging their income tax returns. For expenditure that qualifies for the 125 per cent concession (excluding plant related expenditure), an additional 50 per cent deduction called the '175 per cent premium R&D tax concession' may be available. It is available to those companies that increase their level of this type of R&D expenditure relative to their average of such R&D expenditures over the previous three years.

An 'R&D tax offset' (equivalent to the value of the R&D tax concession) is available to companies with an annual turnover of less than $5 million and whose aggregate R&D amount is more than $20,000 and less than $1 million per year.

In 2008-09, the services sector as a whole claimed $274.3 million in R&D Tax Concession and $227.9 million in R&D Tax Offset for small business, or 44.3 per cent and 53.2 per cent respectively of the total amount claimed by all Australian industries (Table 3-6).

In September 2008, the final report of the *Review of the National Innovation System* (the Cutler Review) was released. The Cutler Review recommended, amongst other things, that the existing R&D Tax Concession, Tax Offset, Premium Tax Concession and International Premium Tax Concession be replaced with an R&D Tax Credit[52].

In its response, the Government accepted the recommended redesign – away from a tax concession to a tax credit scheme – but with some changes in suggested program parameters. Specifically, the Government decided (as announced in the 2009-10 Federal Budget) the refundable credit would be 45 per cent (equivalent to a 150 per cent Tax Concession) for smaller firms, rather than the 50 per cent refundable credit recommended by the Cutler Review. The Government also set the turnover threshold below which the 45 per cent refundable tax credit would apply at $20 million, rather than the $50 million recommended. Moreover, a standard non-refundable 40 per cent tax credit would apply for firms with aggregate turnover of $20 million or more. The Government also tightened the definition of eligible R&D for the tax incentive.

The new R&D tax credit scheme was planned to come into effect from 1 July 2010 and apply to both new and existing R&D activities carried out from that day.

ACCI has expressed concerns that the proposed tightening of definitions for eligible R&D activities under the new R&D tax credit would substantially reduce supports available to all companies, especially small and medium sized enterprises, pharmaceutical, software, engineering, manufacturing and mining firms.

In order to ensure the effectiveness of R&D tax incentives, ACCI notes that the proposed list of criteria to be eligible for the new R&D tax credit needs to be revised in consultation with industry. Any proposed changes to the current R&D tax incentive should be considered in terms of its consistency, efficiency, simplicity and effectiveness in stimulating business research and development.

Moreover, the accessibility of the R&D scheme also poses a challenge especially for SMEs in the services sector. Compliance costs have been noted by many SMEs as outweighing the benefits after costs associated with applying and maintaining contemporaneous records are included.

3.3.3 Export Market Development Grants Scheme

The Export Market Development Grant (EMDG) scheme, administered by AusTrade, partly subsidises export promotion expenses of eligible enterprises in order to boost exports of Australian produced goods and services.

"The accessibility of the R&D scheme also poses a challenge especially for SMEs in the services sector"

The EMDG scheme reimburses up to 50 per cent of eligible export promotion expenses incurred by small to medium sized enterprises. However, in recent years, there have been a number of short falls in reimbursement amounts.

Annual budgetary funding for the scheme is around $150 million. In May 2009, $50 million supplementary funding was provided for 2008-09 in order to meet the shortfall in funding for claims relating to the 2007-08 grant year. The 2009-10 appropriation is at $200.4 million, while the budgeted forward estimates (2010-11 to 2012-13) return to $150.4 million.

Table 3-6 indicates that the services sector received a total of $115.5 million in EMDG grants, representing 62.8 per cent of total grant payments in 2008-09. Amongst the services sector, Property and business services received the largest amount of EMDG grants ($35.3 million), followed by Communication services ($27.4 million), Wholesale trade industry ($14.1 million) and Education services ($12.1 million).

Since its establishment in 1974, the EMDG scheme has been reviewed 14 times and numerous changes have been made to the scheme's eligibility and assistance payments, although the basic forms of the scheme have remained unchanged. Major changes to the scheme include: in 1988, New Zealand was removed from the scheme as an eligible export destination because of market similarities; in 1991, the grant rate was reduced from 70 per cent to 50 per cent of eligible expenses; in 1997-98, funding was capped; and in 2003, eligibility was shifted towards smaller and less experienced exporters.

The EMDG scheme was also reviewed separately as part of the 2008 *Review of Export Policies and Programs 2008* (the Mortimer Review). The Mortimer Review recommended the continuation of the scheme, albeit with some tightening of eligibility criteria.

The Mortimer Review was concerned that current demand for the scheme exceeded available funding allocated by the government. EMDG participants are guaranteed up to a designated amount depending on available funds, while remaining payments depend on residual funding at the end of the financial year.

52. Cutler Review's recommendation 8.2, p. 107 in Cutler, T. 2008, Venturous *Australia Report: Review of National Innovation System*, Cutler & Company Pty. Ltd, North Melbourne.

For example, in 2007-08, 22 per cent of grant recipients received less than 'full re-imbursement' which created uncertainties about how much participants would receive and potentially deterring pre-commitment to services trade promotion. From 1 July 2010, the maximum amount initially payable for eligible expenses incurred in the 2009-10 grant year was reduced to $27,500. This is the maximum amount that will be paid as an initial instalment to eligible EMDG applicants upon assessment of their grant application. Recipients with entitlement above $27,500 will receive a second payment, at the end of June 2011 and the amount of the second payment will be determined at that time[53].

The Mortimer Review recommended capping on-going funding of the EMDG scheme around $200 million per annum, reducing the maximum number of grants available for an individual recipient from eight to five, and increasing the minimum expenses threshold from $10,000 to $30,000 or reducing reimbursement rates[54].

In 2009-10, eligible enterprises with an annual income of not more than $50 million that spent at least $10,000 on eligible export promotion activities were eligible to apply. Successful applicants will get up to 50 per cent of eligible export promotion expenditure over the $10,000 threshold and the maximum grant for eligible applicants is $200,000 subject the funds available in the scheme.

Following the passage of the EMDG Amendment Act 2010, the following are amongst the changes to the EMDG scheme for expenses incurred from 1 July 2010 and applicants lodged from 1 July 2011:

- Reducing the maximum grant from $200,000 to $150,000;
- Reducing the maximum number of grants available for an individual recipient, other than an approved body or joint venture, from eight to seven;
- Capping intellectual property registration expenses at $50,000 per application; and
- Increasing the minimum expenses threshold from $10,000 to $20,000.

ACCI considers that the EMDG scheme is underfunded and the above changes from 1 July 2010 reflect a return to the EMDG scheme as it was in 2007-08. ACCI is concerned that inconsistency of the EMDG scheme and its lack of funding deters services sector export promotions which will in turn negatively affect services sector exports and further exacerbate Australian services trade deficits.

An underfunding of the EMDG scheme also makes it difficult for service exporters to secure market access through regional and bilateral free trade agreements, as well as frustrating the value-add that could be achieved from export promotion activities by organisation, such as Business Chambers, Industry Associations, the Australian Made Australian Grown campaign and AusTrade.

"Inconsistency of the EMDG scheme and its lack of funding deters services sector export promotions"

In 2007-08, almost 4,000 EMDG grants were made – 30 per cent to first timers, averaging around $38,000 per grant. About 80 per cent of the recipients were small exporters with an annual income of $5 million or less and over 60 per cent of recipients were in services industries, predominantly tourism, education and ICT[55]. Hence, ACCI is also concerned that recent changes will also limit the ability for small and new services exporters to explore potential international markets especially in emerging Asia, which has seen strong growth in middle income households and greater demand for better quality services.

3.3.4 Small Business Assistance Program

The Australian Government provides various programs to assist small businesses, especially after the global financial crisis. In 2008-09, 21 per cent of budgetary industry assistance was targeted at small business, and was dominated by CGT concessions as discussed in Section 3.3.1 above. In this section, we will discuss other government assistance programs targeted at small businesses in the services sector.

3.3.4.1 Small Business Support Line

In the May 2009 Federal Budget, the Australian Government announced $10 million to establish a Small Business Support Line to assist small businesses better manage the impacts of the global recession. The Support Line provides initial 'single' point of contact to advise small service business owners and refer them to specialist advisers on matters such as obtaining finance, cash flow management, marketing and promotion

53. Smith, S. 2010, *Initial maximum payment under EMDG scheme for 2009-10 grant year,* Media Release, 1 July 2010.

54. PC 2009, *Trade & Assistance Review 2007-08*, Annual Report Series, Canberra, p. 28 – 32.

55. Ibid.

advices, retail leasing, diagnostic services, and personal stress and hardship counselling. The Support Line was launched in September 2009.

In addition to the above services, the Support Line is also responsible for the Small Business Credit Complaints Clearing House (SBCCCH) which provides an avenue for small businesses in the services sector to direct complaints about access to and the cost of bank finance. ACCI welcomed this initiative to support small business access to affordable finance. Since the onset of the global financial crisis, ACCI has highlighted that small services businesses have continued to face difficulties in accessing adequate finance from major lenders even when a solid lending proposal exists. Moreover, small businesses also face higher interest rate charges for small business loans relative to other borrowers.

A total of $10 million was allocated to the Small Business Support Line over two years from 2009-10, ending on 30 June 2011. Following the allocation of $4 million to the Small Business Online Program (discussed below) in December 2009, the Small Business Support Line budget has been revised.

3.3.4.2 Small Business Online Program

In the May 2009 Federal Budget, the Australian Government also announced $10 million funding over two years (2009-10 and 2010-11) to establish a Small Business Online Program. The program offers grants to service providers to deliver training and mentoring services to small and home-based businesses to assist their businesses to go online, enhance their web presence and engage in e-business capabilities. The program was launched on 17 August 2009.

In January 2010, the Australian Government transferred $4 million from the small Business Support Line to the program to assist small business tourism operators to provide a virtual online tour of their accommodation services.

By March 2010, 47 grants between $60,000 and $700,000 totalling $14.3 billion had been awarded[56].

3.3.4.3 Enterprise Connect

Enterprise Connect, announced in the May 2008 Federal Budget, is a $50 million a year initiative for the establishment of eleven Enterprise Connect centres around Australia with an objective to provide Australia's SMEs, including small service enterprises, with access to technology, research, and business and management advisory services, helping them to become more innovative, efficient and competitive.

Enterprise Connect provides a range of services and support to help SMEs in the services sector build their internal capacity and capability. The core services include:

- A Business Review conducted by a highly skilled business adviser at no cost to the business;
- The Tailored Advisory Service (TAS) which provides matching funding of up to $20,000 to implement actions identified in the Business Review;
- Client Management is an ongoing advisory service for all client firms for up to 12 months following a Business Review;
- Researcher in Business (RiB) which helps place researchers from universities with businesses to develop and implement new commercial ideas;
- Workshops Industry Intelligence and Networking (WIIN) which provides firms with access to events and networking opportunities relevant to their sector;
- Technology and Knowledge Connect (TKC) which provides technology and technical knowledge advice; and
- Technology Partnerships Equipment Register (TPER) which provides firms with access to leading-edge equipment.

3.3.4.4 Small Business and General Business Tax Break

The Small Business and General Business Tax Break (or Investment Allowance) was announced in December 2008 as part of the Australian Government's *Nation Building Package* response to the global financial crisis and further enhanced in February 2009 as part of the *Nation Building and Jobs Plan*. This initiative was first put forward to the Government by ACCI at the height of the crisis. The Tax Break is an investment allowance that provides a tax deduction for investing in new tangible depreciating assets, with the tax deduction rates varying according to the business turnover as well as when that business invests in the asset and has it ready for use.

In the May 2009 Budget, the Australian Government announced an increase in the Tax Break from 30 per cent to 50 per cent for small businesses that have an annual turnover of less than $2 million; acquire assets costing at least $1,000 per asset from 13 December 2008 until 31 December 2009; and install those assets or have them ready for use by 31 December 2010. The Tax Break remained unchanged for all other businesses.

ACCI noted that the Tax Break has provided an incentive for small businesses in particular to bring forward their planned capital expenditure. The Australian Taxation Office advises

56. PC 2009, *Trade & Assistance Review 2008-09*, Annual Report Series, Canberra, p. 41.

that as at 30 May 2010, 234,929 businesses had claimed the Tax Break in their 2008-09 tax returns, with some 208,280 of these small businesses. Of the $5.04 billion worth of bonus deductions that have so far been claimed, $2.841 billion has been claimed by small business[57].

3.3.4.5 Other Small Business Assistance Program

The Australian Tax Office (ATO) conducts free seminar, workshops and information sessions for small businesses, including those in services industries, to assist them on track with their tax and superannuation obligations. The ATO also offers a free, one-on-one assistance visit tailored to individual small businesses. This visit, which is available in all capital cities and most regional areas, is confidential and can cover business basics such as registering for an Australian Business Number (ABN) and Goods and Services Tax (GST), as well as more complex issues such as employers' superannuation obligations and record keeping requirements.

In the aftermath of the global financial crisis, the Government reduced the quarterly pay-as-you go (PAYG) instalments for small business during the 2009-10 financial year. For the 2009 10 financial year, the Government reduced the GDP adjustment from 9 per cent to 2 per cent, aligning it with the expected Consumer Price Index (CPI) growth of 2 per cent for 2009 10, as forecast in the *Updated Economic and Fiscal Outlook*. This initiative better aligned the tax treatment of small businesses, self-funded retirees and small superannuation funds with changing economic conditions and helped prevent businesses paying too much tax. This reduction provided cash flow benefits to around 1.5 million taxpayers at a cost of $720 million, cutting their PAYG instalments by around 6 per cent. This will ensure that their PAYG instalments more closely approximate their actual income tax liability for the year[58].

On 1 June 2009, the ATO also introduced measures to assist small businesses that are struggling to manage their tax payment obligations. These measures haven been further extended for another twelve months until 30 June 2011. Businesses with an annual turnover of less than $2 million and an activity statement debt, e.g. GST and PAYG, can apply for a general interest charge (GIC) free payment arrangement until 30 June 2011. No GIC will be payable for a maximum period of twelve months, provided the payment arrangement is maintained, and there is no limit on the amount of debt a business can have in order to enter into a payment arrangement with the ATO.

Services businesses with an annual turnover of less than $2 million can also apply for a deferral payment on their next activity statement. A payment deferral of up to two months is available for quarterly activity statements (up to and including the June quarter of 2011), or up to one month for monthly activity statements (up to and including June 2011). No interest is payable for the period of the deferral.

These two ATO initiatives have assisted small service businesses in managing their cash flows amidst the slowdown in economic activities and difficulties in obtaining working capital financing from financial institutions.

3.3.5 Policy Recommendations

ACCI proposes that:

Recommendation 20: The Government should continue to support services sector export market development through an adequately funded, consistent, well-designed and targeted Export Market Development Grant Scheme, and restore the funding cuts to the scheme that were made in the 2010-11 Federal Budget.

Recommendation 21: In assessing the importance of industry assistance for the services sector, the Government should acknowledge that the sector currently bears the net costs of tariff assistance.

Recommendation 22: When considering innovation policy and assistance programs, the Government should take into account the difference in business or production processes between the services sector and primary and manufacturing sectors.

Recommendation 23: The government should ensure that any proposed changes to existing tax concessions and government assistance for the services sector are considered after comprehensive consultation with stakeholders and independent analyses have been conducted.

Recommendation 24: Information on government assistance programs should be easily available and reach its targeted audience more effectively. In this regard, government should work more closely with various industry organisations to assist the timely dissemination of information to businesses in the services sector.

Recommendation 25: The compliance burden and application of red tape should be monitored on a regular basis to ensure that paperwork and the red tape burden are minimised while maintaining the integrity of programs.

57. Swan, W. 2010, *Treasurer's Economic Note*, No. 027, Canberra, 11 July 2010.

58. Swan, W. 2009, *$720 Million Cash-Flow Relief for Small Business*, Media Release No. 030, Canberra, 28 March 2009.

Recommendation 26: Broad-based tax reform and reductions of unnecessary costs of doing business should be the government's priority to further promote services sector growth and performance, instead of further reliance on specific budgetary assistance.

Recommendation 27: Regular and comprehensive review on the effectiveness and efficiency of government assistance programs should be conducted by independent agencies such as the Productivity Commission.

3.4 Workplace Regulations and Services

It is essential that labour market regulation is flexible and adaptable to changes in the domestic and global economy. In today's modern economy, these changes take place much more quickly and dramatically than previously was the case. Firms operating within the services sector must be able to react with respect to their workforce in a more dynamic way than other industries. Firms in the services sector tend to generally be lowly unionised and exposed to sudden changes in demand which require agility in matching labour supply and working arrangements to business conditions.

> "Firms in the services sector tend to generally be lowly unionised and exposed to sudden changes in demand"

It is vital that the range of necessary forms of workplace arrangements is recognised by policy makers and regulators. Policy decisions should enhance rather than diminish workplace flexibility and the choices available to employers and employees. Furthermore, consideration should be given by policy makers to increase productivity of the services sector, which should be pursued through "smarter regulation" efforts. That is, regulation must be targeted, efficient and not exceed what is necessary to achieve policy goals.

ACCI supports the recent views expressed by the International Employers Organisation (IOE) and the Business and Industry Advisory Committee to the OECD (BIAC) in the wake of the Global Financial Crisis (GFC) that[59]:

> "[s]tructural reform of labour market rigidities must continue even in this challenging economic environment. Flexibility in labour markets is essential not only for the survival and sustainability of firms, but also for their ability to be able to retain employees through economic downturn. The strictness and scope of employment regulation or social safety nets can impact on capacities for recovery, and can risk perpetuating joblessness and risk worsening the impacts of future economic downturns. This does not mean eliminating regulation – it means smarter, more effective regulation."

3.4.1 Workplace Relations Reforms

Australia has a long history of a highly centralised and regulated labour system. Over the last two decades, federal governments have introduced and developed workplace reforms that were designed to make the Australian economy more efficient and competitive, and to improve employment opportunities. This largely began with the Keating Government's *Industrial Relations Reform Act 1993* and the Howard *Government's Workplace Relations Act 1996 (WR Act)*[60]. More recently other significant policy reforms included the *Workplace Relations Amendment (WorkChoices) Act 2005* and industry specific *Building and Construction Industry Improvement Act 2005*. The passage of the *Independent Contractors Act 2006* was also an important reform which sought to ensure that independent contractors, more often than not in the service industries, are recognised as providing labour on a legitimate commercial basis. Each of these reforms played a positive role in improving firm productivity, efficiencies and overall levels of employment across the Australian economy, particularly for key segments of the services sector.

The major reform direction in each of these years was towards shifting from a centralised system of setting wages and working conditions towards a more enterprise and workplace based system. These reforms increasingly equipped Australia to transform the economy away from traditional industries and towards services. Notwithstanding these inroads, the system remains too complex and not rooted in the realities of modern workplaces, which is typified by the services sector.

More recently, significant legislative changes were made to the national workplace relations laws by the then Rudd Government's *Fair Work Act 2009*, as detailed in its 2007 pre-election policies, *"Forward with Fairness"* and the *"Implementation Plan"*. Whilst the Fair Work laws took further important steps towards meeting a longstanding ACCI policy priority of creating a national industrial relations system for the private sector[61], aspects of the Fair Work system bring back a level of centralisation and workplace inflexibility at the enterprise level which the Australian system was successfully moving away from.

59. IOE and BIAC 2010, *Jobs Preservation And Jobs Growth - G20 Meeting*, International Organisation of Employers , Final Report, March 2010, p. 3 http://www.ioe emp.org/fileadmin/user_upload/documents_pdf/papers/position_papers/english/pos2010_jobspreservation.pdf

60. Econtech 1993, The Economic Effects Of Industrial Relations Reforms Since *(prepared for the Australian Chamber of Commerce and Industry*; Econtech 2007, http://www.econtech.com.au/information/Industry/EcontechAugust2007_ACCI.pdf. (p. 3-8 of the report provides a broad summary of key changes from 1993).

61. This began with the WorkChoices reforms which predominantly relied upon the corporations power under s.51(xx) of the Australian Constitution. Private sectors employers in Western Australia and most public and local council government employers still remain under different State based industrial relations systems.

This is already beginning to negatively impact employers whom operate in the burgeoning services sector, and there remain considerable areas of risk and exposure inherent in the Fair Work reforms which may threaten the viability and growth of the sector once the outer limits are tested by trade unions and regulators. Employer experience and emerging evidence suggests that key aspects of the Fair Work system will need a period of review, and if required, legislative amendment if Australia is to maintain workplace flexibility, increase productivity and jobs, and harness the opportunities the service sector offers.

3.4.2 Impact of Past Reforms

In 2007, ACCI commissioned Econtech to study the impact of rolling back all major industrial relations reforms in Australia from 1993, including those pursued through the *Industrial Relations Reform Act 1993*, the *Workplace Relations Act 1996* and the Workplace Relations Amendment *(WorkChoices) Act 2005*. The findings are contained in its final report titled, *"The Economic Effects of Industrial Relations Reforms Since 1993"* [62].

In summary, the study found that[63]:

- Australian industrial relations reforms from 1993 onwards are estimated conservatively to have reduced the structural unemployment rate by at least **1.77 percentage points**;
- Industrial relations reforms from 1993 onwards are estimated to increase labour productivity by **1.4 per cent**. Reversing the reforms would subtract the same amount of 1.4 per cent from the level of productivity. *Econtech* found that *"some of this increase is still developing as it reflects the recent liberalisation of unfair dismissal laws as part of the introduction of WorkChoices"* [64]; and
- Accelerated growth in labour productivity since 1992/93 supports the widely accepted perspective that industrial relations reform has boosted productivity.

"There remain considerable areas of risk and exposure inherent in the Fair Work reforms which may threaten the viability and growth of the sector"

Some key elements of the former reforms have been retained in the Fair Work system, including a national system for the private sector predominantly based on the corporations power of the Australian Constitution, prohibitions on unlawful industrial action during the life of an enterprise agreement, secret ballots authorising industrial action, prohibitions on industrial action when pattern bargaining occurs, secondary boycotts, and strike pay. However, there are aspects of the Fair Work laws which are negatively impacting business in the services sector. These include new rules around bargaining and agreement making, inflexible transmission of business rules, removal of exemptions which make it easier for employees to make unfair dismissal claims, increased capacities for unions to enter workplaces, the re-regulation of industrial awards and removal of the capacity for an employer and employee to make individual agreements which suits the needs of both parties[65].

The Reserve Bank of Australia (RBA) Governor, Glen Stevens, highlighted the importance of Australia maintaining a flexible labour system in a recent appearance to the House of Representatives Standing Committee on Economics inquiry on increasing Australia's productivity growth rate:

> "Mr BRIGGS— [...] I am interested in your view on the comparison between this downturn and the one of the early 1990s. You said earlier that you thought that it looked like we are getting through this in better condition and that it is not as deep as it was in the early 1990s. What weight do you give to the deregulation of the labour market in helping us get through this turn compared to that of the early 1990s and particularly the fact that employers have been given the opportunity to keep staff on—with reduced hours and so forth but keeping their job? I am interested in your views on that.
>
> Mr Stevens—By anybody's reckoning, the arrangements in the labour market that we have today—and it is not just the black letter law legal arrangements, but also the whole set of attitudes on the part of all the participants—are different to the bad old days. Even by the early 1990s, there had been a fair amount of change in that direction. What I would also say is that I think that this generally more flexible set of arrangements overall was helping in the boom, too.
>
> [...]
>
> Mr Stevens— Whether it turns out to be chronic unemployment—that is, long lived—will hinge mostly—The best way to prevent that is going to be a growing economy, a flexible set of labour arrangements and an economy that is well in balance.
>
> [...]
>
> Mr Stevens—Generally, the set of arrangements that we have had in place in recent years has resulted from a lot of reform over a long period that have made this all work better. We see the advantages of that. Ultimately, labour market arrangements are about where the sustainable unemployment rate is."[66]

62. Econtech, op. cit.,

63. Ibid.

64. Econtech, op. cit., p ii.

65. These matters were identified in detail by the ACCI employer network during various Senate Committee inquiries into the Fair Work Bill 2008 and associated legislation during 2008 and 2009. A copy of all ACCI submissions on the fair work legislation can be found here: http://www.acci.asn.au

66. House of Representatives Standing Committee on Economics 2009, *Inquiry into Raising the Productivity Growth Rate in the Australian economy*, Evidence to Committee, 14 August 2009.

In its report the House of Representatives Standing Committee reaffirmed the importance of maintaining workplace flexibility and reducing the overall regulatory burden on business, stating[67] :

> **"Maintaining flexibility in workplaces**
> 7.109 With the domestic and international economy constantly changing, flexibility in workplace arrangements enables employers to react quickly to changing demands. Inflexible arrangements have a detrimental impact on firm productivity.
>
> 7.110 The PC outlined the importance of such flexibility to productivity:
> … it is important to preserve the ability of organisations to engage effectively with employees to change work arrangements in response to commercial imperatives. As the economy changes, different firms and industries will come under divergent pressures in a way not amenable to enforcement of common employment conditions.
>
> 7.111 In a speech in Melbourne on 5 November 2009, the Chairman of the PC said:
>
> … legitimate concerns for workers' rights need to be balanced against the flexibility that firms need to implement the organisational changes and other innovations on which productivity growth ultimately depends.
>
> […]
>
> **Committee conclusions**
> 7.121 The committee believes that public policy to boost the aggregate productivity growth rate should be primarily directed at maintaining competition in the economy and allowing firms flexibility in their workplace arrangements. Additionally, all levels of Australian government should continue to pursue reductions in red-tape, regulatory burdens on business and to strengthen regulatory consistency."

Officials from the RBA have suggested that the reason Australia's labour market performed relatively well following the GFC is[68] :

> "... partly explained by the greater degree of flexibility in employment and wage-setting practices, compared with those in the 1980s and 1990s recessions. Following a succession of reforms over recent decades, rigidities in the labour market were significantly reduced. This made it easier for firms and employees to negotiate work and pay arrangements that enabled firms to preserve jobs during a period of subdued activity, partly by reducing average hours worked. While lower hours reduce compensation per employee, they avoid the significant social and economic costs associated with unemployment, including detachment from the labour force, skill atrophy and reliance on government assistance."

The International Monetary Fund (IMF) has also commented on Australia's history of workplace relations reforms, indicating that in the past "… *inflexible labour markets have been among the most important causes of Australia's declining productivity performance and have contributed to the increase in structural unemployment*"[69].

The combined efforts prior to the introduction of the Fair Work system correlated with a significant decline in the unemployment rate and industrial disputes. Australia's reputation and performance improved markedly across more than a decade of industrial reform (particularly with respect to a decrease in industrial action), making it a more attractive partner for investment and better able to deliver high quality services in changing markets. Furthermore, the OECD found that increasing flexibility in Australia's labour laws would have positive effects on productivity[70].

The former workplace relations reforms prior to 2009 sought to address numerous OECD studies and reports[71], which consistently recommended member countries[72]:

- Increase flexible work practices through flexible labour markets;
- Increase flexibility of working-time (both short-term and lifetime) voluntarily sought by workers and employers;
- Make wage and labour costs more flexible by removing restrictions that prevent wages from reflecting local conditions and individual skill levels, in particular of younger workers;
- Reform employment security provisions that inhibit the expansion of employment in the private sector; and
- Reduce pay-roll taxes.

Following the repeal of many provisions of the former reforms, the OECD's 2008 *Economic Survey of Australia* found[73]:

> "The simplification and gradual decentralisation of industrial relations since the early 1990s has made the economy more resilient. But the pursuit of reforms towards a greater individualisation of labour relations, following the WorkChoices

67. House of Representatives House Standing Committee on Economics 2010, *Inquiry into Raising the Productivity Growth Rate in the Australian economy*, Committee Report, April 2010.

68. Plumb, M., Baker, M., Spence, G. 2010, 'The Labour Market during the 2008–2009 Downturn', *RBA Bulletin*, March Qtr, 2010, http://www.rba.gov.au/publications/bulletin/2010/mar/1.html#f

69. Singh, A., Felman, J., Brooks, R., Callen, T. & Thimann, C. *Australia: Benefiting from Economic Reform*, IMF, 1998, p.3. The OECD's *2006 Employment Outlook: Boosting Jobs and Incomes and 2004 Country Report* for Australia provided support for continuing reform to Australia's labour market of the character pursued by former reforms.

70. OECD, *Employment Outlook for 2006: Boosting Jobs and Incomes*, 2006. See also ACCI Issues Paper *"OECD Support for Labour Market Reform"* http://www.acci.asn.au/text_files/issues_papers/Trade/June%2006%20-%20OECD%20Labour%20Market%20Reform.pdf.

71. OECD *Implementing The OECD Jobs Strategy Lessons From Member Countries' Experience*, 2002, http://www.oecd.org/dataoecd/42/52/1941687.pdf; OECD 2007, *Micro-Policies for Growth and Productivity* http://www.oecd.org/dataoecd/6/40/38151918.pdf.

72. These policy goals are re-affirmed by subsequent reports. See for example, the OECD's *Boosting Jobs And Incomes – Policy Lessons From Reassessing The OECD Jobs Strategy* (2006) http://www.oecd.org/dataoecd/47/53/36889821.pdf

73. OECD, 'Economic Survey of Australia', *Policy Brief*, 2008, p.8 http://www.oecd.org/dataoecd/40/39/41411272.pdf

> Act in March 2006, did stir much controversy, because of equity concerns. […] While equity concerns need to be addressed, care should be taken not to undermine labour market flexibility. To maintain a close link between productivity gains and wages, the future organisation of collective bargaining must remain within the company framework, as recognised by the government. Harmonising the system of industrial relations across the states is an important goal, but the result must not be alignment on the most restrictive standards." (emphasis added).

The OECD's recent comments about the impact of the Fair Work reforms on youth employment, by reference to the repeal of individual contracts are also noteworthy. The OECD was specifically critical of the repeal of the scope for the making of individual employment agreements and recommended that *"policymakers should be prepared to take steps to amend the new rules if sizeable negative effects are detected"*[74].

"Emerging evidence indicates that there are aspects of the Fair Work reforms that suggest a reversion to structural inflexibility"

No studies have been conducted to measure the impact of the new fair work laws on productivity in the services sector. However, the effect of these new reforms will be felt more acutely over time as they begin to effect participants' behaviours. This has prompted the Chairman of the Productivity Commission in a recent speech titled *"Successful reform: past lessons, future challenges"* to comment on the importance of re-calibrating labour regulation in the context of enhancing Australia's productivity potential[75]:

> "Most other prospective territory for productivity enhancing reform is regulatory in nature, with attention needing to be given not only to reducing compliance burdens (where progress is being made) but also to regulatory constraints on flexibility and adaptability at the enterprise level, and regulations that distort business decision making.
>
> As noted previously, the challenge here is both to reform existing regulations and to prevent new regulatory impositions that would erode our productivity performance. Regulatory proposals that would have pervasive effects across the economy need particular scrutiny, especially those impacting on the markets for labour and capital, and key infrastructural inputs to production such as transport (not forgetting coastal shipping), energy, telecommunications and water.
>
> Among these, industrial relations regulation is arguably the most crucial to get right. Whether productivity growth comes from working harder or working 'smarter', people in workplaces are central to it. The incentives they face and how well their skills are deployed and redeployed in the multitude of enterprises that make up our economy underpins its aggregate performance. It is therefore vital to ensure that regulations intended to promote fairness in Australia's workplaces do not detract unduly from their productivity. Getting the balance right is challenging and requires careful ex ante assessment and ex post review. This is particularly important in the context of the structural pressures described earlier, given the premium they place on flexible, adaptable labour markets. However, regulatory changes (in both directions) have generally been exempt from even the cursory obligations of regulation impact statements. If we are to secure Australia's productivity potential into the future, the regulation of labour markets cannot remain a no-go area for evidence-based policy making."

Emerging evidence indicates that there are aspects of the Fair Work reforms that suggest a reversion to structural inflexibility which will undoubtedly impact productivity and employment in the services sector. ACCI echoes the sentiments of the Chairman of the Productivity Commission that the *"regulation of labour markets cannot remain a no-go area for evidence-based policy making"*[76].

3.4.3 Recent Policy Reform Measures

ACCI's *Modern Workplace: Modern Future Blueprint for the Australian Workplace Relations System 2002 – 2010* called for substantive reforms to workplace relations.

To summarise the main policy reform measures outlined in the Workplace Relations Blueprint, ACCI believes workplace relations laws should:

- Allow for flexible employment regulation that also provides an appropriate safety net of terms and conditions for employees;
- Provide a basis in which collective or individual enterprise agreements in workplaces apply on a voluntary basis and provide wage structures or conditions that reflect local circumstances of employers and employees and eliminate inefficient work practices. There should not be any type of coercive powers (direct or implied) available to employees, unions or third parties, to force bargaining on employers where they do not wish to engage in bargaining on a voluntary basis;

74. Uren, D., 'Labor risk to youth jobs says OECD as PM Kevin Rudd calls recession 'inevitable', The Australian, 21 April 2009.

75. Banks, G., *Successful reform: past lessons, future challenges*, Keynote address to the Annual Forecasting Conference of the Australian Business Economists, Sydney, 8 December 2010. p.16. http://www.pc.gov.au/__data/assets/pdf_file/0018/104229/successful-reform.pdf

76. Banks, G, ibid.

- Recognise that voluntary bargaining and agreement making should be the main vehicle for gaining higher wages and conditions in excess of the safety net. Enterprise agreements should improve workplace productivity and efficiency at the firm level in a real and direct way;
- Require statutory agreements to be subject to minimal approval requirements which should meet minimum safety net standards. Agreements should only deal with matters relevant to the direct employment relationship and not extraneous matters;
- Prohibit industrial action taken during the life of an agreement;
- Not create a safety net that impedes bargaining and be so prescriptive that it impedes existing workplace practices and flexibility;
- Ensure that minimum wage decisions do not impact negatively on jobs, businesses or the wider economy;
- Allow appropriate exemptions for firms, especially SMEs, from unfair dismissal laws. Employers should be able to terminate employees for a valid reason;
- Restrict excessive third party intervention in the workplace;
- Only allow industrial tribunals to arbitrate in disputes between unions, employees and employers in limited and defined circumstances;
- Strictly regulate the taking of industrial action, particularly where industrial action could be protracted and/or have the capacity to negatively affect a major sector of the economy or essential services; and
- Target particular areas in the economy that requires specialised laws to deal with systemic unlawful behaviour (i.e. the building and construction industry).

It appears that some key aspects of the centralised system which dominated the policy landscape pre-1990s, and the subsequent shift towards a hybrid mix of collective and individual based arrangements for employers and employees and reduced third party involvement of setting wage and conditions, have been reactivated:

- The previous reforms which accorded the industrial tribunal to have a less interventionist role in individual workplaces have been quite significantly reversed. The Fair Work laws create new interventionist powers for workplace regulators;
- Collectivist structures are now encouraged or assumed precedence under the Fair Work laws, despite most contemporary and modern workplaces (especially in the services sector) not organising themselves in such a manner. This is not consistent with the freely made choices and preferences of the majority of the contemporary Australian workforce;
- Despite private sector union coverage hovering around 14 per cent, the Fair Work system provides for an automatic right of union intervention in workplace arrangements, against the desire of the majority of employees or the employer; and
- Collective and centralised one-size-fits all "modern" industrial awards have re-emerged, in addition to a comprehensive range of legislated National Employment Standards (NES) to form a dual and a substantial workplace re-regulation.

Being labour intensive yet lowly unionised, many businesses in the services sector are concerned about the impact of the Fair Work laws, including the impact of increased costs under new occupation and industry based awards, an expanded and rigid safety net, and the re-introduction of unfair dismissal laws on small to medium sized firms. Even though some transitional arrangements have been put in place, employers reported that they were already *"worried that they will bear the brunt of the government's reforms in the form of higher labour costs and reduced flexibility"*[77].

The following sections analyse a number of key priority areas of existing workplace regulation in the services sector.

3.4.4 Industrial Awards in the Services Sector

New modern awards generally commenced on 1 January 2010 and followed a process of rationalisation and amalgamation of thousands of federal and state industrial awards into 122 industry and occupational based 'modern awards'. The immediate problem for employers is the prospect of complex transitional wage calculations that employers are required to do over a five year transitional period and increased costs. This is directly contrary to the Government's statutory commitment that *"the creation of modern awards is not intended to disadvantage employees or increase costs for employers"*[78].

The industrial inspectorate, the Fair Work Ombudsman, has acknowledged that the complexity of transitional provisions will negatively impact businesses[79]:

> "Working out how to phase wage rates in a modern award setting can and will be complex. Employers of all levels of sophistication, and in all part of the country, are likely to

77. 'Why businesses are so wary of labour reforms', *The Australian Financial Review*, 19 August 2009, p.60-61.

78. Paragraph 2(c) and (d) of the Award Modernisation Request published by the Minister for Workplace Relations, Hon. Julia Gillard MP, pursuant to s.576C(1) of the Workplace Relations Act 1996.

79. 'Wages shake-up hurts business in awards confusion', *The Australian Financial Review*, 12 October 2010.

struggle with the provisions. Sometimes they will get the calculations wrong, or worse, they may give up because they are too time consuming".

Large penalties and back-pay orders can cripple SMEs in the services sector, operating on tight margins and high labour costs. With the average penalty awarded against businesses for underpaying staff being $33,000[80] implementing new awards has become a significant task which can threaten the existence of smaller service industry operations.

Whilst historical and complex issues concerning overlapping coverage have been removed to some extent and do provide some limited benefit to the services sector, there still remains the enduring problem of in-built regulatory inflexibility in this form of unique regulation. Australia remains the only country in the world to have such a system – with 122 different sets of regulation in a supposedly simplified and reformed system.

The process of 'modernising' awards did not involve a detailed consideration of the merits of whether historical employment standards (which are artefacts of a bygone era of 'paper' disputes initiated by trade unions) should be retained or modified to better suit the contemporary world of work.

"The modernisation process has led to significant new costs and inflexibilities for many of these employers and, in some cases, a loss of jobs for young people in the services sector"

ACCI supports a sustainable and effective safety net of minimum wages and conditions of employment. However, in many ways, the so-called 'modern' awards preserve existing award terms, many of which are inherently inflexible as they operate on a 'one-size fits all' approach and were arbitrated following long forgotten disputes of decades past. The relatively new service sector is extremely diverse and dynamic and such inflexible labour rules do not reflect the evolution of the sector or the specific needs of firms.

For example, an industrial award does not differentiate between a firm within the same sector that:

- Employs 5 employees, 500 or 5,000 employees;
- Operates in regional Australia or one that operates in a metropolitan city;
- Operates during positive economic conditions and one that operates during a downturn or in a recession; and
- Operates during late nights, early mornings or weekends and those that operate Monday to Friday, 9 am to 5 pm.

Firms in the services sector have very different operational and financial capacities and comprehensive national awards remain a very inflexible and inefficient mechanism for regulating the labour market. Moreover, and despite the transitions, the modernisation process has led to significant new costs and inflexibilities for many of these employers and, in some cases, a loss of jobs for young people in the services sector despite promises to the contrary. The following examples highlight either increased inflexibility or cost for business operating in the services sector:

- **Part-Time Employment:** Modern awards have provisions that restrict the flexibility of part-time employment, including engagement and roster changes;
- **Casual Employment:** The casual loading across all modern awards has been set at 25%, which is significantly higher than the more common loading of 20%. A higher casual loading, like any business cost related to labour, acts as a disincentive to offering employment. Many awards also prescribe a minimum engagement period of 3 hours or more. In the general retail, fast food and pharmacy industries, this has already cost the jobs of young workers who can only work after school hours and until the close of business, but are forced to be paid for a minimum of three hours regardless of whether they work 1 or 1.5 hours[81]. This applies, regardless of whether the employer and employee agree to work and be paid for less hours. This is particularly concerning given that the Government has acknowledged that the impact of the GFC disproportionately affected younger people[82]:

  "The impact of the slowdown in Australia was experienced unevenly across various cohorts, as labour market conditions for certain vulnerable groups deteriorated as a result of the global recession. Young people, in particular, have suffered disproportionately, as they generally have less experience and training and are more likely to be employed in lower skilled jobs, which are often more precarious. Indeed, the youth (15–24 years) unemployment rate increased significantly as a result of the global recession, from 8.7 per cent in September 2008 to a high of 12.2 per cent in June 2009, although it subsequently declined to stand at 11.3 per cent in December 2009."

