

# **Australian Services Trade in the Global Economy**

**Excerpt: Health**

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## Executive summary

The ongoing structural transformation towards a services economy, across all countries and at all levels of development, has immense potential to improve the well-being of Australians. Technology has reduced trade and transaction costs for both goods and services, thereby facilitating more complex and services-intensive production networks. Telecommunications, audio-visual and computer services constitute a digital network at the heart of the world trading system. Transportation, courier, logistics and distribution services form the backbone of global supply chains. Legal, accounting, insurance and banking services are essential enablers of trade and finance. Architectural, engineering, mining and constructions services are a fundamental foundation of physical infrastructure. Health, education and tourism services are at the heart of better lives.

Yet impediments to services trade remain pervasive, while trade and regulatory policy in these individual services sectors are often made with limited regard for economy-wide impacts. This report aims to provide a better understanding of Australia's services performance in the global economy, to inform trade and regulatory policy makers of the likely effects of unilateral or concerted reforms and to help prioritise policy action. Taken together, the main findings seek to contribute to a national strategy by which Australia can fully capitalize on the strength of its services sectors and exporters to ensure that services trade works for all Australians.

## Main findings

### ***Services are Australia's gateway to global markets***

Australia's regional and global services trade and productivity performance is strong. Services exports, and services embedded in other exports such as food products, machinery and electronics, account for half of Australia's exported domestic value added. There is evidence, however, that Australian services suppliers face increasing competition. As such, a national services trade strategy can help sustain and strengthen Australia's comparative advantages.

### ***Australia's services regulatory environment is a source of strength***

Australians benefit from an open, efficient and generally pro-competitive regulatory environment that is favourable relative to many of its peers. Australia's domestic regulatory regime is more liberal than average in 21 of the 22 services sectors measured by OECD Services Trade Restrictiveness Indicators. There is scope for improvement in all sectors, however, and a targeted regulatory reform agenda can ensure that Australia's business environment remains a source of international competitiveness.

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### ***Global services sector growth is an opportunity for Australians***

Technical progress, urbanisation and fast-growing markets are driving a rising share of services in consumption across the globe, and Australian exporters are well positioned to capitalize on these trends. Rapid change and dynamic demand factors, however, require adaptation and new approaches to maintain existing strongholds and gain ground in new and diversified markets, especially in strategic sectors such as education, travel and tourism services.

### ***Ambitious services trade policy can transform bottlenecks into gateways***

Services trade restrictions and regulatory heterogeneity impose costs on services and manufacturing sectors, with a disproportionate burden falling on small and medium sized enterprises (SMEs). Enhanced commercial opportunities for Australian exporters can be secured by concerted efforts to encourage behind-the-border regulatory reforms in key markets (through fora such as the G20 and APEC), coupled with an ambitious trade negotiating agenda to secure new market access and bind applied regulatory regimes.

### ***Strategic national reforms can boost Australia's services trade competitiveness***

Services generate more than two-thirds of global gross domestic product (GDP), attract over three-quarters of foreign direct investment (FDI) in advanced economies, employ the most workers, and create most new jobs globally. The OECD recommends that countries adopt a whole-of-government approach to co-ordinated services trade policy and regulatory reforms as a driver of inclusive economic growth and employment, and encourages Australia to seize this opportunity. Horizontal and sector-specific policy conclusions are presented in the final chapter of this report.

## Whole-of-report policy conclusions

The analysis carried out in this report highlights the importance of services in the Australian economy. Evidence demonstrates the relative strength of Australia's services trade and productivity performance, and the opportunities arising from Australia's proximity to the world's most dynamic region. The report also highlights the challenges faced by Australian services exporting firms, including the risk of losing ground in stronghold sectors such as education and tourism. Furthermore, the empirical evidence included in the report highlights how services trade restrictions in foreign countries prevent Australia from exploiting its full export potential.

In this context, there is significant potential for services to sustain productivity and enhance the global competitiveness of Australian businesses. This section delineates key factors to be considered in response to the opportunities and challenges posed by a rising degree of globalisation and a growing tradability of services. On this basis, a strategic whole-of-government approach to the performance of Australian services in the global economy can help Australians fully capitalize on the strength of its services sectors and exporters to ensure that services trade works for all.

### General key findings

- It is important to continue to promote regulatory reforms and the reduction of services trade restrictions in the applied regimes of priority markets abroad by, inter alia, advocating the potential of services reforms to drive inclusive economic growth and employment, ensuring the effective implementation of the APEC Services Competitiveness Roadmap and encouraging national and collective actions consistent with the G20 Strategy for Global Trade Growth.
- In addition to existing FTAs, it would be beneficial to continue pursuing bilateral, plurilateral, regional and multilateral trade agreements with ambitious market access, national treatment and domestic regulation provisions for services. Besides maximising the economic benefits accruing to Australians, this would also lock applied regimes and thereby secure a predictable and rules-based environment for services trade and investment. OECD empirical analysis confirms that the legal bindings found in services trade agreements tend to have a positive effect on services trade by reducing uncertainty.
- Continued investment in an efficient and effective visa system is desirable. The envisaged streamlining of the current visa system would be beneficial to international visitors, international students, and domestic as well as foreign businesses.
- Consideration could be given to the relationship between the Temporary Skill Shortage (TSS) visa and the cost of recruiting highly qualified foreign workers, and the ability of some international students to apply for jobs on the list of skilled occupations (with concomitant implications for the education sector).
- Australia ensures that data can flow freely across borders, while respecting privacy and security considerations. It is important to continue facilitating an environment

that enables digital trade, through free trade agreements, harmonisation of standards and implementation of trade facilitation measures.

