

Overview of Australia's services sector

What are services?

- 2.1 Services are often defined by what they are not (to the annoyance of those representing services industries¹). In statistics, the 'services' or 'tertiary' sector is usually defined as those parts of the economy that are not agriculture, forestry and fishing; mining; or manufacturing. *The Economist* magazine has defined services as 'things you can not drop on your foot'.
- 2.2 The Australian Services Roundtable defined 'services' as follows:
- 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 product.²
- 2.3 In the national accounts and employment statistics, the Australian Bureau of Statistics (ABS) identifies a number of industries based on the Australian and New Zealand Standard Industrial Classification. Those regarded as services in this report are listed in Table 2.1.
- 2.4 'Tourism' is not separately identified in table 2.1, as 'industries' are distinguished by characteristics of the producers, not by characteristics of the consumers. A sandwich eaten by a tourist is regarded as more like a sandwich eaten by a local than it is like a bus trip taken by a tourist, so these two tourist activities are divided between industries H (cafes and restaurants) and I (transport). However, tourism is the subject of a 'satellite

1 Australian Services Roundtable, *Submission no. 44*, p. 4.

2 Australian Services Roundtable, *Submission no. 44*, p. 5.

account'.³ This shows tourism contributed \$37.6 billion (or 3.9 per cent) to Gross Domestic Product (GDP) in 2005-06.

Services and the Australian economy

2.5 Services industries, as the table below demonstrates, account for the majority of the Australian economy. Gross value added (GVA⁴; a concept like GDP) by the services sector is likely to amount to around \$800 billion of Australia's trillion dollar economy in 2006-07.

Table 2.1 Services industries: shares of gross value added and employment

ANZSIC category	Industry	GVA as % of total (2005-06)	Employment as % of total (Feb 2007; seas. adj.)
D	Electricity, gas and water	3	1
E	Construction	8	9
F	Wholesale trade	6	4
G	Retail trade	7	14
H	Accommodation, cafes and restaurants	2	5
I	Transport and storage	5	5
J	Communication services	3	2
K	Finance and insurance	8	4
L	Property and business services	14	12
M	Government administration and defence	5	5
N	Education	5	7
O	Health and community services	7	10
P	Cultural and recreational services	2	3
Q	Personal and other services	2	4
D to Q	Total of above	76	85

Sources Australian Bureau of Statistics, *Australian system of national accounts 2005-06*, cat. no. 5204.0, ABS, Canberra, 2007; Australian Bureau of Statistics, *Labour force Australia (detailed)*, cat. no. 6291.0.55.003, ABS, Canberra, February 2007.

- 3 Australian Bureau of Statistics, *Tourism satellite account 2005-06*, cat. no. 5249.0, ABS, Canberra, May 2007. The satellite account is funded by the Department of Industry, Tourism and Resources. The main components are air and water transport (\$4½ billion in 2005-06), accommodation (\$4 billion), cafes and restaurants (\$3 billion), and education (\$2 billion).
- 4 The GVA of the industries shown in the table, added to industries A (agriculture, fishing and forestry), B (mining) and C (manufacturing), gives the denominator of the ratios shown, but does not equal GDP. Another 'industry', 'ownership of dwellings', must be added to obtain 'gross value added at basic prices'. Adding 'taxes less subsidies' in turn gives gross domestic product.

2.6 The services sector accounts for about three-quarters of Australia's GDP and an even larger share of employment. Around 8.8 million (85 per cent) of employed Australians work in the services sector (as at February 2007).⁵

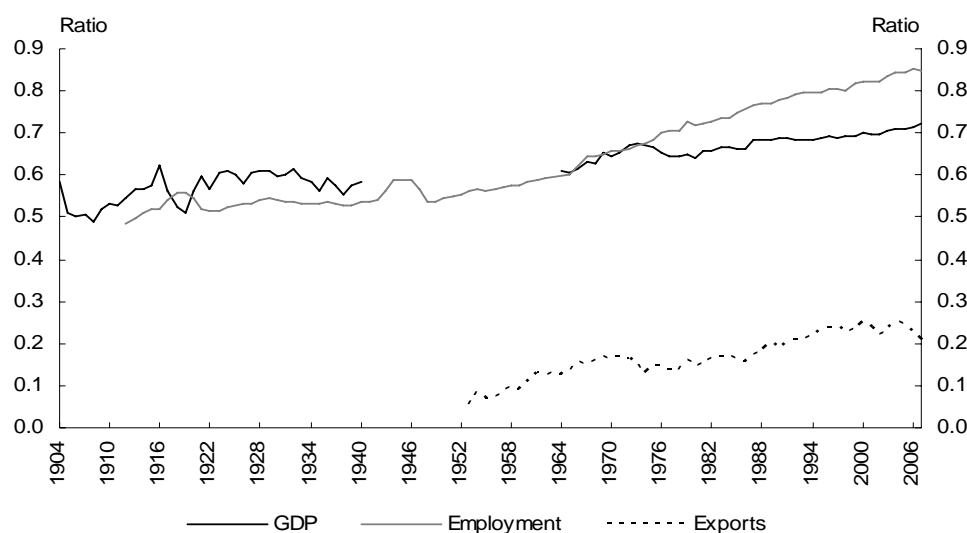
2.7 As in most economies, the share of the services sector in Australia has steadily increased over time (Table 2.2 and Figure 2.1). Subsistence economies devote most of their workers to producing food, but as economies become wealthier, there is more specialisation and scope to consume luxuries, which leads to increases in the services sector.