80. 'Awards maze risky for SME', *The Australian Financial Review*, 12 October 2010.

81. Smith, B., 'Award upheld, young workers lose', *Sydney Morning Herald*, 9 July 2010; Hannan, E., 'New award 'penalises bosses and workers', The Australian, 13 April 2010; Dunn, M. 'Kids 'forced out of casual jobs' by new industrial relations laws', The Herald Sun, 6 May 2010.

82. DEEWR, *Agreement Making in Australia under the Workplace Relations Act 1996, 2007-2009*, p.13.

Other provisions force an employer to offer employment to a casual on a more permanent basis after 6 months of continuous employment, again adding to the costs and multiplying disincentives to create work opportunities;

- **Hours:** Modern awards retain inflexible arrangements when it comes to establishing hours of work. The maximum number of hours an employer is able to roster an employee is often capped at eight, or possibly, ten per day. The inability to agree to longer hours per day can inhibit productivity. Modern awards also do not contain flexible provisions enabling employees to average their hours of work across an extended period, for instance 6 months. These types of provisions are often essential in workplaces that have seasonal or fluctuating workloads. They enable employees to work extra hours in some weeks, but less in others;
- **Penalty Rates:** Late night and weekends are significant trading periods in the services sector. Typically awards have adopted a series of penalty rates which compensate employees for working 'unsociable hours'. This original justification for a penalty rate regime in an award has limited foundation, particular in the retail and restaurant sectors. Some modern awards have adopted a more restrictive span of ordinary hours, that is, hours where employers are not required to pay higher rates of pay, and maintained the penalty rates. These penalty rates are a deterrent to operating outside of designated ordinary hours and where penalties have increased under the new modern award, this has threatened the viability of business, the majority of them SMEs in the services sectors[83]. For example, in Queensland, independent supermarkets traditionally trade long hours and this has been recognised for decades by the former State industrial awards and could trade up to 12 midnight on week nights without having to pay penalty rates. Under the new 'modern' award these businesses will have to pay a 25% penalty after 6pm to permanent employees and overtime rates (50% penalty) to all employees after 9pm. On Sundays a 100% penalty is applied to all hours worked when only a 50% penalty previously applied. On Saturdays after 6pm all employees are paid at overtime rates. The result is increased labour costs and a consequential pressure on these small businesses to reduce operating hours, making them less competitive and reducing employment opportunities. Some fast food operators have indicated that the modern award will increase labour costs by $1,896 per week or $98,600 per year – an increase of 34.5 per cent in total labour costs[84]. Public holiday penalty rate costs have also increased for many employers where their employees work over the Christmas and new year period, with some employees now being entitled to penalty rates for not only the public holiday, but additional days prescribed by State and Territory Governments allowing employees to effectively double-dip; and

> "Penalty rates are a deterrent to operating outside of designated ordinary hours"

- **Dual Regulation:** Modern awards also deal with matters dealt with by other safety net legislation, such as superannuation legislation. Dual regulation increases red-tape for firms and may impose additional costs in the form of higher superannuation levies.

As modern awards will operate on a national 'common rule' basis (by reference to industry or occupation rather than by naming a firm), some employees that were previously award-free will now be award regulated. The extension of regulation can have negative effects for productivity improvements where new inflexible work rules apply.

3.4.5 Minimum Wages

Australia currently has the most regulated and highest minimum wages in the OECD. This is only sustainable if it reflects our economic circumstances and is matched by comparable levels of productivity. Australia is the only country to have a cascade of multiple minimum wage rates which range from the National Minimum Wage of $569.90 per week to over $1900.00 per week and apply to unskilled, trade, managerial and professional employees[85]. On top of these base wage costs are related on-costs, penalty rates, allowances, loadings, workers compensation premiums, payroll tax, superannuation and associated administrative costs. Policymakers need to closely re-examine Australia's minimum wage classification system and its effect on productivity in the services sector.

This has led Professor Mark Wooden of the Melbourne Institute of Applied Economic and Social Research to question the role of our current minimum wage system in achieving an important objective, commenting[86]:

> "Australia is, however, relatively unique among industrial nations in having not one single minimum wage, but a whole raft of different minima that vary both across awards and within awards. While the number of such minima has been

83. Martin, S. 'Retailers say new award wage penalty loads 'too much to bear', *The Advertiser.* 16 July 2010.

84. *'Unions wrong on award modernisation: NRA', Queensland Business Review*, 24 August 2009, http://www.qbr.com.au/news/articleid/58038.aspx

85. As at 1 July 2010. There are also subsidiary wage rates for juniors, trainees/apprentices and persons with a disability, which may be lower than the National Minimum Wage.

86. Wooden, M., "An Unfair Safety Net?", *Australian Bulletin of Labour*, Volume 36, No 3, 2010, p.325.

> greatly streamlined over the years, the question still remains as to why we need to set a multitude of minimum wage floors for jobs scattered across almost the entire wage distribution.
>
> If the rationale behind minimum wage adjustments is to protect the living standards of the lowest paid, I can see little reason why we need more than one global minimum wage. Varying award rates above the global minimum has little to do with protecting the needs of the lowest paid."

In the former Australian Fair Pay Commission's final decision prior to its abolition in 2009, it considered that *"its main priority in this decision is to protect jobs in the short term and help job seekers to be competitive in the labour market"*[87]. It did not grant an increase to minimum wages in the wake of the worst Global Financial Crisis in over 20 years.

However, the new Fair Work laws have shifted the emphasis from ensuring that job seekers remain and obtain in employment to a wider range of considerations. The inaugural decision of the new industrial tribunal, Fair Work Australia, required employers to pay a significant increase to employees regulated by minimum wages, regardless of skill level and regardless of whether the particular firm or industry sector was performing as well as other sectors. It did so as the world continued to face significant economic and labour market uncertainty, and as businesses struggled to recover from the impact of the financial crisis and to remain in business and retain staff.

Professor Mark Wooden commented on the impact of the new Fair Work minimum wage laws on the unemployed following the inaugural minimum wage decision under these laws, stating[88]:

> "Minimum wage rises benefit low-paid workers at the expense of the unemployed. Any action that increases the cost of hiring low-wage labour reduces the likelihood of those without jobs finding one in the future. Moreover, it is the long-term unemployed who's employment chances are most damaged. This seems very unfair. And it certainly doesn't promote social inclusion through greater workforce participation[...] The decision looks even more unfair once you realise that many low-paid workers do not live in poor households, and that a low-paid worker has a much better chance of getting a better paid job than someone who doesn't have a job at all."

A minimum wage set above the level of the marginal value that the worker contributes will discourage employment and lead to higher unemployment[89]. Increases in pay which are paid by higher labour productivity are the only sustainable way of maintaining and increasing real wages and containing the threat of higher inflation. This is also true for enterprise agreements that are made between employers and employees which should link wage increases and benefits to higher productivity gains, rather than being agreed to in response to actual or threatened industrial action or universally applied trade union claims.

If minimum wage rates for various classifications are higher than the equilibrium, then a firm will not engage additional workers. Firms may often cut-costs in other areas, if there are increases in wage rates, to pay for workers already engaged. If they cannot absorb those costs they will reduce staff numbers or firm owners increase their hours of work. Wage increases not agreed to by employers have no reference to productivity and efficiency improvements, which is why they can have such a profound impact on individual firms in the services sectors where labour costs are the biggest cost to a firm.

3.4.6 Enterprise Agreements

The policy reforms prior to the Fair Work laws were based on the premise that the primary responsibility for determining workplace matters should be with the employers and employees at the workplace level, and underpinned by a legislated safety net of employment conditions.

> "Collectivism in the new system does not reflect the contemporary reality of the majority of Australian service industry workplaces"

Under the Fair Work system, only collective agreements are available, with the ability to make a new statutory individual agreements removed (there are some transitions for former agreements). There is also an enhanced supervisory role of the industrial tribunal in agreement making, and unions have more capacity to become involved in bargaining, even in largely non-unionised workplaces. However, many employers in the services sector have no experience or interface with collective bargaining or trade unions, particularly SMEs. In 2008 only 29 per cent of the Australian workforce had their pay regulated by a federally registered collective agreement compared to 37.0 per cent of all non-managerial employees who had their pay set by unregistered individual agreements (i.e. common law contracts)[90]. The assumed or dominant paradigm of collectivism in the new system does not reflect the contemporary reality of the majority of Australian service industry workplaces.

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87. Australian Fair Pay Commission Decision - 2008, Reasons for Decision, p.23.

88. Wooden, M. '*A hole in the safety net*', *The Australian Financial Review*. 9 June 2010

89. Econtech, *The Economic Effects Of Industrial Relations Reforms Since 1993, 2007*,p.9.

90. DEEWR, *Agreement Making in Australia under the Workplace Relations Act 1996, 2007-2009*, p.25.

Moreover, many SMEs who do engage in collective bargaining do so directly with employees. In a recent Department of Education, Employment and Workplace Relations (DEEWR) report, *Agreement Making in Australia under the Workplace Relations Act 1996, 2007-2009*, DEEWR noted that[91]:

> "[t]his is corroborated by the Who Bargains? report, which found that only 11 per cent of employees in workplaces of less than 20 people had a union-negotiated collective agreement, compared with 34 per cent of employees in companies of more than 100 people. Employees in small enterprises (less than 100 people) were even less likely to have a union-negotiated collective agreement, with only 9 per cent of these employees being covered by a union collective agreement, compared with 32 per cent of employees in enterprises of over 100 people."

Employers were promised that the proposed fair work reforms would ensure that[92]:

> " [...] increases in pay and entitlements are linked to productivity increases at the enterprise. This is due to negotiations at the level of the enterprise better reflecting the financial situation of the enterprise. Furthermore, collective bargaining will shift the focus of negotiations towards boosting productivity."

And that:

> "[c]ollective bargaining under the Bill will be less bound by regulation and red tape and is designed to have a positive impact on labour productivity."

Unfortunately, whilst the Fair Work system appears to be delivering enhanced wages and conditions to trade union members and some employees, the early indications are that the system is not delivering equal benefits to employers through higher efficiency or productivity improvements. The latest *Trends in Federal Enterprise Bargaining Report*, also published by the Commonwealth's DEEWR, indicates that collective agreements under which unions are covered paid an average annual increase of 4.1 per cent in the June 2010 quarter, compared to 3.5% for agreements with no unions[93]. In important and vital services sectors, such as transport services in the off-shore mining sector, excessive wage claims by unions backed by crippling industrial action has resulted in employers having no real choice but to accede to union claims, with the result that Australia risks becoming uncompetitive and also risks flow-on claims to other firms and other industries. Some reports indicate that some employees are now earning up to $250,000 per year for only 60 day work[94] and one of the largest oil and gas companies indicated that in the past 12 months it had seen *"a significant and unsustainable escalation"* in offshore construction pay rates and

> "that escalation follows recent excessive outcomes in the offshore maritime sector […] Excessive wage outcomes not linked to productivity increases represent a considerable concern to the oil and gas industry."[95]

Affected employers have indicated that these claims risk future projects in Australia[96]:

> "'[t]hey use the last big claim as the starting point for the next negotiation - they will never accept anything less'. He said he had worked in the industry around the world and not encountered an industrial relations environment like Australia's. 'In the interest of our shareholders, when it comes to projects in the future we are now looking at Australia from an affordability perspective'[…]".

In a rather uncommon signal by at least one large corporate to its shareholders and various stakeholders, BHP Billiton's *2009/10* Annual Report highlights the continued increase in industrial activity and the threat to productivity since the Fair Work system commenced in 2009[97]:

> "Changing industrial relations legislation such as the Australian Fair Work Act 2009 may impact workforce flexibility, productivity and costs [...] Since the introduction of the Australian Fair Work Act in 2009, increasing occurrences of low-level industrial activity have been experienced across many Australian assets. The additional claims relate to increases [sic] access and coverage as provided by the legislation. If this activity continues, some negative productivity impacts may result."

The Fair Work system has resulted in a number of companies within the maritime services sector, having no real alternative but to negotiate with trade unions who pursue excessive wage claims and undertake protracted and open ended industrial action. Maritime unions have acknowledged that a $50,000 allowance claim recently sought was not linked to any productivity or efficiency increases, with one of the targeted companies reflecting on the damage it cause to other projects[98]:

91. Ibid, p.41.

92. *Fair Work Bill 2009 (Cth) Explanatory Memorandum,* Regulatory Analysis to the Fair Work bill, r187- r188.

93. See also *Workplace Express* (17 November), Private sector pay growth picking up pace.

94. Franklin, M., 'Rig worker pay goes up 39pc in year, *The Australian,* 12 October 2010.

95. Franklin, M., 'Oil rig workers on '$2000 a day' as mining execs warn of high wages' *The Australian,* 11 October 2010.

96. Ibid.

97. BHP Billiton, *2009/10 Annual Report,* p 11 http://www.bhpbilliton.com/bbContentRepository/docs/bhpBillitonAnnualReport2010.pdf

98. Hannan, E. and Burrell,A, 'Union leader claims `dinosaur' employers out of touch', *The Australian,* 3 February 2010.

> "This dispute has cost us over a $1 million, and that's a fair amount of money to get an agreement [...] Fair Work Australia are very limited in what they can do in terms of intervention. We called on the federal and state governments to intervene and at least give us some form of assistance. Nothing was offered, nothing at all. It meant what we had to do, to do an agreement, was sit down with the union and negotiate the best outcome we could possibly achieve and do it knowing we are not really going to get the relief that we needed, or any kind of assistance from Fair Work Australia to a point [...] there is going to be a definite increase in costs to projects. Future projects will be costed to accommodate that escalation, therefore will flow on to the project in the majority of cases."

The emphasis on collective bargaining and enhanced rights for unions in the Fair Work laws ignores the fact that a collective enterprise agreement does not, of itself, guarantee increased productivity, efficiency or indeed any other objective benefit. Rather, it is the extent and nature of collaboration between employers and employees that ultimately determines whether productivity and efficiency is improved, and this can be achieved by individual or collective based agreements.

Prior to the Fair Work reforms, an employer was not compelled to bargain with employees or unions for an enterprise agreement. Bargaining was truly voluntary[99]. However, under the Fair Work laws, an employer can be directed to bargain with a *"bargaining representative"* regardless of their capacity or desire to do so. This will occur where a bargaining representative of the employees (deemed by the Fair Work laws to be an employee's trade union), obtains a "majority support" determination. A union need only have one member at a worksite to trigger this legal obligation, despite the majority of employees preferring to deal directly with the employer and not in association with the trade union. A union can also obtain "good faith bargaining orders" during bargaining which can prevent an employer and its employees voting on a proposed agreement [100]. This has the effect of interfering with the rights of employees and their employer who may wish to implement an agreement that has productivity improvements.

Under the Fair Work laws, an employer must bargain with unions under prescriptive bargaining rules or face orders being made by the industrial tribunal. If an employer breaches these orders, the tribunal can impose an outcome on an employer. Putting aside the ability for employees to take protected industrial action, these new rules ultimately place undue pressure on employers to reluctantly agree to commence bargaining and/or accept a union's proposed agreement, which are often devoid of productivity benefits or efficiencies and do not represent a fair exchange for higher wages and conditions. These one sided agreements threaten the drive up prices as they are passed on to the consumer in the form of higher prices for goods and services. This is not a hypothetical argument. This has happened before in Australia, such as in the 1970s and early 1980s, with disastrous consequences for our economy and for employment.

"There has been a worrying surge in applications for protected action ballot orders"

Under the Fair Work laws, there has been a worrying surge in applications for protected action ballot orders with approximately 981 orders applied for by unions in 2009-10 compared to 271 in 2006-07[101]. Moreover, it would also appear that a union is now able to initiate protected industrial action on behalf of its members in circumstances where bargaining has not occurred and no series of claims have been made known to an employer[102]. This only increases the prospects of industrial action which unions will apply on reluctant employers in order to secure increased wages without any improvement in efficiency or productivity for individual firms. Such an outcome is at odds with government policy intent outlined to the parliament on the passage of the new workplace laws.

3.4.6.1 Multi-employer Bargaining

Prior to the Fair Work laws, collective agreements that covered multiple businesses could only be approved if it was in the 'public interest'. The rationale was to limit pressure of unions on firms to engage in "pattern bargaining" where common conditions applied to various enterprises without taking into account the operational requirements of each firm. Multi-employer bargaining is now authorised without being approved by the tribunal, and indeed it is even encouraged for "low paid" employees.

In the Minister's second reading speech to the Fair Work laws, it was stated that:

> "The Bill provides a new scheme of bargaining for low paid employees. There is significant evidence that enterprise bargaining benefits employees, employers and the economy and we want more Australians to benefit from it [...] The Bill provides for the possibility of a workplace determination in the low-paid stream [...]"

99. This was consistent with article 4 of ILO Convention No. 98 Right to Organise and Collective Bargaining Convention, 1949.

100. *ASU v Queensland Tertiary Admissions Centre Ltd* [2009] FWA 53 (unreported); *CFMEU v Australian Precast Solutions Pty Ltd and Abigroup Contractors Pty Ltd* [2009] FWA 68 (unreported).

101. Fair Work Australia, *Fair Work Australia: Annual Report 2009/10.*

102. *JJ Richards & Sons v TWU* [2010] FWAFB 9963.

This is an entirely new creation in the industrial relation system that will unnecessarily place pressure on multiple employers within an industry to make an agreement on terms suited to unions rather than its business operations or the majority of its employees.

The first low paid claim has been launched by trade unions in the services sector – the funded aged care sector. The claim attempts to force over 300 aged care service providers into mandatory bargaining, even where some employers have existing collective agreements with their workforce providing higher wages and conditions than the award.

There are a number of problems with the low paid provisions for the services industry. Firstly, there is no definition of 'low-paid' and could include any sector where employees were covered by industrial awards. Secondly, the actual process for unions to force employers into this stream appears similar to the archaic 'log of claims' system of award making. This is contrary to Government promises that under the fair work system, such *"arcane"* processes characterised by *"junior union employees whose job it was to comb through the new Yellow Pages each year and lick the stamps on the thousands of envelopes"* would be *"gone from the system for good"*[103].

Employers do not have a choice whether to be part of this process, which is ultimately determined by the industrial tribunal. Thirdly, whilst there is a 'public interest' test, there are limited requirements for evidence of productivity improvements in a proposed industry wide agreement. In essence, there remains very little in the new low paid bargaining stream that would actually enhance a firm's productivity or deliver any benefit to employers. Every indication is that it will have the opposite effect.

3.4.6.2 Agreement Content

Prior to the Fair Work laws, statutory agreements could only include matters that pertained to the employment relationship. As a result, unions could not pursue industrial action in support of claims for terms extraneous to this relationship (i.e. about social, environmental, commercial or union matters).

Therefore, conditions that unions often wanted included in agreements which had no bearing on firm efficiency, productivity, or employment, were not permissible under what were employment based agreements. The new Fair Work laws now allow agreements to deal with any matter that relates to the employment relationship, as well as the relationship between an employer and union. It also allows unions to take lawful industrial action over non-permissible matters, where they reasonably consider these matters to be permissible. For example, unions are now increasingly making claims for new agreements that would effectively limit or regulate the use of labour hire by companies and this has been permitted by the fair work laws [104]. This is yet another development which would decrease the flexibility and competitiveness available to Australian businesses.

3.4.6.3 Individual Agreements

From 1996 employers and employees could make a statutory individual agreement in the form of an Australian Workplace Agreement (AWA), and some service industry employers did. AWAs were removed from the national system in the most recent changes by the then Rudd Government. Presently, the only form of quasi individual agreement that is currently available is the very limited Individual Flexibility Arrangements (IFAs).

It remains to be seen whether IFAs will deliver the intended benefit of increased flexibility as was promised by the Government [105]. IFAs differ considerably from AWAs in that IFAs:

- Can only deal with a number of limited matters regulated under awards[106]. AWAs enabled an employer to tailor an agreement to the circumstances and needs of both the individual employee and the enterprise and dealt with all award and over-award components (such as cashing out of accrued annual leave, incentive and bonus payments);
- Can deal with all, some or no matters under an enterprise agreement depending on whether the enterprise agreement limits the terms to be subject to an IFA;
- Can be terminated by either party (without any requirement to consult with the other party) by giving not less than 28 days. The power of an employee to unilaterally terminate an IFA does not give the employer the ability to manage that aspect of the employment with long-term certainty. Adjustments made to pay rates (possibly to simplify payroll administration) can be terminated, and the employer is forced to return to the complexities of the award; and
- Cannot be made a condition of employment and must be agreed to by both new and existing employees and their employer.

103. Deputy Prime Minister, Hon. Julia Gillard MP, *Address to the Australian Labour Law Association's Fourth Biennial Conference*, Melbourne, 14 November 2008.

104. *Ascurco Contracting Pty Ltd v CFMEU* [2010] FWAFB 6180.

105. ALP, *Forward with Fairness – Policy Implementation Plan,* August 2007.

106. This includes: arrangements for when work is performed, overtime rates, penalty rates, allowances; and annual leave loading.

There is already some evidence that unions are limiting the number of matters an IFA can deal with in bargaining and rendering it fundamentally ineffective as a vehicle for promised flexibility[107] with reports that one trade union leader indicating that he *"would be seeking to have the capacity for individual bargaining prohibited at other companies"* following a large manufacturer agreeing to water down the Government's own default IFA clause[108].

3.4.7 Statutory Employment Conditions

The new National Employment Standards (NES) commenced on 1 January 2010. These statutory minima regulate hours of work, leave arrangements and termination benefits. They operate in conjunction with any industrial award that may apply and cannot be overridden by either a registered or unregistered agreement. The NES covers every employee from clerical employees to chief executive officers.

Employees not bound by enterprise agreements and awards can deal flexibly with a number of conditions under the NES. For example, employees are able to cash-out annual leave or average hours of work over a period of time. However, for award regulated employees, unless the award provides for that flexibility, they must abide by the terms of the NES without that additional flexibility. This is a default favouring inflexibility in a system charged with supporting the competitiveness of Australian enterprises in the services sector and beyond.

ACCI supports a sustainable system of minimum standards. However, given that statutory minima operate across different firms, it is important that they operate as flexibly as possible within the services industry where many employees remain award and statute reliant given the low unionisation and non-collectivist nature of labour relationships at the enterprise level. They should not restrict the manner by which businesses operate and they should support operational flexibility and competitiveness, not retard it.

3.4.8 Employment Protection

The new employment protection laws impact upon the capacity of services sector employers to manage their workforce. For example, the new Fair Work laws *"general protections"* regime significantly extends the capacity for employees and unions to litigate in the federal courts, including obtaining injunctions stopping legitimate business decisions from occurring (i.e. redundancies and restructuring). Employers who wish to terminate or alter the working arrangements may be liable under these laws if the employee alleges that action was taken as a result of a *"workplace right"*.

This is an entirely new area of law and avenue for litigation that may impact on the ability of employers to structure their workplace arrangements to enhance their business operations and productive capacity. This very recent substantial extension of regulation is at odds with recommendations by key international organisations, such as the OECD.

"The new employment protection laws impact upon the capacity of services sector employers to manage their workforce"

Similarly, the unfair dismissal laws under the Fair Work system also have the effect of limiting the capacity of a firm to terminate the employment of an employee, where an employee has a right to challenge that dismissal on procedural grounds, despite the employer having a valid reason to terminate the employee. A firm who wishes to restructure and make redundancies may also be required to reinstate the worker if they do not follow certain procedures under the Fair Work laws. While some recognition is given to service redundancies, a right to challenge termination on procedural grounds bears no relationship to the actual operational requirements or needs of the firm to restructure, but penalises employers for failing to comply with procedural rules. Other requirements force a service industry business within a large corporate group to consider alternative positions not only within its own business, but across hundreds of other disparate business operations which imposes significant red-tape and challenges on even the most well-resourced companies.

In the *Econtech report* commissioned by ACCI, the authors concluded that *"the assessment of the international and national evidence presented later in this section concludes that there is an adverse impact of unfair dismissal legislation in Australia on the structural unemployment rate and labour productivity."*

The fair work laws removed an exemption for smaller firms (100 or fewer employees) and replaced this by a special small business employer rule (under 15 employees) that extends qualifying periods of time before an employee can make an unfair dismissal claim, and allows employers to rely upon a Fair Dismissal Code when a business does dismiss an employee after serving the required qualifying period. Smaller service industry employers may benefit from this dismissal code,

107. Australian Mines And Metals *Association Individual Flexibility Arrangements (under the Fair Work Act 2009) - The Great Illusion*, Research Paper, 2010. http://www.amma.org.au/home/publications/AMMA_Paper_IFAs.pdf

108. Hannan, E., 'New workplace laws failing Julia Gillard's flexibility test', *The Australian*. 17 September 2009.

depending on how it comes to be administered and interpreted by the regulator. However, reliance on the Code does not prevent a claim being brought by an employee with a small business employer having the onus to defend their actions and reliance on the Code before Fair Work Australia. Following these changes, there has been a significant increase in the number of unfair dismissal applications made against employers, with 13,054 applications made in 2009/10 compared with 6,707 made in 2004/5 (prior to the *WorkChoices* reforms)[109].

A growing number of cases illustrate that employers are being penalised for dismissing an employee despite having a valid reason for doing so. For example, employers have been successfully sued by employees in circumstances where serious misconduct has occurred (i.e. not following strictly OH&S protocols[110] , or trying to protect other employees from sexual harassment and stalking[111]) or where redundancies were overturned because procedural requirements were not followed strictly[112].

Despite assurances to business that the new Fair Work laws would *"remove 'go away money"* from the unfair dismissal system", anecdotal and independent research suggests that this is not occurring[113], even though the system may not have reached the level of excess that was seen under the pre-2005 laws. Fair Work Australia officials recently told a Senate Education, Employment and Workplace Relations Committee that in the two months from July 1, 2010 (when official records started to be kept of unfair dismissal settlements), 979 of conciliated unfair dismissal claims - or 75 per cent of the total - involved a payment to an employee, with the most common ranging from $2,000-to-$4,000, and 1% involving sums of between $30,000 and $40,000. Furthermore, a recent report commissioned for Fair Work Australia indicated that 76 per cent of employer participants surveyed wanted to avoid the *"cost, time, inconvenience or stress of further legal proceedings"* by settling the matter at *"out of court"*, rather than defending the matter in further arbitral proceedings[114].

3.4.9 Building and Construction Industry

Following an extensive Commonwealth Royal Commission by Commissioner Cole in 2001 which found widespread unlawfulness in the building and construction industry, the then Howard Government introduced into Parliament targeted laws in the form of the *Building and Construction Industry Improvement Act 2005* (BCII Act). This was the legislative response to the Royal Commission extensive findings and recommendations into the industry, which was described by Commissioner Cole in the following terms:

> At the heart of the findings is lawlessness. It is exhibited in many ways. There are breaches of the criminal law. There are breaches of laws of general application to all Australians where the sanction is a penalty rather than possible imprisonment. There are breaches of many provisions of the Workplace Relations Act 1996 (Cwth). [Volume 1, page 6, para 17]
>
> These findings demonstrate an industry which departs from the standards of commercial and industrial conduct exhibited in the rest of the Australian economy. They mark the industry as singular. They indicate an urgent need for structural and cultural reform. [volume 1, page 6, para 16]

Economic modelling of the operation of targeted laws for the building and construction sector found that the 2005 reforms are having a beneficial and positive economic effect. The activities of the industry regulator, the Australian Building and Construction Commission (ABCC), are delivering real economic and industrial benefits to the construction industry, other industries and to the wider economy and society. This is evidenced in the various independent Econtech reports and in the feedback of other industries reliant on construction[115].

In 2009 the third *Econtech/KPMG* report, '*Economic Analysis of Building and Construction Industry Productivity*', was released. The report was an update of the analysis previously undertaken by Econtech in 2007 and 2008.

Importantly, economic modelling estimated a number of positive economic impacts due to the ABCC's activities and industrial relations reforms:

- GDP is 1.5 per cent higher than it otherwise would be;
- CPI is 1.2 per cent lower than it otherwise would be; and
- Improved consumer living standards are reflected in an annual economic welfare gain of $5.1 billion.

Econtech also interviewed representative from four major construction companies. These interviews reported further benefits including, (a) a significant reduction in the number of days lost to industrial action; (b) improved management of occupational health and safety issues and a reduction in their misuse for industrial purposes and (c) productivity gains from improved rostering flexibility.

109. Fair Work Australia, op. cit.

110. Hannan, E., 'Bosses rapped for valid sacking', The Australian, 19 February, 2010.

111. *Sex offender wins unfair dismissal case*, online news, ABC, 7 July 2010, http://www.abc.net.au/news/stories/2010/07/07/2947360.htm

112. *Ulan Coal Mines Limited v A. Honeysett, A. Oldfield, C. Michaelides, G. Atkinson, R. Butler and D. Dixon* (C2010/4468); *R. Murray, M. Butler and C. Butler v Ulan Coal Mines Limited* (C2010/4457) ([2010] FWAFB 7578).

113. ALP *Forward with Fairness – Policy Implementation Plan,* August 2007, p.20.

114. Fair Work Australia, *Fair Work Australia: Unfair Dismissal Conciliation Research Survey Results,* November 2010. http://www.fwa.gov.au/documents/dismissals/report.pdf

115. KPMG/Econtech, *Economic Analysis of Building and Construction Industry Productivity* (series), 2007, 2008 and 2009 reports.

In terms of reducing the incidence of unlawfulness, of significance is the record penalty of $1.325 million ordered by the Federal Court against building unions in July 2010[116]. The case was initiated by the ABCC in response to a protracted union demarcation dispute at the West Gate Bridge strengthening project in 2009. The unlawful conduct which occurred at the Westgate project were the precise types of unlawful practices which the Cole Royal Commission recommendations were designed to stamp out. The introduction of higher penalties and a dedicated regulator with similar coercive powers to other Commonwealth enforcement agencies (such as the ATO and ACCC), which were also recommended by the Cole Royal Commission, have been invaluable to the ABCC in regulating the industry. Former ABC Commissioner, Mr John Lloyd, warned that *"[a]ny watered-down circumstances would see the bad practices of the past return. This would be damaging to the industry and the Australian economy"*[117].

Many of these effective and targeted laws will be repealed if the government's *Building and Construction Industry Improvement Amendment (Transition to Fair Work) Bill 2010* is passed by Parliament. Therefore, it is important that existing laws and institutions are retained in a substantive way to continue to drive industry specific productivity gains that have a positive impact on the sector and the Australian community.

Further discussion of the issue can be found in Chapter 4 of this report.

3.4.10 ACCI Recommendations

The following recommendations are consistent with domestic and international evidence on the importance of ensuring that workplace regulations have a positive effect on productivity, investment, and jobs in the services sector. Whilst they do not attempt to address every aspect of workplace regulation, they should be considered as short to medium term microeconomic reform measures that will preserve or improve the vital services sector:

Recommendation 28: *(Fair Work System and Industrial awards)* The Government should direct the Productivity Commission to examine the effects of the Fair Work laws, particularly the operation of modern awards on firms in priority services sectors. Provisions that are too prescriptive, inflexible or do not assist in achieving productivity should be reviewed and changed following extensive consultation with industry. Awards should be a genuine minimum safety net only and not impede bargaining. The process of creating or varying industrial awards should not increase costs or introduce new inflexibilities on employers.

Recommendation 29: *(Enterprise Agreements)* Agreement making between employers and employees facilitated by bargaining agents should be truly voluntary. There should not be any capacity to frustrate formal agreement making where a majority of employees and the employer wish to bargain and make an agreement. Agreement making should be flexible to reflect both collectivist and non-collectivist workplaces in Australia. The content of agreements should be limited to employment matters only. Statutory agreements should have limited procedural requirements for approval. Agreements should pass a No-Disadvantage Test against a clear safety net of terms and conditions. Individual Flexibility Arrangements (IFAs) need to be able to flexibly deal with modifying the application of terms as originally intended.

Recommendation 30: *(Bargaining/Arbitration)* There should be limited scope for an industrial tribunal to arbitrate and impose a workplace determination or order on an employer. There should be no powers to coerce an employer into bargaining or prescriptive rules about bargaining which could lead to orders made against a business. Access to protected industrial action should only occur once bargaining commences and should be accessed only as a last resort.

Recommendation 31: *(Statutory Minima)* Statutory minimum standards are warranted but must be flexible and adaptable to suit a variety of workplace circumstances. They should be monitored to ensure sufficient flexibility and to identify any negative effects in a workplace. Modern awards and agreements should facilitate flexibility of the NES (for example, cashing out of annual leave).

Recommendation 32: *(Minimum wages)* Minimum wages should operate in conjunction with the tax transfer system and the primary focus should be on improving social inclusion through increased workforce participation. Minimum wages for juniors, apprentices and trainees need to be retained and assist in maximising employment and training opportunities for the most vulnerable in our labour market. Decisions by industrial tribunals should not price these workers out of the labour market. A primary consideration for an industrial tribunal should be how non-productivity based minimum wage decisions will impact individual businesses, including factors such as additional labour on-costs and its capacity to pay.

116. *Williams v AMWU* [2010] FCA 754.

117. Lloyd, J., "Only a watchdog with bite can deal with thugs", *The Australian*, 22 September 2010.

Recommendation 33: *(Transfer of business)* Rules on transmission of agreements should be flexible. Inflexible agreements should not apply indefinitely to an in-coming employer.

Recommendation 34: *(Employment Protection)* Unfair dismissal laws should not penalise an employer where they have terminated an employee based on a valid reason. Similarly, procedural deficiencies in termination or carrying out redundancies should not render an otherwise justified termination, unlawful. Appropriate exemptions should be considered after extensive consultation with industry. There should be low cost and fast track processes to exclude inappropriate or non-qualifying claims.

Recommendation 35: *(General Protections)* The general protection regime under Part 3-1 of the *Fair Work Act 2009* should be reviewed to ensure that the majority of laws are aimed at governing "freedom of association" as was historically the case under previous laws. Anti-discrimination provisions should be aligned with federal and state anti-discrimination legislation by removing *"reverse onus"* provisions which deem an employer liable unless they can demonstrate that their conduct was not for unlawful reasons. Laws should generally apply a *"dominant purpose"* test.

Recommendation 36: *(Independent Contractors)* Employment laws should not apply to genuine independent contractors who operate on a commercial basis (apart from special cases, such as the TCF industry).

Recommendation 37: *(Superannuation)* The overall regulatory burdens on firms should be decreased. Dual regulation of superannuation should be removed and only dealt with in the federal Superannuation Guarantee legislation (i.e. not in modern awards). There should be no additional costs to employers through higher Superannuation Guarantee levies without commensurate off-sets in other business costs.

Recommendation 38: *(Red Tape)* Red tape on business should be minimised. The existing 'employee records' exemption and 'small business' exemption in national privacy laws must be retained. The small business exemption threshold should be indexed and immediately extended from $3 million to $5 million (which is based on a firm's annual turnover). There should be no obligation on an employer to administer Government schemes and programs unless there is a real and equal benefit. Therefore, the Government's Paid Parental Leave scheme, whereby employers are forced to act as the "paymaster" (i.e. pass public monies to individuals on behalf of the Government) without any benefit to the employer or employee, should be modified.

3.5 Human Capital Development and Services

As at February 2010, the services sector (as broadly defined) employed nearly 9.4 million people, which accounts for around 86 per cent of the Australia's total employment. Employment across the six service industry groups covered in this paper has experienced steady growth in the previous decade and all groups have reported significant wide spread skills shortages at entry level and higher skills levels both immediately prior to and emerging from the global financial crisis. Competition from other sectors, the perception of many services sector jobs as low payed and low skilled and the transitionary nature of many entry level service positions has caused considerable drain on the inflow of labour into the services sector.

"The transitionary nature of many entry level service positions has caused considerable drain on the inflow of labour into the services sector"

In the lead up to the 2010 federal election, ACCI conducted a survey of members to ascertain the top issues facing businesses. Of the total respondents, 80.4 per cent per cent were from the identified services sectors covered in this report. Skills Development ranked highly amongst businesses with 82 per cent per cent of businesses identifying either "major or moderate concerns" with recruitment of employees with appropriate skills, while 70 per cent per cent were concerned about difficulties in recruiting employees with acceptable levels of numeracy and literacy, confirming that Australian employers have significant issues around low levels of literacy and numeracy reducing the productive capacity of some employees to perform workplace tasks.

Given the re-emergence of skills shortages and projections that they will deepen across the labour market, skills development in the services sector is a crucial area of domestic policy worthy of further focus.

3.5.1 The Skills Base in the Services Sector

All four service industry groups are characterised by high percentage of employees with no post school qualifications. At the entry level for employment, the services industries are, in general, characterised by their high demand for labour due to the constant turnover of employees and low entry barriers due to the perceived lack of required skills to secure an entry level position.

However, there is a strong demand for skills at an intermediate and higher level within these sectors. Some industry sectors within the four identified service industry groups do have high levels of demand for higher level Vocational Education (diploma and above) and Training (VET) and tertiary qualifications at entry and intermediate levels, especially those with a strong reliance on traditional trades training for skilled employees. All subsectors within the four service industry groups have strong demand for predominantly tertiary, but also some higher level VET qualifications in senior level and management roles[118].

"There is a strong demand for skills at an intermediate and higher level within these sectors"

Of the six identified services industry groups outlined in this report, distributive services and inbound tourism have the highest proportion employed without a non-school qualification (60.7 per cent per cent), reflecting the dominance of lower skill occupations associated with the Wholesale and Retail trade, and Transport, postal and warehousing industries that make up this sector and the transitional nature of the workforce (Figure 3-5). However, of those who had completed a non-school qualification, the highest proportion had a Bachelor degree or above (15.9 per cent per cent) which would emphasise skills requirements determined by the subsector for those in senior management positions. Career transitioning into management roles within the sector, as part of an industry accepted planned workforce development approach, would require significant upskilling as entry level employees tend to have a very low skills base as a starting point.

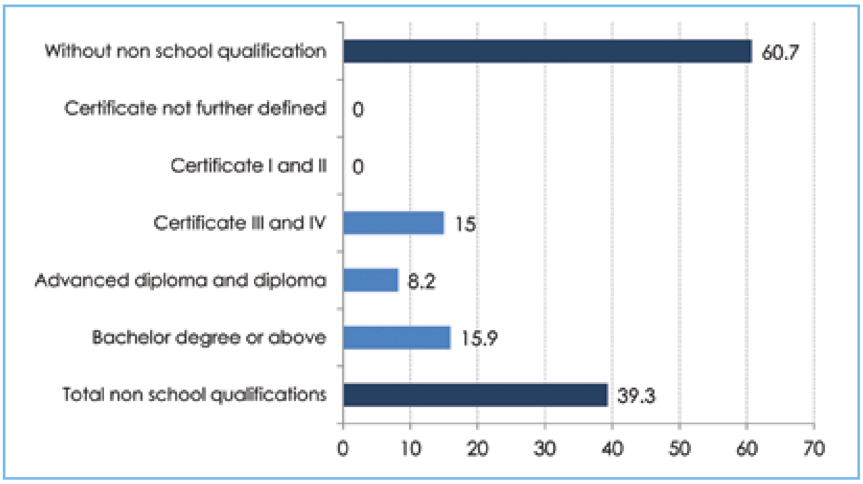
Certain sectors of the services industries such as Retail and Restaurants, cafes and accommodation services all heavily rely on younger students in casual positions to meet their entry level labour needs. However, this particular demographic often sees employment in these industries as transitional as they move on to complete their studies and move into other sectors. This poses significant skills retention issues as a constant flow through of employees means an unrelenting cycle of training new employees to the standard required by the business.

Training is often done in-house based around the specific equipment and procedures in use within the business. The informal nature of this training makes it difficult to gauge the true investment in training within these industry sectors. The National Centre for Vocational Education Research (NCVER) *Survey of Employer Use and Views*[120] found that while only 45 per cent per cent of employers in the retail sector used formal Vocational Education and Training to upskill their employees, over 80 per cent per cent stated they used informal training to upskill employees. Only 9.8 per cent per cent stated they provided no training for employees. This serves to dispel the generally regarded perception that industry does not have a commitment to training.

Construction and Engineering services, on the other hand, have a strong reliance on Vocational Education and Training due to the prevalence of apprenticeships and traineeships as a pathway into the sector. While there remains a high number percentage of those without post-school qualifications (44.5 per cent), 27.4 per cent have qualifications at the Certificate III/IV level are indicative on the strong reliance on traditional trades qualifications in this area (Figure 3-6).

Figure 3-5: Distributive trades industry – educational attainment May 2009[119]

(per cent share)



Source: Department of Education, Employment and Workplace Relations (DEEWR) Labour Market Research and Analysis Branch.

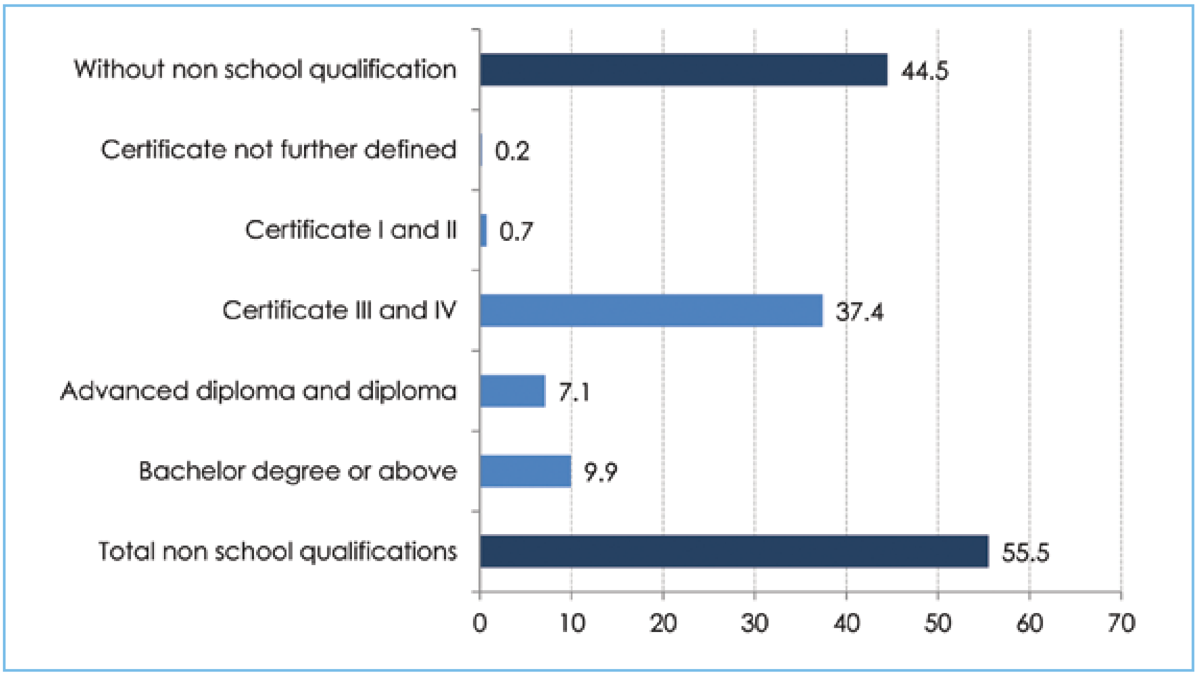
118. Australian Bureau of Statistics (ABS) Sep 2010, *Australian Social Trends: Australian Workers, Education and Workplace Training,* Cat. No. 4102.0.

119. Raw data from the Department of Education, Employment and Workplace Relations (DEEWR) Labour Market Research and Analysis Branch.

120. NCVER, 2009, *Survey of Employer Use and Views*, Adelaide.

Figure 3-6: Utilities and construction services – educational attainment May 2009[122]

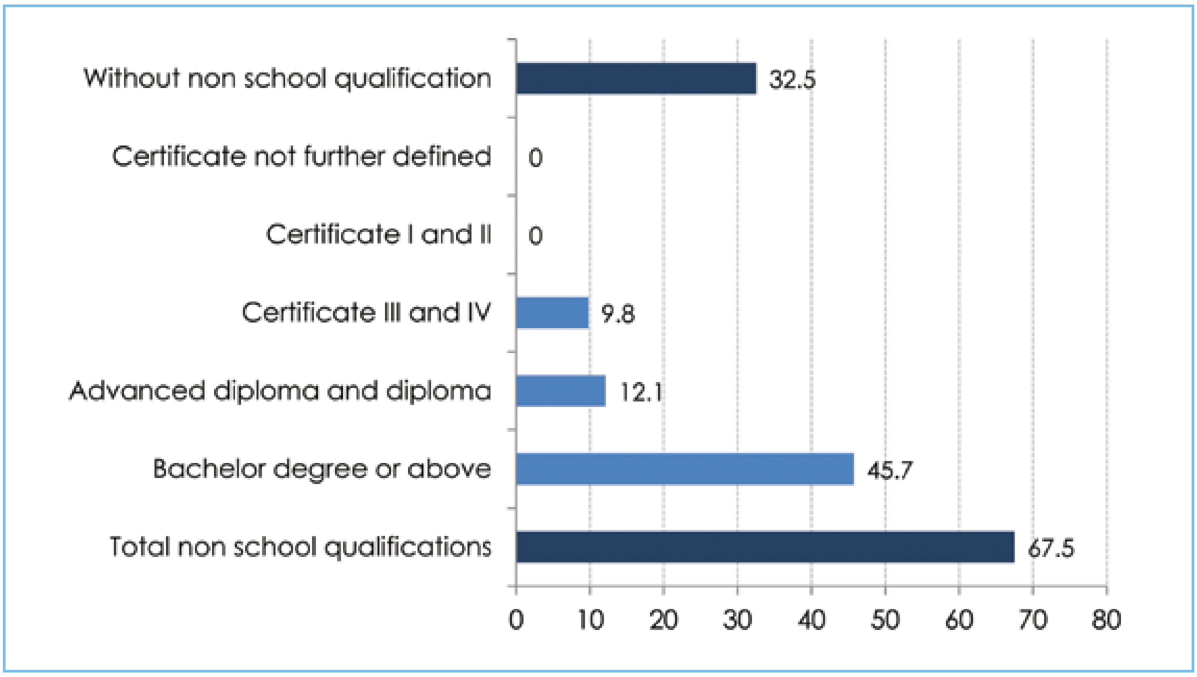
(per cent share)



Source: Department of Education, Employment and Workplace Relations (DEEWR) Labour Market Research and Analysis Branch.

Figure 3-7: Business Services – educational attainment May 2009[124]

(per cent share)



Source: Department of Education, Employment and Workplace Relations (DEEWR) Labour Market Research and Analysis Branch

In contrast to the Distributive services sector, training in Construction and Engineering services sector is often formal training aimed at the completion of a qualification or skills set. Training is often undertaken to achieve the requirements of a certain licence or legislative requirement. The NCVER *Survey of Employer Use and Views*[121] found that 79 per cent of employers in the Construction and Engineering services sector used formal Vocational Education and Training to upskill their employees, over 75.5 per cent stated they used informal training to upskill employees. Only 6.5 per cent stated they provided no training for employees.

The Business Services sector has a strong reliance on tertiary qualifications to meet the skills requirements of the sector. The high proportion of professional occupations requiring a tertiary qualification means that the entry point for most people entering the industry sector is at graduate level.

The Business Services sector is characterised by a large proportion of those employed in the sector had obtained a non-school qualification, 67.5 per cent. Most had obtained a Bachelor degree or above (45.7 per cent), followed by Advanced diploma and diploma (12.1 per cent) and Certificate III and IV (9.8 per cent) (Figure 3-7).

Education and training in Business Services sector is often a combination of formal and informal training aimed at maintaining qualification requirements to meet the professional standards and ongoing professional development for employees. The NCVER *Survey of Employer Use and Views*[123] found that 68 per cent of employers in the Business Services sector used formal Vocational Education and Training to upskill their employees, over 80 per cent stated they used informal training to upskill employees. Only 9 per cent stated they provided no training for employees.

3.5.2 Employee Retention in the Services Sectors

The ageing population, the decline in the percentage of young people in the workforce and low completion rates in tertiary and VET courses of study will lead to an increased emphasis on retention strategies to maintain a base of skilled workers within the services sector.

The high mobility of those employed in the services sectors industry compared with other industries could be contributing to increased training costs and lower productivity in the workplace. In 2006, 38.0 per cent[125] of employees in the accommodation, café and restaurant sector had been in their current job less than a year while for the Retail Services sector, 28.2 per cent[126] had been in their current job less than a year, compared with 21.3 per cent for all industries. In comparison, only 11 per cent of Construction Services employees had been with their current employer for less than 12 months[127].

> "The high mobility of those employed in the services sectors industry compared with other industries could be contributing to increased training costs and lower productivity"

Increasing retention rates for all workers across the services sector will increase the skills base of the sectors while lowering training and supervision costs and increasing productivity.

ACCI believes that there needs to be more clearly defined workforce development strategies encompassing training and career pathways for new entrants into the sectors.

One approach to minimising training costs and maximising return on investment in training is increased commitment to upskilling existing workers to trade level or higher-level qualifications where there is demand for these skills by the employer. In many cases, existing workers have a sound level of knowledge of the work environment and the required job specific skills base. Existing workers also have had exposure to the industry and, unlike many new entrants into the industry, will have formed an understanding of the nature of the work and preconceived expectations of their employment within the industry, and thus have an increased likelihood of complete training.

3.5.3 Planning for Skills Development

All Australian businesses must have access to effective business planning and workforce development and diagnostic tools and training needs analyses (TNAs) and assistance. While some tools do exist, businesses, especially SMEs with no specialist human resources department, often encounter problems in accessing and using the tools to full effect.

121. Ibid.

122. Raw data from the Department of Education, Employment and Workplace Relations (DEEWR) Labour Market Research and Analysis Branch.

123. NCVER 2009, *Survey of Employer Use and Views*, Adelaide.

124. Raw data from the Department of Education, Employment and Workplace Relations (DEEWR) Labour Market Research and Analysis Branch.

125. NCVER 2007, *Industry and Training 2007: Accommodation, Café and Restaurants*, Adelaide.

126. NCVER 2007, *Industry and Training 2007: Retail Trade*, Adelaide.

127. ABS, Feb 2010, *Labour Mobility*, Cat. No. 6209.0.

NCVER, in their *Survey of Employer Use and Views*[128] of VET reports that the main methods used by employers to determine their training needs are informal methods at 62.8 per cent, and performance management and analysis of training needs, at 23.5 per cent of employers.

Workforce planning relates to forecasting demand; analysing workforce supply and undertaking a gap analysis of the skills and labour needs of the business if it is to grow.

Support to use TNAs and workforce development and diagnostic tools in the workplace would enable many businesses to identify areas of potential productivity growth and facilitate training for existing workers to meet the skills needs or enable the business to hire new staff.

Business and industry associations are well placed to work with SMEs to identify skills needs and advise on training opportunities to address those needs and could play a brokerage role in this respect in a similar way already adopted by the previous Rudd Government in relation to employment services.

Business and industry associations must be the key driver behind identifying training needs and determining where the training effort should be directed so as to drive productivity and economic growth and provide employment opportunities for Australian workers.

There is also a role for Government and business in the identification of infrastructure and community projects to ensure that money spent in supporting the business community is well targeted, meets current project requirements and leads to long term skill sustainability.

Ensuring that the available workforce has the skills and knowledge required to meet the skills needs of employers is a prominent issue for business and industry in Australia. Productivity gains can be driven through upskilling the existing workforce to ensure that there is a best fit between the skills base required within the workplace and the existing workforce. This can be achieved by the engagement of Australian business and industry working closely with training providers to ensure that training directly matches the skills needs of individual employers.

The Commonwealth Government should consider introducing a tax discount on training to be given to employers who invest in the training of their employees. An initial figure of 30 per cent would provide a comparable benefit to that announced by the government in relation to capital expenditure.

3.5.3.1 Better Partnerships between Employers and Registered Training Organisations

Employers working in partnership with training providers can tailor and contextualise training to suit their immediate needs. This means that formal training can be delivered as 'just in time' training that will add to the productivity and profitability of the business.

The focus of skills development initiatives needs to secure the current workforce and drive productivity growth through programs that will effectively upskill existing workers. There are many benefits gained from skilling existing workers; for the individual business, they are starting with workers that have a knowledge of the specific workplace practices relevant to the company. This will enable them to more readily apply the skills and knowledge they acquire to the workplace.

In most cases, existing workers will also have a degree of technical knowledge and skill that they have developed during their working life. This technical knowledge and skills can be captured and recognised through Recognition of Prior Learning (RPL) processes. RPL captures existing skills and knowledge and maps it against existing competency standards and uses this to contribute towards a qualification outcome.

> "There are many benefits gained from skilling existing workers"

In 2008, only 59,000 or 4.9 per cent of the 1.2 million VET students in fully or partial government funded VET places received RPL for all or part of their training[129]. Only four and a half per cent of the national training effort went into recognising the skills and knowledge of the ten million members of the Australian workforce. Increasing effective RPL pathways could effectively decrease training cost to Government and the Australian business community by reducing the training cost and effort by Registered Training Organisations (RTOs) and shortening training time.

3.5.4 The Ageing Workforce

A key concern of industry has been the ageing of the workforce, the overall decline of youth entering the labour market over time and the impact these issues may have on the future supply of skills. Increasingly employers must have dual strategies to attract the most suitable young employees and retain older workers with enhanced skills.

128. NCVER 2009, *Australian Vocational Education and Training Statistics: Employers' Use and Views of the VET System 2009*, Adelaide.

129. Department of Education, Employment and Workplace Relations (DEEWR) 2009, *Annual National Report of the Australian VET System 2008,*Canberra.

The ageing of the workforce implies a radical change in human resource strategies and a new approach to managing age at the workplace. The service industries often characterised by younger employees and owner operators, must grapple with this reality of population and labour force ageing. Future competitiveness will rest partly on the performance and productivity of ageing workforces and, therefore, on the efficient utilisation of older workers. While there are cyclical pressures on the labour market that create fluctuations in the supply of labour, in the long term Australia must maximise the numbers of working age people in the workforce.

The average age of the Australian workforce is rising significantly as "baby boomers" move towards retirement and years of low birth rates combine to reduce the size of the Australian workforce. By 2015, it is estimated that around 85 per cent of labour market growth will come from people over the age of 45[130]. The three oldest workforces in Australian industry today are Agriculture, forestry & fishing, Education and Transport & storage. Retail and Accommodation, cafes & restaurants are the youngest, reflecting the more transitional nature of the workforce and the attractiveness of the sectors to students and younger workers using the services sector as a stepping stone to other sectors. Figure 3-8 below displays the average age of workers in across a range of industries.

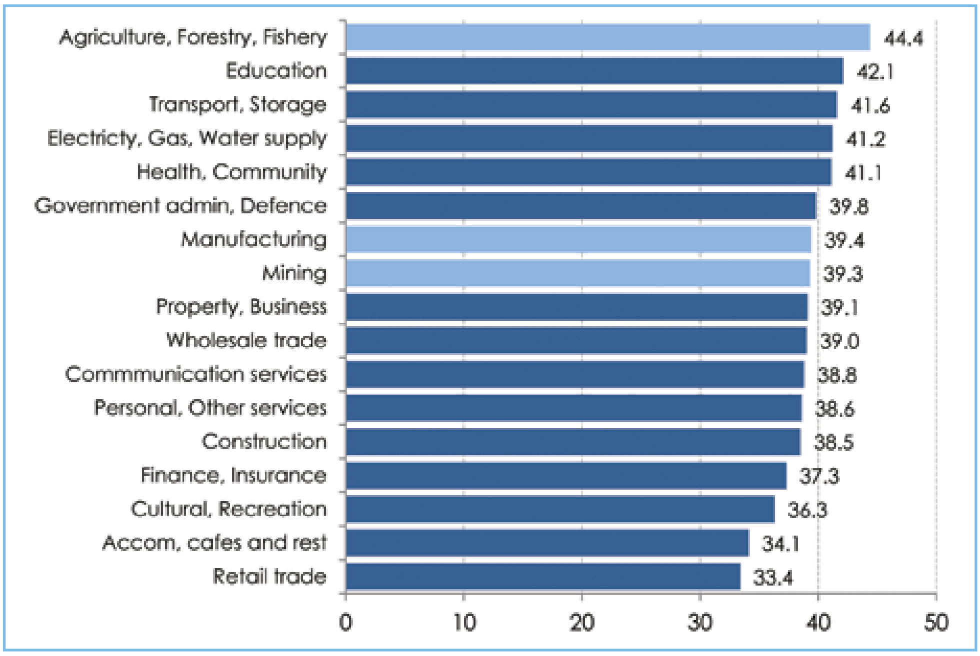
While the bulk of the services sector is at the younger end of the average age spectrum, there are considerable benefits to employers in developing strategies aimed at attracting and retaining older workers.

"The service industries often characterised by younger employees and owner operators, must grapple with this reality of population and labour force ageing"

The extension of the apprenticeship system to mature aged apprenticeships in service industry workplace will need to be a goal of industry over the coming decade. Potential benefits of such initiatives have been recently published in a joint ACCI/ Department of Education, Employment and Workplace Relations research paper[131].

Remaining in paid employment is of benefit to individual mature aged workers, businesses and society as a whole as a lengthened contribution to the production of goods and services and a consequential relatively shortened dependence welfare services lessens the load carried by the Australian taxpayers.

Figure 3-8: Average age of workers by industry sector



Source: Australian National Training Authority (ANTA), 2004, *Valuing Older Workers*

130. ABS 2009, *Australian Labour Market Statistics*, Cat. No. 6105.0., January.

131. ACCI 2010, *It's Not About Age*, A Research Report funded by Australian Government's Industry Training Strategies Programme, administered by the Department of Education, Employment and Workplace Relations, Canberra, October.

Continued participation in the workforce and/or re-entry into the workforce at an older age is facilitated by a number of factors. These include:

- Flexible IR arrangements to suit the mutual needs of employers and employees;
- A holistic approach that includes strategies to address health and skills issues and their contribution to ongoing workplace effectiveness with an emphasis on a preventative approach;
- Access to ongoing skills programs that have been aligned with industry needs;
- Incentive regimes that support individuals and employers to participate in mature aged labour market programs;
- Appropriate work placement matching between the employer and employee supported by quality career support; and
- The availability of quality information for employers and employees about practical approaches to participation in mature aged employment including retention of existing workers and transition assistance.

As a priority for industry, there is an immediate need to develop a more responsive education and training system to enhance the skills of older workers. Currently, there is no clear strategy to target existing mature age workers to enhance their skills and productivity.

"There is an immediate need to develop a more responsive education and training system to enhance the skills of older workers"

In 2003, ACCI recognised that older workers needed to maintain the currency of their existing skills and learn new skills as required. There is additional urgency in developing this approach given the impact of new and emerging technologies on all workplaces, the lack of post-compulsory qualifications held by mature age Australians and the need for some mature age people to update their skills as they change employment.

Central to increasing labour market participation amongst older workers is ensuring that they have in-demand skills by industry that will enable them to participate fully in the workplace. Encouraging mature age workers to upskill or retrain has many benefits to employers, their workers and the economy as a whole. The National Industry Skills Committee in *A Framework for Building the Skills of the Existing Workforce*[132], noted that there are many likely benefits from investing in mature age and existing worker skills development such as; improved retention of existing employees; increased capacity of workers to take on new roles and tasks; linking organisational goals to workforce training and development and using existing, particularly mature aged workers, to pass on invaluable skills and experience to younger workers.

3.5.5 Skills Development in the Services Sectors

A highly transitional workforce, such as that of most services industries, presents a variety of challenges for skilling and workforce development. While employees will develop skills sets with each employer, in most cases there is no ongoing connection between training on the job and the formal training structures as employees often move between employers.

ACCI believes that consideration should be given to the establishment of a Skills Passport for employees within the services sector. A Skills Passport would be used to record an employee training, whether formal or informal, with each employer for whom they work for, the passport would be transferrable between employers, and ideally, between industry sectors in order to maximise the mobility of transferrable skills. The passport would record the date of training, information in the type of training delivered including competencies achieved if formal training is undertaken. Training in areas such as Responsible Service of Alcohol, Hazard Analysis and Critical Control Points (HACCP) training, OH&S training or first aid training along with training in other areas such as customer service, food service training or training on specific machinery and equipment would be recorded, detailing a brief description of the content of the training. The passport could also be used to record the employees Employability Skills development during their employment.

A Skills Passport would ideally be supported by an electronic database that allows the employee and the employer to access their files and record activities and observations that lead to the development of Employability Skills. Access to input information could also be given to employers to enable them to provide feedback and observations on the employees' portfolio.

Also, a simple paper based skills passport could be issued to students that explains the concept to employers and provides the mechanism for written observations from employers.

132. National Industry Skills Committee (NISC) 2008, *A Framework for Building the Skills of the Existing Workforce: A Strategic Issues Paper*, Melbourne.

The Skills Passport would have input from three main areas:

- **Employee self-reflection** – opportunity for the employee to record and reflect on skills developed through:
  - Work undertaken; and
  - Learning activities, whether formal or informal.
- **Formal learning and assessment** – training undertaken through registered Training Organisations that leads to a Qualification, Skills Set or Statement of Attainment.
- **Workplace assessment** – The opportunity for employers to record observations on Employability Skills and attitudes development in the workplace and record "soft skills" training.

ACCI believes that whilst a Skills Passport will be supported by employers, in many cases employers may need to develop mentoring and training skills to assist in the recognition and development of Employability Skills and to ensure the most effective transfer of skills from employer to student is achieved.

ACCI believes that employers or supervisors responsible for overseeing students should be offered training in the mentoring skills set from the Certificate IV in Training and Assessment qualification, where the employer sees the benefit of this training. This would give them the skills and knowledge needed to effectively mentor students throughout time in the workplace.

Initially a tradesperson or supervisor could complete the mentoring and assessment competencies of the Training and Education Training Package to enable them to train and supervise new employees and for building a structure within the enterprise for ensuring that training can take place.

3.5.6 Recognising the Contribution of Employers

One important step in encouraging employers to increase their engagement with the training system is to recognise and promote those who have best practice training strategies as part of their business direction.

ACCI believes that a *Building Our Future Challenge* should be established so that employers who show a strong commitment to building the future workforce should be publically recognised.

Under this scheme, employers showing a commitment to training by having a 6 per cent or greater portion of their workforce as apprentices or trainees become recognised as an employer of choice for apprentices and eligible for membership of the group.

This would recognise the employer as an employer of choice for apprentices and trainees and provide the employer with a marketing tool in the form of a logo/ Employer of Choice tick, for use on stationery and websites.

Ideally this system would be administered by business and industry associations in conjunction with the Australian Apprenticeships Centres.

A National Skills Survey being undertaken by ACCI will help establish a body of evidence about the direct and indirect investment which employers are making to skills development. The results of that national Survey can help frame the terms under which such a scheme should operate.

3.5.7 Apprenticeships and Traineeships

The six identified service sector groups outlined in this report have a heavy reliance on apprenticeships and traineeships to facilitate skills development at the entry level for employment. The Construction and Engineering Services sector and the Inbound Tourism, through the restaurant subsector, rely heavily on traditional trades apprenticeships to ensure the supply of qualified tradespeople while the Business Services and the Distributive Trades sector make considerable use of traineeships in training workers at the entry level.

It is essential that incentives for apprentices and trainees are flexible and responsive to ensure that the skills needs of industry can be adequately met by the national training system. At the base level, incentives should be a broad platform that enables industry to meet their skills needs regardless of their industry sector or the size of the employment base in that field. In a truly flexible and responsive system, niche occupation areas would have the same access to incentives as high demand occupations areas and be available regardless of the location of the employer or the training provider.

ACCI has identified key target areas where incentives should be directed:

- Financial incentives as productivity offsets in the early stages of training – to encourage employers to hire Australian Apprentices;
- Exemptions from WorkCover payments and/or payroll tax, to encourage employers to hire Australian Apprentices;
- Access to training for employers and supervisors – to increase completions rates;
- Support for mentoring and other support programs for apprentices;

- Targeted financial incentives to employers to encourage the hiring of jobseekers from disadvantaged groups; and
- Industry based awards and recognition, to help employers see the value of hiring Australian Apprentices.

The main cost of the Australian Apprenticeship lies in the costs associated with supervision and the reduced productivity of the Australian Apprentice early in their tenure, with the government incentive payments offsetting these costs only to a minimal degree. NCVER[133] estimated that the cost to an employer in directly hiring an apprentice can be well in excess of $200,000 over the life of the apprenticeship, with only around half of this amount being the apprentices wages. The remainder of the costs are attributed to training fees, administration costs and supervision of the apprentice. Through the same research, NCVER estimates the actual productive contribution of the apprentice to be only around 50 to 60 per cent of the total cost of the apprentice with government incentives making up around 2 to 3 per cent of the total cost of the apprentice.

3.5.7.1 Apprenticeship and Traineeship Non-Completions

Apprenticeship non-completions are a major concern for the Australian business community and are a significant drain on the national training effort. Increasing completion rates will lead to better return on investment in training for employers and governments and increase the skills level of the Australian workforce.

The non-completion rates for trades apprentices in the four identified services groups are high. Foods trades apprentices in the Inbound Tourism sector have a 54.6 per cent attrition rate while construction apprentices have a 55.0 per cent attrition rate. Other services sector apprenticeships also have worryingly high attrition rates[134].

While traineeship attrition rates tend to be lower than those for the traditional trades, they are still of considerable concern. In some cases, the lower attrition rates can be attributed to the shorter training duration and the differing pay structures for apprenticeships and traineeships. ICT traineeships have a 38.6 per cent attrition rate, retail traineeships, a 37.2 per cent attrition rate and Business Administration traineeships, a 33.2 per cent attrition rate[135].

ACCI research into apprentice non-completions developed a series of recommended principles for employers to follow and processes to implement as part of a holistic workplace management strategy through the recruitment and employment of an apprentice.

The key findings of *A Systematic Approach to Retaining Apprentices*[136] are structured around the following core concepts for retention as identified in the research:

- Attracting the right person;
- Recruiting and inducting good apprentices;
- Making work and training meaningful;
- Providing personal and professional support;
- Providing effective training; and
- Making full use of information and support services.

A Systematic Approach to Retaining Apprentices focuses on employer perspectives to determine views, actions and attitudes of employers that have a positive impact on completion rates of apprenticeships ensuring that the Australian business community has access to a highly skilled and motivated workforce.

3.5.7.2 Apprenticeships and Traineeships to Increase Workforce Participation

Between 2008 and 2009 the rate of unemployment among teenagers who were not in full-time education rose from 12.2 per cent to 18.5 per cent, the largest annual increase since the recession in the early 1990s[137]. The number of 20 to 24-year-olds not engaged in full-time work or full-time education also rose considerably, to around 25 per cent, reversing the downward trend of the previous decade. Previous economic downturns have shown that it takes considerable time for youth unemployment to drop back to pre-downturn levels.

> "Youth unemployment puts considerable constraint on the capacity for growth within the economy"

Sustained youth unemployment puts considerable constraint on the capacity for growth within the economy, not only in the area of shortages in skills and labour, but in the reduced spending power of a major section of the population. In many cases, we see the perverse situation of high levels of youth

133. NCVER 2009, *The Cost of Training Apprentices*, Adelaide.

134. NCVER 2010, *Australian Vocational Education and Training Statistics: Apprentices and Trainees, 2009—Annual*, Adelaide.

135. Ibid.

136. ACCI 2007, *A Systematic Approach to Retaining Apprentices*, Canberra.

137. The Foundation for Young Australians, 2009, *How Young People are Faring*, Melbourne.

unemployment prevalent in regions experiencing critical skills shortages in occupations requiring higher level and trades qualifications. Long periods of unemployment for young individuals often leads to longer term unemployment as this cohort ages or disengages from the workforce altogether.

Apprenticeships and traineeships remain an important vehicle for targeting youth engagement and boosting the skills levels of young people. Apprenticeships and traineeships, particularly lower lever qualifications such as Certificates I and II are essential in providing young people with a pathway into meaningful, highly valued work and are often the first step on the ladder to higher qualification levels.

ACCI believes that it is essential that governments and business work in partnership to develop strategies that will ultimately lead to sustainable increases in apprenticeship commencements for those young Australians currently outside the workforce. The Commonwealth Government, in conjunction with industry, should work to develop strategies that will ultimately lead to sustainable increases in apprenticeship commencements for those young Australians currently outside the workforce. Government Departments and Job Network Providers need to work with the business community to ensure that employers are fully aware of the benefits that employing an apprentice can bring to their business and the incentives that are available.

3.5.7.3 Mentoring for Apprentices and Trainees

ACCI believes that employers of apprentices need to develop mentoring and training skills to assist in keeping apprentices engaged for the duration of their tenure and ensuring the most effective transfer of skills from employer to apprentice is achieved.

The introduction of an Apprentice Mentor Program would operate with employers of apprentices or supervising trades people be given the option to undertake training in the mentoring skills set from the Certificate IV in Training and Assessment (TAA) qualification and be given the skills and knowledge needed to effectively mentor apprentices throughout their tenure.

Initially a tradesperson or existing worker could complete the mentoring and assessment competencies of the TAA package to make them immediately useful in the workplace for supervising apprentices and for building a structure within the enterprise for ensuring that training can take place. They could then complete their TAA qualification while bringing immediate benefits to the workplace.

Mature-aged workers considering exiting a trade could be specifically targeted for this approach, but it should be available to enterprises where they can demonstrate a need.

One aspect of the program would be to provide wage subsidies to employers who have an onsite apprentice mentor to cover the non-productive time spent with apprentices instead of being on the job. This would ensure that the employer does not suffer any adverse effects from lost productivity.

"Commonwealth and State and Territory Governments should offer wage subsidies to encourage job sharing arrangements"

ACCI also sees strong benefits to the Vocational Education and training Workforce in the upskilling of tradespeople with the TAA qualification. To secure the future VET workforce, the Commonwealth and State and Territory Governments should offer wage subsidies to encourage job sharing arrangements between TAA qualified mentors.

3.5.8 Policy Recommendations

Recommendation 39: The Australian Government, in conjunction with industry, should work to provide Australian businesses with support to access effective business planning and workforce development and diagnostic tools and Training Needs Analysis (TNA) assistance.

Recommendation 40: The Australian Government should introduce a tax discount on training to be given to employers who invest in the training of their employees. An initial figure of 30 per cent would provide a comparable benefit to that announced by the government in relation to capital expenditure.

Recommendation 41: The Australian Government, in conjunction with industry, should develop key strategies that will increase employers' knowledge base of the value of older workers and the benefits to be gained by their employment. Expansion and marketing of the *Commonwealth Government's Experience Plus initiative*[138] along with consideration being given to training and employment incentives for employers who take on older workers, including through the apprenticeship system.

Recommendation 42: The Australian Government, in conjunction with industry, should work to develop a Skills Passport Model for use in the services sectors with the view to expanding to cover the breadth of Australian industry.

138. http://www.deewr.gov.au/Employment/Programs/ExpPlus/Pages/default.aspx

Recommendation 43: The Australian Government, in conjunction with industry, should work to develop a *Building Our Future Challenge* so that employers who show a strong commitment to building the future workforce can be publically recognised. The results of ACCI's National Skills Survey should be used to frame such a scheme.

Recommendation 44: The Australian Government should undertake a review of Apprentice and Trainee incentives and modify the incentives structure to more closely reflect the needs of employers and the productivity impositions that employing an apprentice or trainee can cause.

Recommendation 45: The Australian Government, in conjunction with industry, should work to develop strategies that will ultimately lead to sustainable increases in apprenticeship commencements for those young Australians currently outside the workforce.

Recommendation 46: The Australian Government, in consultation with industry, should introduce an Apprentice Mentoring Program for employers who have an onsite apprentice mentor to cover the non-productive time spent with apprentices instead of being on the job.

3.6 International Trade and Services

Trade in services has become an important part of the international trading system and has led to significant economic gains for both developed and developing economies over the past two decades. The services trade is the fastest growing international trade sector, accounting for around 20 per cent of total trade in the OECD countries (Figure 3-9), with the world exports of services valued at US$3.9 trillion in 2008, up 11.7 per cent or US$404.1 billion on 2007 levels[139].

The advent of globalisation has largely facilitated the growth in services trade. The expansion of communication, information technology, and transport systems has provided for increased integration and the types and numbers of international transactions conducted across geographical borders. Services to a large extent provide the means, by which individuals, businesses and governments interact, communicate, move and transact across national boundaries and thus increase the global demand for services. As such, the economic gains that can be made by promoting trade in services are significant.

Australia's services trade is currently rising at a faster rate than trade in goods. Since 1980, Australia's services exports have grown at an annual average rate of 6.6 per cent, outpacing the average growth rate of 5.0 per cent per annum for goods exports.

A similar trend is also evident around the world. Thus, in order to maintain the competitiveness of Australia's services industries, the ability to meet the quality and value demands by consumers and compete with rising services intensive economies in the developing world, the Australian government should further invest in trade facilitation to assist Australia's services sector and engage in effective trade liberalisation negotiations to lower the trade barriers faced by both domestic and foreign service providers.

"Australia's services exports have grown at an annual average rate of 6.6 per cent, outpacing the average growth rate of 5.0 per cent per annum for goods exports"

Trade in services is the fastest growing component of the global economy, with the share of total global trade accounting for commercial services trade increasing from 18.4 to 20.4 per cent in 2009. Services exports have grown at an average rate of 8 per cent per annum in developed countries from 1999 to 2009 surpassing that of merchandise trade and investment. This growth has remained constant and relatively stable in both OECD and middle income nations. The resilience of global services exports to the global economic downturn is apparent. While global merchandise goods exports fell 22.6 per cent, commercial services exports only declined by 12 per cent during the global financial crisis[140].

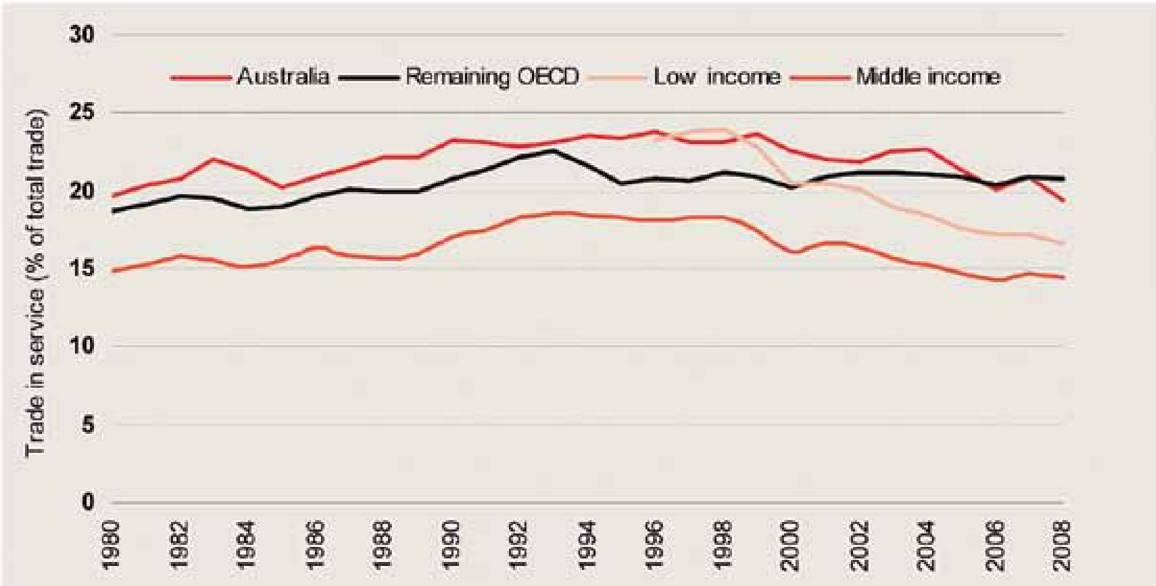
The supply of trade in services differs significantly, and is much more diverse than that of trade in goods. The World Trade Organisation's (WTO) General Agreement on Trade in Services (GATS), describes four modes of services trade delivery:

- Mode 1 cross border supply: Services are delivered from the territory of the services supplier into the territory of the consumer, with a clear geographical separation between the services supplier and the consumer. For example, an Australian service provider sells consulting services to a Canadian company;
- Mode 2 consumption abroad: Services are delivered by the supplier to the consumer, with the consumer travelling or moving to the foreign market. For example, a Chinese tourist joins a one day Yarra Valley winery tour;

139. Department of Foreign Affairs and Trade (DFAT) 2010, *Trade in Services 2009*, p.8.

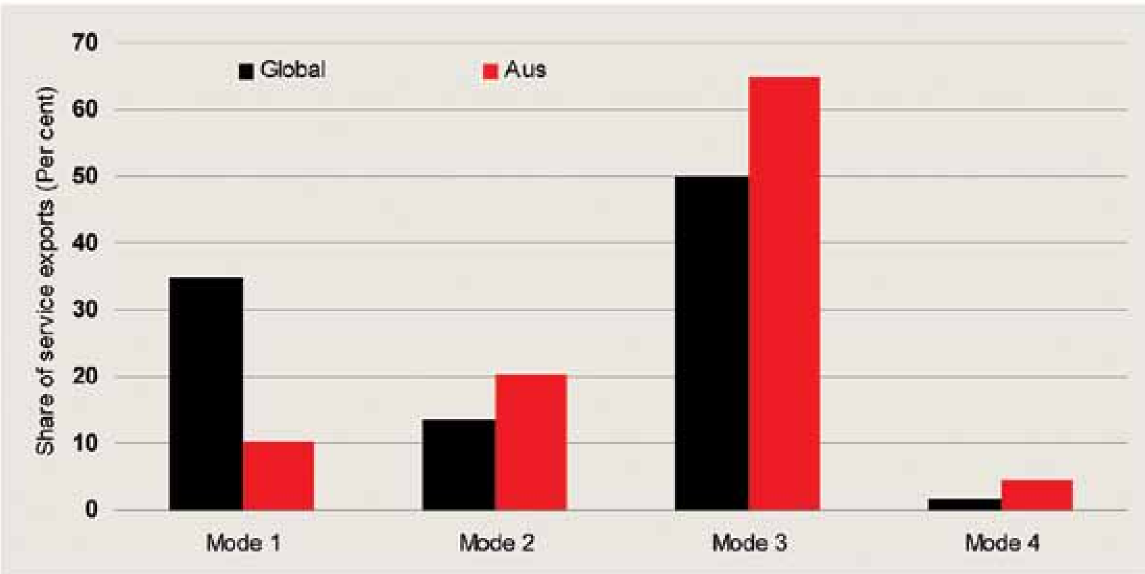
140. Centre for International Economics (CIE) 2010, *Quantifying the Benefits of Services Trade Liberalisation*, p. 7.

Figure 3-9: Importance of trade in services



Source: Centre for International Economics (CIE) 2010, *Quantifying the Benefits of Services Trade Liberalisation,* p. 8.

Figure 3-10: Services exports by mode of delivery



Source: Centre for International Economics (CIE) 2010, *Quantifying the Benefits of Services Trade Liberalisation*, p. 4.

- Mode 3 commercial presence: Services are delivered by the movement of capital of the exporter moving to the foreign market. For example, an Australian company set up a branch in New Zealand; and
- Mode 4 movement of natural persons: Services are delivered by the services supplier temporarily staying or travelling as a natural person to the foreign market to deliver the services to the consumer. For example, an Australian engineer works in a mining project in Brazil for three weeks.

Figure 3-10 shows that commercial presence supply currently accounts for the largest share in overall global services trade (50 per cent), and the largest share of Australia's services trade (65 per cent). This figure reflects the importance of foreign direct investment and the use of foreign commercial affiliates as a means of trading services.

Given the strength of Australia's services industries, the potential economic gains that can be made by promoting trade in services are significant. Although not widely acknowledged as compared to trade in goods, trade in services is currently an important contributor to Australia's export performance.

In 2009, trade in services accounted for 21.1 per cent of Australia's total trade in goods and services (totalling $106.8 billion in 2009), with total trade in services increasing well above the rate of trade in goods, at an average of 8 per cent per annum[141]. In global terms, Australia is a strong commercial services provider, ranked 24 out of the 40 leading commercial services exporters, and holds a 1.2 per cent share (US$45.6 Billion) of global commercial services exports[143].