Table 2.2 Proportion of employment in services (excluding construction and utilities) (percentage)

	Australia	Canada	France	Netherlands	United Kingdom	United States
1700	n.a.	n.a.	n.a.	27	22	n.a.
1870	37	19	23	34	35	26
1913	41	n.a.	27	40	44	43
1950	49	42	37	46	50	54
1973	58	63	51	58	55	64
2005	75	75	74	77	76	79

Sources A Maddison, *Monitoring the world economy, 1820-1992*, OECD, p.39 and *Dynamic forces in capitalist development; a long-run comparative view, 1991*; G Withers, A Endres & L Perry 'Labour' in W Vamplew (ed) *Australians: Historical statistics*, Fairfax, Syme & Weldon, p. 149; OECD, *Labour force statistics 1985-2005*.

Figure 2.1 Australia's services sector (proportion of total)



Source Updated from *The Treasury, Submission no. 30, p. 2*.

5 The ABS does not classify 'electricity, gas and water' or 'construction' in services. Their submission therefore has lower numbers for the size of the services sector; 67 per cent of GVA and 75 per cent of employment; Australian Bureau of Statistics, *Submission no. 8, p.2*. Note also that about a tenth of 'mining' GVA comprises 'services to mining'.

Innovation and productivity in the services sector

2.8 It can also be seen from Figure 2.1 that the services sector's share of total employment has grown more than its share of GDP.⁶ This is consistent with the common global pattern of slower growth of productivity in the services sector than in the rest of the economy.⁷ For example, over the period 1993-94 to 2003-04, labour productivity rose by more in Australia's manufacturing and agriculture industries than in all but two service industries (Table 2.3). While productivity grows more slowly in the services sector than the goods sector, as the services sector is so much larger than the goods sector, the services sector contributes more to total productivity growth in the economy than does the goods sector.⁸

Table 2.3 Services industries: labour productivity (annual average percentage change)

ANZSIC category	Industry	1993-94 to 2003-04	2003-04 to 2005-06
D	Electricity, gas and water	2.1	-5.1
E	Construction	1.6	1.4
F	Wholesale trade	5.1	4.4
G	Retail trade	2.2	1.0
H	Accommodation, cafes and restaurants	1.8	3.3
I	Transport and storage	2.7	1.9
J	Communication services	5.1	1.8
K	Finance and insurance	3.1	0.1
P	Culture and recreational services	1.0	-2.0
Memo			
A	Agriculture, forestry and fishing	4.7	5.9
C	Manufacturing	3.1	-0.0

Source Derived from data on Productivity Commission website (www.pc.gov.au).

- 6 Notwithstanding the tendency for the price of services to rise relative to goods, which inflates the share of services in the value of output.
- 7 The classic paper on the slower growth in productivity in the services sector is W Baumol, 'Macroeconomics of unbalanced growth', *American Economic Review*, June 1967. A recent study by the Department of Communications, Information Technology and the Arts concluded 'in recent years productivity improvement in the goods producing sectors (agriculture, mining and manufacturing) tended to exceed productivity improvements in most services'; *Productivity growth in service industries*, DIMIA occasional economic paper, April 2005, p. 11. This pattern is also observed across the G7 economies in D Pilat et al, 'The changing nature of manufacturing in OECD economies', *OECD STI working paper*, 2006/9, p. 10. It is shown to hold in almost all OECD economies in A Wölfel, 'Productivity growth in service industries', *OECD science, technology and industry working paper*, 2003/7.
- 8 This point is made by the Australian Services Roundtable, *Submission no. 44*, p. 7.

- 2.9 The slower growth in services productivity is not a reflection on the managers or workers in the sector. It reflects the inherent difficulty of increasing measured productivity in some aspects of service industries.⁹ Productivity has slowed in most service industries recently, although there is no consensus about the cause.
- 2.10 There are many areas where innovation has improved productivity in service industries. For example, information technology has improved efficiency in areas such as cutting inventories for retailers and wholesalers and reducing vacant seats on planes and vacant rooms in hotels. There have been large improvements in communications technology.
- 2.11 But there are some areas where there has been almost no improvement. For example, the 'technology' used by hairdressers has barely changed in decades. There is limited scope for productivity improvements in child care or aged care. While vast economies of scale and efficiency improvements have been achieved in producing basic clothing, seamstresses or tailors doing alterations operate in much the same way as they have for decades.
- 2.12 As there is less scope for innovation in many areas of services, the services sector accounts for a lot smaller proportion of research and development (R&D) activity than it does of output and employment. The majority of business R&D is undertaken by the mining and manufacturing sectors.¹⁰ The finance industry accounts for 10 per cent of business R&D and 'property and business services' almost 20 per cent. The remainder of the services sector accounts for around 15 per cent.¹¹
- 2.13 It is notable that the submissions to the services inquiry had much less discussion of productivity and innovation than did those to the parallel inquiry into manufacturing. The academic literature and statistical publications also have less discussion. For example, in tables on labour productivity by industry, the ABS does not present estimates for the

9 In some 'industries' where output is not sold in the marketplace, such as government administration, statisticians may assume no increase in productivity, valuing output as the value of inputs.

10 The services sector as a whole accounts for more R&D than any individual industry within the goods sector, which may be the basis for the claim that 'services industries are the most important source of ... innovation in Australia' in the Services Roundtable, *Submission no. 44*, p. 7. Alternatively they may be arguing that R&D (or on-the-job improvements) is more successful in generating innovation in the services sector than the goods sector, which would be hard to prove, or just that innovation is more important in services because services are a larger proportion of the economy.

11 These numbers refer to 2004-05 and are taken from Australian Bureau of Statistics, *Research and experimental development, Businesses, Australia, 2004-05*, cat. no. 8104.0, ABS, Canberra.

'education' or 'property and business services' industries because they are hard to measure.¹²

- 2.14 The limited role of R&D in some service industries was acknowledged by David Etherton of Tourism Western Australia:

What was the last hotel R&D initiative? It was when they started folding the toilet paper so they do not have to give you new toilet paper every time you come in.¹³

- 2.15 Conversely, Lloyd Downey of Austrade felt that the importance of innovation in services is understated:

I do not think enough attention is given to innovation in services ... We talk about innovation and it seems to go hand in hand with some sort of technology, although innovation is occurring all the time in services and some of the most important developments we have ever had have been in services: the invention, for example, of the proprietary limited company; the invention of paper money – those sorts of things that have enabled credit and businesses to develop. They are not really listed in your list of major inventions of the last 200 years.¹⁴

- 2.16 Mr Downey further commented:

It would be nice to see a chair of service studies or something like that at a university.¹⁵

- 2.17 A similar view was put by the Australian Services Roundtable:

Australia needs a better developed, more robust understanding of what drives both innovation and competitiveness in its services sector. Initial studies suggest that the factors which drive innovation and the manner in which innovation takes place are very different in the services sector compared with the good sectors, suggesting that quite different policy instruments also might be required to promote it.¹⁶