Moreover, Australia's trade in services appears to be resilient; declining just -0.2 per cent in the aftermath of the global financial crisis, compared with a -14.3 per cent and -11.1 per cent decline respectively in primary products and manufactured goods exports in between 2008-09 and 2009-10[142].

Table 3-7 shows that Australia's biggest services export income earners in 2009-10 were:

- Education related services, contributing $18.5 billion or 35 per cent of total services exports;
- Non-education related travel services, contributing $14.9 billion or 28.2 per cent of total services exports;
- Professional and other business related services, contributing $7.0 billion or 13.3 per cent of total services export; and
- Transport services contributing $6.2 billion or 11.7 per cent of total services exports.

"Australia's education industry not only is Australia's largest and fastest growing services export industry but also Australia's third largest overall export earner"

Moreover, Australia's education industry not only is Australia's largest and fastest growing services export industry, increasing 19 per cent from 2008-09, but also contributes significantly to Australia's overall international trade in goods and services, being Australia's third largest overall export earner behind coal and iron ore (Table 3-8).

Table 3-7: Australia's leading services exports, 2009-10

Services	Value ($ billion)	Share of total %
Education related services	18.5	35.0
Non-education related travel	14.9	28.2
Professional and other business services	7.0	13.3
Transport	6.2	11.7
Telecommunication, computer and information services	1.7	3.2
Financial services	1.0	1.9
Total services exports	**52.8**	**100.0**

Source: ABS Catalogue No. 5368.0.55.003, Table 1.

141. DFAT 2010, *Trade in Services 2009*, p 8.

142. World Trade Organisation (WTO), *World Trade Developments 2009*, p. 14. http://www.wto.org/english/res_e/statis_e/its2009_e/its09_world_trade_dev_e.pdf

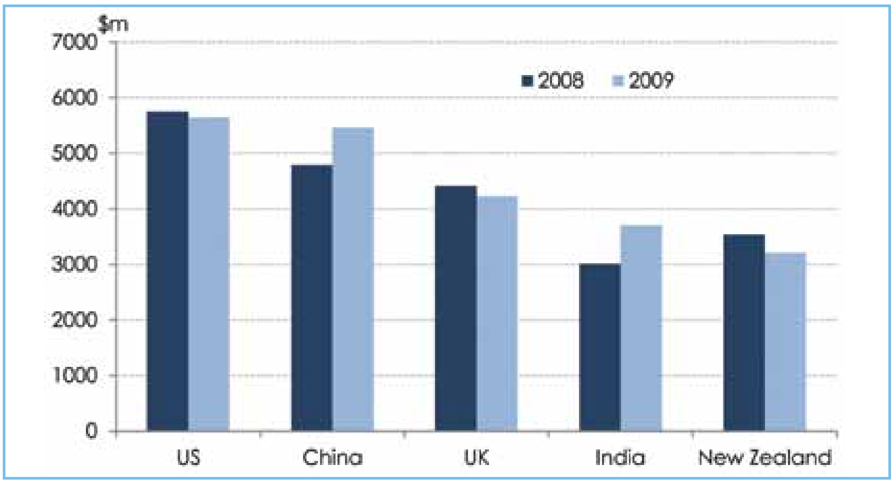
143. DFAT 2010, *Monthly Trade Data*, September 2010, p.2. http://www.dfat.gov.au/publications/stats-pubs/mtd/australia_trade_1009.pdf

Table 3-8: Australia's top ten exports, 2009-10

Australia's top ten exports	Value ($ billion)
Coal	36.5
Iron ore	35.1
Education related services	18.5
Non-education related travel	14.9
Gold	13.8
Crude oil	9.0
Natural gas	8.8
Professional and other business services	7.0
Transport	6.2
Aluminium ore	4.9

Source: DFAT 2010, *Exports of Primary and Manufactured Products 2009-10*, p. 5; ABS Catalogue No. 5368.0.55.003, Table 1.

Figure 3-11: Australia's major services export markets



Source: DFAT 2010, *Trade in Services 2009*, Table 9.

In terms of the direction of Australia's services trade, our main services export markets have significantly changed in recent years, moving away from western industrialised nations toward Asia. Around 51 per cent ($27.1 billion) of Australia's services exports are now directed to Asia, with this figure set to rise after increasing at around 10 per cent from 2008-09.

Whilst exports to the United States and United Kingdom have gradually decreased over the past 3 years, Australia's service industries have flourished in the emerging and dynamic markets of China and India. In the past five years, services exports to India alone have increased by 34.8 per cent; while exports to China increased by 16.4 per cent. The two markets alone account for 17 per cent of Australia's total service exports ($ 9.2 billion) in 2009 (Figure 3-11)[144].

This trend towards Asia also reflected in Australia's overall two-way trade figures with ASEAN countries, with Australia's exports of services to the ASEAN bloc increasing by an average 10 per cent per annum over the past five years and valued at $8.3 billion. In particular, Business services[145] exports to ASEAN countries were valued at $1.8 billion in 2009 and have increased by an average 16.7 per cent per annum over the past five years, making Business services the fastest growing sector for Australia's service exports to ASEAN countries (Figure 3-12).

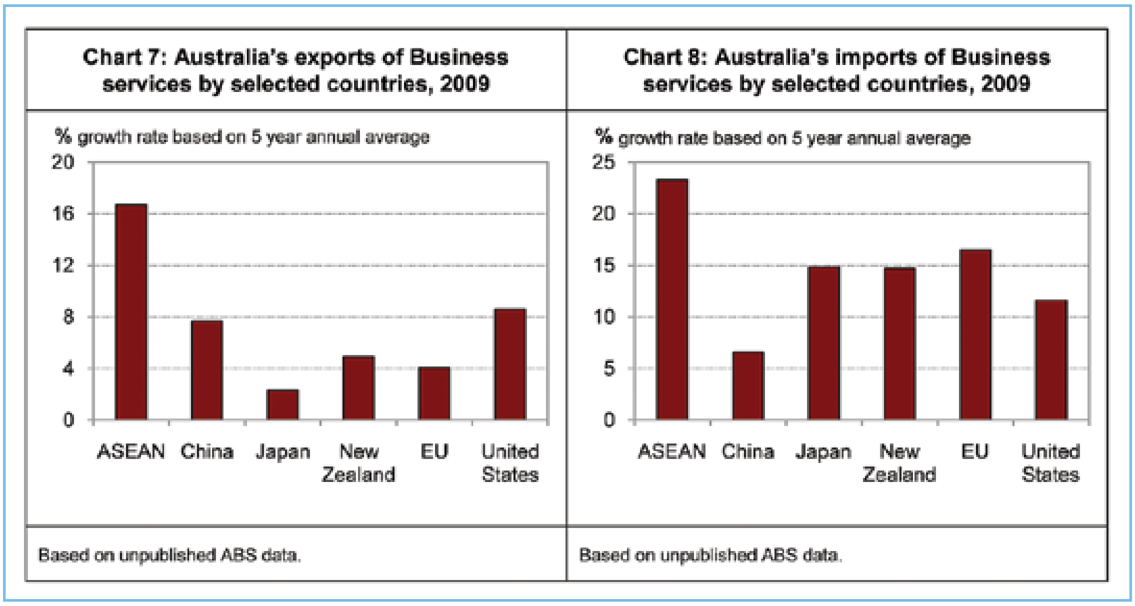
3.6.1 Trade Liberalisation

Trade liberalisation has been an important element in the creation of efficient and competitive services industries globally, and as with the liberalisation in goods trade, has led to significant global economic growth and development. The 2009 Centre for International Economics (CIE)'s report –Benefits of Trade and Trade Liberalisation to the Department of Foreign Affairs and Trade (DFAT) highlighted the importance

144. DFAT 2010, *Trade in Services 2009*, p. 40.

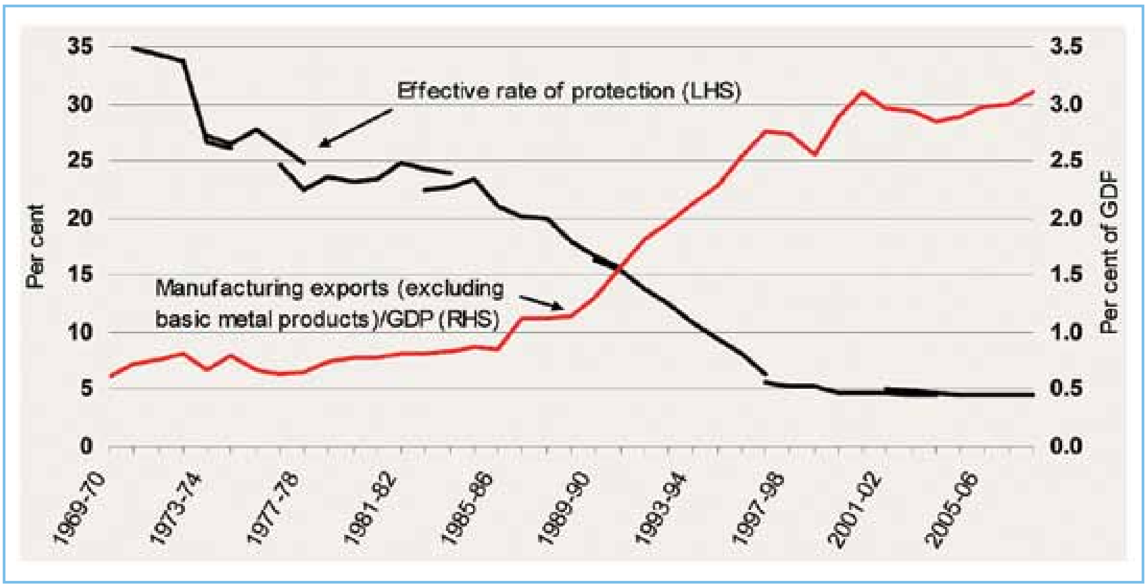
145. Business services include Construction, Financial & Insurance services, Intellectual property charges, Telecommunications, Computer and Information services, and Other Business services.

Figure 3-12: Australia's trade in business services



Source: DFAT 2010, *Trade in services 2009*, p.13.

Figure 3-13: Goods trade liberalisation and manufacturing exports



Source: CIE 2009, *Benefits of Trade and Trade Liberalisation*, p.15.

of trade liberalisation in driving Australia's dynamic productivity gains and economic growth[146]. The effects of investing in export intensive industries, reducing trade barriers and encouraging open export and import markets are noted to have created significant efficiency and productivity gains in many of Australia's service industries.

The process of liberalising trade in goods in Australia highlights the profound economic impact that trade liberalisation can have on both import and export volumes, industry growth, business competiveness, and Australia's economic growth. As shown in Figure 3-13, the lowering of trade restrictions on goods exports between 1988 and 2000, saw Australia's manufacturing exports doubling.

Import competition, rather than hindering the performance of domestic industries, increased competition in Australia's domestic markets and henceforth promoted and encouraged more productive, efficient and innovative industry practices, and increased industry expertise. The improved competitive position of Australian goods exporters lead to new export opportunities as Australian manufacturers produced goods with higher quality and at a lower price relative to its international competitors.

146. CIE 2009, *Benefits of Trade and Trade Liberalisation*, p.10

147. Parham, D. 2004, *Sources of Australia's productivity revival*, The Economic Record, Vol. 80 (249).

In general, Australia's unilateral trade liberalisation efforts strengthened domestic industries and increased domestic output, with Australia's GDP estimated to have grown by about 0.5 per cent as a result of Australia's increased openness in trade[147].

3.6.1.1 Impact and Benefit of Services Trade Liberalisation

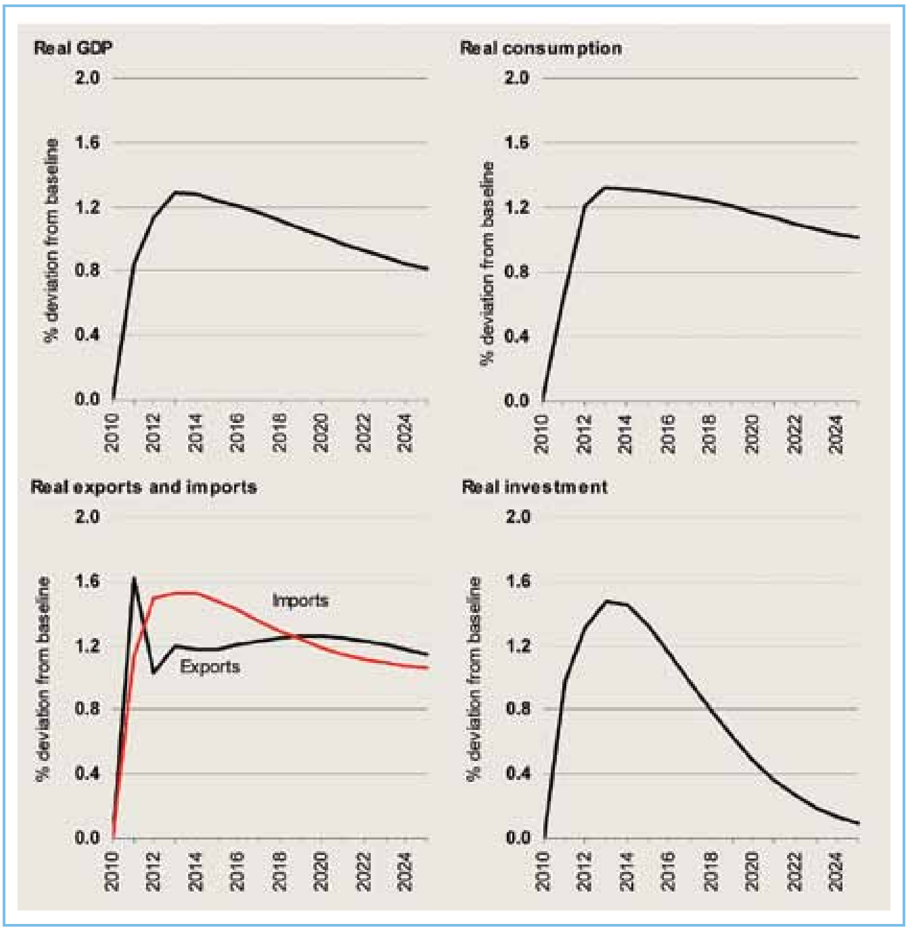
It is well established that the economic benefits of openness and trade liberalisation in the services sector are substantial. The World Bank noted that the benefits of openness in services trade are proven, stating that countries with an open financial services sector have grown at an average one percentage point faster than other countries[148].

"Services trade liberalisation provides a catalyst for greater export opportunities"

Services trade liberalisation provides a catalyst for greater export opportunities on two fronts. Firstly, greater export opportunities arise and inward foreign direct investment increases as restrictions faced by Australian exporters are lowered. Secondly, import competitiveness encourages service enterprises to be more efficient, innovative and productive. In addition, consumers are provided with better quality and a wider choice of products at lower prices and the fall in import prices also flows on to businesses that source services from overseas providers. Hence, services trade liberalisation strengthens the performance of Australia's services enterprises and allows them to compete effectively in international markets.

Moreover, greater openness to foreign competition in Australian services markets allows for increased integration of the Australian economy with international markets. This openness facilitates greater movement and transfer of knowledge and innovation ideas, increases modernity in services infrastructure, promotes new business and export links, and provides greater access to foreign capital and finance to support existing and new business opportunities in Australia.

Figure 3-14: Macroeconomics impact of services trade liberalisation in Australia



Source: CIE 2010, *Quantifying the Benefits of Services Trade Liberalisation*, p. 39.

148. Australian Services Roundtable (ASR) 2010, *The New Economic Challenge: Responding to the Rise of Services in The Australian Economy*, p. 50.

The CIE's 2010 report - *Quantifying the Benefits of Services Trade Liberalisation* estimated that global cumulative real GDP gains from services trade liberalisation over 2011 to 2025 are worth around $5.3 trillion and real household consumption gains of around $3.8 trillion expressed in 2010 dollar terms[149].

For Australia, it was predicted that by engaging in services trade liberalisation, Australian real GDP will peak at 1.3 per cent above the annual average in 2013, and continue to increase steadily at 0.7 per cent, whilst real consumption is predicted to rise around 1 per cent above average. These figures indicate significant economic gains for Australia's overall economic activity, with national GDP gains of around $155 billion or around 2.9 per cent of global GDP gains over the 14 years from 2011 to 2025 (Figure 3-14)[150]. The Productivity Commission also estimated that the economic gains from trade liberalisation in services could double the gains which might accrue for example in agricultural goods trade.

"A small rise of 0.1 per cent in services productivity could result in a sustained annual rise of over $1 billion in Australian GDP"

The CIE report also highlighted the risk of raising global services barriers and adopting protectionist policies. It was estimated that global GDP would be around 0.1 per cent or $920 billion (in 2010 dollar terms) below the business-as-usual (BAU) scenario over 2011 to 2025 as a result of increasing services trade barriers by 10 per cent. For Australia, GDP is estimated to be $15 billion lower (or 1.7 per cent of total global losses) and consumption is estimated to fall by $10 billion (or 1.8 per cent of total global losses)[151]. Lower exports, increasing import costs and capital costs will see higher production costs, lower return to capital, higher unemployment and lower household income.

ACCI supports the Australian Government's view that continuing the tradition of trade liberalisation in the area of services will lead to enormous potential gains and must be recognised as the new pathway to growth, jobs creation and prosperity in Australia[152].

As noted by the Trade Minister, the Hon. Craig Emerson MP, a small rise of 0.1 per cent in services productivity could result in a sustained annual rise of over $1 billion in Australian GDP. Thus, the importance of Australia investing in its services industries and engaging in services trade liberalisation cannot be understated.

Given the strength of Australia's services industries, substantial growth in our services sector will in turn encourage overall growth in the wider economy. Given the past and current trends show that trade liberalisation is a proven means of achieving this growth, a policy which supports the reduction in services trade barriers to allow for greater export and import opportunities for Australian service enterprises should be pursued.

3.6.2 Barriers to Services Trade Liberalisation

Despite Australia's services sector accounting for four fifths of Australia's GDP, services exports are relatively limited, accounting for only around 21 per cent of Australia's total trade. Notwithstanding the strong performance of the services sector in the past two decades, Australia's services exports do appear to be of a smaller magnitude than in the case for the other 29 OECD countries. In 2008, Australian services exports were equivalent to 4.6 per cent of Australia's GDP compared to 6.4 per cent in the case for other OECD countries[153].

Over the period between 1980 and 2008, Australian services exports via Modes 1, 2 and 4 were lower than OECD services exports by an amount equivalent to 0.7 per cent of GDP per annum on average. If Australia's services export performance had matched that of other 29 OECD countries, then Australian services exports would have been nearly $66 billion higher over 1980 to 2008.

There are several reasons that may explain the reduced intensity of Australian services exports compared to other OECD countries. These include Australia's geographical distance from major markets, the lack of inclusion in a formal regulatory regime with trading partners such as in the European Union, and possibly the lack of commitment to trade by our services industries themself[154].

However it is the vast services trade barriers, imposed by both our trading partners and the Australian government, which present the greatest challenge for our services exports and imports. Currently, the services sector faces the most extensive trade barriers of all top ten Australian exports.

The barriers imposed on the international trade in services are distinct from, and much more difficult to target and reduce than those faced by the trade in merchandise goods. Most are not measurable, opaque and deeply embedded in government regulations, practices and standards[155]. This makes trade in services and the task of liberalising services trade, a far

149. CIE 2010, *Quantifying the Benefits of Services Trade Liberalisation*, p. 36.

150. Ibid, p. 38.

151. CIE 2010, *Quantifying the Benefits of Services Trade Liberalisation*, p. 53.

152. Emerson, C. 2010, *Trade liberalisation the pathway to growth, jobs and prosperity*, Speech delivered at the launch of the Australian Services Roundtable report on services in the Australian Economy, Parliament House, Canberra, 4th October 2010.

153. Op. cit., p. 12.

154. Ibid.

155. ACCI 2007, *Trade in Services – not just a poor Cousin to Manufacturers*, ACCI Review September 2007, p. 16.

more challenging task than the liberalisation of goods trade, and one which requires a significant amount of attention and commitment.

3.6.2.1 Non-Tariff Barriers Facing Service Exporters

The barriers faced by the service exporters are generally labelled as 'non- tariff barriers' (NTBs). They are generally 'behind the border' restrictions and are regulatory in nature, making them less transparent and therefore more difficult to identify, measure and assess their impact on services trade, which complicates the effort to reduce the barriers[156]. These impediments are generally driven by nationalistic sentiment and government policy. They are usually designed to protect local markets by limiting market access of foreign service providers, constraining how and where business is conducted, and limiting competition between imported services and domestic service providers.

NTBs in services trade differ significantly from those in the goods trade and are inherently more complex to identify and break down because they are not found at the border such as with tariffs and quotas, and cannot be easily measured, wound back or streamlined.

The key impediments facing our service exporters include[157]:

- Domestic laws and instruments regulating and restricting the market access of foreign service providers, and the supply and consumption of foreign services. Such restrictions include limits on amounts and types of foreign investment, ownership and activity; restrictions on numbers of branches or representative offices; visa restrictions; higher charges and taxes; restrictions on the right to practice; and education/qualification/accreditation recognitions;
- Barriers imposed by private bodies, such as professional bodies, or private enterprises, rather than governments. Such restrictions could be of the same nature as that imposed by domestic regulations and could also include restrictions on admission and training in certain professional services imposed by professional bodies, exclusion from investment incentives, corporation equity limitations, and differential treatment of non-residents; and
- Other restrictions not intended to be directly discriminatory or restrict market access, but do so in practice. Such restrictions may be both government and privately imposed, and include consumer protection laws, licensing and pricing regulations, labelling requirements and difficulties with jurisdictional arrangements imposed by federal, state and local governments.

All these services trade barriers significantly hinder the ability of Australian businesses to access and operate in foreign markets, and place immediate restrictions on the quantity of Australian services exported and consumed abroad. Furthermore, as these impediments in many cases are not easily observable, and may not at first instance directly deny market access, they might only be realised after the service provider has entered the market.

While Australian service exporters face trade barriers imposed by foreign jurisdictions, to some extent Australia itself also imposes barriers on services imports. Australian import barriers, although imposed to protect local service providers, in reality also protect Australian service enterprises from foreign competition which has a negative impact on business productivity.

"Services trade barriers restrain the integration of Australia's economy with the rest of the world"

In 2000, the Productivity Commission published the trade restrictiveness estimates for a range of Mode 1 'cross border' supply of a range of services in various economies. It took into account many of the barriers imposed by both government and private enterprises as outlined above. For Australia, our trade restrictiveness indices were well above average for accountancy, below average for engineering and about average for maritime services[158]. Australia's foreign direct investment (FDI) barriers remain high for an OECD nation, with screening, operation and equity barriers greater than those imposed by the EU and US (Figure 3-15).

Restricting trade openness to foreign investment and foreign service providers by placing barriers on imports can have a broad range of negative implications. Many of these stem from the fact that restricting imports undermines business competition which in turn will negatively affect domestic business growth, productivity and innovation; increase domestic service prices; and reduce household income and consumption.

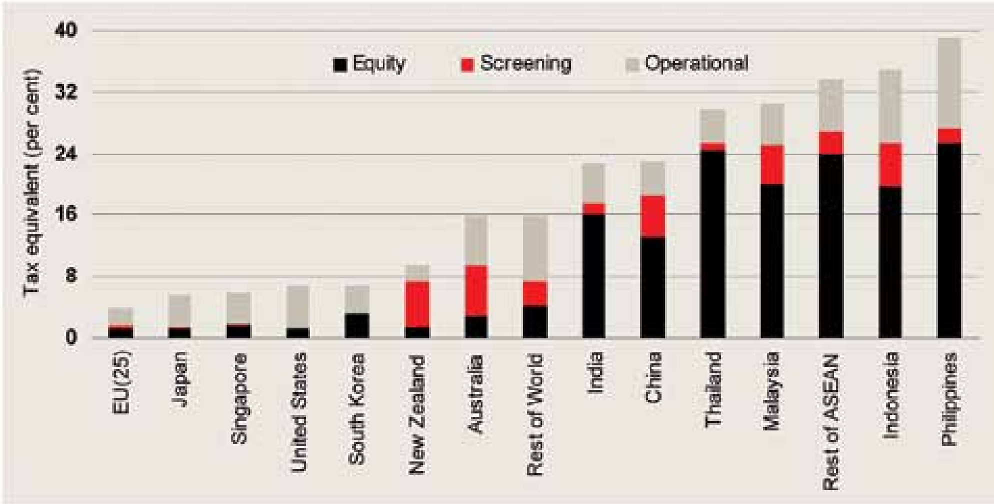
Moreover, services trade barriers restrain the integration of Australia's economy with the rest of the world; limit the flow of ideas and know-how between economies; and the diffusion of new technology. Liberalisation in services trade and investment can help alleviate these problems by reducing the search, transaction, establishment and investment costs, which deliver positive social and economic gains to the domestic economy.

156. CIE 2010, *Quantifying the Benefits of Services Trade Liberalisation*, p. 13 – 4.

157. Hurford, K. 2003, *Going Global: The case for enhancing global trade in professional services*, Institution of Engineers, p. 12.

158. ACCI 2007, *Trade in Services – not just a poor Cousin to Manufacturers*, ACCI Review September 2007, p. 16.

Figure 3-15: FDI restriction index



Source: CIE 2010, *Quantifying the Benefits of Services Trade Liberalisation*, p.18.

3.6.3 Achieving Effective Services Trade Liberalisation

The commitment to reduce services trade barriers is an important element to promote the strength of Australia's services industries and overall economy. Given that services trade barriers are extensive, it is important to identify, analyse and formulate the best achievable means of reducing the barriers that currently inhibit services trade which will enable Australia to achieve the full potential of services industries.

There are several means to achieve effective services trade liberalisation. Australia has historically engaged in significant unilateral trade liberalisation reform, and continues to independently reduce its own trade barriers. The benefits of unilateral trade barrier reductions are widely acknowledged, and have been recently expressed by the Productivity Commission (PC) in its 2010 *Bilateral and Regional Trade Agreements* report. Such benefits include greater opportunities for local providers to source and import services to use in their own business at the lowest price available, whilst also exposing local services industries to import competition. Increased competition drives productivity, innovation, and efficient resources utilisation[159].

However, the full economic benefits of trade liberalisation cannot be achieved without the reciprocal reduction of trade barriers by Australia's trading partners. As such it is imperative that Australia continues to engage in multilateral, bilateral and regional trade negotiations, and encourage the agenda of greater trade openness and services trade barrier reductions in those negotiations.

3.6.3.1 Multilateral Trade Liberalisation

Given the expansion of international economic interdependency and globalisation, engagement in a multilateral trading system has become a vital component for securing domestic and international economic growth. Some of the greatest advances and economic gains can be produced through multilateral trade liberalisation. Australian governments have consistently engaged in multilateral negotiations through the WTO to further reduce global trade barriers and encourage greater market access for Australian goods and services in other economies.

The reductions in trade barriers that have been made to date from multilateral trade negotiations have been substantial. Average tariff rates have fallen from 40 per cent in 1940 to the current rate of 5 per cent, and world trade has multiplied by 22 times[160].

Substantial gains could be made globally and domestically following a comprehensive services trade liberalisation.

For example, if overnight and comprehensive services trade liberalisation on 1 January 2011 were to occur, in which all barriers to services trade are eliminated via Mode 1 'cross border supply' and Mode 3 'commercial presence' following a successful Doha Round negotiation, the CIE estimated that

159. PC 2010, *Bilateral and Regional Trade Agreements,* Research Report, Canberra, November 2010, p. xxvi.

160. ACCI 2008, *Submission to the Review of Export Policies and Programs*, May 2008, p 23.

over the 14 years from 2011 to 2025, the global economy is estimated to gain $5.3 trillion in real GDP and $3.8 trillion in real consumption (expressed in 2010 dollar terms). Australia is expected to experience $155 billion in real GDP gains, or around 2.9 per cent of global GDP gains, which equates to average annual GDP gains of $10.3 billion each year over 2011 to 2025[161].

The General Agreement on the Trade in Services (GATS) is the key multilateral instrument covering international trade in services. The agreement builds on the four 'Modes' for the delivery of services, and sets out the framework and rules relating to the liberalisation of trade in services. The GATS framework is aimed at reducing services trade barriers, the preferential treatment of service providers and restrictive domestic regulations.

The GATS works to facilitate services trade liberalisation through the following core principles:

- 'National Treatment' (non-discrimination): requires that countries set conditions for imported goods and services no less favourable than those for domestically produced products;
- 'Most- Favoured Nation Treatment': requires the equal treatment of all WTO members, so that no more favourable treatment to service providers is given to any one country;
- 'Transparency': requires compulsory identification and exposure of trade impediments, restrictive policies and domestic regulation, as well as the trade commitments of members; and
- 'Market Access': requires no additional measures to restrict market access, above those negotiated and outlined in the members' schedule of commitments.

ACCI supports the view that multilateral services trade liberalisation undertaken on a non-discriminatory or most favoured nation basis and where the best offers given by each nation extend to all nations is the most beneficial means of liberalising trade in services. These conditions provide the best environment for enhancing Australia's trade and business interests. This is particularly the case for services trade, as services trade impediments are often opaque and entwined in domestic regulation and processes such as the GATS encourages transparency and more open and predictable trading environment.

The PC also supports this view, stating that:

> "…The benefits of trade liberalisation are greatest if the liberalisation is undertaken on a multilateral basis. By lowering barriers to all countries, multilateral reform avoids the potential for trade diversion inherent in Preferential Trade agreements, and affords the liberalising economies with access to lowest-cost imported supplies…"[162]

Therefore ACCI supports the full and effective engagement of the Australian Government in WTO trade negotiations, including its commitment to progress the Doha Rounds GATS negotiation, and recent involvement in the Global Services Summit 2010.

However, it appears that the current GATS Doha Round negotiations have stalled as a result of the lack of commitment by many WTO members, the difficulty of managing the diverse interests and economies of WTO members and the competing priority given to goods trade. As a result it is unclear whether and when a bold, comprehensive and effective services trade liberalisation agreement will be negotiated.

Nevertheless, ACCI maintains that the Doha Round negotiations and the importance attached to the WTO should not be neglected. We welcome the strong position taken by the Minister of Trade in his advocacy for a greater global commitment to trade liberalisation. Given the potential outcomes, ACCI calls on the Government to continue to engage in further WTO negotiations and support its efforts to reach a worthwhile result in the Doha Round. Businesses encourage the Australian Government to uphold its recent commitment to promote amongst WTO members the conclusion of the Doha Round.

3.6.3.2 Bilateral and Regional Trade Liberalisation

Given the difficulties associated with its multilateral negotiations, the Australian government has taken a proactive approach to negotiate comprehensive Bilateral and Regional Trade Agreements (BRTAs) in the last decade.

Currently, the main Australian BRTAs that cover the services trade are:

- Australia-New Zealand Closer Economic Relations Trade Agreements, commenced in 1983;
- Singapore – Australia Free Trade Agreement (FTA) , commenced on 28 July 2003;
- Thailand – Australia FTA, commenced on 1 January 2005;
- Australia – United States FTA, commenced on 1 January 2005;
- Australia – Chile FTA, commenced on 1 January 2009; and
- ASEAN – Australia – New Zealand FTA (AANZFTA), commenced on 1 January 2010[163].

161. CIE 2010, *Quantifying the Benefits of Services Trade Liberalisation*, p. 36.

162. PC 2010, *Bilateral and Regional Trade Agreements*, Research Report, Canberra, November 2010, p. xxvii.

163. Ibid, p. 54.

Under these agreements the Australian government has sought to secure preferential treatment for Australian service providers through provisions such as[164]:

- 'National treatment' clauses whereby Australian service providers are not treated any less favourably than domestic service provider;
- 'Most-favoured nation provisions' whereby Australia gains the benefits offered to future FTA partners under the same agreement;
- Mutual and expanded recognition of professional and educational qualifications;
- Reductions in restrictions on commercial presence, including foreign investment, establishment, ownership and rights to practice;
- Reductions in visa restrictions; and
- Provisions which encourage domestic regulatory reform to reduce the 'behind the border' restrictions facing service providers and encourage regulatory transparency.

The aim of the government in negotiating these provisions is to reduce barriers to services trade and restrictions on foreign competition. This is to secure and improve the access of Australian service providers in the markets of our key trading partners as well as increase competition amongst our domestic services industries in order to encourage more efficiency and productivity gain and expand Australia's trade in services.

For example, AANZFTA attempts to promote greater certainty and transparency for Australian service suppliers doing business in the region via both specific market access commitments and regulatory reform commitments. Many of these commitments go beyond the offers made by ASEAN countries in the WTO Doha Round. Some of these commitments include[165] :

- Binding levels of market openness in various services industries, such as obligations on regulators not to place undue restrictions on the use of business names;
- Enhanced transparency and review and appeal disciplines in relation to licensing and qualification recognition procedures;
- Enhanced foreign equity and acquisition guarantees in financial and telecommunication sectors; and
- Guarantees of certain legal protection for investment in their territories.

The potential gains that can be made by liberalising services trade through negotiated BRTAs are clear. AusTrade has reported that Australia's Free Trade agreements with the US, Singapore and Thailand have been very beneficial for Australian service providers seeking to export their services[166].

The PC also indicated that some 62 firms, including Telstra, reported actual or prospective benefits to their businesses from Australia's recent bilateral arrangements, which include improved market access for business through reductions in visa restrictions, and recognition of qualifications in education and legal professional services[167].

Nonetheless, many of the potential benefits that can be achieved through BRTAs' services trade liberalisation have not been fully realised. This negative outcome is due to the fact that many of the market access barriers that Australian service providers face in foreign markets either cannot be addressed in BRTAs, or have been left off the agenda in negotiations, or the provisions contained in the BRTA aimed at reducing these barriers are too broad and do not in practice target and break down specific barriers, which block market access[168].

"Services trade barriers are often opaque, and are borne out of and entwined in domestic regulation"

Given that services trade barriers are often opaque, and are borne out of and entwined in domestic regulation, complex domestic reform may be the only means in which such barriers can be eliminated. National governments may be unable to negotiate and implement such changes through BRTAs, or unwilling to pursue opportunities to break down remaining impediments because of competing domestic interests. Furthermore, even where provisions in BRTAs have been included to address such restrictions, such provisions may not be specific or comprehensive enough to effectively eliminate such barriers[169].

Another issue affecting the positive impact of BRTAs is the fact that for many services industries the actual barriers faced are administered outside of government, in some cases by private bodies, or industry-led professional associations. Therefore, government-to-government negotiations may be unable to achieve a significant reduction in behind the border restrictions.

164. Ibid, p. 56.

165. DFTA, *ASEAN- Australia- New Zealand Free Trade Agreement*, *Guide to the Agreement*.

166. House of Representatives Standing Committee on Economics, Finance and Public Administration, *Servicing our Future: Inquiry into current and future directions of Australia's service export sector*, May 2007, p. 40.

167. PC 2010, *Bilateral and Regional Trade Agreement*, Research Report, Canberra, November 2010, p. 98.

168. Ibid p. 99.

169. Ibid p. 153.

As noted by the Productivity Commission:

> "…Effective liberalisation of services trade may not be achievable without supporting agreements between national standard setting and professional bodies. To this end, it is suggested that effective liberalisation of barriers is more likely to be achieved, through the use of ongoing working groups and joint-committees comprised of both government and industry bodies within and between trading nations, who are aimed at harmonizing regulation, and encouraging mutual recognition…"[170]

Therefore, while BRTAs can reduce services trade barriers, their potential impact is limited and other options such as trade facilitation services may be more cost effective. Moreover, current processes of assessing and prioritising BRTAs lack transparency and tend to oversell the likely benefits.

As such, Australia's services trade liberalisation agenda should not be restricted to BRTA promotion only. Instead, an overarching trade liberalisation agenda should incorporate wider industry consultation, which includes a greater role for industry group input.

ACCI encourages the government to consult more widely with industry and seek business input into the services trade liberalisation agenda including the BRTA process. This would also include a willingness to provide greater support to viable complementary trade facilitation programs that deliver results and value for money, such as the Export Market Development Grants (EMDG) scheme[171] and TradeStart, as well as utilise industry's knowledge of behind-the-border restrictions in overseas markets.

It is ACCI's view that if BRTAs are to be negotiated in the area of services trade liberalisation, they should:

- Address restrictions faced by individual services industries broadly, comprehensively and specifically;
- Avoid discriminatory terms and conditions, and preferably include most-favoured nation provisions;
- Not preclude or prejudice current or future BRTA or multilateral agreements with other trading partners;
- Cover substantially all trade between the relevant parties to the agreement; and
- Be WTO-plus in that they must deliver trade liberalisation outcomes for Australia beyond those negotiated within, and required by the WTO-GATS system.

3.6.3.3 Domestic Regulatory Reform

As noted above, domestic regulatory reform is an important factor in achieving effective services trade liberalisation. Regulation includes laws, orders and rules issued by all levels of government and by delegated non-government or self-regulatory bodies. The complex regulatory environment facing Australian service exporters and importers in many cases creates a significant impediment to gaining market access, and realising the benefits of services trade liberalisation.

Analysing and reforming Australia's own domestic regulation, as well as promoting the importance and benefits of having effective and efficient regulatory practices that support openness, non-discrimination, mutual recognition, and competition amongst its trading partners, can in many cases facilitate effective services trade liberalisation. Such regulatory changes within Australia and abroad, may include introducing, amending, standardising, or harmonising domestic regulations.

While much regulatory reform has taken place over the past two decades in favour of open trade facilitation, many foreign regulators have not adapted to the realities and pace of the globalised economy, whilst others have resorted back to protectionist measures in the wake of the global financial crisis. ACCI welcomes the Australian Government's recent commitment to emphasise to its trading partners the need to reject trade protectionism, and the importance of engaging in domestic regulatory reform initiatives which promote services competitiveness and foreign market access[172].

Australia must also look into its own regulatory regimes, and assess the need for regulatory reform of its own services industries. Although Australia has engaged in substantial trade liberalisation, with tariff rates close to zero, the Government has acknowledged that "*business impediments…unnecessary business regulation… [and] ad-hoc, overlapping and contradictory Commonwealth, state and territory and local government regulation*" continue to obstruct foreign access to our domestic services markets[173].

The link between productivity and the competitiveness of Australian businesses, and domestic regulatory reform has been emphasised by the Productivity Commission:

> "…Productivity is boosted by a focus on reforming those regulations that are overly prescriptive, poorly targeted, mutually inconsistent, duplicative, difficult to enforce or unduly resource intensive for business to comply with. Equally

170. Ibid, p.100.

171. Detailed discussion on the EMDG scheme is available in Section 3.3.3.

172. Emerson, C. 2010, *Trade liberalisation the pathway to growth, jobs, and prosperity*, Speech delivered at the launch of the Australian Services Roundtable report on services in the Australian Economy, Parliament House, Canberra, 4th October 2010.

173. Ibid.

> important are overlaps or inconsistencies between the States that fragment the national market. Industry self-regulation similarly needs ongoing critical evaluation and assessment. The Productivity Commission estimates that a quarter of the compliance burden associated with business regulation in Australia is unnecessary to meet the policy objectives of the regulation, and that such compliance may cost up to 4 per cent of GDP, i.e. around $40 billion per year…"[174]

ACCI welcomes the Government's commitment to invest in regulatory reform measures which will rationalise the unwarranted government imposed restrictions on the international flow of goods and services. This will in turn encourage foreign investment and competition in Australia's services sector, promote export and import volumes, and the productivity and competiveness of Australian services enterprises.

3.6.4 Policy Recommendations

In order to further encourage Australia's services exports, ACCI proposes that:

Recommendation 47: The Australian Government should provide strong advocacy internationally on the benefits of services trade liberalisation and a concerted effort to ensure services trade liberalisation remains high on the global agenda.

Recommendation 48: The Australian Government should consult more widely with industry and seek business input into the services trade liberalisation agenda to ensure that Australian trade liberalisation negotiations deliver their potential benefits.

Recommendation 49: The Australian Government should give priority to those trade agreements, which practicably and cost-effectively reduce trade barriers faced by Australia's service exporters, avoid discriminatory terms and conditions and ultimately provide significant economic benefits to the domestic economy.