12 Australian Bureau of Statistics, *Australian system of national accounts*, cat. no. 5204.0, ABS, Canberra.

13 Mr D Etherton, Tourism Western Australia, *Transcript of evidence*, 20 February 2007, p. 22.

14 Mr L Downey, Austrade, *Transcript of evidence*, 1 December 2006, p. 8.

15 Mr L Downey, Austrade, *Transcript of evidence*, 1 December 2006, p. 8.

16 Australian Services Roundtable, *Submission no. 44*, p. 14.

Services exports and the Australian economy

- 2.18 Australian exports of services were worth around \$44 billion in 2006. This represents more than a fifth of exports, much more than rural exports, and of a similar size to manufactures exports. This may surprise many people, who would immediately think of coal or wheat when they think of Australian exports. It is perhaps apt that service exports are sometimes referred to as 'invisible exports'. Indeed, it is not long ago that some 'services' were regarded as virtually synonymous with 'non-tradeables'.
- 2.19 As shown in Figure 2.1, services' share of total exports has increased considerably. It is likely to rise further (particularly if mineral prices fall back, as discussed later in this chapter). However, the share of services in exports is likely to remain well below their overall importance in the economy.
- 2.20 Statisticians identify four 'modes' by which services are provided to foreign consumers. These are:
- Mode 1: Cross-border supply is defined to cover services flows from the territory of one country (the exporter) into the territory of another (e.g. banking or architectural services transmitted via telecommunications or e-mail);
 - Mode 2: Consumption abroad refers to situations where a services consumer (e.g. a tourist, student or medical patient) travels temporarily into another country's territory (that of the exporter) to obtain a service abroad;
 - Mode 3: Commercial presence takes place where a services supplier of one country (the exporter) establishes a local presence, including through ownership or lease of premises, in another country's territory to provide a service in that market (e.g. domestic subsidiaries of foreign insurance companies or hotel chains);
 - Mode 4: Movement of natural persons consists of services providers of one country (the exporter) travelling temporarily to the territory of another country to supply a service (e.g. accountants, lawyers, doctors and teachers).¹⁷
- 2.21 The provision of services through modes 1 and 2 are classified as 'exports' in the balance of payments. As is the case for Australian companies owning a factory or mine overseas, the provision of services that occurs

17 Australian Services Roundtable, *Submission no. 44*, p. 9.

overseas (modes 3 and 4) is not classified as an export. Rather the profit accruing to the Australian owner is included as an 'income credit' in the balance of payments.

2.22 The main service exports identified by the ABS in the balance of payments, as shown in Figure 2.3, are services to:

- 'other personal travellers' (ie leisure tourists) in Australia (around \$11 billion in 2006);
- passenger transport (\$8 billion);
- education (\$10½ billion);
- services to business travellers (\$2½ billion);
- financial and insurance services (\$1½ billion); and
- a variety of other business services are also collectively significant (\$5½ billion).

2.23 Some of these components are aggregated by the ABS to give their estimate of 'tourism related services' (\$28 billion) in the balance of payments.¹⁸ The ABS also publish an estimate of 'consumption by international visitors of goods and services produced by the Australian economy', (\$20.5 billion in 2005-06), in their annual *Tourism Satellite Accounts*.¹⁹ There are a range of other estimates cited by other groups and agencies.²⁰

2.24 Australia's main markets for services have long been the United States, Japan and the United Kingdom, but China has been growing in

18 Derived from Australian Bureau of Statistics, *Balance of payments and international investment position March quarter 2007*, cat. no. 5302.0, ABS, Canberra, 2007. The 'tourism related services' is calculated by adding total travel services (business, education-related and other personal travel), passenger fares and the air transport component of other transportation services.

19 Australian Bureau of Statistics, *Tourism satellite account 2005-06*, cat. no. 5249.0, ABS, Canberra, May 2007. This concept is cited in the ABS, *Submission no. 8*, p. 3 and by the Department of Foreign Affairs and Trade, *Submission no. 34*, p. 3.

20 These include 'export revenue from visitors', \$18.2 billion in 2005 according to the Australian Tourism Export Council, *Submission no. 3*, p.3; 'tourism export receipts', \$23.2 billion in 2004-05 according to DITR, *Submission no. 21*, p.3; 'income from tourism exports', \$17 billion according to AusTrade, *Submission no. 26*, p. 5; 'inbound tourism', \$18.5 billion in 2005 and forecast to reach \$19.1 billion in 2006 according to Qantas, *Submission no. 37*, p.3; 'international inbound economic value', \$17.1 billion (in 2003-04 dollars) in 2004-05 according to Tourism Australia, *Submission no. 41*, p. 7; 'tourism exports', \$11 billion in 2005 according to Services Roundtable, *Submission no. 44*, p. 6.

Note that 'tourism' in these statistics includes spending by many people travelling for business or education, not just for leisure.

importance and is now the fifth largest market (with New Zealand fourth).²¹

Recent trends in services exports

2.25 The Treasury described recent trends in service exports as follows:

Growth in Australia's exports of services has slowed over the past decade, abstracting from the spike and subsequent unwind associated with the 2000 Sydney Olympics and September 11 terrorist attacks.²²

2.26 The value of service exports increased by 5½ per cent in 2005-06 (Table 2.4). This was comprised of a modest 2 per cent increase in volumes (Figure 2.2) and a 3½ per cent increase in prices.

Table 2.4 Recent trends in service exports (values)

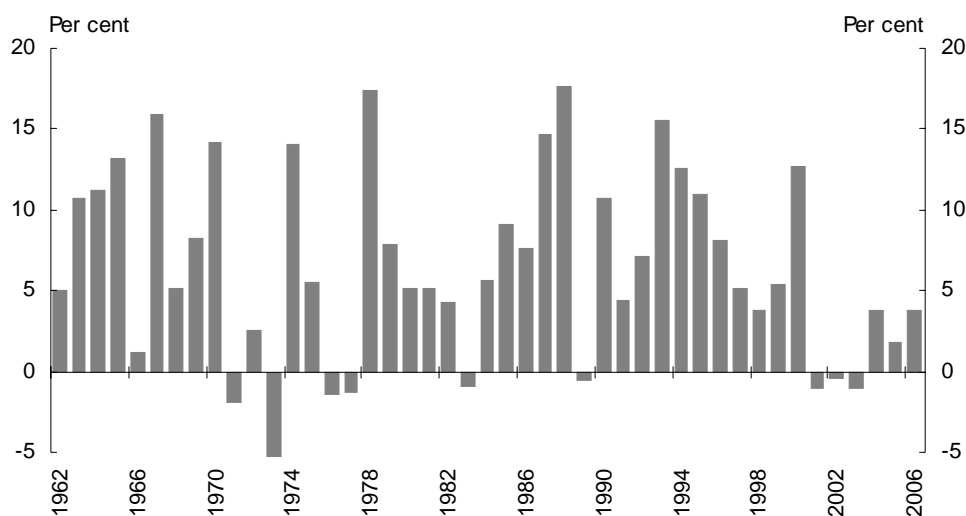
	2003-04	2004-05	2005-06	2005-06
	\$ billion	\$ billion	\$ billion	% change
Passenger transport	6.8	7.3	7.6	4.1
Freight transport	0.8	0.7	0.6	-13.6
Travel services: business	1.9	1.7	2.1	20.9
Travel services: education	7.8	8.8	9.7	11.2
Travel services: other personal	10.5	10.9	10.8	-1.4
Insurance and financial services	1.7	1.7	1.7	1.4
Computer and information services	1.2	1.3	1.2	-4.2
Other services	7.2	7.3	8.1	10.8
<i>Total services exports</i>	<i>37.7</i>	<i>39.7</i>	<i>41.9</i>	<i>5.4</i>
Memo item: total goods exports	109.5	127.9	154.4	20.8

Source Australian Bureau of Statistics, *Balance of payments and international investment position, March quarter 2007*, cat. no. 5302.0, ABS, Canberra, 2007.

21 The Treasury, *Submission no. 30*, p. 2.

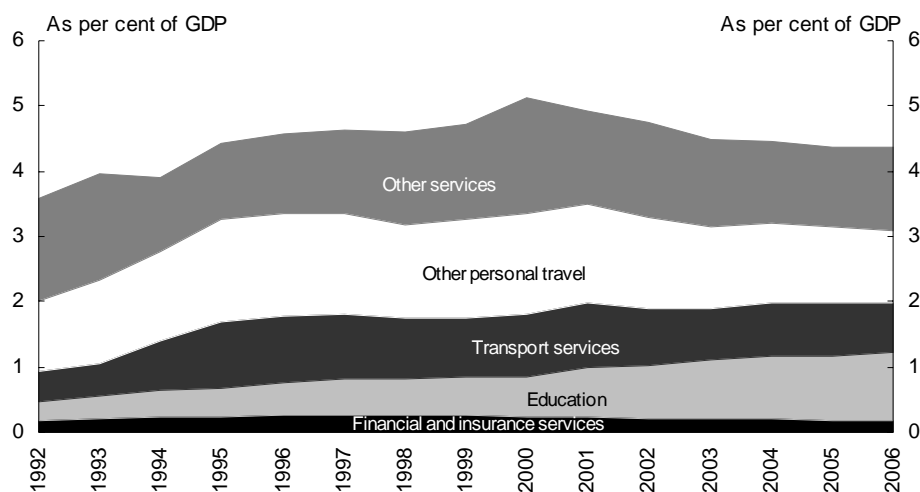
22 The Treasury, *Submission no. 30*, p. 3.

Figure 2.2 Australia's exports of services (chain volume measure; annual percentage change)



Source Updated from *The Treasury, Submission no. 30, p. 3.*

Figure 2.3 Australia's exports of services by type (nominal)



Source Updated from *The Treasury, Submission no. 30, p. 4.*

Tourism

2.27 The recent slowing in service exports has partly been attributable to the stronger Australian dollar leading to slower growth in tourism-related services. Data from the World Tourism Organization show strong growth in total international tourist trips after the dip in 2003. International tourist trips grew by 10 per cent in 2004, 5½ per cent in 2005 and 4½ per cent in

2006.²³ This strong growth is attributed to pent-up demand for travel as concerns about terrorism and SARS wane. While tourist arrivals to Australia matched this growth in 2004 and 2005, they grew by less than 1 per cent in 2006.²⁴ (Figure 2.4).