Recommendation 50: The Australian Government should develop and publish an overarching trade policy strategy to better coordinate and track the progress of Australia's trade policy initiatives and to ensure that limited resources and efforts are channelled to areas that provide the greatest prospective return.

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174. PC 2010, *Bilateral and Regional Trade Agreement*, Research Report, Canberra, November 2010, p. 64.

CHAPTER 4

CONSTRUCTION SERVICES INDUSTRY

4. CONSTRUCTION SERVICES INDUSTRY

Construction services are closely related to the process of urbanisation and industrialisation. Through the component of fixed capital formation or investment, there is a strong link between construction and economic growth.

Construction services provide the infrastructure needed for the production and consumption of all goods and services: from the physical structures required for the product extraction and energy generation, through to manufacturing and services facilities and finally to the housing used by final consumers. Therefore, as a provider of physical infrastructure, the sector has links to many different sectors and activities, such as mining, electricity and water supplies, waste and sewerage, transportation, public health, and manufacturing etc.

The Construction services industry consists of businesses mainly engaged in construction of buildings and other structures, additions, alterations, reconstruction, installation, and maintenance and repairs of buildings and other structures. According to the ANZSIC 2006 industry classification Construction services industry (Division E) includes:

- Residential and building construction;
- Non-Residential building construction such as commercial buildings, hotels, hospitals and other buildings;
- Heavy and civil engineering construction, such as road and bridge construction and other infrastructure construction;
- Land development and site preparation services;
- Building structure services such as concreting, bricklayering and roofing services;
- Building installation services such as electrical services, plumbing services, air conditioning and heating services, fire and safety alarm installation services; and
- Building completion services such as plastering and ceiling services, carpentry services and tiling and carpeting services.

4.1 Industry Size and Characteristics

In 2008-09, the Construction industry contributed 8.0 per cent of GDP or $81.6 billion in gross value-added (chain volumes measures) to the Australian economy[175]. During the same period, Australia exported $103 million of construction services, with a five year trend growth of 7.6 per cent[176].

The Construction industry is often characterised by a large number of small businesses generally specialising in certain areas or operating in small geographical regions. Moreover, construction services may be carried out by general contractors who complete the entire work for the client, or by specialised subcontractors who undertake parts of the work or project.

As of June 2007, there were 322,404 businesses operating in the Construction industry, 16 per cent of Australian businesses. The survival rate for construction businesses operating since June 2003 was 56.7 per cent, comparable to the 58.4 per cent survival rate for all industries[177].

Over one million people were employed in construction in 2008-09, representing around 9 per cent of the total number of people employed. Table 4-1 shows that small businesses play an important role in the construction sector compared to other industries. In 2008-09, small construction enterprises employed 72.1 per cent of all labour employed in construction industry and contributed 53.0 per cent of total construction industry value-added. In contrast, small businesses only contributed around 50 per cent of total industries' employment and 35 per cent of industry value-added.

Within Australia, New South Wales contributed the most to GDP in construction, contributing around 31 per cent or $25 billion in 2008-09, followed by Queensland (around 22 per cent) and Victoria (around 20 per cent). The largest employers by state in construction were again New South Wales, Queensland and Victoria, the most populous states (Table 4-2).

Table 4-3 shows that construction services are the largest subsector within the Construction industry, accounting for almost 60 per cent of construction industry production and more than 70 per cent of employment.

The Construction industry has a high prevalence of full time employment and male workers. As of May 2010, 85.6 per cent of workers in construction were employed on a full time basis, compared to 70 per cent for the total working population. Around 88 per cent of workers in construction were males, compared to 54.6 per cent for the total working population (Table 4-4).

175. ABS 2009, *Australian System of National Accounts*, Cat. No. 5204.0, Table 5.

176. DFAT 2010, *Trade in Services Australia 2008-09*, Canberra, p. 28.

177. ABS 2007, *Counts of Australian Businesses, Including Entries and Exits*, Cat. No. 8165.0.

Table 4-1: Construction's Industry value-added and employment by business size, 2008-09

		Small	Medium	Large	Total
Construction					
Employment	`000	743	150	136	1,030
	%	72.1	14.6	13.2	100.0
Industry Value-added	$m	44,080	20,315	18,816	83,210
	%	53.0	24.4	22.6	100.0
Total Selected Industries					
Employment	`000	4,764	2,331	2,901	9,997
	%	47.7	23.3	29.0	100.0
Industry Value-added	$m	290,348	198,853	353,382	842,582
	%	34.5	23.6	41.9	100.0

Source: ABS Cat. No. 8155.0 *Australian Industry 2008-09.*

Note: Industry value-added is related to, but different from, the national accounts' gross value-added, which is calculated by adjusting industry value-added to include General Government units and also to account for some other effects. Total Selected Industries excludes Division 7 Financial and Insurance Services. For the purpose of Table 4-1, businesses are categorised as large businesses, with employment of 200 or more persons; medium businesses, with employment of 20 to less than 200 person; and small businesses, with employment of less than 20 persons (including non-employing businesses).

Table 4-2: Construction's value-added and employment by state/territory, 2008-09

	Gross Value-added		Employment	
	$m	%	`000	%
NSW	24,934	30.6	310	30.1
VIC	16,553	20.3	240	23.3
QLD	17,887	21.9	256	24.9
SA	4,297	5.3	54	5.2
WA	14,270	17.5	130	12.6
TAS	1,013	1.2	16	1.6
NT	838	1.0	11	1.1
ACT	1,809	2.2	11	1.1
Total	**81,601**	**100.0**	**1,030**	**100.0**

Source: Gross value-added data are from ABS Cat. No. 5220.0 *Australian National Accounts, State Accounts, 2008-09;* while employment data are from ABS Cat. No. 8155.0 *Australian Industry 2008-09.*

Table 4-3: Industry value-added and employment by subdivision, 2008-09

	Employment		Industry Value-added	
	`000	%	$m	%
Building construction	198	19.2	20,146	24.2
Heavy and civil engineering construction	108	10.5	13,211	15.9
Construction services	723	70.2	49,853	59.9
Total Construction	**1030**	**100.0**	**83,210**	**100.0**

Source: ABS Cat. No. 8155.0 *Australian Industry 2008-09.*

Table 4-4: Employment in construction, May 2010

	Full time	Part time	Males	Females	Total
	Number of people employed (`000)				
Construction	***867.5***	***146.0***	***896.1***	***117.4***	***1013.5***
Building construction	218.6	29.0	210.1	37.5	247.6
Heavy and civil engineering construction	66.9	5.6	64.4	8.1	72.5
Construction services	557.0	108.4	598.0	67.4	665.4
All Industries	**7750.6**	**3303.2**	**6032.7**	**5021.2**	**11053.8**
	Number of people employed (% total)				
Construction	***85.6***	***14.4***	***88.4***	***11.6***	***100.0***
Building construction	88.3	11.7	84.9	15.1	100.0
Heavy and civil engineering construction	92.3	7.7	88.8	11.2	100.0
Construction services	83.7	16.3	89.9	10.1	100.0
All Industries	**70.1**	**29.9**	**54.6**	**45.4**	**100.0**

Source: ABS Cat. No. 6105 *Australian Labour Market Statistics,* July 2010.

Note: The total number of people employed in Construction industry includes any person whose industry subdivision was not further defined within the Construction industry.

4.2 Issues and Challenges for the Industry[178]

The Construction industry plays an important role in ensuring Australia's long term economic and social well-being. Given the industry is highly labour intensive, the success of the industry is vital to Australia's job creation and wealth accumulation. This section addresses some of the contemporary issues and challenges faced by businesses in the construction industry.

4.2.1 Flexible Workplace Policy

Workplace relations reform has to be ongoing to ensure that the building and construction industry can contribute to a resilient and competitive economy.

The workplace relations system should not create barriers to labour market efficiency and flexibility nor should it prevent workers from being able to negotiate arrangements with their employer that best suit their circumstances without unnecessary third party intervention.

4.2.1.1 The Australian Building and Construction Commission

Lawful industrial behaviour is high on the building industry's priority list. The industry needs a "strong cop on the beat" with the retention of a well empowered regulator. Australians have gained from the benefits of the industrial relations reforms that have been introduced since the establishment of the Office of the Australian Building and Construction Commissioner (ABCC) and the related industry specific reforms.

The Cole Royal Commission[179] comprehensively documented the workplace relations problems of the construction industry. It found that unacceptable and unlawful behaviours of unions in the commercial sector were a systemic problem.

The findings of the Royal Commission were supported by the work of the Interim Building Industry Taskforce which became the Building Industry Taskforce (the Taskforce) and then the ABCC. Both taskforces published reports that documented the unacceptable face of the building and construction industry[180]. In addition, the ABCC has published five reports on its compliance activities[181], as well as a number of other reports that highlight the need for continuing action to curb unacceptable behaviour.

178. The issues on workplace policy, housing affordability, environmental sustainability and energy efficiency discussed in this section are adapted from ACCI member's publication - Master Builders Australia 2010, *Federal Election Policy Priorities 2010*, 27 July 2010. ACCI thanks Master Builders Australia for their input.

179. Commonwealth of Australia, *Final Report of the Royal Commission into the Building and Construction Industry*, February 2003, www.royalcombci.gov.au, accessed 9 September 2008.

180. Commonwealth of Australia, Interim Building Taskforce, Upholding the Law – One Year On: Findings of the Interim Building Industry Taskforce, March 2004 and Commonwealth of Australia, Taskforce, Upholding the Law – Findings of the Building Industry Taskforce, September 2005.

181. Commonwealth of Australia, Office of the Australian Building and Construction Commissioner, Report on the Exercise of Compliance Powers by the ABCC for the period 1 October 2005 to 31 March 2008; Exercise of Compliance Powers by the ABCC for the period 1 October 2005 to 31 August 2007; Exercise of Compliance Powers by the ABCC for the period 1 October 2005 to 31 December 2006; and Exercise of Compliance Powers by the ABCC for the period 1 October 2005 to 30 June 2006, www.abcc.gov.au/abcc/Reports/LegalReports/, accessed 9 September 2008.

These reports also document clearly the important role that the ABCC has played in changing the industry culture and deterring unlawful industrial action. There is a clear correlation between the ABCC's activities and the improvements in the culture and productivity of the industry.

The September 2005 Taskforce Report[182] highlighted the rationale for specific building industry workplace reform. It found that the industry norm was to disregard the then *Workplace Relations Act 1996* (Cth) (WRA) and adhere instead to "the law of the jungle". The Taskforce reported that incidences of inappropriate industrial pressure, sometimes involving violent and thuggish behaviour, contributed to the lawless culture that has plagued the construction industry for decades.

The specific reforms for the building and construction industry were introduced to transform the unacceptable culture identified by the Royal Commission. It was the singularity of the poor standard of industrial behaviour that led to the introduction of industry specific reform, the rationale for which has not at all altered. That is the important point: there is no case for changing something that was established following a detailed and rigorous Royal Commission that exposed unlawful and inappropriate behaviour.

Since September 2005, following the passage of the *Building and Construction Industry Improvement Act 2005* (Cth) (BCII Act), which created the ABCC, the building and construction industry has enjoyed a period of significantly improved industrial relations calm and increased productivity in which industrial relations has not been the predominant and negative influence that it has been in the past. Certainty for investors has been elevated when compared with the past. This change has benefited all parties in the industry, including workers. Equally importantly, it has benefited the Australian economy and the community.

"The ABCC and related industrial relations reforms have added over 9 per cent to labour productivity in the building and construction industry"

The ABCC and related industrial relations reforms have added over 9 per cent to labour productivity in the building and construction industry. The community is also $5.9 billion better off through economic welfare gain because of the work of the ABCC. The effects of the ABCC also contributed to a reduction in inflation of 0.7 per cent and added 0.6 per cent to GDP. These findings were contained In the July 2010 Master Builders Australia commissioned KPMG Econtech report on the economic effects of the work of the regulator. Abolition of the ABCC would throw away this vital economic activity with industry therefore remaining strongly supportive of the retention of a well empowered regulator.

The Report also found that there has been a gain in industry productivity from the ABCC reforms. Since 2002 construction industry labour productivity has outperformed predictions based on historical performance relative to other industries by 7.7 per cent. Multifactor productivity in the industry was no higher in 2000-01 than 20 years earlier yet then accelerated to rise by 14.8 per cent in the six years to 2007-08.

This rise in productivity and economic benefits to the community must not be put in jeopardy by the watering down of the powers of the ABCC or through its abolition.

The advent of good industrial relations in the construction industry is related to the exercise of the powers of the ABCC, the work of which the Government's own recent inquiry into the industry found has not yet been done. The Wilcox Report made it clear that:

> "The ABCC's work is not yet done. Although I accept there has been a big improvement in building industry behaviour during recent years, some problems remain. It would be unfortunate if the inclusion of the ABCC in the OFWO led to a reversal of the progress that has been made."[183]

Therefore, there is no case to abolish a system that is only just beginning to have an effect on cultural change. Industry strongly opposed the terms of the *Building and Construction Industry Improvement Amendment (Transition to Fair Work) Bill 2009* introduced by the Government as a vehicle to replace the ABCC with another, weaker regulator.

This Bill would have unacceptably:

- Abolished the Office of the ABCC and created the Office of the Fair Work Building Industry Inspectorate (Inspectorate);
- Removed existing building industry specific laws that have been tailored to the industry's circumstances; and
- Enabled the Inspectorate to compulsorily obtain information or documents relevant to an investigation from certain persons only after complying with strangling red tape.

182. Note 58.

183. Cth of Australia Transition to Fair Work Australia for the Building and Construction Industry, para 3.23 http://www.deewr.gov.au/WorkplaceRelations/Policies/Buildingand-Construction/WilcoxReport/Pages/default.aspx.

4.2.1.2 Reform of Procurement Instruments - The National Code and Implementation Guidelines

The National Code and Guidelines have had a fundamental impact on agreement making in the building and construction industry. In particular, the Implementation Guidelines have been a means by which the Government has used its purchasing power to set the standards of workplace arrangements where building industry participants undertake work for the Commonwealth and its agencies, and where there is an element of Commonwealth funding associated with state and territory public works. Despite that policy, the Government determined that workplace relations laws are not to be affected by the Implementation Guidelines, where the Guidelines clash with a Fair Work enterprise agreements, the terms of the agreement will prevail.

The adoption of this policy position was made via a Ministerial Direction in October 2009. That Direction requires the Department of Education, Employment and Workplace Relations in assessing agreements made under the *Fair Work Act* to give precedence to the terms of those agreements. In examining agreements for compliance with the 2006 Implementation Guidelines, the Direction instructs the Department to give primacy to section 8.1.1 of the Guidelines and 6.1 in the 2009 Guidelines so that if a Fair Work enterprise agreement is inconsistent with the Guidelines, the agreement prevails.

There is nothing on the face of the published documents (the 2006 and 2009 Guidelines) to indicate the fact that they are not to be interpreted as they have been read and understood by industry. In other words, the Guidelines should not be contradicted by a Ministerial Direction that builders are frequently not aware of. This concern also applies to the application of the Guidelines by Government Departments and agencies when procuring construction work. The National Code and Guidelines not be subject to the relevant Ministerial Direction or, at the least, that their terms reflect the Ministerial Direction.

At present, there are other procurement instruments that affect enterprise agreements reached in the building and construction industry, particularly the *Fair Work Principles*. The threshold for the application of these principles is different from the application of the Code and Guidelines. The method of enforcing compliance is also different from the Code and Guidelines. These instruments should be rationalised so that they have common thresholds and like compliance regimes.

4.2.1.3 Modern Awards

The modern awards which commenced on 1 January 2010 have had a substantial effect on the building and construction industry. The *Building and Construction General On-Site Award 2010*, does not seem to be able to deliver a safety net that is appropriate or sufficiently flexible to maintain productivity. Its terms are unclear and the links with history muddy its interpretation.

The re-regulation of the labour market under the *Fair Work Act, 2009 (Cth)* is reducing employment flexibility and is unnecessarily adding to labour costs. The award modernisation process was cumbersome and added a considerable new compliance burden.

A further review of the industry modern awards is required to assist with eliminating inflexibilities and to rationalise matters such as the more than 60 allowances that must be paid by building and construction employers for a vast array of matters. This could also lead to the consideration of one model for the structure of modern awards adopted, so that there are few differences in fundamental employment terms between industry sectors.

4.2.1.4 Independent Contractors

The building and construction industry uses independent contracting to flexibly satisfy labour requirements and to deliver a number of efficiencies. Subcontracting needs to be recognised as a legitimate form of delivering cost effective and highly productive outcomes.

> "The subcontract system has demonstrated itself to be a highly productive and cost effective method of building"

The subcontract system has demonstrated itself to be a highly productive and cost effective method of building. More importantly, the subcontract system exemplifies the principles of freedom of association, enterprise, competition and independent endeavour. It is one where earnings directly motivate productivity and one in which efficient trades persons can maximise their income. In order for such contractors to fairly compete, they should be regulated by commercial, not industrial, law.

Business is also concerned that the *Fair Work Act 2009 (Cth)* currently allows for independent contractors to be regulated by enterprise agreements under the guise of job security for employees. This is unnecessary as contractors are used to fill temporary skills shortages. It is also directly contrary to the principles of freedom of contract and amounts to 'back-door' regulation which unfairly protects the privileges of one set of employees over the rights of another. Industry advocates the prohibition of any regulation of independent contractors by way of enterprise agreements or any other workplace law.

Similarly, the current taxation rules on when a contractor conducts a personal services business should not be changed. They allow contractors' businesses to be appropriately taxed as a business rather than as an individual. They work well and have become familiar to the construction industry[184].

4.2.2 Occupational Health and Safety

Two of the main policy objectives for construction industry occupational health and safety (OHS) are to achieve improved building and construction industry OHS performance and a national, consistent OH&S regulatory framework that reduces the complexity of the regulatory burden on businesses operating across jurisdictions and that is reasonable and fair to employers.

The building and construction industry is improving its occupational health and safety record. The personal and community costs of serious injuries and death at work are unacceptable and strategies are being adopted to lessen this toll.

4.2.2.1 Nationally Consistent OHS Laws

Industry supports the harmonisation of OHS laws provided that it results in regulation that is fair and reasonable for industry and does not disadvantage companies that conduct business in one jurisdiction only. In particular, model OHS regulations must be clear and workable for the industry and not unnecessarily add to the industry's regulatory burden.

4.2.2.2 Nationally Consistent Enforcement of OHS Legislation

Penalties for breaches of OHS legislation should be consistently applied across all jurisdictions. A focus of resources upon preventative measures will generate better OHS outcomes than the diversion of resources into enforcing legislation such as industrial manslaughter offences.

184. The proposed changes to the tax arrangement for independent contractors were discussed in Section 3.1.7.

4.2.2.3 Review of the FSC Accreditation Scheme

The Accreditation Scheme overseen by the Federal Safety Commissioner (FSC) is now in its 5th year of operation. It is timely for a comprehensive, independent review of the Scheme to assess what role it is playing in achieving improved OHS performance in the industry. The review is also needed to address industry concerns about the structure and operation of the Scheme and to ensure that the Scheme is consistent with, and does not operate in isolation from, harmonised OHS laws.

4.2.2.4 National Asbestos Policy Unit

Industry supports the establishment of a national asbestos policy unit to properly address the legacy of widespread asbestos use in Australia. Currently there is insufficient community understanding of the circumstances in which asbestos poses a risk to health. Establishing a national asbestos unit would help raise community awareness of asbestos. The unit could also develop a long-term national strategy to deal with asbestos which appropriately takes into account the complex issues around the removal and disposal of asbestos.

4.2.3 Housing Supply and Affordability

Home ownership is an integral part of Australia's social fabric. However the cost of a family home has increasingly become prohibitive as a confluence of circumstances have mitigated against an average Australian household realising the goal of affordable home ownership.

As home ownership is one of the cornerstones of Australia's social wellbeing it is important that affordable housing is within reach of all Australians.

The lack of affordable housing adds to social dislocation and threatens Australia's economic growth and productivity. The National Housing Supply Council has estimated the cumulative shortfall in new housing at around 180,000 dwellings.

The key factors leading to a worsening of housing affordability include:

- Shortage of available land and inefficient land release strategies;
- Infrastructure costs being loaded onto developers and in turn passed on to home owners;
- Excessive infrastructure specifications in subdivisions;
- Excessive Council development levies, taxes and charges imposed by state and territory governments;

- Excessive Council planning and building requirements;
- Regulatory creep pushing codes and standards higher than required; and
- Uncoordinated local and state government environmental regulations.

Governments need to embrace a package of reforms including reform of developer charges, timely land release programs, effective planning approval processes and removal of stamp duties.

Industry welcomes the Government's range of initiatives for dealing with housing affordability, including: infrastructure assistance to local governments; subsidies for rental investment properties; setting up a special savings fund for first home buyers; and releasing Commonwealth land. These are important and immediate first steps but by themselves are not long term sustainable solutions.

A recent key decision of COAG was to make housing a priority for microeconomic reform for 2010 with Treasurers to lead the development of a housing reform agenda with Housing and Planning Ministers. State and Territory Treasurers have been tasked with the job of developing a reform agenda to tackle housing supply and affordability issues. States and Territories also agreed to have capital city strategic plans by 2012 that will be independently assessed by the COAG Reform Council.

The Henry Tax Review undertook a major analysis of Australia's housing affordability challenge and has come up with two key recommendations to free up zoning and planning and to set appropriate infrastructure charges (developer charges). Those reforms must be top priorities for the Government to be pursued through COAG.

The Henry Review categorically stated that taxation is not the major source of supply constraints in the Australian housing market. It made the point strongly that reforms designed to change the tax treatment of investor housing should only be considered once the housing supply issue has been resolved.

Mandatory minimum energy efficiency standards for new homes are a critical determinant in the cost of new housing. One ACCI member, Master Builders Australia, recently commissioned research which shows that energy efficiency standards for residential dwellings should not go beyond the proposed six star rating agreed to by COAG. Going to seven and eight star is not warranted and can only unnecessarily add to the cost of home ownership for first home buyers and add a further cost barrier to home ownership[185].

185. This issue is discussed further in Section 4.2.4.

4.2.3.1 Inefficient Infrastructure Charges

Inefficient infrastructure charges threaten intergenerational equity and should be reformed. Recent research by Master Builders Australia shows that developer charges, one of the fastest growing taxes in Australia, flow through to higher prices for newly built homes, making them less affordable and depressing building activity.

The problem has been recognised by the Australian Government and the Reserve Bank Governor. Unreasonably high developer charges have contributed to the current housing undersupply situation which in turn has exacerbated broader problems such as a higher house prices, a lower level of home ownership, and undersupply of rental housing leading to higher rents.

Historically, urban infrastructure provision for housing development has been funded through a combination of local council rates and state/territory government general taxes, but state and local governments have imposed high developer charges which have risen to unprecedented and hurtful levels over time.

4.2.3.2 Land Supply

Australia has plenty of habitable land. Restrictions on the supply of land are driven by state and local government policies largely to reduce urban sprawl.

Limiting urban sprawl became a predominant policy as governments became increasingly less willing to fund new urban infrastructure associated with growth.

Public policy now typically seeks to contain growth within existing urban footprints, citing the need for more efficient use of existing infrastructure (through higher density) and attempting to prescribe this outcome by creating urban land boundaries around major cities.

Industry advocates that all governments, at all levels, collaborate to increase both the supply of affordable land and the construction of well-planned infrastructure to support new land releases.

4.2.3.3 Local Government Planning Approvals

Industry believes more reform is needed within the planning approval system. Councils need to effectively develop strategic planning frameworks to encourage more investment expenditure to facilitate opportunities for growth.

Amongst the key areas of reform are:

- Involving independent experts in decision making;
- Creating a statutory framework for private certification;
- Allowing as of right compliance with planning schemes; and
- Ensuring planning schemes are easily accessible and drafted in plain English.

4.2.3.4 Provision of Public and Social Housing

There are compelling social and economic reasons for the provision of housing assistance by governments. Secure and affordable housing provides substantial direct and indirect benefits to households and the economy as a whole.

Housing assistance helps to relieve poverty, provides a stable and secure home environment, enhances employment prospects, contributes to better health and provides one of the critical components for security in retirement.

Therefore, provision of quality shelter for those individuals and families who, for social, health or other reasons, are unable to obtain a home themselves or rental assistance should be available.

Nonetheless, public housing should not be seen as an alternative to home ownership. Public housing should be the solution for those in housing difficulties.

Thus, an increase in the supply of housing, both in the private and public sector, is important. For the public sector this means maintaining funding in real terms and reviewing the efficiency and effectiveness of the delivery system for this sector of housing.

4.2.4 Environmental Sustainability and Energy Efficiency

Business accepts that it has a leadership role in influencing the way in which the built environment is constructed, thus mitigating the impact on the environment.

Industry in general supports measures which:

- Minimise greenhouse gas emissions;
- Promote cost effective energy efficiency particularly in existing buildings;
- Assist builders to reduce and recycle building materials;
- Promote sustainable building practices to builders and consumers; and
- Promote the efficient use of water.

4.2.4.1 Energy Efficiency

In July 2009, COAG agreed to the National Strategy on Energy Efficiency (NSEE). The NSEE is designed to substantially improve minimum standards for energy efficiency and accelerate the introduction of new technologies through improving regulatory processes and addressing barriers to the uptake of new energy-efficient products.

Part of the NSEE is designed to drive significant improvement in minimum energy efficiency standards to deliver substantial growth in the number of highly energy efficient homes and commercial buildings. The transformation is expected to be achieved through a combination of measures addressing both new building construction and the existing building stock.

It states that new buildings will be constructed according to increasingly stringent energy efficiency standards that will lead to a reduction in energy consumption. Governments will set out a clear process and timetable for periodic review (for example, every three years starting in 2012) of energy efficiency standards so that over the life of this strategy energy efficiency requirements will be progressively increased. Six, seven and eight star buildings, or equivalent, will become the norm in Australia, not the exception.

Industry has serious concerns about this approach, which mandate increasing stringency for energy efficiency in new buildings without regard to the economic cost to the community.

Australia is in the process of moving to more stringent mandated levels of energy efficiency in new buildings during 1 May 2010 to 1 May 2011 in its States and Territories, i.e. 6-star in residential buildings. The Government's own cost benefit analysis, i.e. the Australian Building Codes Board (ABCB) Regulatory Impact Statement, showed that the imminent move to 6-star will be at a great cost to the community, not to mention housing affordability. The cost to the community to move to 6-star in residential buildings was estimated to be $444 million. One ACCI member, Master Builders Australia, believes this is an under-estimate.

In a report recently commissioned by Master Builders Australia entitled *"Energy-efficiency: building code star-ratings. What's optimal, what's not"*, the independent research firm, the CIE, argues:

- It is a fallacy to assume that energy savings can be achieved at no resource cost;
- It is economically reckless to relentlessly pursue ever higher energy efficiency star ratings in buildings with no consideration of costs - this only creates political pressures to achieve incorrect economic targets;
- Forcing home owners to build houses with higher star ratings (using mandatory minimum standards) will be financially detrimental to most new home owners and economically detrimental to the community; and
- Higher star ratings will manifest in higher house prices and lower disposable incomes of Australians and it will not result in efficient reductions in greenhouse gases.

Based on 700 model simulations conducted by *Pitt & Sherry and Energy Partners* using AccuRate software, the CIE found that in all new house designs evaluated, marginal costs escalate rapidly above 6 stars, while benefits continue to diminish. For many new house designs this occurs at a lower star rating (around 5 stars). Even quite large increases in electricity prices or falls in construction or design costs will make very little difference to the conclusion that raising the minimum mandated star rating above current levels will be economically detrimental to Australia.

On the other hand, the report found that for existing homes, potential for economic gain may exist. For those homes with very low existing star ratings, those with star rating of 1 or below, there is probably potential for an economical 1 to 1.5 star gain.

4.2.5 Trade in Construction Services

Unlike many other services industries, the output of the construction industry is physical in nature. In terms of exports of construction services, only the production process is exported, while the final output or finished product is located in the host country.

Trade in construction services is limited in Australia. In 2007-08, Australia only exported $22 million of construction services[186], compared to the US$21.7 billion and US$10.3 billion services exported by the European Union and Japan respectively in 2007[187].

Exports of construction services are often limited given the laws, regulations, decision and other forms of restrictions imposed by the host country. Given its intensive use of labour force (notably low to medium skilled), materials, equipment and capital, any barriers to movement in these factors of production will impact on the trade in construction services.

For example, the movement of labour force from a foreign country are often subjected to labour market tests, residency and other staffing regulations; construction equipment and building materials often have to comply with a variety of national technical standards and specifications that are not always internationally harmonised.

Construction companies attempting to participate in foreign construction services must conform with numerous host country's restrictions and regulations. These might include controls on land use and urban planning, building standards and regulation, technical requirements, safety and environmental regulations. Moreover, some of the required permits and licences are granted by many different authorities at different jurisdictions. The lack of transparency concerning the rules that apply could hamper market access by foreign construction companies.

4.3 Policy Recommendations

To address the issues and challenges discussed above and realise the potential gains from reforms, it is recommended that:

Recommendation 51: The work of the Australian Building and Construction Commission (ABCC) should be preserved in its current form and continued. The existence of a well empowered regulator has been paramount in achieving a return to the rule of law in the industry. The continued existence of the industry regulator is essential to maintain labour and multi-factor productivity.

Recommendation 52: It is imperative that the ABCC continue its work with current statutory powers of investigation and current levels of funding retained, and that the work of the ABCC is able to continue as a "strong cop on the beat".

Recommendation 53: The modern Awards should be re-written in plain English such that legal disputes are minimised.

Recommendation 54: The sub-contracting system in the building and construction industry should be retained and enhanced, including the retention and enhancement of the Independent Contractors legislation.

Recommendation 55: In order to ensure Australia's housing affordability, reforms are needed to:

186. DFAT 2010, *Trade in Services Australia 2008-09*, Canberra.

187. World Trade Organisation 2009, *Construction and Related Engineering Services*, Background Note by the Secretariat, S/C/W/302.

- Reduce, with the aim of eventual abolition of, inefficient and costly infrastructure charges and levies;
- Increase land supply;
- Expedite planning and development processes to reduce costs and delays;
- Ensure mandatory minimum energy efficiency standards do not exceed six stars; and
- Secure provision of an appropriate level of public housing.

Recommendation 56: Statutory sustainable policies should be developed in full partnership with industry that are nationally consistent with the Building Code of Australia (BCA), while allowing for appropriate regional variations, ground and climatic conditions. It is also imperative that State and local variations not contradict the BCA's climate zones. All proposed regulations need to be supported by a rigorous cost benefit analysis.

Recommendation 57: Since new buildings replace only about 2 per cent of the stock each year, the Government's policy focus in relation to building energy efficiency should be on retrofitting the nearly $3 trillion worth of existing stock of buildings to make them more energy efficient and therefore less carbon intensive. A stronger focus on policies to ensure that existing buildings become more energy efficient is the most effective way of achieving carbon abatement in the short to medium term.

Recommendation 58: The construction of new, more energy efficient buildings and the retrofitting of existing buildings will require a more skilled workforce. Thus government assistance is needed to overcome structural skills shortages in the building industry and to train workers in the new green building techniques that will be required.

Recommendation 59: National environmental registration, regulation and reporting should be standardised.

Recommendation 60: The Government should aim to reduce barriers of entry to international markets in trade negotiations to promote the export of construction services.

CHAPTER 5

BUSINESS SERVICES INDUSTRY

5. BUSINESS SERVICES INDUSTRY

Business or producer services are intermediate inputs to further production activities that are sold to other firms or businesses, although households are also important consumers in some cases. Business services usually contain high information content and their strong growth in recent years often reflects the growing trend of outsourcing or contracting out of support services that could be provided in-house. Business services industry covers two main industry divisions: Finance and insurance, and Property and business services.

According to the ANZSIC 2006 industry classification the above two areas of business services industry includes:

- Division K: Financial and insurance services
  - Finance, including depository financial intermediation, non-depository financing, financial asset investing;
  - Insurance and superannuation funds; and
  - Auxiliary finance and investment services, including financial asset broking services.
- Division L: Rental, hiring and real estate services
  - Rental and hiring services, including motor vehicle and transport equipment rental and hiring, other goods and equipment hiring; and
  - Property operators and real estate services.
- Division M: Professional, scientific and technical services
  - Professional, scientific and technical services, including scientific research services, architectural, engineering and technical services, legal and accounting services, advertising services, market research and statistical services, management and related consulting services; and
  - Computer system design and related services.
- Division N: Administrative and support services
  - Administrative services, including employment services, labour supply services, travel agency and tour arrangement services; and
  - Building cleaning, pest control and other support services.

As of June 2007, Property and business services had the greatest number of businesses with 507,508 enterprises, 25 per cent of the total Australian businesses. There were 136,587 businesses operating in Finance and insurance industry, 6.8 per cent of the total Australian businesses. The survival rates for Finance and insurance businesses and Property and business services enterprises operating since June 2003 were 56.3 and 59.1 per cent respectively, compared to the 58.4 per cent survival rate for all industries[188].

5.1 Industry Size and Characteristics

In 2008-09, the Finance and insurance services contributed 11.7 per cent of GDP or $118.2 billion in gross value-added (chain volumes measures), while Property and business services contributed the most to the Australian economy, contributing 13.3 per cent of GDP or $134.7 billion[189]. During the same period, Australia exported $365 million of Insurance and pension services, $1.2 billion of Financial services, and $7.7 billion of Business services[190]. Business services exports recorded a strong five year trend growth of 14.1 per cent, the highest amongst all the major services exports; while Insurance and pension services recorded a negative five year trend growth of -3.1 per cent[191].

In 2008-09, around 2.0 million people were employed in Property and business services industry, representing around 18 per cent of the total number of people employed. Table 5-1 shows that Rental, hiring and real estate services enterprises were predominantly small businesses, employing almost 80 per cent of the workforce and contributing almost three quarters of Rental, hiring and real estate services value-added. In contrast, medium and large enterprises played a more dominant role in Professional, scientific and technical services and Administrative and support services.

In 2008-09, New South Wales contributed the most to GDP in Property and business services industry – around 30 per cent for each industry or $11.8 billion in Rental, hiring and real estate services, $26.6 billion Professional, scientific and technical services and $10.5 billion in Administrative and support services. Victoria and Queensland also contributed significantly to GDP in these industries. The largest employers by state in these industries were again New South Wales, Queensland and Victoria, the most populous states (Table 5-2).

There are marked differences in the predominant type of employment between the four industry divisions. Administrative and support services had the lowest rate of full-time employment. As at May 2010, less than 60 per cent of employment in Administrative and support services was on a full time basis, compared to more than 80 per cent full time employment in Financial and insurance services. A higher proportion of employees in Professional, scientific and technical services was male (57.4 per cent) compared to the other three industry subdivisions (Table 5-3).

188. ABS 2007, Counts of Australian Businesses, Including Entries and Exits, Cat. No. 8165.0.

189. ABS 2009, *Australian System of National Accounts*, Cat. No. 5204.0, Table 5.

190. Excluding Telecommunications, computer and information services.

191. DFAT 2010, *Trade in Services Australia 2008-09*, Canberra, p. 28.

Table 5-1: Property and business services industry value-added and employment by business size, 2008-09

	Small		Medium		Large		Total	
Employment	**`000**	**%**	**`000**	**%**	**`000**	**%**	**`000**	**%**
Rental, hiring and real estate services	286	77.1	52	14.0	33	8.9	371	100
Professional, scientific and technical services	530	57.5	213	23.1	178	19.3	922	100
Administrative and support services	275	37.6	199	27.2	258	35.2	732	100
Total Selected Industries	4,764	47.7	2,331	23.3	2,901	29.0	9,997	100
Industry Value-added	**$m**	**%**	**$m**	**%**	**$m**	**%**	**$m**	**%**
Rental, hiring and real estate services	36,791	74.6	5,630	11.4	6,915	14.0	49,336	100
Professional, scientific and technical services	39,479	47.1	22,526	26.9	21,824	26.0	83,829	100
Administrative and support services	12,476	32.3	10,281	26.6	15,863	41.1	38,620	100
Total Selected Industries	290,348	34.5	198,853	23.6	353,382	41.9	842,582	100

Source: See Table 4-1.

Note: Information on Division K Finance and Insurance industry are not available.

Table 5-2: Property and business services value-added and employment by state/territory, 2008-09

	Gross Value-added						Employment					
	Rental, hiring and real estate services		Professional, scientific and technical services		Administrative and support services		Rental, hiring and real estate services		Professional, scientific and technical		Administrative and support services	
	$m	%	$m	%	$m	%	`000	%	`000	%	`000	%
NSW	11,753	32.6	26,554	37.7	10,548	37.4	130	35.0	334	36.2	257	35.1
VIC	8,300	23.0	18,617	26.4	7,566	26.8	81	21.8	240	26.0	193	26.4
QLD	7,730	21.5	11,138	15.8	4,750	16.9	82	22.1	160	17.4	138	18.9
SA	2,011	5.6	3,664	5.2	1,602	5.7	21	5.7	47	5.1	43	5.9
WA	4,752	13.2	7,887	11.2	3,154	11.2	43	11.6	104	11.3	73	10.0
TAS	393	1.1	530	0.8	299	1.1	6	1.6	10	1.1	9	1.2
NT	302	0.8	535	0.8	262	0.9	3	0.8	4	0.4	5	0.7
ACT	683	1.9	1,410	2.0	525	1.9	4	1.1	22	2.4	14	1.9
Total	**36,033**	**100.0**	**70,517**	**100.0**	**28,182**	**100.0**	**371**	**100.0**	**922**	**100.0**	**732**	**100.0**

Source: See Table 4-2.

Table 5-3: Employment in business services, May 2010

	Full time	Part time	Males	Females	Total
Number of people employed (`000)					
Financial and insurance services	318.1	70.8	179.6	209.3	388.9
Rental, hiring and real estate services	145.1	52.0	99.8	97.3	197.1
Professional, scientific and technical services	654.7	183.2	481.0	356.8	837.8
Administrative and support services	219.7	147.9	182.2	185.3	367.6
All Industries	**7750.6**	**3303.2**	**6032.7**	**5021.2**	**11053.8**
Number of people employed (% total)					
Financial and insurance services	81.8	18.2	46.2	53.8	100.0
Rental, hiring and real estate services	73.6	26.4	50.6	49.4	100.0
Professional, scientific and technical services	78.1	21.9	57.4	42.6	100.0
Administrative and support services	59.8	40.2	49.6	50.4	100.0
All Industries	**70.1**	**29.9**	**54.6**	**45.4**	**100.0**

Source: See Table 4-4.

Figure 5-1: Employment growth within the business services industry, 1996, 2001 and 2006

Source: DIISR 2009, *Services Sector: Overview of Structural Change*, Industry Brief 2007-08, Canberra p.48-50.

Note: The figures are calculated using ABS unpublished population census data. At this level of disaggregation, caution is needed when the data is interpreted, but it nevertheless shows some broad trends.

Figure 5-1 shows employment in Accounting services grew steadily between 1996 and 2006, with the employment increasing 40 per cent from 1996 to 2006; while employment in Legal services levelled out, although it was still 30 per cent higher than in 1996. Most of the recent growth in Technical services was driven by growth in Consulting engineering services. Employment in Architectural services also grew steadily. Almost all the early growth in employment in Computer services was in Computer consultancy services, which almost doubled in size between 1996 and 2001. Since 2001, employment growth in all other categories more or less stopped, if not declined, in Data processing services and Information storage, retrieval services.

Figure 5-1 also indicates that Other business services constituted by far the largest industry subdivision in terms of employment. Cleaning services was the largest area of employment. While employment in Contract staff services grew strongly, employment in Employment placement services levelled out and fell in Secretary services.

5.2 Growth in Business Services Sector

Similar to other OECD countries, the business services sector has been growing rapidly in Australia over the last decade due to the growth in outsourcing activity. In the past, software development, R&D and other knowledge-intensive service activities – including legal, accounting, advertising and recruitment services were largely conducted in-house given their strategic importance and firm-specific nature. However, in recent years, firms have been acquiring knowledge-intensive services from external sources or companies which specialise in these activities, in order to capitalise on economies of scale, reduce operating costs, and to remain competitive.