Figure 2.4 Short-term arrivals to Australia (monthly)



Source Australian Bureau of Statistics, *Overseas arrivals and departures*, cat. no. 3401.0, ABS, Canberra, 2007.

- 2.28 In particular, there has been a decline in tourist arrivals from Japan over the past decade. The levelling off in Japan's population and modest economic growth partly explains this. However, it is not the whole story as Japanese tourism to China, Singapore and South Korea has continued to grow over this period.
- 2.29 Tourist arrivals from China have been the growth area. 283,000 Chinese tourists visited Australia in 2005, compared to just 16,300 in 1991. This strong growth in Chinese tourist arrivals has been assisted by Australia being the first Western country awarded Approved Destination Status, a bilateral tourism arrangement allowing Chinese group leisure travel, in 1999. However, in 2006, China awarded this status to another 100 destinations worldwide, eroding this advantage.
- 2.30 One challenge for Australia as a tourist destination is that the growth of low-cost carriers flying within Europe and within Asia has increased the relative price of a holiday in Australia for European and Asian tourists. So

23 World Tourism Organization, *Facts and figures and news release*, viewed on 1 May 2007, <www.world-tourism.org>.

24 Australian Bureau of Statistics, *Overseas arrivals and departures February 2007*, cat. no. 3401.0, ABS, Canberra, 2007.

far there has been relatively little development of low-cost long haul flights.

- 2.31 Furthermore, high world crude oil prices during 2006 resulted in many airlines introducing fuel surcharges of around \$75-100 on long haul flights, which further increased the cost of travel to Australia relative to other destinations. Fortunately, these are starting to be removed in response to easing world crude oil prices.
- 2.32 The opportunities and challenges for inbound tourism are discussed in detail in chapter 4.

Education

- 2.33 Education exports continue to grow strongly, with the industry contributing around \$10 billion to the economy in 2005-06. While growth has been strong, there are signs that the market is maturing and it is therefore not showing the extremely rapid growth it achieved in the two decades since public institutions were first encouraged to enrol and charge international students in the mid-1980s. The strong growth from markets such as China, India and Thailand has been partially offset by continuing declines from some of Australia's more traditional source markets such as Hong Kong, Malaysia, Singapore and Indonesia.
- 2.34 International student enrolments grew by over 10 per cent in 2006. The value of education exports rose by 11 per cent in 2005-06 and is estimated to increase by a similar amount in 2006-07.
- 2.35 The Department of Education, Science and Training (DEST) commented:
- Traditional source countries are increasing their domestic educational capacity and more competitors are emerging for Australia and other traditional English-speaking destination countries.²⁵
- 2.36 DEST also drew attention to recent initiatives by the governments of our competitors, such as the United Kingdom, United States, New Zealand and Canada, to boost international student numbers. Scandinavian and German universities are increasingly offering English-language tuition and becoming competitors. Singapore aims to become a regional education hub and China is seeking to develop Beijing and Tsinghua universities as international education destinations.
- 2.37 Treasury remarked that:
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25 Department of Education, Science and Training, *Submission no. 35*, p. 6.

Competition is intensifying in the Asia Pacific education market as Asian universities are offering modern facilities. Some Australian universities are responding to this competition by offering courses in Asia rather than requiring students to come to Australia. This allows them to offer part-time as well as full-time courses, which may be more attractive to students who do not wish to interrupt their careers.²⁶

- 2.38 The strong Australian dollar is also making Australia a less attractive destination for study. The opportunities and challenges for education exports are discussed in detail in chapter 5.

Other services

- 2.39 There continued to be strong increases in many of these exports (Table 2.3), reflecting an increase in the demand for Australian business and professional services. Some highlights include the value of 'legal, accounting, management and public relations' service exports increasing by 24 per cent in 2005-06 and 'architectural and engineering' services by 43 per cent. Data for the first half of 2006-07 suggest there has been further strong growth in exports of legal, accounting and architectural services.
- 2.40 However, there were some weak areas, with insurance and financial services exports only rising by 1 per cent, communications service exports flat, and computer and information service exports falling by 4 per cent. Data for the first half of 2006-07 suggest insurance and financial service exports have remained flat while there has been some pick-up in computer and information services.
- 2.41 The opportunities and challenges for some of Australia's 'other' services are discussed in detail in chapter 6.

Services exports now and beyond the resources boom

- 2.42 Over the longer term, the services sector is likely to increase further its share of the economy. This process has been slowed by the resources boom and might be expected to accelerate if or when the resources boom finishes.
- 2.43 In particular, the resources boom has affected the growth of services exports. Firstly, workers and investors are attracted to the mining sector by

26 The Treasury, *Submission no. 30*, p. 7.

the higher wages and profits on offer there. (The resultant shortage of workers and skills in the services sector is discussed in chapter 3.) Secondly, the increase in mining exports is associated with an appreciation of the Australian dollar, rendering Australian services (such as a holiday in Australia) more expensive in world markets.

- 2.44 This phenomenon is more usually discussed in the context of mining hurting the manufacturing sector, where it is referred to as the 'Dutch disease'.²⁷ But it applies to the services sector as well. The effect may be less stark, though, as it is likely to be associated with only a *slower growth* in services, whereas the manufacturing share of the economy is actually falling.
- 2.45 The appreciation of the Australian dollar is indirectly a result of the industrialisation of China. This is bidding up prices of Australia's mining exports and leading to resources being diverted to expanding mining production. While prognosticating about exchange rates is fraught with difficulty, it is a fairly widely held view that:
- There is a tendency for countries who have a large increase in their resource exports to have an appreciation in their currency and, other things being equal, that will hurt their manufacturing and services sectors.²⁸
- 2.46 A shift in labour and capital to the mining sector from the services (and other) sectors is an entirely appropriate response to a long-lasting increase in returns in the mining sector. Of course, while beneficial to the economy as a whole, it poses challenges for the non-resources sectors, as discussed in chapter 3.
- 2.47 There may be wider challenges if commodity prices subside. These prices could fall back even if the Chinese economy continues to grow strongly, as the huge amount of mining investment seen recently in Australia and elsewhere should lead to large increases in mineral production in coming years. Of course, if the world's mining capacity increases faster than demand, mineral prices should fall. The 2007-08 budget papers acknowledge that some fall in commodity prices is likely:

27 The expression was coined in 1977 when the manufacturing sector in the Netherlands appeared to have suffered from the development of gasfields. In Australia, it is often termed the 'Gregory thesis'. It will be more fully discussed in this committee's manufacturing report.

28 Mr J Hawkins, The Treasury, *Transcript of evidence*, 1 December 2006, p. 13.

Despite continued strong world growth, [commodity] prices are expected to fall as global mining supply comes on line.²⁹

- 2.48 It should be noted, however, that predicting when commodity prices and the Australian dollar will ease is an inherently difficult task. Almost all of Australia's leading economists, including Treasury in its budget papers, have made incorrect forecasts about the length of the boom in the past few years. Most would have predicted that by mid-2007 commodity prices would at very least have fallen away from their record highs. But this is not the case. Commodity prices have stabilised in the past 12 months, but have not fallen, and the Australian dollar continues to perform strongly.
- 2.49 Economic theory would suggest that if commodity prices fall back, and the Australian dollar subsequently depreciates, other sectors, including services, will expand to fill the space vacated by shrinking mining exports. But if services infrastructure (in particular tourism and education facilities) has been underdeveloped during the boom, it may not be possible to meet the increased demand for some time.
- 2.50 It is, of course, primarily the responsibility of the private sector to predict and prepare for any surge in demand for services exports. Treasury noted:
- Governments are no better placed than firms and investors, responding to signals in the market, to determine whether [the resources boom] is temporary.³⁰
- 2.51 Tourism Australia questioned whether the tourism industry would be fully prepared for potential increased demand:
- I think the resources boom is having an impact on both the short-term growth of the Australian tourism industry and certainly the investment that is necessary to deliver the potential of the industry going forward, particularly if we see the resources boom – as all other resources booms – coming to an end.³¹
- 2.52 The government also has a role in preparing the services sector for the future, through the provision of appropriate infrastructure, as well as through the assistance it provides to various service industries. But

29 Australian Government, *Budget paper no. 1: Budget outlook and strategy 2007-08*, Australian Government, Canberra, 2007, p. 3-22.

30 The Treasury, *Submission no. 21*, p. 13. This argument is developed further by Treasury Secretary Dr K Henry in his speech 'Implications of China's re-emergence for the fiscal and economic outlook', reprinted in *Economic Roundup*, Winter 2006.

31 Mr K Flowers, Tourism Australia, *Transcript of evidence*, 15 November 2006, p. 7. (He makes similar points on p. 12.)

Treasury argues the best assistance the government can provide is to allow the market to operate efficiently:

The government can more effectively help the economy achieve its productive potential by allowing the market to operate unimpeded and allow resources to flow to their most efficient use. This will achieve improved productivity, economic growth and expanded national income in the long term.³²

- 2.53 Overall, the resources boom has and continues to pose challenges for the services sector – the export sector, in particular. The end of the boom, if or when it occurs, appears likely to pose new challenges.