The business services sector plays an important role in the Australian economy as a whole due to its strong forward linkages with other sectors, i.e. it is an important supplier of inputs to other industries further along the value chain.

"The business services sector plays an important role in the Australian economy as a whole due to its strong forward linkages with other sectors"

Between 1994-95 and 2003-04, the value of Property and business services input into other services industry, except Finance and insurance services, had increased significantly, ranging from 61 per cent growth in Wholesale and Retail trade to 163 per cent growth in Accommodation, cafés and restaurant services. It is also evident from Table 5-4 that the Property and business services sector relied heavily on itself as an input source.

The use of outsourcing within the Property and business services contributed to a rise of 171 per cent in Other business services over 1994-95 to 2003-04, to be worth almost $30 billion in 2003-04. The 118 per cent growth in Property and business services input into Government administration and defence represents the general shift toward outsourcing of many services previously provided internally, particularly in the area of IT and communications.

Given the role of Business services as an important intermediate input in other industries, access to an efficient and innovative business services sector is essential for economy-wide productivity growth.

Moreover, an efficient business services sector can also help to accelerate and deepen the innovation process. While a significant amount of innovation takes place within business service firms, which tend to innovate more than firms in other sectors, business services providers can also play several 'supporting' roles in innovation process:

- Source of innovation: if they play a role in initiating and developing innovation activities in client organisations;
- Facilitators of innovation: if they support an organisation in the innovation process; and
- Carriers of innovation: if they transfer existing knowledge among or within organisations, industries or networks so that it can be applied in a new context.

The growth in outsourcing of business services had also led to a surge in international trade in the sector. Since the mid-1990s, trade in the sector has increased significantly, partly due to the liberalisation efforts agreed at the time of the Uruguay Round. Australia's share of business services exports has increased from 1.7 per cent of Australia's total exports in 1995 to 3.3 per cent in 2003[192]. In 2008-09, Australia exported $7.7 billion of business services, recording a five year trend growth of 14.1 per cent.

Rapid advancement in information and communication technologies (ICTs) and on-going liberalisation of trade and advancement in services have increased the tradability of business services activities. This has facilitated ICT-enabled off-shoring of business services. For example, some call centres or customer support services for major Australian companies are based in other countries such as in India.

5.2.1 Policy Recommendations

In order to realise the full potential of the Business services sector as a whole, ACCI recommends that:

Recommendation 61: The government should ensure a business enabling environment and ensure that the regulatory framework within the Business services sector is not overly restrictive. Instead it should be streamlined without jeopardising service quality.

Recommendation 62: Labour market regulation applying to the Business services sector should be flexible. Non-standard employment practices should be considered to enable the use of short term contract and agency staffing. This would have an immediate impact on the recruitment and contract staff services industry, and facilitate other business services outsourcing and contracting.

Given the diversity within the business services sector and for the purpose of this report, the following sections examine the issues and challenges faced by the Consulting engineering services and Accounting services in greater detail.

5.3 Consulting Engineering Services[193]

The Australian Bureau of Statistics (ABS) defines *consultant engineering services* as including firms providing the usual range of services for the building and construction industry – civil, structural, mechanical and electrical engineering – as well as chemical, mining and industrial and process consulting

192. OECD 2007, *Globalisation and Structural Adjustment: Summary Report of the Study in Globalisation and Innovation in the Business Services Sector*, p. 8.

193. The issues and challenges currently facing the consulting engineering services industry are provided by ACCI member – Consult Australia (formerly the Association of Consulting Engineers Australia). ACCI thanks Consult Australia for its input.

engineering services. Their services include: building consultancy and inspection, boat designing and marine engineering, materials handling, sanitary engineering, hydraulic engineering, traffic engineering and construction project management services on a fee or contract basis. Firms mainly engaged in providing quantity surveying services are also included in this industry class.

Over the past seven years the industries that drive consulting engineering revenues have grown strongly: industrial and commercial building by 14 per cent a year, engineering construction by 21 per cent a year, and investment in mining by an extraordinary 26 per cent a year.

As a result, fees earned by consulting engineers have increased from $8.9 billion in 2001-02 to an estimated $24.6 billion in 2008-09, with an average annual growth rate of 15.6 per cent. Part of the increase has been caused by rising costs in client industries: building and construction costs, for example, have increased by about 5 per cent a year over this period. However, this still puts real growth at more than 10 per cent a year, which is about three times the rate of growth of the Australian economy.

The picture that emerges today is an industry of some 17,000 firms, employing about 130,000 people and earning pre-tax profits of around $2.7 billion. Most of these firms, more than 96 per cent of them, are small, employing fewer than 20 people. Only about 650 firms employ more than 20 employees.

As a result of strong growth in the market and considerable merger and acquisition activity, the number of large consulting engineering firms, those employing 100 or more, has nearly doubled over the past seven years, to about 80. The biggest dozen of these large firms rank among of the largest 1 000 enterprises in Australia; and the biggest of all ranks in the top 50.

Figure 5-2 highlights the estimated consulting engineering fees earned in ten major building and construction markets in the years immediately ahead, and shows how they compare with activity in 2008-09. In most segments of the market, average fees earned over the next five years are forecast to exceed fees earned in 2008-09. Nationally, average future fees are forecast to be 12 per cent higher than in 2008-09.

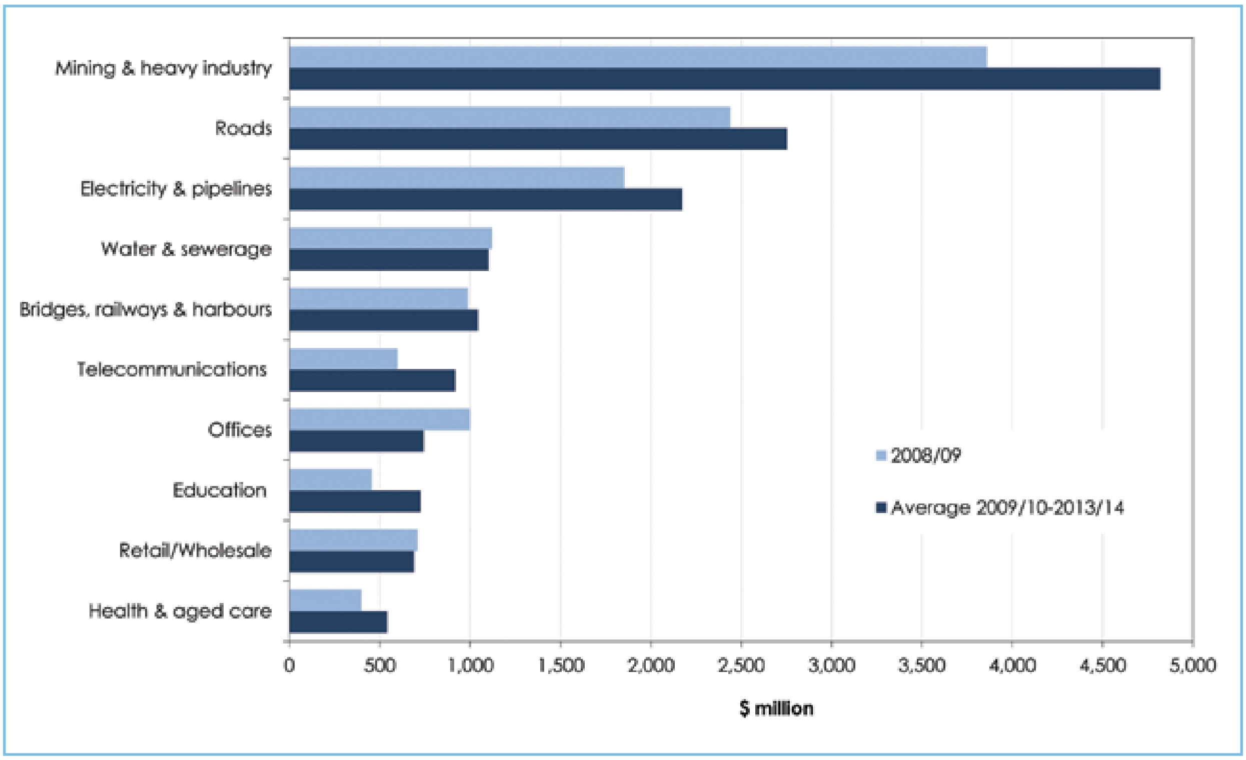
Table 5-4: Property and Business services input into other services between 1994-95 and 2003-04

Sector	Growth (per cent)
Electricity, gas and water services	158
Construction services	132
Wholesale trade	61
Retail trade	61
Accommodation, cafés and restaurant services	163
Transport and storage services	92
Communication services	84
Finance and insurance services	-3
Government administration and defence	118
Education	147
Health and community services	61
Cultural and recreational services	70
Personal and other services	77
Property and business services	120

Sources: Adapted from the Department of Innovation, Industry, Science and Research 2009, *Services Sector: Overview of Structural Change*, Industry Brief 2007-08, Canberra, p. 24-40.

Figure 5-2: Ten major markets for consulting engineering in Australia

Estimated consulting engineering fees earned



Source: Consult Australia and Bills, G. 2010, *Outlook 2010: An Economic Forecast for Consulting in the Built and Natural Environment.*

Table 5-5: Exports of construction and related services

Exports $ million	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
Construction	36	43	42	21	22	103
Construction related services						
Architectural	40	43	74	82	98	118
Engineering	672	614	986	1191	1447	1204
Surveying	21	16	15	35	43	57
All Services	37312	39289	41641	45956	50645	53287
Construction related services % of all services	**2.0**	**1.7**	**2.6**	**2.8**	**3.1**	**2.6**

Source: ABS Cat. No. 5368.0.55.033.

Note: The exports measured here include only the supply of services from the territory of one country into the territory of another. They do not include the supply of services abroad from wholly- or partly-owned subsidiary or associated companies, or from Australian consultants working abroad on overseas projects.

5.3.1 Drivers for the Industry

Six major drivers of demand for consulting engineering services are: private sector spending on non-residential building; engineering construction; new housing; mining; manufacturing; and the service industries.

Most of the work done on non-residential building – especially on shops, factories and offices – is done by private-sector builders for private-sector owners. In recent years only about 22 per cent of non-residential work is for governments. Most of this work is also undertaken by private builders. As private builders generally rely heavily on engineering consultants for design and supervision services, all non-residential building is a major source of work.

Engineering construction work carried out by private contractors for private clients is another significant source of work – work on mines and heavy industrial plants, and increasingly work for private operators in telecommunications, freeway construction, electricity and water supply.

Much engineering construction work – recently about 36 per cent – is done for governments, which often undertake their own engineering design and construction rather than letting it out to private contractors. Since the late 1990s, however, there has been a significant trend towards contracting out.

Until 2003-04, public spending on non-residential building and engineering construction had increased very little. Since then, however, spending on engineering construction has risen by 140 per cent and on non-residential building has doubled. The rise in non-residential building was mainly the result of increased spending on education, entertainment and recreation facilities, and on offices. The increase in engineering construction was caused by substantial rises in spending on roads, electricity generation, transmission and distribution, railways and water.

5.3.2 International Trade

Many of the larger consulting engineering firms operate overseas offices, and routinely manage contracts on overseas projects from their Australian offices.

Table 5-5 shows the extent to which consulting engineering services have been exported over the past six years, in the context of all construction and construction-related exports, and all exports of services.

The ABS has recently revised its classification and estimates of imports and exports of services. As a result, construction exports, previously estimated to average more than $100 million a year, are now shown to have been only a third of that, whereas engineering exports have been revised upward by around $50 million a year.

Over the past six years:

- Exports of engineering services have averaged more than $1 billion a year and accounted for 87 per cent of all construction and related services exports;
- Despite strong local demand, exports of construction-related services have averaged $1.4 billion a year over the past three years; and
- Construction-related exports accounted for 2.6 per cent of Australia's total service exports.

Table 5-6 shows that the industry has also been subject to competition from abroad. Over the past six years, imports of construction-related services have averaged $720 million a year, and in 2008-09 rose sharply to exceed $1.5 billion. The great bulk of these imports – 92 per cent over the six years – has been of engineering services.

> "Exports of engineering services have averaged more than $1 billion a year"

As the net exports section of the table shows, exports of construction-related services have nevertheless exceeded imports in every year except 2008-09. Over the six years, they have averaged $406 million a year, making a positive contribution to the balance of payments at a time when the strong Australian dollar was encouraging imports and discouraging exports of (mainly travel) services.

Engineering services played a major role and architectural services a growing role, in achieving these net exports.

5.3.3 Future Growth of the Industry

Similar to other sectors, recent years have seen some turbulence in the market for consulting services in the built environment.

Market deterioration in the first half of 2008-09 saw many consulting engineering firms trim their costs, modify their marketing strategy and organisational structure, and some implemented leadership changes.

Table 5-6: Imports and net exports of Construction and related services

	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
Imports $ million						
Construction	0	0	0	0	0	0
Construction related services						
Architectural	6	4	9	11	14	19
Engineering	282	370	337	347	1289	1348
Surveying	33	12	16	15	64	145
Total related services	*321*	*386*	*362*	*373*	*1367*	*1512*
All Services	35961	39703	41519	45139	53330	56499
Net Exports $ million						
Construction	36	43	42	21	22	103
Construction related services						
Architectural	34	39	65	71	84	99
Engineering	390	244	649	844	158	-144
Surveying	-12	4	-1	20	-21	-88
Total related services	*412*	*287*	*713*	*935*	*221*	*-133*
All Services	1351	-414	122	817	-2685	-3212

Source: ABS Cat. No. 5368.0.55.033.

The second half of 2008-09 saw many of the earlier fears confirmed, but by early 2009-10 some markets began to improve, though not all. Some companies were still reporting that project delays, slowdowns and cancellations— especially in overseas markets—were still hurting revenues and profits. But most saw better times ahead which have been confirmed through the 2010 calendar year.

Access Economics has forecast that business spending on building and construction will increase by 4 per cent in 2010-11, by 6 per cent in 2011-12, and by 2.5 per cent a year over the following two years. It sees real business spending on engineering construction remaining steady in 2009-10, and rising by 6 per cent in 2010-11, by 14 per cent in 2011-12, 8 per cent in 2012-13 and 3 per cent in 2013-14.

In the March quarter of 2010, forty-two new projects were added to the list of definite and planned projects maintained by Access Economics-ARUP's Investment Monitor. At the end of March, Investment Monitor recorded $267.2 billion of definite projects (under construction or committed) and $716.2 billion of projects in planning (under consideration or possible).

With work just started on the Gorgon LNG project, total commencements in the year to December 2009 exceeded work done by 43 per cent and at the end of the year there was nearly 14 months work yet to be done. The indicators are, of course, extraordinarily strong in WA, but also strong in SA and Victoria; relatively weak in NSW and Queensland.

Forward indicators of non-residential building suggest that, following seven years of rapid growth, the value of work done is likely to rise only slightly in the current financial year. New private sector work approved – mainly offices, shops, factories and warehouses – has been trending downward for more than two years. It has recently been supplemented by greatly increased public sector approvals of schools and hospitals. In the March quarter of 2010, however, these too fell sharply, signalling tougher times ahead in 2010-11 if there is no recovery in private sector work.

5.3.4 Issues and Challenges of the Industry

5.3.4.1 Procurement and Allocation of Risk

As part of a knowledge-based economy, growth in professional services is a core driver of productivity. By comparison, growth in trade services is often part of a broader economic response to that increased productivity. In this context the process by which professional services are procured should seek to foster growth in that sector, encourage innovation and support competition. Relative to the procurement of goods, the procurement of professional services continues to be fraught by misunderstanding and the inequitable allocation of risk.

Many contracting behaviours that are evident across the building and construction industry are driving poor risk management behaviours and exposing all parties to the possibility of project failure and unforseen cost. Consulting engineering firms accept that they have professional liability for the services they deliver, however it is common practice for the client to pass most or all of the risk for the entire project to the consulting firm through contractual conditions, resulting in excessively high or unlimited liability to the extent that it is unmanageable in the event that a risk is realised. The liabilities accepted by consulting engineering firms must be equitable, reasonable and manageable and not extend liability beyond the consulting firm's professional indemnity insurance coverage.

Consulting engineers also believe that the cost of tendering to be significant given the time and resource that is expended putting tenders together. There is also the intellectual property cost, which is often lost during the tender process.

Anecdotal evidence has been collected by organisations that have identified this as an issue in the past. In 1996, for example, the Office of Building Asset and Building Policy in Victoria[194] compiled some examples, including:

- For a $320,000 public facility, one tender submission by an architectural consultant cost $9,000 to prepare. 102 tenders were submitted. Potentially $918,000 was spent on the preparation of submissions by tenderers and the total cost of tendering equated to almost 3 times the project value; and
- For a $5-6million project a consultant spent $100,000 to prepare a bid, the successful bid was for $180,000, meaning that the consultant only received $80,000 for the project and the rest covered his tender costs. The unsuccessful tenderers did not recoup any costs.

This demonstrates the significant amount of cost that consultants are required to sink into bidding for work. Each time a bid is unsuccessful the cost is never recovered. It is also important to note the resources that must be allocated to prepare bids. Many hours of skilled professional time is wasted in responding to a call for tender, when much of that time can be saved and put to better purpose or use.

Moreover, the lack of standardisation of contractual terms across the public and private sector means that cost and time are lost in the parties repeatedly negotiating the core terms. This can be resolved by the take up across the market of model terms and conditions that have been developed by consultant and client groups working together to achieve balance and consistency.

The Victorian Government is currently considering new draft guidelines for alliance contracting. Industry supports alliance contracting as a valuable tool to deliver projects with benefits for all participants through a collaborative approach and shared allocation of risk and reward across project partners. However the draft guidelines proposed by the Victorian Government set out a default approach to competitive tendering for consultants participating in alliances that risks undermining the principles of collaboration and best practice that underpin this method of project delivery. This approach fails to recognise the benefits of procurement methods tailored to project objectives and circumstances. It is vital to the Australian economy that competition in the consulting industry across project delivery methods be based on recognition of the value of technical and commercial performance outcomes.

5.3.4.2 Skills Shortages

Engineering skills shortages continue to constrain Australia's growth and limit innovation. While the issues are complex and information incomplete, it is widely accepted that national and international labour market for engineering services are not operating to meet current and emerging demand.

The two main engineering disciplines in shortage are civil and structural engineers. Firms have also reported shortages in a range of other engineering disciplines including; environmental, geotechnical, mining, traffic/transport, water, fire/hydraulics and mechanical.

Skills Australia has designated engineering as an occupation requiring market interventions while employers report long delays and cost blowouts on projects as a direct consequence of undersupply of qualified engineers. About 40 per cent of commencing engineering students do not complete their studies; while only 17 per cent of graduates are women. Overseas students were 40 per cent of all graduates from Australian universities in 2005.

Other issues contributing to the problem include low levels of suitably qualified secondary students; increased international competition for talent; poor retention rates within the engineering profession; and a lack of suitable pathways to transition employment between disciplines and regions.

Competition between sectors for scarce engineering resources risks amplifying these problems while the situation in general threatens to undermine the productivity benefits of increased investment in national infrastructure.

The number of Australian engineers graduating from our universities has remained almost stagnant over the past 12 years and a significant number of engineers has reached or will soon be reaching retirement age. Interestingly, overall graduate intake

194. Department of Infrastructure Victoria 1996, *The Cost of Tendering A Position Paper*, Asset and Building Policy.

has not deviated with the onset of the global recession. The consulting engineering industry recognises that securing skills for the future is paramount to long term viability and growth.

Industry believes that both urgent and strategic actions are required to relieve the current skills shortages in consulting engineering. A two part strategic approach is required to ensure that the demand for consulting engineers is met now and in the future. This approach will entail a long term strategy centred on education, complemented by a short term strategy which focuses on the effective use of skilled international professionals on a temporary basis to solve the immediate skills shortage crisis.

5.3.4.3 Infrastructure Funding and Development

Infrastructure provision has lagged population growth in Australia for three decades. If we are to seize an advantage in what is the fastest growing region of the world's economy, obstacles to the development and delivery of infrastructure must be overcome.

Since 2004, Australia's strong economy, supported by the mining boom and AusLink investments, together with an increase in private financing has seen some improvements in the delivery of infrastructure projects that have helped to manage congestion costs and supply constraints. The benefits of this investment to our productivity are clear. However, while positive, these improvements are against a growing infrastructure deficit that puts at risk our ability to maintain economic prosperity in the longer term.

Increased infrastructure investment that improves economic capacity and productivity must be the first policy response to the challenges of increasing congestion and declining quality of life in Australian cities, and will have the added benefit of easing pressure on migration policy and achieving a more sustainable future.

Recent uncertainties associated with infrastructure funding, planning and governance for major infrastructure projects have negatively impacted consulting engineering firms involved in these projects. Effective governance combined with a long-term funding framework supporting a strong pipeline of infrastructure projects at all levels of government is vital, and will support the growth of consulting engineering services in the years ahead.

5.3.5 Policy Recommendations

To ensure continued productivity growth in consulting engineering services, it is recommended that:

Recommendation 63: The Government's skilled migration policy should create a flexible and accessible skilled migration program and visa system that facilitates the fast processing of applications and both permanent and temporary migration of skilled workers, catering for a variety of situations and circumstances, where gaps in domestic labour supply exist or are forecast.

Recommendation 64: Education in primary and secondary schools should focus more on maths and science outcomes to promote uptake of engineering and other technical disciplines as a rewarding career. Education resources must meet the contemporary needs of dynamic mathematics and science disciplines to help facilitate this objective.

Recommendation 65: Improved and continued funding for government supported engineering places in higher education institutions.

Recommendation 66: Governments at all levels should lead by example through their procurement processes and adopt existing standard model contract terms and conditions (developed through collaboration between industry and government) that are fair, reflect an appropriate allocation of risk, and that support competition.

5.4 Accounting Services[195]

Accounting is a very diverse profession. Accountants work in accounting firms undertaking tasks such as auditing and providing tax advice and as employees in businesses of all sizes and across all sectors, including the public sector, academia and the not-for-profit sector.

> "Strong growth in demand is not being met by supply of accountants, leading to a long-term shortage"

Based on the most recently available Australian Bureau of Statistics data, there are 135,330 people in Australia who described themselves as accountants, auditors or corporate treasurers. This is up more than 17 per cent from 2001. Independent projections estimate the profession will continue to grow strongly. However, this strong growth in demand is not being met by supply of accountants, leading to a long-term shortage.

195. The issues and challenges currently facing the accounting services industry are provided by the CPA Australia. ACCI thanks CPA Australia for its input.

Accountants play a fundamental role in:

- Making of decisions about the allocation of scarce resources in order to maximise their value to business, investors and the broader community;
- In the provision of financial information, which is crucial to the operation of efficient and well-informed capital markets ;
- Supporting strong governance. Accountants help to promote improved performance through fiduciary controls, process analysis and resource allocation, thus generating greater value for business, investors and the community;
- Assisting business meet their compliance requirements; and
- Supporting management develop and maintain ethical corporate cultures.

The primary job functions that accountants generally undertake are:

- Taxation;
- Management accounting;
- Financial control;
- Accounts administration;
- Financial and general management; and
- Business advisory services

5.4.1 Accounting Practices in Australia

According to the ABS, at the end of June 2002, there were 9,860 accounting practices operating in Australia, employing 81,127 persons and generating $7.7billion in income[196].

Estimates provided by IBISWorld suggest that by 2009-10, the number of accounting practices had increased to 11,650, and that such accounting practices employed 99,093 staff, generated revenue of over $13.9 billion or over one per cent of Australian GDP and the value-added was over $9.5 billion[197].

Accounting practices are generally divided into three main groups: the Big 4, the Second Tier and smaller operators and bookkeepers. According to IBISWorld estimates, in 2009-10 the Big 4 accounting firms accounted for 30.4 per cent of total industry revenue, the next top 96 firms were estimated to account for 19.1 per cent of industry revenue and the remaining firms accounted for 50.5 per cent of industry revenue[198].

According to the 2001-02 ABS data, the largest single source of revenue for accounting practices was from business taxation advice at 36.7 per cent, followed by personal accounting and taxation work at 18 per cent and auditing and assurance services at 16.5 per cent. IBISWorld estimates that in 2009-10, business tax advice was still the largest source of revenue at 35 per cent, followed by audit at 27 per cent, advisory services at 23 per cent, personal tax at 10 per cent and bookkeeping at 5 per cent[199]. The percentage of income individual firms received from these sources varies considerably depending on the size and expertise of the practice.

A report published by Singapore's *Accounting and Corporate Regulatory Authority* in 2009 estimated that the size of the Asia-Pacific accountancy market in 2008 was US$30.8 billion, and of that, Australia contributed 30 per cent of that market. The next highest contributors were China with 16.6 per cent, India with 16.4 per cent and Japan with 14.9 per cent[200].

In spite of this dominance in the region, the focus for Australian accounting practices is overwhelmingly domestic, with IBISWorld estimating that accounting practices generated $64 million in exports in 2009-10. IBISWorld however states that the *'whole area of the export of accounting and advice services, particularly to the Asian region, is seen as having significant growth potential'*[201]. This export figure compares unfavourably with the UK. In a report prepared by the UK Department of Trade and Industry, exports by accounting practices made up 8.7 per cent of domestic output or approximately £870 million in 2004.

IBISWorld estimates the annual growth in revenue of accounting practices between 2010 and 2015 to be 5.4 per cent. IBISWorld attributes this strong growth to increased compliance and reporting requirements.

IBISWorld predicts that employment in accounting practices alone (which is one of the employers of accountants) will grow to just over 118,000 by 2014-15, or an increase of nearly 20,000[202].

196. ABS 2003, *Accounting Practices Australia 2001-02*, Cat. No.8668.0, May 2003, p. 3.
197. IBISWorld 2010, *Accounting Services in Australia*, Industry Report, January 2010, p.32.
198. Ibid, p.18 and p.26.
199. Ibid, p.13.
200. Committee to Develop the Accountancy Sector 2009, *Transforming Singapore into a Leading Global Accountancy Hub 2009*, Singapore, p.11.
201. Op.cit. p.15.
202. Ibid, p.32.

As the economy recovers, CPA Australia predicts that demand for accountants from other sectors, particularly commerce and industry will also increase. On the supply side, evidence suggests that there is a shortage of domestic accounting graduates and there continues to be movement of experienced accountants from the profession. This supports the general view that the shortage of accountants, particularly experienced accountants, is predicted to continue.

According to research undertaken on behalf of the former Department of Employment and Workplace Relations (DEWR) titled '*Skills in Demand Assessment Report' and published in November 2006* (the DEWR Research), the major attractions to seeking a career in accounting are:

- Enjoyed working with numbers (61 per cent of respondents);
- The potential for high levels of pay (58 per cent of respondents); and
- Guaranteed high levels of employment (51 per cent of respondents).

Accounting is also seen as a good career 'stepping stone' as the skills known to make a successful accountant (e.g. communication and diagnostic skills) are required in other roles such as banking and finance.

5.4.2 Regulatory Environment

The regulatory environment for the accounting profession is best described as co-regulatory. That is, the profession both self-regulates and is subject to regulation by government, depending on the service being provided and if the services were offered to the public at large.

There are few barriers to entry to the accounting profession as membership of an accounting body is not a prerequisite. However, due to the knowledge intensive nature of the profession, employers and clients typically insist that accountants be a member of one of three professional accounting bodies, i.e. the CPA Australia, the Institute of Chartered Accountants in Australia and the National Institute of Accountants. Hence, a significant majority of accountants are members of at least one of these bodies.

The accounting bodies self-regulate by imposing certain education and experience requirements on potential members and conditions for maintaining membership. Conditions for maintaining membership include abiding by professional (including meeting minimum professional development requirements) and ethical requirements. The ethical requirements are set by an independent body, the *Accounting Professional and Ethical Standards Board*. Breaches of such professional and ethical conditions can be subject to an investigation and possible disciplinary action. Such disciplinary action can result in the forfeiture of membership.

In relation to the accounting services that are restricted by Government through regulation, for an accountant to offer such services, they generally must meet certain education and experience requirements that reflect the service provided. Such requirements are either set in legislation or by the regulator.

Examples of accounting services that are restricted to people that meet certain licensing requirements include company audits performed under the *Corporations Act 2001*, liquidations, financial advice and the preparation and lodgement of tax returns. The registration processes for regulated services are administered by relevant government agencies.

Figure 5-3 indicates that the regulation of the Australian accounting profession and other professions compares favourably to other OECD countries. According to an OECD report, this benefits Australia because countries which have a less regulated accounting profession are more likely to have a higher output per accountant and for the profession to experience more dynamic growth[203]. The report also stated that there is no evidence of the greater probability of market failure in less-regulated countries.

5.4.3 Issues and Challenges for the Industry

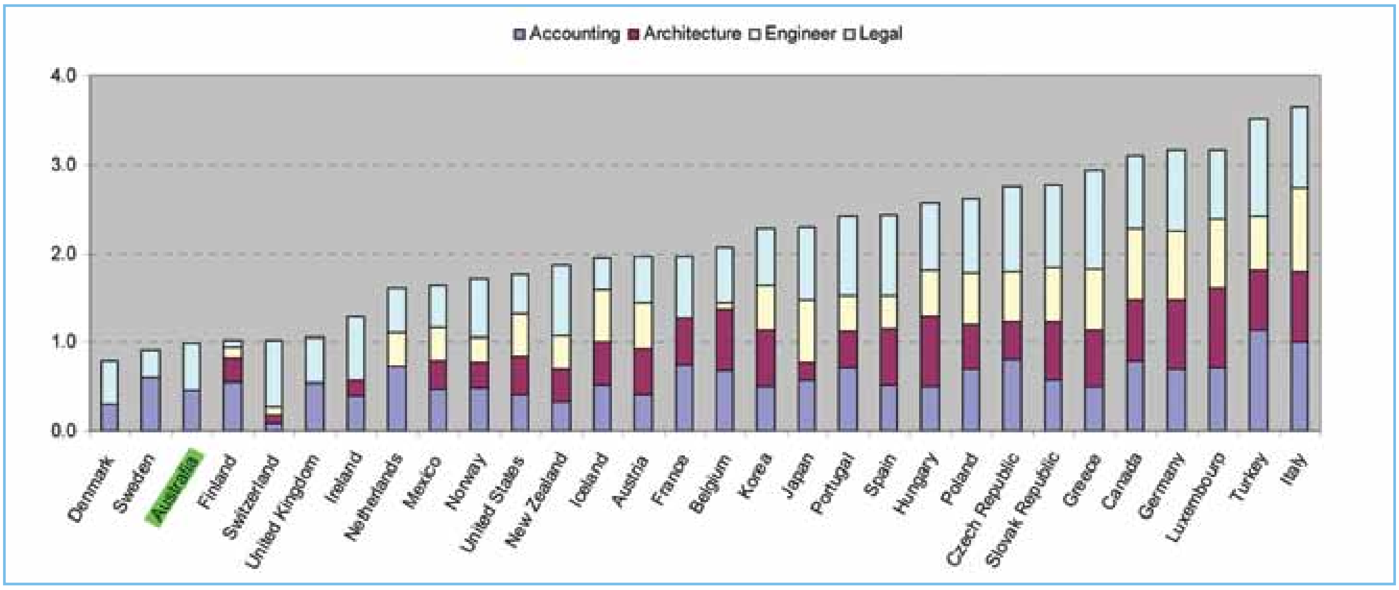
5.4.3.1 Skills Shortages

Various research, including the DEWR Research and research undertaken on behalf of CPA Australia in 2008 confirms that at that time, there was an acute shortage of accountants. Such shortages of accountants were a product of both demand and supply factors. Industry anticipates that those shortages remain and will become more acute as the economy recovers.

Employer demand for accountants was strong in the period leading up to the global financial crisis. During the global financial crisis, many accounting firms reduced the number of accountants they employed (usually by reducing their graduate intake) and supply problems consequentially eased partially because of large numbers of expatriate accountants returning to Australia. However as the economy recovers, anecdotal evidence suggests that a shortage of accountants will recur and this appears to be happening.

203. OECD 2007, *Globalisation and Structural Adjustment: Summary Report of the Study in Globalisation and Innovation in the Business Services Sector*, p.15.

Figure 5-3: Regulations in professional services, 2003



Source: OECD 2007, *Globalisation and Structural Adjustment: Summary Report of the Study in Globalisation and Innovation in the Business Services Sector*, p.15.

Note: Index 0-6 scale from least to most restrictive.

In addition to the growth in demand as the economy accelerates, demand for accountants by employers has been heavily driven by changes in taxation laws and regulations, changes in compliance requirements, advancements in banking and finance, financial planning and the adoption of international accounting standards. Such factors still exist and will continue to exist in the foreseeable future.

Leakage of accountants from the profession

The DEWR Research and CPA Australia's research confirms that the most acute shortage of accountants is with accountants with three to seven years experience. This shortage is in part caused by significant numbers of accountants with such experience leaving the profession.

Important factors influencing decisions to leave the accounting profession include:

- Level of pay, particularly in comparison to comparable occupations;
- Stress;
- Work/life balance;
- Hours required to work;
- Keeping up to date;
- Profession not living up to expectations;
- The role of the accountant did not compare favorably to other occupations;
- Pace of career advancement; and
- Early retirement.

Leakage of experienced accountants from the Australian profession is also caused by the desire of many accountants to work overseas. In the years immediately preceding the global financial crisis, there was an average loss of approximately 1,500 accountants from Australia each year[204]. However, such people are not entirely lost to the Australian profession and many return with significantly improved skills. Nonetheless, the number of accountants coming into Australia as migrants was significantly greater than this loss.

Lack of growth in domestic accounting students

Due to the well documented reduction (in real terms) in Commonwealth funding for universities over the last ten years, the overall number of places for domestic accounting students in universities has remained fairly static, while the number of international students has increased substantially and now makes up more than half the accounting student population in many universities. This emphasis and growth in international students has implications for the adequate provision of domestic accounting degree places because of finite teaching resources.

204. Birrell, B. 2006, *The Changing Face of the Accounting Profession in Australia*, Report prepared for CPA Australia, November 2006, p. 2.

To ration the demand for domestic accounting places, the entrance score for many accounting degree courses has become unrealistically inflated. In other words, the entrance scores do not necessarily reflect the level of intelligence and ability required to study accounting. This signalling has an impact on careers advice and course choice. Anecdotal evidence shows that participation in secondary accounting subjects does not reflect the current requirements of the profession.

Graduate accountants not possessing the skills employers desire

Many employers in both the DEWR Research and the CPA Australia research also expressed disappointment with the job readiness of graduates, both domestic and international students. For example, one-half of the employers responding to the DEWR Research stated that graduates did not have adequate skills to commence working as an accountant.

Academics who responded to the CPA Australia survey acknowledged that the education outcomes of accounting degrees do not always produce the skills employers demand and many international students lack the English language skills employers require. However, academics felt unable to raise English language standards to the levels required in the time available to them. Debates continue among accounting educators about where the responsibility to develop English language proficiency rests. Many faculties are trialling or have introduced tools aimed at developing students' awareness of employer expectations.

Skilled migrants not having the skills employers desire

Employers and recruiters responding to the CPA Australia research reported that there are a large number of skilled migrants actively seeking employment. However, they were often perceived as poor quality candidates who were lacking the required language skills. In 2006, 47 per cent of former overseas students applying for skilled migration did not have a level of English that is deemed competent, which is still below the level employers desired[205] and lack general job 'readiness'.

In response to this, the Government introduced a new graduate visa category 485 on 1 September 2007. This graduate visa was created to enable overseas students, who have completed their study in Australia to remain in Australia while they gain appropriate work experience, improve their English language or undertake further training.

The professional accounting bodies have responded to these new requirements by developing the Skilled Migration Internship Program – Accounting, which has been approved by the Department of Immigration and Citizenship (DIAC). The program is for international graduates of Australian accounting degrees, and involves a minimum of 44 weeks training, including a 12-week internship placement. It aims to develop an understanding of Australian workplace cultures and ensure that participants improve essential employability skills.

Where is the skills shortage?

The greatest skills shortages identified in both the DEWR Research and the 2008 CPA Australia research were accountants:

- Having three to five years experience;
- Having five to eight years experience and with managerial experience;
- Specialising in tax, audit, compliance and reporting; and
- Having soft skills and analytical thinking.

The regions or areas under the greatest skills pressure appear to be in Perth, Brisbane and other regional cities.

5.4.3.2 Regulatory Intrusions

A growing challenge for accounting firms is the increasing regulatory restrictions on the services accountants can offer, both being implemented and considered by government. While such regulatory measures taken in isolation can be managed by most accounting firms, the cumulative affect of these changes is causing and will cause significant pressure on accounting firms, particularly smaller accounting practices.

In addition to impacting on the viability of some practices, these changes will reduce the scope of services accounting firms currently provide to business and force accountants to become more focused on compliance issues rather than working with their business clients to increase the value-added.

The other continuous challenge for the accounting profession is to manage the work stemming out of regular changes to legislation and administrative practices, including changes to long-standing interpretation of the law.

The regulatory challenges and the workload issues caused by changes to legislative and administrative practices by government agencies, particularly the Australian Taxation Office, that accounting firms are facing or will soon face include:

205. Ibid, p.14.

- Workflow issues arising from problems associated with the ATO systems upgrade;
- The changes that will come out of the Cooper Review into superannuation; and
- The changes that may come out of the Henry Tax Report.

5.4.4 Policy Recommendations

In order to further enhance the growth in accounting services industry, it is important tha t:

Recommendation 67: The professional accounting bodies, government, employers, higher education providers and recruitment firms need to cooperate to develop a range of potential solutions to encourage experienced accountants to remain in the profession including:

- Encourage more flexible working arrangements;
- Increase pay and remuneration;
- The Australian Government establish a task force to consider ways to increase the participation rates of mature aged workers, including accountants; and
- Encourage outsourcing, particularly basic accounting work.

Recommendation 68: Additional investment in the higher education sector needs to be committed to ensure the higher education sector continues to play a pivotal role in the supply of accountants. This investment should be aimed at increasing the capacity of higher education providers to:

- Increase the number of funded accounting degree places available to domestic students;
- Increase support for international students in accounting degrees to improve their employment outcomes in Australia, including English language training;
- Develop innovative course curriculum to respond to the needs and requirements of employers, particularly the integration of generic skills into accounting curriculum;
- Support more accounting research activities, including increased support for PhD programs; and
- Increase the number of students able to participate in work integrated learning opportunities as part of the accounting curriculum.

Recommendation 69: In relation to regulation, the government needs to take a more holistic view of regulation impacting the accounting profession. Such a view would increase the government's understanding of the cumulative impact of regulation, so that they can better manage this impact.

Recommendation 70: The Australian Government should seek as part of bi-lateral free trade agreement negotiations, the removal of unnecessary restrictions (restrictions not related to quality) for Australian accountants to participate as accountants in those jurisdictions.

CHAPTER 6

TOURISM AND EVENTS INDUSTRIES

6. TOURISM AND EVENTS INDUSTRIES

Tourism is a sector made up of diverse industry participants. It is generally accepted that the tourism product, i.e. the visitor experience, is provided through a combination of services across a broad range of industry participants. They include, but are not limited to, accommodation, cafés and restaurants, transport, retail, business and major events, recreation, travel agencies and education and cultural services. Hospitality and events industries share many of the service providers in the tourism sector. Therefore tourism, hospitality and events industries are interconnected.

"ACCI notes with concern that tourism is not defined in official data as an industry in the conventional sense"

ACCI notes with concern that tourism is not defined in official data as an industry in the conventional sense; it does not appear in the national accounts or in international statistical classification. Thus in order to establish adequate statistical information for the tourism industry, the United Nations World Tourism Organisation (UNWTO) has developed the Tourism Satellite Accounts (TSA) to measure tourism's contributions to the economy. UNWTO defines tourism as:

> "…Tourism comprises activities of persons travelling to and staying in places outside their usual environment for not more than one consecutive year for leisure, business and other purposes not related to the exercise of any activity remunerated from within the places visited."[206]

Twelve tourism related industries are identified as part of the TSA:

- Accommodation services for visitors;
- Food and beverage serving industry;
- Railway passenger transport;
- Water passenger transport;
- Air passenger transport;
- Transport equipment rental;
- Travel agencies and other reservation services industry;
- Cultural industry;
- Sports and recreational industry;
- Retail trade; and
- Country-specific tourism related industries[207].