Government assistance to the services sector

- 2.54 The greatest assistance the government can provide to the services sector is to ensure a healthy economy. More generally, the services sector has benefited from a range of sound policies. As Treasury commented:

Sound macroeconomic policy has led to low and steady inflation and low interest rates. Microeconomic reforms have enhanced domestic competition, and removed unnecessary impediments to business activity such as inefficient government process or excessive regulation, thereby providing business a sound basis on which to plan. Good government helps attract tourist and business visitors by making Australia a safe and environmentally attractive destination.³³

- 2.55 In addition to this healthy economic setting, there are a number of schemes whereby the government assists the services sector. These are listed in Appendix D. Some are general schemes, such as Austrade's Export Market Development Grants and its general advisory services to potential exporters, while others are specific to a particular service industry such as tourism.
- 2.56 At around 30 per cent, the share of government assistance going to the services sector is much smaller than its share of output or employment of around 75-85 per cent. An important reason for this is that much government assistance supports exporting and research, and, as shown above, the services sector has a smaller involvement in these activities.

32 The Treasury, *Submission no. 21*, p. 13.

33 The Treasury, *Submission no. 30*, p. 9.

Furthermore, a large amount of government assistance to manufacturing is directed to specific industries (cars and clothing) to help them adjust to the removal of tariff protection, and there are no comparable troubled service industries.

- 2.57 But, more fundamentally, there is no reason why government assistance should be regarded as like a pie to be sliced up and served to sectors in proportion to their size. As a senior Treasury economist put it:

On the question about the pie, you also want to think about, 'What is this pie? Where does it come from?' In other words, 'Is there an amount of money that now we are going to carve up to give to various industries for assistance?, – or have I thought through carefully how I can contribute to making the economy operate more productively and efficiently in these various areas?' I think the review saying, 'We spend X billion dollars and Y goes to services and that looks a bit low; perhaps we could spend a bit more,' would not lead necessarily to particularly good outcomes.³⁴

- 2.58 There are areas where the government assists the services sector due to market failures. Probably the most obvious and prominent is in promoting Australia as a tourist destination overseas. Clearly, individual restaurants and bed-and-breakfasts cannot afford to advertise overseas.³⁵ It is also not possible for an industry organisation to levy its members to pay for an advertising campaign because of the 'free rider' problem. Individual hotels, retailers and tourist operators who did not contribute to the cost of the campaign would still gain just as much benefit from it, so there is no incentive to contribute. If an industry organisation forced its members to contribute, it may find it just loses members.

Conclusions

- 2.59 As in comparable countries, the services sector continues to increase in importance and now constitutes the majority of economic activity.
- 2.60 Innovation, particularly in the use of information technology, has lifted productivity in the services sector, though there has been a more recent slowdown in services sector productivity growth. It would seem that the

34 Dr S Kennedy, Treasury, *Transcript of evidence*, 1 December 2006, p. 6.

35 Although it was noted that there are some B&Bs that are 'bringing in people from New Zealand and further afield through their internet presence'. Mr P Richardson, Australian Services Roundtable, *Transcript of evidence*, 14 March 2007, p. 9.

nature of many services limits the scope for productivity improvements. But there has been much less study of the role of research and innovation in lifting productivity in the services sector than in the goods sector. It seems more could be done in this area.

- 2.61 The role of services in exports is smaller than in domestic activity, but it is important and likely to grow. The main service exports are tourism and education. Both grew rapidly in the 1990s but slowed more recently, in part due to the appreciation of the dollar and some labour shortages associated with the mining boom. If conditions in the mining industry ease, this would offer scope for faster growth in services exports.
- 2.62 The current movement of some resources from the services sector to mining is a desirable response by the private sector to market signals rather than a problem needing to be addressed. Nonetheless, it is prudent to ensure the services sector is well-placed to respond should the market later signal (eg through falling commodity prices) that resources should flow back from the mining sector to the services sector. Most of the recommendations in this report are aimed at making the services sector more efficient, which is desirable whether the current mining boom turns out to be temporary or long-lasting.
- 2.63 Services receive a proportionally smaller share of government assistance than other sectors, but this reflects a smaller need rather than assistance being insufficient. Governments will continue to provide assistance to the service sector where appropriate, but it remains the responsibility of the private sector to show initiative and drive the expansion of services exports.

Recommendation 1

- 2.64 **The committee recommends that the government commission research into innovation in the services sector and its implications for productivity.**