A high number of businesses in tourism, hospitality and events are active in two or more sectors. Hotels, for example, need tourism to generate part of their business, and events cooperate with tourism to promote their location.

6.1 Industry Size and Characteristics

6.1.1 Tourism in General

Tourism is a significant and vital industry to the Australian economy. In 2008-09, it contributed $32.8 billion to Australia's GDP, a fall of 0.4 per cent compared to the $33 billion recorded in 2007-08. In 2008-09, the tourism share of GDP was 2.6 per cent, a decrease of 0.2 percentage points from 2007-08[208].

Accommodation; Air, water and other transport; Cafés, restaurants and takeaway food services and Other retail trade continued to be the most important tourism industries, together accounting for over 57.2 per cent of direct tourism gross value-added in 2008-09. Table 6-1 shows industries with significant tourism-related activities were: Accommodation and food services; Transport, postal and warehousing; Arts and recreational services; and Retail trade. Specifically, tourism accounted for 34.8 per cent of industry gross valued added in Accommodation and food services industry; 11.8 per cent in Arts and recreation services; almost 10 per cent in Transport, postal and warehousing and around over 7 per cent in Retail trade.

Table 6-2 indicates that consumption of 'long distance passenger transportation' was the highest share of tourism consumption (16.13 per cent) in 2008-09. The consumption of 'long distance passenger transportation', 'takeaway and restaurant meals', 'shopping' and 'accommodation services' combined accounted for over half (or 55.9 per cent) of all tourism consumption in Australia.

The tourism industry employed 486,200 people in 2008-09, a decrease of 1,400 (or 0.3 per cent) on 2007-08. Tourism share of total employment decreased by 0.1 percentage points to 4.5 per cent when compared to 2007-08. Table 6-3 indicates that 25.4 per cent of workers employed in tourism work in Cafés, restaurants and takeaway food services, 19.9 per cent worked in Retail trade and 14 per cent worked in Accommodation services.

206. ABS 2010, Tourism Satellite Account 2008-09, Cat. No. 5249.0.

207. World Trade Organisation 2009, *Tourism Services,* Background Note by the Secretariat S/C/W/298, p.4.

208. Op. Cit.

Table 6-1: Tourism contribution to industry gross value-added, by industry 2008-09

	Direct tourism gross value-added $m	Total selected industry gross value-added $m	Tourism share of industry gross value-added %
Accommodation and food services	9,903	28,457	34.80
Arts and recreation services	1,155	9,790	11.80
Transport, postal and warehousing	6,686	66,968	9.98
Retail trade	3,979	54,305	7.33
Administrative and support services	1,616	30,941	5.22
Education and training	2,309	50,185	4.60
Ownership of dwellings	2,378	92,019	2.58
Rental, hiring and real estate services	684	35,065	1.95
Information media and telecommunications	486	39,155	1.24
Other services	204	23,110	0.88
Health care and social assistance	545	70,346	0.77
Financial and insurance services	61	124,615	0.05
Professional, scientific and technical services	4	70,371	0.01

Source: ABS *Tourism Satellite Account*, Cat. No. 5249.0.

Table 6-2: Itemised domestic tourism consumption, 2008-09

	$m	Share (%)
Tourism characteristic products		
Accommodation services	10,198	11.08
Actual and imputed rent on dwellings	3,226	3.51
Takeaway and restaurant meals	13,657	14.84
Taxi fares	740	0.80
Local area passenger transportation	638	0.69
Long distance passenger transportation	14,837	16.13
Motor vehicle hire and lease	1,393	1.51
Travel agency and tour operator services	2,684	2.92
Recreational, cultural and sporting services	3,102	3.37
Gambling and betting services	1,282	1.39
Tourism connected products		
Shopping (inclduing gifts and souvenirs)	12,715	13.82
Food products	7,356	8.00
Alchoholic beverages and other beverages	4,199	4.56
Motor vehicles, caravans, boats, etc.	2,067	2.25
Fuel (petrol, diesel)	7,714	8.38
Repair and maintenance of motor vehicles	411	0.45
Education Services	2,890	3.14
Other tourism goods and servcies	2,895	3.15
TOTAL	**92,003**	**100**

Source: ABS *Tourism Satellite Account,* Cat. No. 5249.0.

Table 6-3: People employed in tourism, by industry 2008-09

	Number of people employed `000	Share %
Tourism characteristic and connected industries		
Accommodation	68	14.0
Cafes, restaurants and takeaway food services	123.4	25.4
Clubs, pubs, taverns and bars	23.1	4.8
Rail transport	4.2	0.9
Road transport and transport equipment rental	21.4	4.4
Air, water and other transport	35.5	7.3
Travel agency and tour operator services	28	5.8
Cultural services	9.1	1.9
Casinos and other gambling services	2.3	0.5
Other sports and recreation services	19.2	3.9
Retail trade	96.9	19.9
Education and training	31.6	6.5
Total tourism characteristic and connected industries	***462.8***	***95.2***
All other industries	23.4	4.8
TOTAL TOURISM EMPLOYED PERSONS	**486.2**	**100.0**
Total Employed Persons	10820.8	-
TOURISM INDUSTRY SHARE OF TOTAL EMPLOYED PERSON		**4.5**

Source: ABS *Tourism Satellite Account*, Cat. No. 5249.0.

The Northern Territory and Tasmania have a higher reliance on tourism than other Australian states. Tourism's gross state product share was 6.2 per cent for the Northern Territory and 5.0 per cent for Tasmania in 2007-08. 9.3 per cent and 6.2 per cent of total employment in the Northern Territory and Tasmania respectively were employed in tourism related activities. Moreover, around 46 cents for every dollar spent on tourism in 2009 were spent in regional Australia.

6.1.2 Events Industry

The Events industry in Australia includes a wide range of activities:

- Major events;
- Business events;
- Sporting events;
- Festival;
- Cultural events;
- Regional events; and
- Community and local events.

The Events industry is closely linked to the tourism industry. Attendees or delegates (local, intrastate, interstate or international) usually consume services in the areas or region the event is being held, e.g. accommodation services, restaurants and food services, transport services, and retail services. Moreover, events attendees often join pre- or post-event leisure tours which benefit local tourism operators.

The events industry makes an important economic contribution to the Australian economy. The overall estimated expenditure associated with business events, a high yielding component of the industry, was in excess of $17.3 billion in 2003, with the largest expenditure items being registration fees ($7.55 billion), floor space ($2.41 billion), food and beverage ($2.16 billion) and accommodation ($1.53 billion)[209].

The direct contribution of business events to value-added and employment was over $6.1 billion and 116,000 jobs respectively[210].

On average, each business events delegate spent $558 per trip within Australia. However, the expenditure varied substantially according to the type of delegate, with local delegates spending $430 per trip, intrastate delegates spending $892 per trip, interstate delegates spending $2,019 per trip, and international delegates spending $3,526 per trip[211].

209. Deery, et al. 2005, *The National Business Events Study: An Evaluation of the Australian Business Events Sector*, Victoria.

210. Ibid.

211. Ibid.

Table 6-4: State tourism satellite accounts, 2007-08

	Tourism Gross State Product		Tourism Employment	
	$m	Share (%)	`000	Share (%)
NSW	13,925	3.9	162.5	4.8
VIC	8,608	3.2	105.3	4.0
QLD	9,192	4.3	122.6	5.7
SA	2,345	3.2	28.6	3.7
WA	3,813	2.4	47.1	4.2
TAS	1,060	5.0	14.2	6.2
NT	965	6.2	10	9.3
ACT	732	3.1	7.5	4.0
Australia	**40,639**	**3.6**	**497.8**	**4.7**

Source: Department of Resources, Energy and Tourism 2010, *Tourism Industry Facts and Figures,* May 2010, Canberra, p. 45.

For example, according to Live Performance Australia's *Ticket Attendance and Revenue Survey 2009*, more than 15.19 million tickets were issued to live entertainment events around Australia in 2009. This generated total revenues of $1.083 billion, as compared to $1.061 billion in 2008, an increase of 3.3 per cent year on year[212].

"More than 15.19 million tickets were issued to live entertainment events around Australia in 2009"

6.2 Issues and Challenges for the Industry[213]

6.2.1 Macroeconomic Conditions

Demand for tourism and events services is dependent on household disposable income and business expenditure thus its growth is highly sensitive to the business cycle. The global financial crisis has caused many households and corporate consumers to watch their budgets and look more closely at their expenditure pattern and savings.

Some consumers are turning to low cost options such as backpacking, camping and caravanning, others who continue to spend are seeking assurance that they receive value for money. Technology advancement, through video and teleconferencing, has enabled corporate consumers to reduce the frequency of their face-to-face meetings to save cost.

Operators also face competition from substitute products and services, such as home entertainment, hobbies and pets.

6.2.2 Competition from International Destinations

Domestic operators face strong competition from international destinations.

The recent strength of the Australian dollar against a number of major foreign currencies has had a profound impact on the tourism industry. Growth in the number of foreign visitors to Australia in some markets has slowed, while the number of Australian residents travelling abroad has risen sharply.

"The recent strength of the Australian dollar against a number of major foreign currencies has had a profound impact on the tourism industry"

Moreover, with the expansion of international low cost carriers, the increase in airline capacity, and an increase in packaging, quality offerings and relative pricing by international competitors, domestic and international consumers have a wider range of choice and competition is heightening. In the events industry, Australia also faces increasing competition from Asia and the Middle East, not only for major events but also business events.

212. Live Performance Australia 2010, *Ticket Attendance and Revenue Survey 2009*, p. 7.

213. Information for this section is adapted from *Victoria's Tourism and Events Industry Strategy 2020*. ACCI thanks the Victorian Employers' Chamber of Commerce and Industry (VECCI) for its input.

Given Australia's relative distance from source markets and increasing international competition, the Australian tourism industry must rethink its value propositions and marketing strategies, continue to further differentiate from its main competitors, and ensure it provides both value and quality.

While the emergence of international low cost carriers is often a problem as it encourages outbound tourism, it also presents a significant opportunity to attract international visitors to 9Australia through strategic and effective marketing campaigns and attractive product packaging.

6.2.3 Demographic Changes

Changing demographic and household structures represents both a challenge and an opportunity for the industry. The growth in double income households often provides higher disposable income which can be used for discretionary spending. However, at the same time, the higher income is regularly offset by greater financial pressure from rising interest rates, higher house prices and family care services. Moreover, working commitments can lead to stockpiling of annual leave.

While the aging population is having a significant impact on the availability of skill and labour supply in tourism related industries, it also presents an opportunity for the industry to tailor products and services to suit the demand for this large cohort of potential holiday makers.

Varying generational expectations and preference also present challenges and opportunities to the industry. For example, generation Y has grown up taking international holidays while traditional domestic holidays have become increasingly rare. With almost 25 per cent of Australian residents born overseas, holiday times are often reserved for visiting families and relatives overseas. Nonetheless, it also presents opportunities in the VFR – visiting friends and relatives (VFR) market when overseas families visit Australia-based relatives. Moreover Australia's vast international student market has a flow on impact on tourism including the VFR market.

6.2.4 Workplace Challenge

Similar to other services industry, the tourism and event industry continue to face many workplace challenges. The tourism industry is dominated by small operators and has a high proportion of transitional workers, including casual and part-time workers. Moreover, the industry often attracts young workers who see it as a stepping-stone to other industries or careers. Therefore, it can be a challenge to both attract and retain a sufficiently skilled and experienced labour force, and businesses have to continue to train new employees to suit their business needs.

For the events industry, in particular, while a significant amount of work is required in advance, the majority of employees are required immediately before, during and immediately after the actual event. Events are short term occurrences and rely heavily on the skills and availability of paid and volunteer workforce in order to succeed. As individual events require the majority of employees during the peak and for a relatively short duration, there is often a major challenge to find a sufficient number of suitable and skilled staff and/or volunteers.

6.2.5 Barriers to Private Sector Investment

Barriers to private sector investment remain a challenge. Disincentives resulting from complicated planning processes and regulatory impacts, particularly for private sector investors seeking to invest across regions, on public land or in a development that involves multiple agencies are a concern and must be addressed. In order to ensure that opportunities are not lost, greater transparency and improved timeliness in development applications and a greater understanding of the value of tourism and events related investment in the wider community can ensure greater support for such developments.

Moreover, access to affordable finance to fund private investment in tourism remains a problem, particularly in the aftermath of the global financial crisis, and can deter and delay viable and profitable investment in the industry.

6.3 Opportunities for Growth

6.3.1 Improved Aviation and Transport Network

Improved aviation access and transportation networks are vital to the attraction, retention and dispersal of visitors around Australia. Growth in direct international flights to major cities around Australia can be achieved through cooperative promotion and negotiation by airport authorities and government.

> "Improved aviation access and transportation networks are vital"

The increase in international low cost carriers has created both a challenge and opportunity for the industry. While it makes visiting Australia more attractive, it also makes international travel more appealing to Australian residents. There is a significant opportunity to capitalise on the offering of low cost carriers, through increasing alignment between aviation, transport and tourism policies.

Many major events involve the arrivals of a large number of attendees or delegates at the event destination in a very short space of time. Therefore efficient and effective transport services network from the airports to major hotels and events locations are important to cope with this excess demand. Any delays will lead to substantial frustration for attendees, potential safety issues and a poor first impression about Australia.

Moreover more works need to be done to encourage dispersal of visitors, both leisure and business, from major Australian cities to regional Australia. The ongoing development of regional airports and fly-drive holiday programs is important to facilitate the regional dispersal of visitors. Consistent and clear road signage is vital to support visitors' experience in regional areas. Upgrade and further investment in Australia's existing and new road network are also important to support the ongoing growth and competitiveness of tourism and events industry.

6.3.2 Improved Public Transport System

Efficient public transport system not only improved visitors experience to Australia, it also plays an important role to ensure efficient and safe movement of people and goods around Australia. Thus, an effective transport systems not only beneficial to tourism industry, but also critical to Australian quality of life and well-being.

Many visitors or events delegates often do not have their own independent transport and thus often rely on public transport and tour services to visit the places of interest. Thus access to regular, convenient, timely and well sign-posted public transport is essential if the visitors were to utilise other tourism related products.

Moreover, improved public transport system and services can help ease the problem of growing road congestion problem and reduce Australia's greenhouse gas emissions. Australian public transport systems and services must play a larger role in Australia's future national land transport solutions, as a key means of improving the sustainability of these systems.

The Bureau of Transport and Regional Economics has estimated that road traffic congestion cost Australia almost $10 billion nationally in 2005 and that this cost will double by 2020. All capital cities are affected, with the Bureau estimating that congestion cost Sydney $3.5 billion in 2005, Melbourne $3 billion, Brisbane $1.2 billion, Perth $0.9 billion and Adelaide $0.6 billion, with smaller cost in other capital cities. These costs represent significant economic waste, negatively impacting industry competitiveness and reducing the liveability of Australian cities. In addition, transport contributes around 14 per cent of Australian greenhouse gas emissions and emissions from transport are growing faster than from any other sector except stationary energy[214].

6.3.3 Fostering Business and Services Excellence

Fostering business and services excellence remains a key priority for the growth and development of the tourism and events industries. The industries have been significantly impacted by the recent economic downturn following the global financial crisis. While Australia emerged in a much better position than many of the other developed economies, many tourism industry operators have been negatively impacted and conditions remain weak. A relatively high Australian dollar and other new cost pressures, including wages, energy and water costs and higher finance costs have impacted many small business operators in particular.

Despite these constraints, there is an increasing challenge to provide high quality and excellence in order to remain competitive and provide value for money to attract new and repeat customers, ensure business profitability, and support ongoing industry growth.

Continually updated industry and employee skills are a vital part of meeting the challenge. There is a strong link between trained and skilled staff and repeat visitation and profitability, which makes ongoing training essential. Excellent customer service that meets the demand and needs of current and potential markets is important. There is a need for greater industry input into training programs as well as greater recognition for on the job training. The skills development issues and challenges faced by the tourism and events industries have been discussed in detail in Section 3.5 above.

There are also significant product benefits to be gained through enhanced communication and collaboration between tourism and events operators. Many event organisers only focus on delivering a successful event, they often do not have time, resources or expertise to consider activities beyond the event itself. Similarly, many tourism operators do not fully recognise the incremental value that event patrons can offer and therefore may not provide appropriately priced packages to attract event delegates.

Both the tourism and events industry would benefit from a greater strategic approach and further cooperation in order to develop packaged product and service offerings, and improve marketing and communications with attendees.

> "Tourism and events industry would benefit from a greater strategic approach and further cooperation"

214. *Moving People: Solutions for Growing Australia, 2010* - A joint publication by the Australasian Railway Association, the Bus Industry Confederation and the International Association of Public Transport. ACCI thanks the Bus Industry Confederation for its input.

6.4 Policy Recommendations

In addition to a direct economic contribution to the Australian economy, the tourism and events industries also bring in significant indirect or intangible benefits to Australia, such as lifting Australia's profile in the international market, and providing networking and trade opportunities through major and business events. Therefore to promote further growth in this industry, it is recommended that:

Recommendation 71: The government should establish an investment and regulatory reform working group to improve the efficiency and transparency in the planning and development process, and to implement and progress the tourism regulatory reform priorities. The Government should also ensure the alignment of tourism policy and planning schemes.

Recommendation 72: The government should ensure stronger alignment of aviation, transport and tourism policies and increase investment in new and existing rail and road networks, and continue the focus on increasing direct international flights to major cities.

Recommendation 73: There must be increased investment in the public transportation network, with greater private sector involvement, to meet existing and future demand, through increased service levels, improved connectivity between urban and regional areas, improved linkage between different modes of transport and wider transport choice.

Recommendation 74: The government should collaborate with industry to conduct relevant research and prepare updated visitor profiles to reflect new market information and trends. Industry networks can be used to distribute the new information as it becomes available in a user friendly format. Updated research and visitor profiles can be used to develop effective marketing strategies to promote the tourism and events industry.

Recommendation 75: The government should provide sufficient funding to ensure the ongoing maintenance of existing tourism and events infrastructure and assets. This is particularly the case in the wake of the 2010-11 floods and cyclone activity affecting parts of regional Australia, especially Queensland. Specific initiatives to promote regional tourism in flood and cyclone affected areas should be implemented jointly by industry and governments. Moreover the government should establish an investment development profile, outlining the top ten tourism and investment ready infrastructure opportunities across Australia to attract and assist potential private investors.

CHAPTER 7

ACCOMMODATION, RESTAURANT AND CATERING INDUSTRIES

7. ACCOMMODATION, RESTAURANT AND CATERING INDUSTRIES

According to the Australian Bureau of Statistics, at the end of June 2007, there were 5,891 businesses in Australia mainly involved in the provision of accommodation services to visitors, such as hotels, motels, caravan park and camping ground operations. Collectively, these businesses employed 95,931 people. There were 15,423 businesses involved in the provision of café, restaurant and catering services, which collectively employed 195,814 people at the end of June 2007.

Accommodation, restaurant and catering industries are classified under Division H – Accommodation and food services industry of the ANZSIC 2006 industry classification, which includes:

- Accommodation; and
- Food and beverage services
  - Cafés, restaurants and takeaway food services;
  - Pubs, taverns and bars; and
  - Clubs (hospitality).

7.1 Industry Size and Characteristics

In 2008-09, the Accommodation and food services sector contributed around 3.4 per cent of GDP or $26.8 billion in gross value-added. Within the sector, accommodation services industry contributed $4.7 billion in industry value-added or 0.5 per cent of Australia's GDP in 2006-07[215] ; while Café, restaurant and catering services contributed $5.7 billion in industry value-added or 0.5 per cent of GDP in 2006-07[216].

At the end of June 2007, around 708,400 people are employed in the Accommodation and food services sector, representing around 6.7 per cent of the total number of people employed. Within the sector, the number of people employed in Cafés, restaurant and catering services industry (195,814 employees) more than doubled those employed in Accommodation services industry (95,931 employees).

Table 7-1 shows that the Accommodation and food services sector is made up of mainly small and medium sized businesses and employs more than 70 per cent of all workers employed in the industry.

At the end of June 2007, 5,891 accommodation businesses operated 6,668 accommodation establishments around Australia. Almost half (46.2 per cent or 2,722) of all accommodation businesses employed fewer than five people, and accounted for 10.6 per cent ($1044.1 million) of total income. Larger accommodation businesses, those employing at least 50 people, accounted for 5.9 per cent (345 businesses) of all accommodation businesses, generating over half of total income (56.9 per cent or $5614.7 million).

There were 15,423 businesses in Australia involved in the provision of café, restaurant and catering services, with 13,987 café and restaurant businesses and 1,437 catering businesses at the end of June 2007. These businesses had 17,006 locations around Australia and more than three quarters or 72.6 per cent of these locations were in metropolitan areas.

Smaller cafés and restaurants, those employing fewer than 10 people accounted for around two thirds (67.5 per cent) of café and restaurant businesses and over a quarter (27.7 per cent or $2,685.7 million) of income. Larger café and restaurant businesses, those that employed 50 people or more, accounted for 1.5 per cent of all café and restaurant businesses and generated over one-fifth of total café and restaurant income (21.8 per cent or $2,115.5 million).

Smaller catering businesses accounted for more than half (57.8 per cent) of all catering businesses and less than one-tenth (9.2 per cent of $362.9 million) of total income; while larger catering businesses accounted for 5.2 per cent of all catering businesses but generated over three quarters of total income (77.9 per cent or $3,096.3 million).

Table 7-2 indicates that within Australia, New South Wales contributed the most to GDP in Accommodation and food services in 2008-09, around $9.1 billion or 33.9 per cent of total gross value-added, and employed the largest number of workers (258,000 people). Victoria and Queensland also contributed significantly to GDP, with Queensland overtaking Victoria as the second largest contributor in the sector's gross value-added, but Victoria continued to have the second largest workforce in Accommodation and food services sector.

Table 7-3 illustrates that within the sector, the Food and beverage services industry was the largest employer (employing 678,000 people or 89.7 per cent) and contributor to industry value-added ($21.4 billion or 76.7 per cent) in 2008-09.

215. ABS 2009, *Accommodation Services 2006-07*, Cat. No. 8695

216. ABS 2009, *Cafés, Restaurants and Catering Services 2006-07*, Cat. No. 8655.

Table 7-1: Accommodation and food services sector value-added and employment by business size, 2008-09

		Small	Medium	Large	Total
Accommodation and food services					
Employment	`000	399	191	166	756
	%	52.8	25.3	22.0	100.0
Industry Value-added	$m	11,377	9,769	6,687	27,833
	%	40.9	35.1	24.0	100.0
Total Selected Industries					
Employment	`000	4,764	2,331	2,901	9,997
	%	47.7	23.3	29.0	100.0
Industry Value-added	$m	290,348	198,853	353,382	842,582
	%	34.5	23.6	41.9	100.0

Source: See Table 4-1.

Table 7-2: Accommodation and food services sector's value-added and employment by state/territory, 2008-09

	Gross Value-added		Employment	
	$m	%	`000	%
NSW	9,089	33.9	258	34.1
VIC	5,463	20.4	169	22.4
QLD	6,729	25.1	157	20.8
SA	1,696	6.3	49	6.5
WA	2,186	8.2	80	10.6
TAS	673	2.5	18	2.4
NT	443	1.7	11	1.5
ACT	522	1.9	14	1.9
Total	**26,801**	**100.0**	**756**	**100.0**

Source: See Table 4-2.

Table 7-3: Accommodation and food services sector value-added and employment by subdivision, 2008-09

	Employment		Industry Value-added	
	`000	%	$m	%
Accommodation	78	10.3	6,474	23.3
Food and beverage services	678	89.7	21,359	76.7
Total Accommodation and food services	**756**	**100.0**	**27,833**	**100.0**

Source: See Table 4-3.

Table 7-4 indicates that there are marked differences in the predominant types of employment between the Accommodation and the Food and beverage services industry. Food and beverage services industry has one of the lowest rates of full time employment. In May 2010, only 41.5 per cent of employment in Food and beverage services was on a full time basis, compared to 70.1 per cent of the total working population. The Accommodation services industry has a higher prevalence of full time employment, with around 56.8 per cent of employees working on a full time basis. The Accommodation services industry employed a greater proportion of female employees (62.7 per cent) than the Food and beverage services industry (55.1 per cent).

At the end of June 2007, there were 95,931 people employed by Accommodation services businesses in Australia. Casual employees accounted for 44.1 per cent (42,285 people), permanent full time employees accounted for 37 per cent (35,515 people), while permanent part time employees accounted for 12.2 per cent (11,741 people) of total employment. Females accounted for 60 per cent (57,516 people) of all employment and of these, half (49.8 per cent of female employment) worked as casuals. Males accounted for 40 per cent (38,415 people) of all employment and of these, almost half (46.5 per cent of male employment) occupied permanent full-time positions.

In terms of types of occupations in Accommodation services industry, 26,979 people (28.1 per cent) were employed as room attendants. Food and beverage staff accounted for 17.7 per cent (17,019 people), clerical and administrative staff for 17.3 per cent (16,590 people) and managers and supervisors for 14.5 per cent (13,918 people). Collectively, chefs, cooks and kitchen hands accounted for 12 per cent (11,537 people) of all people employed in the industry.

At the end of June 2007, there were 195,814 people working in café, restaurant and catering services. Almost three-quarters (74.3 per cent or 145,546 people) worked in café and restaurant businesses.

"At the end of June 2007, there were 195,814 people working in café, restaurant and catering services"

Café, restaurant and catering services were characterised by a large casual work force which accounted for just over half (50.2 per cent or 98,324 people) of all employment. Permanent full-time employees accounted for under a quarter (22.9 per cent or 44,851 people) of all employment, while permanent part-time employees accounted for 15.5 per cent (30,384 people). Females accounted for just over half (53.2 per cent or 104,164 people) of all employment and most (57 per cent of female employment or 59,332 people) worked as casuals. Permanent full-time positions were occupied by more males (26,077) than females (18,774).

There were 11,165 working proprietors and partners of unincorporated businesses at the end of June 2007, accounting for 5.7 per cent of total employment. More people were employed as waiting staff (74,328 people or 38 per cent of total employ-

Table 7-4: Employment in Accommodation and food services sector, May 2010

	Full time	Part time	Males	Females	Total
Number of people employed (`000)					
Accommodation and food services	***335.0***	***430.3***	***334.6***	***430.7***	***765.3***
Accommodation	65.1	49.6	42.8	71.9	114.7
Food and beverage services	269.9	380.6	291.8	358.8	650.6
All Industries	**7750.6**	**3303.2**	**6032.7**	**5021.2**	**11053.8**
Number of people employed (% total)					
Accommodation and food services	***43.8***	***56.2***	***43.7***	***56.3***	***100.0***
Accommodation	56.8	43.2	37.3	62.7	100.0
Food and beverage services	41.5	58.5	44.9	55.1	100.0
All Industries	**70.1**	**29.9**	**54.6**	**45.4**	**100.0**

Source: See Table 4-4.

ment) than any other occupation. Collectively, qualified and other chefs/cooks accounted for 20.5 per cent (40,053 people) of all people employed, while kitchen hands accounted for 18.2 per cent (35,586 people) of total employment.

7.2 Issues and Challenges for the Industry[217]

7.2.1 Skills Development[218]

The biggest challenge for the Accommodation, Restaurant and Catering industries is the problem of skills and labour shortages. These industries have a high prevalence of casual workers, around 50 per cent of the total number of people employed in the sector. According to Restaurant and Catering Australia (R&CA), the Restaurant and catering industry needs nearly 50,000 new skilled workers to maintain staffing levels given the growth in demand and attrition from the workforce and competition from other services industries.

Moreover, the issue of an ageing population poses a challenge for the Accommodation, Restaurant and catering industries as they have traditionally employed younger workers to fulfil their workforce requirements. For example, in 2008, the median age of workers in Accommodation and food services industry was 27, compared to the median age of 37 for all industries. Mirroring this, Accommodation and food services industry had the lowest share of workers aged 45 and over.

Therefore, upskilling, retraining and retaining existing staff are important to meet the industry workforce needs. Encouraging people currently on welfare who are able to work to move into employment will also assist in addressing some of the labour shortages problem in the industry.

> "Upskilling, retraining and retaining existing staff are important to meet the industry workforce needs. Encouraging people currently on welfare who are able to work to move into employment will also assist"

The role that the migration program has played in maintaining staffing levels in the restaurant, cafés and catering industries should not be under-estimated. The growth in turnover in the last ten years has only been able to be realised through the large number of overseas workers that have been engaged to meet local employment demand. R&CA estimates that there are 44,500 overseas workers engaged in the industry, with half being overseas students and the balance as skilled migrants and working holidaymakers.

7.2.2 Workplace Related Issues[219]

Given that the Accommodation, Restaurant and catering industries are labour intensive, any changes to workplace regulations and regulated wage increases will negatively impact business operators in the industry. Frequent changes to workplace relations laws have caused confusion amongst businesses understanding employers' obligations and requirements. Businesses that operate in more than one jurisdiction face additional regulatory and compliance burdens due to the differences amongst states and territories' workplace regulations, such as payroll tax definitions and rates, workers' compensation, occupational health and safety regulations and compliance.

Regulated increases in wages, for example through minimum wage increases or the new national industrial awards, which are not being met by productivity improvements, threaten the viability of business operators and reduce the ability of business to employ workers.

The Accommodation, Restaurant and catering industries are also concerned about the compliance burden related to the superannuation guarantee. The key concern is the monthly income threshold which requires those employees earning $450 per month to be included in the superannuation guarantee arrangements. This threshold was considered inappropriate as the:

- Industry has a transient workforce, with many staff working casually for short durations and then leaving the employer;
- Threshold has not increased in tandem with the increase in award wages; and
- Administrative burdens on small business associated with making very small payments to many staff are significant.

217. ACCI thanks the Restaurant and Catering Australia for its input into this section.

218. Detailed discussion on issues and policy recommendations for skills development is in Section 3.5.

219. Detailed discussion on issues and policy recommendations for workplace relations and regulations is in Section 3-4.

To reduce compliance costs for employers and for fund administrators, the Regulation Taskforce recommended increasing the monthly income threshold to around $800 a month, which represented approximate indexation to average weekly ordinary time earnings since the introduction of compulsory superannuation in 1992, and subjecting it to periodic review[220].

7.2.3 Regulatory Burden

According to the R&CA report, government regulation has increased in its ranking as a barrier to operating an effective café, restaurant and catering business. The number of respondents rated it as a constraint has increased from 17 per cent in 1998 to 47 per cent in 2003[221]. The industry also remains concerned about the regulatory requirement and compliance burden flow through from the food safety regulations.

In May 2009, amendments to section 53C of the *Trade Practices Act 1974* (TPA) came into force requiring businesses to provide a single total price in any representation to consumers, rather than a price based on component parts. Businesses can continue to use component pricing in advertising, provided that a single total price is also displayed as prominently as any component price. The purpose of these amendments was to ensure that consumers were aware of the actual price that was to be paid for a good or service and were not misled by advertisements that only covered part or a component of the price.

Previously, restaurant menus could indicate that there was a surcharge on Sundays and/or public holidays. However following the above amendments, a total price, including the surcharge, had to be provided for each item on the menu. These amendments have impacted cafés and restaurants by imposing extra costs in regard to their menus, as business operators have to:

- Print and distribute different menus for these days; and/or
- Show two or more lists of prices on the same menu.

This has imposed extra costs and complications on these cafés and restaurants, and will not provide any significant benefits to consumers.

The Productivity Commission also notes that the surcharges on restaurant meals on Sunday and/ or public holidays were not a focus of the original concerns raised in regard to component pricing. The initial moves to amend the TPA began in 2005 in response to various concerns regarding businesses that offered a 'cheap' price to consumers which was then increased with taxes, further fees and/or additional charges when payment was required[222].

7.3 Policy Recommendations

ACCI proposes that:

Recommendation 76: To address the severe skills shortages in the Accommodation and food services industry, the Government should utilise the training system to respond with:

- An employer responsive apprenticeship system that provides training where employer demand exists;
- Entry level training in occupations that are in demand; and
- Industry quality training.

Recommendation 77: The increase in the monthly income threshold of the superannuation guarantee levy should be considered and subject to periodic review.

Recommendation 78: Any amendment to existing regulations and legislation and new legislative proposals should go through the government's best practice regulation assessment processes. A corresponding Regulatory Impact Statements, which assess the total cost to business of compliance, fees and paperwork and compare this total cost to business with the estimated benefits of the proposed regulation, should be prepared. The process and the result should be made public.

220. Australian Government 2006, *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business,* Australian Government's Response, August.

221. Restaurant and Catering Australia 2010, *Submission to the Annual Review of Regulatory Burdens on Business and Consumer Services,* February.

222. Productivity Commission 2010, *Annual Review of Regulatory Burdens on Business: Business and Consumer Services*, Research Report, Canberra, p. 106.

CHAPTER 8

DISTRIBUTIVE TRADES (WHOLESALE AND RETAIL TRADE) INDUSTRY

8. DISTRIBUTIVE TRADES (WHOLESALE AND RETAIL TRADE) INDUSTRY

The Distributive trades industry corresponds to the Wholesale and Retail trade industry. The Distributive trades industry contributed 10.7 per cent to Australia's GDP (or $108 billion) in 2008-09, and employed more than 1.4 million people. Besides the economic contribution, the value of the sector to the Australian economy and community cannot be understated. The Distributive trades sector provides the first job for many Australians, either as a full time job or part-time job during studies. It provides the foundation for the basic work-related skills and knowledge of many individuals for their ongoing careers, whether in the service industries or outside them[223].

The Wholesale trade industry includes enterprises mainly engaged in the purchase and onselling, and commission-based buying and selling of goods, without significant transformation, to other businesses. Wholesalers' premises are usually a warehouse or office with little or no display of goods, large storage facilities, and are not generally located or designed to attract a high proportion of walk-in customers.

In contrast, the Retail trade industry includes enterprises mainly engaged in the purchase and onselling, and commission-based buying and selling of goods, without significant transformation, to the general public. The retail trade industry also includes businesses that purchase and onsell goods to the general public using non-traditional means, including the internet. Retailers generally operate from premises located and designed to attract a high traffic of walk-in customers, have an extensive display of goods, and/or use mass media advertising to attract customers. The display and advertising of goods may be physical or electronic.

According to the ANZSIC 2006 industry classification, the Distributive trades industry includes:

- Division F: Wholesale Trade
  - Basic material wholesaling, including Agricultural product wholesaling; Mineral, metal and chemical wholesaling; and Timber and hardware goods wholesaling;
  - Machinery and equipment wholesaling;
  - Motor vehicle and motor vehicle parts wholesaling;
  - Grocery, liquor and tobacco product wholesaling;
  - Other goods wholesaling, including Textile, clothing and footwear wholesaling; Pharmaceutical and toiletry goods wholesaling; Furniture, floor covering and other goods wholesaling; and
  - Commission-based wholesaling.
- Division G: Retail Trade
  - Motor vehicle and motor vehicle parts retailing;
  - Fuel retailing;
  - Food retailing; and
  - Other store-based retailing, including Furniture, floor covering, houseware and textile goods retailing; Electrical and electronic goods retailing; Hardware, building and garden supplies retailing; Recreational goods retailing; Clothing, footwear and personal accessory retailing; Department stores; and Pharmaceutical and other store-based retailing; and
  - Non-store retailing and retail commission based buying and/or selling.

As of June 2007, there were 304,706 businesses operating in the Distributive trade industry, 15.1 per cent of the total number of Australian businesses. The survival rates for Wholesale trade businesses and Retail trade enterprises operating since June 2003 were 60.8 and 55.3 per cent respectively, compared to the 58.4 per cent survival rate for all industries[224].

8.1 Industry Size and Characteristics

In 2008-09, the Distributive trades sector contributed around 10.7 per cent of GDP or $108 billion in gross value-added. Within the Distributive trades sector, Retail trade (5.35 per cent or $54.2 billion) contributed a little more to GDP than Wholesale trade (5.31 per cent or $53.8 billion)[225]. The Distributive trades sector does not produce goods for export and thus does not feature in industry of origin or commodity based or export statistics. Nonetheless, Wholesale and Retail trade play an important role in the distribution and exchange of goods from overseas producers to domestic consumers or vice versa. In 2006-07, the ABS estimated that over 16,000 businesses in the Distributive trades sector exported goods valued at $31 billion[226].

223. Service Skills Australia (SSA) 2010, *Wholesale, Retail and Floristry,* Environmental Scan, p.3.

224. ABS 2007, *Counts of Australian Businesses, Including Entries and Exits*, Cat. No. 8165.0.

225. ABS 2009, *Australian System of National Accounts,* Cat. No. 5204.0, Table 5.

226. PC 2008, *Annual Review of Regulatory Burdens on Business: Manufacturing and Distributive Trades*, Research Report, Canberra, p. 13.

Around 1.8 million people were employed in the Distributive trade sector in 2008-09, representing around 16 per cent of the total number of people employed. Within the Distributive trade sector, the number of people employed in the Retail trade industry (around 1.3 million employees) more than doubled those employed in Wholesale trade (around 0.6 million employees). More significantly, Retail trade was the second largest employer by industry in Australia after Health care and social assistance, employing over 10 per cent of the Australian working population in 2008-09.

Table 8-1 shows that the Distributive trades sector is made up of mainly small and medium sized businesses, although large enterprises also play an important role in the Retail trade industry. Small and medium sized wholesalers employed more than 73 per cent of all workers employed in Wholesale trade; while small and medium sized retailers employed more than 55 per cent of all workers employed in Retail trade.

Table 8-2 indicates that within Australia, New South Wales contributed the most to GDP in Distributive trades – around $17 billion in Wholesale trade and $16.5 billion in Retail trade, and employed the largest number of workers in Wholesale trade (204,000 people) and Retail trade (397,000 people) in 2008-09. Victoria and Queensland also contributed significantly to GDP in Distributive trades, with Queensland overtaking Victoria as the second largest contributor in Retail trade gross value-added.

Table 8-3 illustrates the composition of distributive trades in 2008-09. Within Wholesale trade, the Machinery and equipment sector was the largest employer (employing 149,000 people) and contributor to industry value-added ($19.6 billion industry value-added). Within Retail trade, Other store-based retailing, i.e. personal and household goods retailing was the largest sector accounting for just over half of total production and employment.

Table 8-4 indicates that there are marked differences in the predominant types of employment between the Wholesale trade and Retail trade industry. Retail trade has one of the lowest rates of full time employment. In May 2010, 51.5 per cent of employment in retail trade was on a full time basis, compared to 70.1 per cent of the total working population. Food retailing in particular had a low rate of full time employment, with only around 40 per cent of workers employed full time. In contrast, the Wholesale trade sector had a high prevalence of full time employment, with around 85 per cent of employees working on a full time basis. The Retail trade industry employed a greater proportion of female employees (56.4 per cent) than the Wholesale trade industry (32.7 per cent).

8.2 Issues and Challenges for the Industry in General[227]

8.2.1 Macroeconomic Conditions

Sales and turnover in the retail trade industry are highly cyclical with sales reacting quickly to economic conditions, household disposable income, market trends and changes in consumer spending patterns.

The recent economic downturn following the global financial crisis has dented consumer confidence globally, with consumers increasing their precautionary spending and reducing their consumption. The fall in consumer spending has negatively impacted many retail operators in Australia.

While many retailers continued to report growth in sales volume, their revenue has slowed and growth is stagnant due to a fall in retail prices through heavy discounting to attract customers. The fall in retail revenue coupled with increasing operating costs, such as increases in wages following the

Table 8-1: Distributive trades industry value-added and employment by business size, 2008-09

	Small		Medium		Large		Total	
Employment	`000	%	`000	%	`000	%	`000	%
Wholesale trade	210	37.8	196	35.3	149	26.8	555	100
Retail trade	490	38.7	215	17.0	562	44.4	1,266	100
Total Selected Industries	4,764	47.7	2,331	23.3	2,901	29.0	9,997	100
Industry Value-added	$m	%	$m	%	$m	%	$m	%
Wholesale trade	15,522	26.4	23,114	39.2	20,259	34.4	58,895	100
Retail trade	17,516	31.6	12,203	22.0	25,940	46.9	55,359	100
Total Selected Industries	290,348	34.5	198,853	23.6	353,382	41.9	842,582	100

Source: See Table 4-1.

227. ACCI thanks Australian Retailers Association and Victorian Automobile Chamber of Commerce for their input into this chapter.

Table 8-2: Distributive trades sector's value-added and employment by state/territory, 2008-09

	Gross Value-added				Employment			
	Wholesale trade		Retail trade		Wholesale trade		Retail trade	
	$m	%	$m	%	`000	%	`000	%
NSW	17,127	31.8	16,464	30.4	204	36.8	397	31.4
VIC	16,320	30.3	12,809	23.6	159	28.6	332	26.2
QLD	10,601	19.7	13,120	24.2	92	16.6	253	20.0
SA	3,179	5.9	3,815	7.0	31	5.6	90	7.1
WA	5,209	9.7	5,596	10.3	54	9.7	137	10.8
TAS	719	1.3	1,184	2.2	8	1.4	26	2.1
NT	343	0.6	461	0.9	3	0.5	12	0.9
ACT	326	0.6	740	1.4	3	0.5	18	1.4
Total	**53,824**	**100.0**	**54,189**	**100.0**	**555**	**100.0**	**1266**	**100.0**

Source: See Table 4-2.

Table 8-3: Distributive trade industry value-added and employment by subdivision, 2008-09

	Employment		Industry Value-added	
	`000	%	$m	%
Wholesale trade				
Basic material	124	22.3	11,342	19.3
Machinery and equipment	149	26.8	19,592	33.3
Motor vehicle and motor vehicle parts	42	7.6	5,742	9.7
Grocery, liquor and tobacco product	85	15.3	7,804	13.3
Other goods	140	25.2	12,861	21.8
Commision-based	14	2.5	1,555	2.6
Total	**555**	**100.0**	**58,895**	**100.0**
Retail Trade				
Motor vehicle and motor vehicle parts	97	7.7	7,914	14.3
Fuel	40	3.2	2,522	4.6
Food	403	31.8	15,393	27.8
Other store-based	710	56.1	29,016	52.4
Non-store and commission-based	16	1.3	514	0.9
Total	**1266**	**100.0**	**55.359**	**100.0**

Source: See Table 4-3

Table 8-4: Employment in Distributive trades, May 2010

	Full time	Part time	Males	Females	Total
Number of people employed (`000)					
Wholesale trade	***346.4***	***61.5***	***274.6***	***133.3***	***407.9***
Basic material	85.1	14.7	77.9	21.9	99.8
Machinery and equipment	87.9	9.6	67.1	30.3	97.5
Motor vehicle and motor vehicle parts	21.5	1.7	19.7	3.6	23.3
Grocery, liquor and tobacco product	54.7	9.8	43.9	20.6	64.6
Other goods	69.4	19.6	42.8	46.5	89.0
Commision-based	9.9	1.8	8.6	3.1	11.7
Retail Trade	***610.8***	***575.4***	***516.9***	***669.4***	***1186.2***
Motor vehicle and motor vehicle parts	76.2	13.6	69.0	20.7	89.8
Fuel	14.5	15.3	16.7	13.1	29.8
Food	154.2	222.2	173.4	202.9	376.4
Other store-based	344.1	304.5	241.7	406.9	648.5
Non-store and commission-based	6.3	4.6	5.1	5.9	11.0
Number of people employed (% total)					
Wholesale trade	***84.9***	***15.1***	***67.3***	***32.7***	***100.0***
Basic material	85.3	14.7	78.1	21.9	100.0
Machinery and equipment	90.2	9.8	68.8	31.1	100.0
Motor vehicle and motor vehicle parts	92.3	7.3	84.5	15.5	100.0
Grocery, liquor and tobacco product	84.7	15.2	68.0	31.9	100.0
Other goods	78.0	22.0	48.1	52.2	100.0
Commision-based	84.6	15.4	73.5	26.5	100.0
Retail Trade	***51.5***	***48.5***	***43.6***	***56.4***	***100.0***
Motor vehicle and motor vehicle parts	84.9	15.1	76.8	23.1	100.0
Fuel	48.7	51.3	56.0	44.0	100.0
Food	41.0	59.0	46.1	53.9	100.0
Other store-based	53.1	47.0	37.3	62.7	100.0
Non-store and commission-based	57.3	41.8	46.4	53.6	100.0

Source: See Table 4-4.

Note: The total number of people employed in Wholesale and Retail trade industry includes any person whose industry subdivision was not further defined within the Wholesale and Retail Trade industry.

awards modernisation, increasing funding costs and charges, and higher energy prices, have put significant pressure on retailers' cash flows and their profitability. Cash flow management, which is a constant problem in the retail industry due to the holding of large inventories, has become increasingly difficult after the GFC as retailers are facing difficulties in a ccessing finance from financial institutions to manage their working capital.

"Cash flow management has become increasingly difficult after the GFC as retailers are facing difficulties in accessing finance"

As a consequence, many retailers have indicated that they are very conscious of expenditure and have minimised their expenditure where possible, for example, delaying capital works, cutting back on training for existing employees, and not taking on additional trainees.

8.2.2 Changing Landscape

Change is a constant theme within the Distributive trades industry. The difference between business operators that foresee and embrace the changes and those that do not is survival. In the past several years, the pace of change has been accelerating, especially with the progress in technology. Being first to the market or being the market leader is the key to success in the industry. Table 8-5 summarises changes occurring in the retail sector.

Quick delivery, immediate decision making and a results-focused business environment are critical to the viability and success of Distributive trades industries.

Changes in technology present both an opportunity and challenge for the industry.

Technology advancement enables a retailer to reduce its operating costs, such as the widespread adoption of product numbering (i.e. barcode) and scanning devices; Enterprise Resource Planning (ERP) systems which integrate each department in an organisation, e.g. from marketing to accounts, ordering and finance forecasting; development of 'just-in-time' inventory management systems, including automatic replenishment orders based on stock levels; self-checkout system; and the utility of internet-based retailing in respect of certain goods and services.

However, at the same time, retailers will need to provide their employees with ongoing training and skills development to utilise these technologies effectively. For example, in the automotive service industry, new vehicle technology is moving automotive repair towards electrical systems. Furthermore, remote diagnostics and driver assist systems may mean less need for repair work and more of a trend towards replacing parts. Heavy reliance on vehicle manufacturers to provide reasonable access to adequate diagnostic services and repair information continues to affect small businesses in the service and repair sector of the automotive services industry.

Increasing concern about the negative impact of climate change and policy debate surrounding the introduction of an emissions trading scheme or carbon tax to address Australia's greenhouse gas emissions have also increased consumer awareness and changed consumer preferences.

Combined with concerns for energy security, consumers are increasingly demanding environmentally sustainable product options, especially in durable white goods and vehicles. For example, consumer preferences have shifted to 'greener' vehicles - smaller and more fuel efficient vehicles and are encouraging further development in areas such as the electric vehicles market. Demand for 'greener' cars will also change the way vehicles are made and re-organise value chains.

8.2.3 Competition[228]

For independent retailers, price and product competitions from major retail chains and factory/discount outlets, which enjoy the economies of scale, remain a key challenge. This problem has been further exacerbated following the global financial crisis, with major retailers having permanent or rolling promotions or discounting and increasing their sale advertising, in-store promotion and catalogues sales. Some independent retailers have claimed that some major retailers have been selling below their wholesale prices to build up their customer base.

Rising rental and leasing costs also make it harder for small businesses to compete for prime location.

Retailers are also facing increasing competition from domestic and international internet-based retailers. Internet-based retailers are able to compete effectively in price and product due to their lower operating costs, location and a wider-range of product choices which are sourced globally. The strength in the Australian dollar also encourages Australian consumers to shop-online from retailers based overseas, such as Amazon, EBay etc.

228. Information for this section is adapted from *Australian Retailers Association (ARA) 2010, State of the Independent Retail Sector 2010.*

Table 8-5: Industry feedback on changes in the retail sector

From	To
Dynastic, privately owned business empires operating in the Australian market.	A plethora of privately owned, specialty, franchisee, publicly listed small and large businesses operating in a global environment.
Operating in a stable environment with small incremental change	Operating in a fast paced environment where sustainability is driven by the capacity to respond nimbly to growth, increased customer expectations, increased competition and increased excitement in product design and availability.
Less complexity and fewer processes	Increased complexity, process systems and legislation impacting on product selection, in store merchandising and decision making.
Mundane, repetitive tasks, high costs of doing business, command and control culture where decisions are made by managers	Increased process and technology, reduced cost of doing business, emphasis on driving business efficiency and continuous improvement, increased automation (floor ready stock), problem solving and decision making developed to shop floor.
Operations driven strategies	Customer, employee and community focus and involvement (live and work in community)

Source: Service Skills Australia (SSA) 2010, *Wholesale, Retail and Floristry,* Environmental Scan, p.11.

Improvement in technology, with increasing use of electronic readers and web-based applications, has caused a slow growth in the sales of magazines, newspapers and greeting cards which negatively affect the revenue streams of independent retailers, especially newsagents and convenience stores.

8.2.4 Workplace Relations and Regulations[229]

Recent changes to the Fair Work system and award modernisations have negatively affected the industry, especially small independent retailers. For example, increases in penalty rates for Sunday and late night trading have caused retailers to reduce the number of employees working during these times. Further staff reductions are also expected to be made as a result of the minimum hour work requirements.

"Increases in penalty rates for Sunday and late night trading have caused retailers to reduce the number of employees"

A recent survey conducted by the Australian Retailers Association (ARA) found that 39.3 per cent of retailers indicated that changes to the Fair Work system from 1 July 2010, will cause retailers to restructure their staff rosters and cut back on staff hours to cope with any increase in employee wages and entitlements.

Moreover, with wages taking up the biggest slice of retailers' operating costs, any regulated increase in wages without corresponding productivity improvement will negatively impact on profitability of retailers. This will ultimately impact on employees, as wages are the most elastic element of retailers' operating costs to any price changes. The recent ARA survey also reported that 62.5 per cent of businesses are concerned about the wage bill increases as a result of the Fair Work laws and the Modern Retail Award.

Retailers that operate in different jurisdictions are also concerned about inconsistencies in workers' compensation schemes, in particular about inconsistencies in employee definitions, return to work requirements, different benefit requirements and different reporting requirements.

8.2.5 Skills Shortages[230]

The ageing of the population means a declining working age population, with Australia's population aged 15 to 64 years projected to decline from 67 per cent in 2004 to between 57-59 per cent in 2051[231]. Coupled with industry's preference for younger workers, skills shortages are prevalent within the industry and the problem is particularly acute in retail automotive services industry.

Within the Automotive retail, services and repair (RS&R) Sector, the challenge to reduce skills shortages will be accompanied by a projected increase in skilled labour demand. By 2012, the RS&R Sector will face a critical trade skills shortage; for example, apprentices in the 15-19 age groups are expected to drop by 9 per cent between 2005 and 2025.

This problem is exacerbated by difficulties in attracting people to automotive apprenticeships. This is partly due to a labour force choosing higher wage jobs in other industries such as mining[232]. Since new technological innovation adds complexity to the average vehicle, the retail service and repair sector must develop skill sets which are capable of dealing with more complex repairs.

8.2.6 Regulatory Burden

The lack of regulatory and legislative consistency across jurisdictions has caused a significant compliance and reporting burden for businesses that operate in more than one jurisdiction.

For example, there were concerns that the different state and territory regulations surrounding the sale, promotion and supply of tobacco products increased the regulatory compliance burdens for retailers. Tobacco retailers that operate in different states have to frequently redesign or purchase new tobacco displays to accommodate the different display size restrictions in each state and territory.

Moreover, frequent regulatory and legislative changes, relatively short time frames to implement or comply with these changes and the lack of adequate information about the changes have put additional pressure on operators. For example, independent service stations and convenience store operators have reported that recent states' legislative changes to ban point-of-sale displays of tobacco products will impose capital costs between $5,000 and $10,000 to change the fitting of new tobacco storage units[233].

229. Detailed discussion on workplace relations and regulations is in Section 3.4.

230. Detailed discussion on skills development is in Section 3.5.

231. ABS, *Population Projections, Australia 2006 to 2101*, Cat. No. 3222.0.

232. Automotive Training Australia 2009, *Victorian Automotive Industry Skill Needs Report 2010.*

233. Australian Retailers Association (ARA) 2010, *State of the Independent Retail Sector 2010*, p.21 and 27.

Operators often have to retrain staff to comply with the regulatory changes which adds another layer of cost and time that could be used in other more productive channels.

> "Operators often have to retrain staff to comply with the regulatory changes"

Retailers also expressed their concern about general compliance costs arising from the collection, payment and administration of the Goods and Services Tax (GST). Retailers collect GST on the point of sales, and pay it to the Australian Tax Office through their Business Activity Statement (BAS), which is submitted on a quarterly basis for small businesses with a turnover less than $20 million, or on a monthly basis for larger enterprises.

The GST compliance burden is significant for small operators as they must take time away from their businesses to complete the required paperwork to transfer the GST collected to the ATO. While businesses accepted their role as 'GST collector', the Government should consider further opportunities to simplify the form and reduce the amount of red tape surrounding the reporting requirements. The GST exemption on specific items also imposes an unnecessary burden for retailers.

8.3 Issues and Challenges for the Automotive Service Industry[234]

Australia's Automotive service industry has grown significantly in recent decades following a significant increase in the number of cars driven on Australian roads. While Australia's population has increased over the past ten years, the number of registered passenger cars has swelled from 8.6 million in 1995 to approximately 10.6 million today. While Australia has the third highest vehicle ownership rate in the world, Australia also has one of the oldest fleets in the world, with an average passenger vehicle age of 9.9 years (in 2005).

> "Australia's downstream retail automotive industry generates an estimated $127 billion in revenue per annum, employing some 277,000 people"

The Automotive service industry plays an important role in the Australian economy. IBISWorld estimates that Australia's downstream retail automotive industry generates an estimated $127 billion in revenue per annum, employing some 277,000 people. Of the estimated 68,220 automotive businesses in Australia, 16,800 are in Victoria. This sector has continued to grow with the growing fleet; however, intense competition continues to put pressure on industry participants. Average profit margins are estimated at 2.3 per cent, with the majority of players generally being small independent operators. Non-employing enterprises are estimated to be over 52 per cent, consisting mainly of mechanical repairers, smash repairers and used car retailers[235].

Australia's Automotive service industry continues to change, rationalise and restructure to accommodate changes in global and domestic trends. Global market trends will continue to drive and shape the overall global and local automotive value chain, from suppliers to dealers, automotive retailers, service providers and repairers (RS&R). For example, suppliers are dependent on the way motor vehicle manufacturers (MVMs) distribute their products, and the RS&R sector is dependent on what types of vehicles are in the market and the respective servicing and repair requirements.

Similar global dynamics are at play within the motorcycle, truck and farm equipment industries. Operating in a global environment expands the competition borders beyond just local geographies, which are not just impacting upon the vehicle and equipment manufacturers, but the entire supply and distribution chain.

8.3.1 Changes in Market Demand

One of the key challenges facing the Automotive service industry is the changes in market or consumer demand. Global climate change has accelerated worldwide pressure to reduce carbon emissions. Combined with concerns for energy security, consumer preferences have shifted to 'greener' vehicles and environmentally friendly products from the global automotive industry, for example, smaller and more fuel efficient vehicles. This has also encouraged further development in areas such as the electric vehicle market. Demand for 'greener' cars also changes the way vehicles are made and restructures the value chain.

234. ACCI thanks Victorian Automobile Chamber of Commerce (VACC) for its inputs into this section.

235. VACC 2006, *HORIZON 2015 – Change and Challenges for the Australian Retail Automotive Industry*.

236. Brand and Ownership concentration in the European automotive industry possible scenarios to 2025 KPMG.

Consumer demands can potentially bring radical change to the automotive industry. If hypothetically, consumers start to prefer vehicle use for only specific occasions, or on an 'as needed' basis, vehicle ownership may be more likely to decline, and car makers may find themselves being less of a motor vehicle manufacturer and operating more as a mobility provider instead[236]. This could lead to complete industry restructure with flow on effects for the retail automotive industry.

8.3.2 Skills Shortages

The retail automotive services industry continues to experience the problem of long term skills shortages. The challenge to reduce skills shortages will be accompanied by a projected increase in skilled labour demand within the Automotive retail, services and repair (RS&R) sector. By 2012, the RS&R sector will face a critical trade skills shortage. For example, apprentices in the 15-19 age groups are expected to drop by 9 per cent by 2025.

This problem is exacerbated by difficulties in attracting people into automotive apprenticeships, partly due to workers' preference for higher wage jobs in other industries such as mining.

Moreover, new vehicle technologies using more advanced materials and vehicle telematics are moving automotive repair towards electrical systems. Since these new technological innovations add complexity to the average vehicle, the retail service and repair sector must develop relevant skill sets which are capable of dealing with more complex repairs.

Reducing long term skills shortages and meeting industry demand for a more highly skilled and adaptable labour force are compounded by an ageing population.

8.4 Policy Recommendations

ACCI proposes that:

Recommendation 79: The government should maintain a flexible labour market framework and any regulated wage increases should correspond to productivity gains.

Recommendation 80: COAG should streamline and harmonise regulations across different jurisdictions, where possible. Any proposed regulatory changes should only be considered after comprehensive cost and benefit analyses and industry consultation.

Recommendation 81: The Government should streamline and improve the operation of the GST with the aim of reducing compliance costs.

CHAPTER 9

HIGHER EDUCATION INDUSTRY

9. HIGHER EDUCATION INDUSTRY

Higher education in Australia has changed significantly over the last three decades. Australia has developed an effective and efficient higher education system. A recent *University World News* analysis ranked Australia as the third most efficient producer of top ranking universities in the world, behind New Zealand and Finland[237]. There are now 37 public universities, two private universities and 150 or so other providers of higher education in Australia.

Australia has also been extremely successful as a world leader in international education and has developed education services as an important export industry.

9.1 International Education as an Export Industry

9.1.1 Value of Exports

Australia's international education services industry has grown dramatically over the last twenty years. In 1991-92, Australia's education exports were worth only about $1.2 billion to the Australian economy. However in 2008-09, international education services contributed $17.2 billion in export income to the Australian economy, up from $14.0 billion in 2007-08. Of the total export income generated by education services, $16.6 billion was from spending on fees and goods and services by onshore students and a further $553 million was earned through offshore educational activities[238].

In 2008-09, the education services industry was the fourth largest export industry behind coal, iron ore and gold ($54.7 billion, $34.2 billion and $17.5 billion respectively). Education services was ranked Australia's 3rd largest export in 2006-07 and 2007-08 and the value of education exports has continued to grow strongly. In 2008-09, education exports were up 23.2 per cent over the previous financial year. However, coal, iron ore and gold increased in exports value by much higher rates; 123.9 per cent, 66.9 per cent and 42.7 per cent respectively in the same period. Education continues to be the largest services export industry ahead of personal travel services ($11.7 billion)[239].

Income from education exports is significant to some states. For example, income generated through expenditure by international students amounted to $6.4 billion and $5.4 billion in New South Wales and Victoria respectively, representing 38 and 31.5 per cent of total export income from all onshore students in 2008-09.

"The education services industry was the fourth largest export industry behind coal, iron ore and gold"

In 2008-09, more than half of the $17.1 billion export earnings came from the top five source countries of China, India, South Korea, Malaysia and Thailand, with $3.8 billion and $2.8 respectively from education exports to China and India alone.

Higher education services has grown rapidly and makes the largest contributions to exports of total education services, generating $9.5 billion in export income or 57.1 per cent of total onshore earnings in 2008-09.

9.1.2 International Student Enrolments in Higher Education

Today, Australia has the highest proportion of international students in higher education Type A programs – university level first qualification in the OECD (Figure 9-1) and accounts for one tenth of the world market for international higher education.

While OECD data shows that the number of international higher education students in the world has multiplied by three between 1985 and 1996, it has multiplied by 12 in Australia.

The current phase of globalisation has seen international students in Australian higher education grow from less than 73,000 in 2000 to over 200,000 in 2009, with an average annual growth rate of 12.5 per cent between 2000 and 2009.

In 2009, international student enrolments grew by 12.1 per cent between 2008 and 2009. Commencements grew by 15.4 per cent in the same period.

"China was the largest source country for higher education, representing 31.7 per cent of total enrolments"

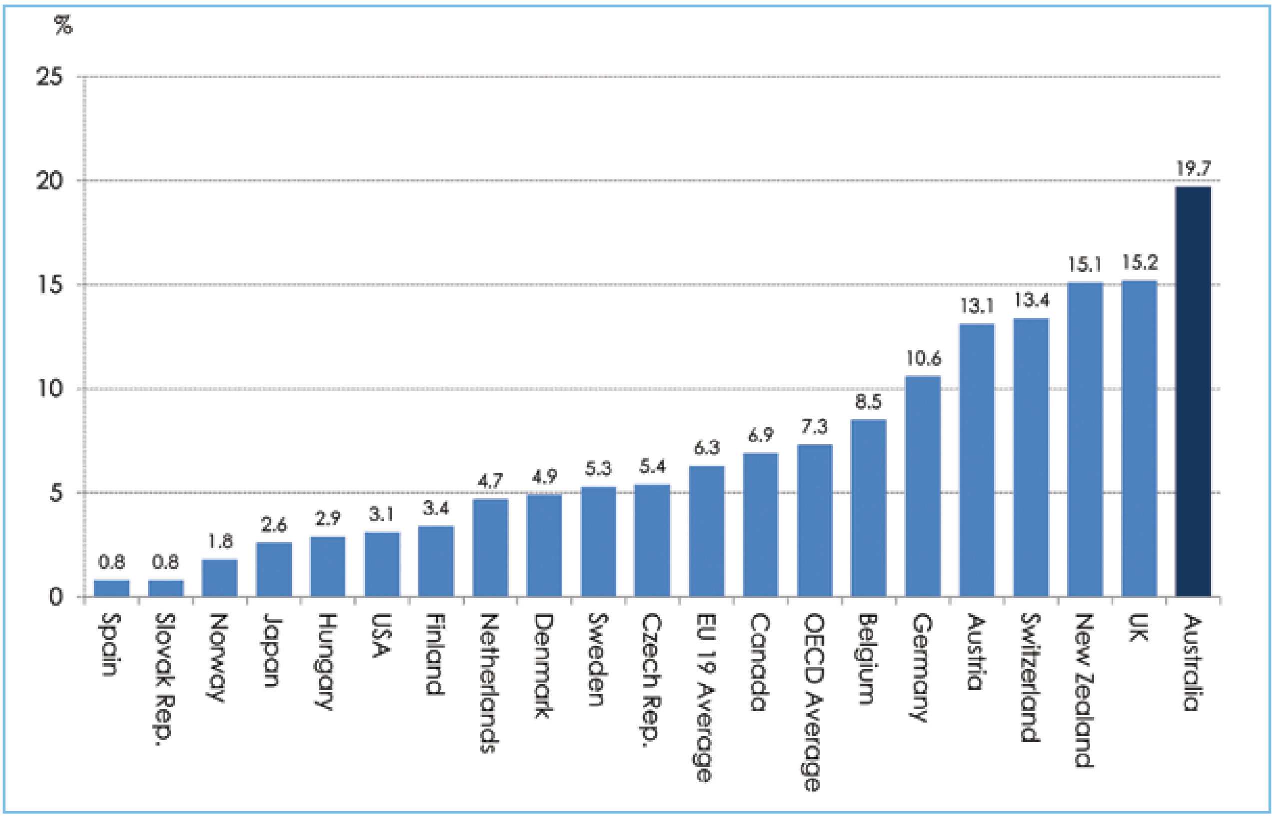
China was the largest source country for higher education, representing 31.7 per cent of total enrolments and 33.8 per cent of total commencements in 2009. India was the second largest source country by volume of enrolments (13.5 per cent) and by volume of commencements (12.6 per cent).

237. Gerritsen, J. 2008, *Global: Revealed Best Producers of Top Universities*, University World News, Issue 49, 19 October 2008.

238. Australian Education International (AEI) 2009, *Export Income to Australia from Education Services in 2008-09*, Research Snapshot, December 2009.

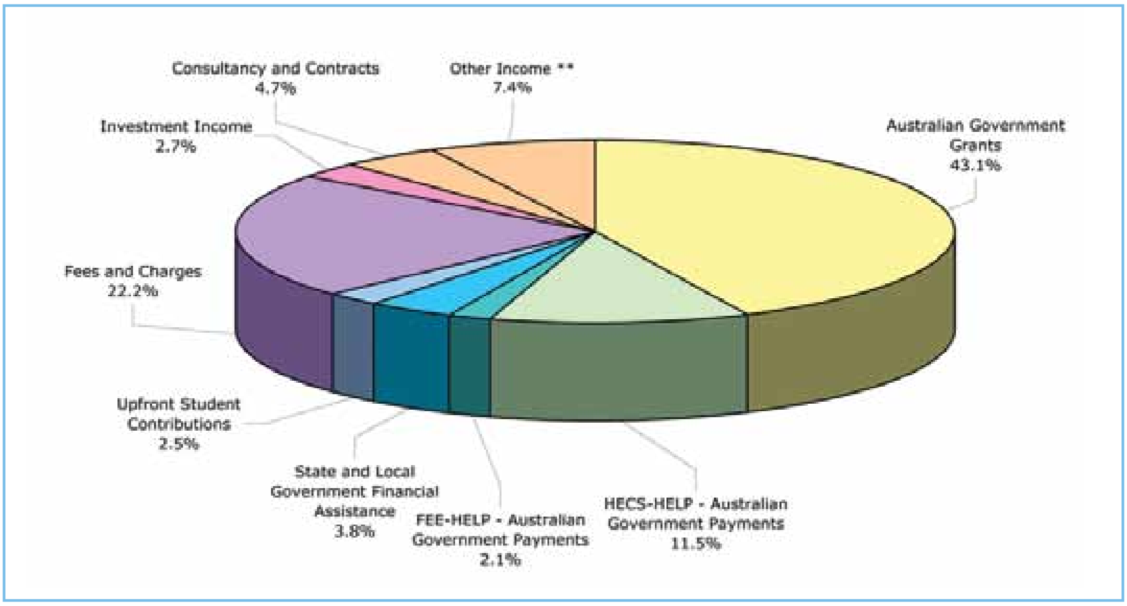
239. Ibid.

Figure 9-1: International students as a percentage of tertiary Type A enrolment, 2006



Source: Australian Government 2008, *Review of Higher Education* (Bradley Review), p. 91.

Figure 9-2: Total Australian higher education institutions revenue by source, 2008



Source: DEEWR 2009, Financial Reports of Higher Education Providers 2008, p.3.

Asian countries collectively accounted for 83.2 per cent of enrolments and 82.0 per cent of commencements. Enrolments in this region grew by 11.6 per cent between 2008 and 2009, compared with 14.6 per cent for all other regions combined. Commencements in the Asian region grew by 14.4 per cent in the same period, compared with 20.4 per cent for all other regions combined.

Management and Commerce was the largest broad field of education with 48.4 per cent of enrolments and 50.6 per cent of commencements. No other broad field of education individually contributed more than a 10 per cent share of enrolments or commencements.

9.2 Issues and Challenges for the Industry

9.2.1 Sustainability of International Education Market

While Australia has been extremely successful in attracting international students since 2000, recently there have been some concerns about the sustainability and viability of this growth.

Some higher education providers' revenues are highly dependent on full fee paying international students, which leaves them vulnerable to any changes in the source markets on which they depend. The December *2008 Review of Australian Education: Final Report* (Bradley Review) finds that the average proportion of total revenue derived from overseas student fees is 15 per cent for all Australian universities. However, two universities earned more than 30 per cent of their revenues from international student fees, with the highest at 44 per cent[240]. A fall in international student enrolments and commencements will put significant pressure on these providers.

Some institutions could also be vulnerable to sudden changes in demand for higher education. Australia's international student market is very sensitive to changes of currency, skilled migration policies and other government policy settings. Prospective international students will choose between countries that offer a quality and affordable international education experience. Recent strength in the Australian dollar has deterred foreign student enrolments in Australia, as the United States and the United Kingdom have emerged as lower cost substitutes.

Recent reports have indicated that enrolments of foreign students were down as much as 30 per cent in some universities in 2010 and the downturn is expected to worsen in 2011. Universities are forecasting sector-wide losses of $1.2 billion and 19,000 jobs over the next two years[241].

Another aspect of sustainability relates to the narrowness of the international student cohort in terms of country of origin, field of study and level of study. In 2009, over 80 per cent of international students in Australian higher education were from Asia, with 31.7 per cent from mainland China. Almost half of the international students were studying in management and commerce disciplines. While this sort of concentration may reflect Australia has a comparative advantage, it may lessen the value of the international education experience for both international and domestic students.

It also appears that many higher education institutions use international student revenue to support or cross subsidise services to domestic students, strengthen their research infrastructure and other institutional activities. Therefore any decline in international student enrolments may affect the ability of these institutions to provide quality learning and teaching as well as research environment, if other sources of funding remained unchanged.

9.2.2 Funding Models for Higher Education

Sufficient funding is always an issue for higher education institutions. Over the last two decades, the public policy directions relating to financing universities and other higher education providers have changed significantly. There has been a major policy shift towards increasing the contribution students make to the cost of their tuition, although students have access to income contingents loans, HECS-HELP and FEE-HELP, to remove any up-front costs.

Higher education institutions derive their income from a variety of sources, as depicted in Figure 9-2.

In 2008, revenue from the Australian Government was $10.8 billion (or around 58 per cent), of which $8.2 billion was for Australian Government grants and $2.8 billion was for HECS-HELP and FEE-HELP payments toward the cost of an agreed number of Commonwealth supported places.

Various competitive, conditional and performance based funding mechanisms have also been introduced as a substitute for increasing the base grants for teaching and research to public universities.

240. Australian Government 2008, *Review of Higher Education* (Bradley Review), p. 91.

241. Lebihan, R. and Mather, J. (2010, 13 October), *Education exports hit by dollar*, the Australian Financial Review.

Over the last decade, private contributions from HECS, fees and charges rose strongly as did revenue from all sources except direct Commonwealth funding. This shift in the sources of funding means that universities are less reliant on government and more able to determine their own future. However, financial risks have increased with their income increasingly contingent upon their ability to compete for private sources of revenues.

Financial pressures have been increasing for some years in the public universities. As the levels for funding per student declined, most universities increased student-to-staff ratios as the primary means of remaining financially viable. In aggregate, student-to-staff ratios have increased by 57 per cent from 1990 to 2007[242]. The Bradley Review indicates that these trends are related to the decline in student satisfaction.

Therefore, ACCI considers that serious consideration should be given to the introduction of a student centred funding arrangement. The Industry Commission, the predecessor to the Productivity Commission, was established in 1990 as the major public independent review and advisory body on industry policy for Australian governments. It found that:

- Students would have a more direct influence over the course offerings of institutions; and
- Public institutions would face stronger competitive pressures and be directly rewarded for responding effectively to student preferences. This could produce gains in various areas, notably:
    - A greater variety of course offerings in terms of price/quality combinations;
    - Increased stimulus to improve efficiency;
    - Enhanced capacity to strike a better balance between revenues and costs in providing different course combinations; and
    - Stronger stimulus and rewards to innovation.

"Student centred funding should be the cornerstone of further reforms to higher education"

The introduction of student centred funding should be the cornerstone of further reforms to higher education. Essentially it allows for a basic financial entitlement for all to be used in post compulsory education and training activity. Core funding should be replaced by portable Australian Government funded vouchers. Student vouchers would work to replace current core funding arrangements by endowing students with a direct subsidy to use at any of Australia's public universities. This subsidy would be collected by the University upon enrolment or transfer of the student.

To encourage students into critical areas of skills shortages the student-centred funding model would include weightings that recognise current and future skills needs, and similarly for socio-economic status (SES) and other nationally agreed priorities.

For a student centred funding model to provide maximum impact on meeting skills needs of Australian business there would need to be careers guidance given to students as to where strong employment prospects lie. A strong careers information service would serve to avoid over enrolment in high demand, popular courses of study with poor job prospects.

9.2.3 Innovation Policy and R&D

Innovation policy is not the same as, but is closely linked to, research policy. Research policy is aimed at advancing scientific knowledge, whereas innovation policy is aimed at helping businesses innovate successfully, and assist them to get new products and processes onto the market. That is, put simply, research is a process which converts money into knowledge and innovation is a process which converts knowledge into money. Innovation is therefore what provides the return on investment in knowledge generation.

The overall objective of public innovation policy must be to strengthen the long term competitiveness of Australia's businesses by creating a climate conducive to research. This applies to both traditional and emerging sectors.

There are two criteria that are essential for Australia's innovation policy. These criteria are:

- The need to allow flexible application of research and development funds by institutions; and
- The need for research to flow into innovation.

Universities are funded by the Australian Government to undertake research through a dual system of competitive grants and block grants. The Australian Government provided a total of $946 million to universities in competitive grants in 2006[243].

In a broad sense, a reasonable level of public funding on research and development exists in Australia although better targeting and supplementation of private investment are areas for policy attention. This is borne out by OECD comparisons

242. Ibid, p.149.

243. Ibid, p.181.

which rank Australia relatively highly for government expenditure on research and development. However, Australia fares less well on international comparisons of business expenditure on research and development.

ACCI believes that in terms of research funding by universities, there should be more focus on how the universities can leverage their existing funding to better interact with business. Ultimately, this would be to achieve greater commercialisation of research.

ACCI fully supports the notion of greater integration and coordination of research activities by universities and publicly funded research organisations. ACCI has also consistently called for greater linkages within the research community and subsequently with the broader business community.

"ACCI fully supports the notion of greater integration and coordination of research activities by universities and publicly funded research organisations"

Whilst there are good examples of industry and higher education provider partnerships, the extent of small business involvement is marginal. There should be focussed activity on small business–university partnerships, with a small amount of funding provided for specific collaborative projects. There is a potential role for State/Territory governments in supporting this activity.

9.3 Policy Recommendations

ACCI proposes that:

Recommendation 82: There should be a balance between private and public funding for the Australian higher education system. The Government should consider student centred funding arrangements. Students should be able to purchase a course from any public or private provider (User Choice). Funding should be linked to student outcomes/achievements with prices determined by market forces. It is recognised that some transitional arrangements will be required to implement this arrangement.

Recommendation 83: University research funding should continue to be performance based. There should be greater linkages within the research and business community to encourage greater commercialisation of research.

CHAPTER 10

ACCI MEMBERS

10. ACCI MEMBERS

CHAMBERS OF COMMERCE & INDUSTRY

ACT AND REGION CHAMBER OF COMMERCE & INDUSTRY
12A THESIGER COURT
DEAKIN ACT 2600

AUSTRALIAN FEDERATION OF EMPLOYERS & INDUSTRIES
LEVEL 2, 97-99 BATHURST STREET
DEAKIN ACT 2600

BUSINESS SA
ENTERPRISE HOUSE
136 GREENHILL ROAD
UNLEY SA 5061

CHAMBER OF COMMERCE & INDUSTRY QUEENSLAND
INDUSTRY HOUSE
375 WICKHAM TERRACE
BRISBANE QLD 4000

CHAMBER OF COMMERCE & INDUSTRY WESTERN AUSTRALIA
180 HAY STREET
EAST PERTH WA 6004

CHAMBER OF COMMERCE NORTHERN TERRITORY
CONFEDERATION HOUSE
SUITE 1, 2 SHEPHERD STREET
DARWIN NT 0800

NEW SOUTH WALES BUSINESS CHAMBER
LEVEL 15, 140 ARTHUR STREET
NORTH SYDNEY NSW 2060

TASMANIAN CHAMBER OF COMMERCE & INDUSTRY
30 BURNETT STREET
NORTH HOBART TAS 7000

VICTORIAN EMPLOYERS' CHAMBER OF COMMERCE & INDUSTRY
486 ALBERT STREET
EAST MELBOURNE VIC 3002

NATIONAL INDUSTRY ASSOCIATIONS

ACCORD
FUSION BUILDING SUITE 4.02, LEVEL 4,
22-36 MOUNTAIN STREET
ULTIMO NSW 2007

AGRIBUSINESS EMPLOYERS' FEDERATION
LEVEL 6, 41 CURRIE STREET
ADELAIDE SA 5000

AIR CONDITIONING & MECHANICAL CONTRACTORS' ASSOCIATION
30 CROMWELL STREET
BURWOOD VIC 3125

AUSTRALIAN BEVERAGES COUNCIL
LEVEL 1, SUITE 4
6-8 CREWE PLACE
ROSEBERRY NSW 2018

AUSTRALIAN DENTAL INDUSTRY ASSOCIATION
LEVEL 5, 757 ELIZABETH STREET
ZETLAND NSW 2017

AUSTRALIAN FOOD & GROCERY COUNCIL ASSOCIATION
LEVEL 2, SALVATION ARMY BUILDING
2-4 BRISBANE AVENUE
BARTON ACT 2600

AUSTRALIAN HOTELS ASSOCIATION
LEVEL 4, COMMERCE HOUSE
24 BRISBANE AVENUE
BARTON ACT 2600

AUSTRALIAN INTERNATIONAL AIRLINES OPERATIONS GROUP
C/- QANTAS AIRWAYS QANTAS CENTRE
QCA4, 203 COWARD STREET
MASCOT NSW 2020

AUSTRALIAN MADE, AUSTRALIAN GROWN CAMPAIGN
SUITE 105, 161 PARK STREET
SOUTH MELBOURNE VIC 3205

AUSTRALIAN MINES & METALS ASSOCIATION
LEVEL 10, 607 BOURKE STREET
MELBOURNE VIC 3000

AUSTRALIAN PAINT MANUFACTURERS' FEDERATION
SUITE 1203, LEVEL 12
275 ALFRED STREET
NORTH SYDNEY NSW 2060

AUSTRALIAN RETAILERS' ASSOCIATION
LEVEL 10, 136 EXHIBITION STREET
MELBOURNE VIC 3000

BUS INDUSTRY CONFEDERATION
LEVEL 2, 14-16 BRISBANE AVENUE
BARTON ACT 2600

CONSULT AUSTRALIA
LEVEL 6, 50 CLARENCE STREET
SYDNEY NSW 2000

HOUSING INDUSTRY ASSOCIATION
79 CONSTITUTION AVENUE,
CAMPBELL ACT 2612

LIVE PERFORMANCE AUSTRALIA
LEVEL 1
15-17 QUEEN STREET
MELBOURNE VIC 3000

MASTER BUILDERS AUSTRALIA LTD
LEVEL 1, 16 BENTHAM STREET
YARRALUMLA ACT 2600

MASTER PLUMBERS' & MECHANICAL SERVICES ASSOCIATION OF AUSTRALIA (THE)
525 KING STREET
WEST MELBOURNE VIC 3003

NATIONAL BAKING INDUSTRY ASSOCIATION
BREAD HOUSE
49 GREGORY TERRACE
SPRING HILL QLD 4000

NATIONAL ELECTRICAL & COMMUNICATIONS ASSOCIATION
LEVEL 4, 30 ATCHISON STREET
ST LEONARDS NSW 2065

NATIONAL FIRE INDUSTRY ASSOCIATION
PO BOX 2466
WERRIBEE NSW 3030

NATIONAL RETAIL ASSOCIATION
6 OVEREND STREET
EAST BRISBANE QLD 4169

OIL INDUSTRY INDUSTRIAL ASSOCIATION
C/- SHELL AUSTRALIA
GPO BOX 872K
MELBOURNE VIC 3001

PHARMACY GUILD OF AUSTRALIA
LEVEL 2, 15 NATIONAL CIRCUIRT
BARTON ACT 2600

PLASTICS & CHEMICALS INDUSTRIES ASSOCIATION
LEVEL 10, 10 QUEEN STREET
MELBOURNE VIC 3000

PRINTING INDUSTRIES ASSOCIATION OF AUSTRALIA
25 SOUTH PARADE
AUBURN NSW 2144

RESTAURANT & CATERING AUSTRALIA
SUITE 17, 401 PACIFIC HIGHWAY
ARTARMON NSW 2064

VICTORIAN AUTOMOBILE CHAMBER OF COMMERCE
LEVEL 7, 464 ST KILDA ROAD
MELBOURNE VIC 3004

AUSTRALIAN CHAMBER OF COMMERCE AND INDUSTRY

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