- Despite efforts to improve coordination of government initiatives promoting export capability, innovation and growth, there is still some work to do to increase transparency and to improve the dialogue between the different level of government agencies and transparency. Firms find it difficult to navigate through the different programmes available to them. Also, there is a lack of co-operation between businesses and other actors, such as universities or research institutes. Hence, as recommended in the OECD *Economic Surveys: Australia 2017*, there is a need to develop a more integrated, “whole-of-government” approach to science, research and innovation and consolidate innovation support programmes. This approach could help to reduce the number of support schemes for innovative SMEs and exporters, facilitating the management and efficiency of the different schemes, allowing for more generous programmes while keeping total expenditure constant.
- A review of the R&D Tax Incentive, a program supporting business innovation, found that smaller firms face compliance costs of up to 23% of the of the program benefits. The Government continued efforts, through the recently announced reforms of the R&D TI, to improve the integrity of the program, continue assist smaller companies and refocus support for larger companies undertaking higher intensity R&D, are commendable. However, in line with other recommendations (Ferris et al., 2016), it would be desirable to improve also the administration of the R&D TI program by reducing compliance costs. This would increase companies accessibility and ensure a more inclusive participation.
- Application processes for government support schemes, such as the Export Market Development Grant (EMDG) are often time consuming and unnecessarily burdensome. Many firms turn to professional consultants for these processes. Application and reporting could be simplified so that firms could reap the full amount of the incentives available.
- The paucity of official statistical trade data, including the lack of Foreign Affiliate Trade Statistics (FATS), complicates the understanding of Australia’s strength and weaknesses in services. Improving the statistical base would allow for a more robust analysis of services trade and investment. While efforts in this direction are underway, the timely implementation of an annual survey to collect on a regular basis information on inwards, but also outwards, foreign affiliate sales and a harmonisation of the disaggregation level for the collection of trade statistics and business statistics are essential for an accurate investigation of the benefits of FTAs.

## Insights into strategic sectors: Australia's exports of health services

The Australia New Zealand Standard Industrial Classification (ANZSIC) contains a Division Q on Health Care and Social Assistance. Within this division, the health segment can be further differentiated into Subdivision 84 on Hospitals and Subdivision 85 which covers Medical services (including General Practice and Specialist Medical Services), Pathology and Diagnostic Imaging Services, Allied Health Services (comprised of Dental Services, Optometry, Physiotherapy, and Chiropractic and Osteopathic Services) and Other Health Care Services (e.g. Ambulance services and other health care services not elsewhere classified).

From a trade perspective, these services can be distinguished by modes of supply. Important activities include exports of health care services via Mode 3 through outbound investment activity. Depending on the type of service and regulatory requirements in the host country, Australian firms will either set up specialist service providers abroad or they will partner up with local firms in order to provide health services.

Foreign direct investment in health services accounts for a relatively small share of total Australian outward FDI stocks. In 2016, Australian investors held direct investment in the health sector worth AUD 6.3 billion, corresponding to 1.1% of total Australian outward FDI stocks of that year, even though value added in health and social work accounts for roughly 7% of Australia's GDP. However, there is anecdotal evidence from various firms that successfully operate affiliates abroad.

The hospital business is usually heavily regulated. However, market access barriers have recently been reduced for operating hospitals in the People's Republic of China (hereafter "China"). Through the China-Australia Free Trade Agreement (ChAFTA), Australian services providers are now allowed to establish fully owned private hospitals in seven Chinese provinces.<sup>1</sup> Even though this segment is liberalised on paper, no Australian health services companies have so far managed to successfully establish and operate private hospitals in China.

Weak enforcement of national laws by provincial governments is among the most important barriers to entry in China mentioned by health businesses. Contacts with provincial and municipal government representatives are crucial to smooth business operations. Hence, even though fully owned subsidiaries are now possible, local partners are still essential to overcome difficulties on the ground. Furthermore, businesses reported fears about a loss of reputation in an environment where the legal system is not sufficiently strong and mediation of complaints is unregulated. Instead, people often use public media and orchestrated protests to enforce redress in cases of malpractice. In addition, there is a general fear that red tape might be added after entry in an attempt to thwart the operation of successful foreign hospital to the benefit of local providers.

However, some important steps have been taken to facilitate entry of foreign hospital operators into China. For example, a regulation that used to restrict doctors from practising in more than one hospital has recently been removed. The abolition of this policy brings benefits from economies of scale in the operation of commercial hospitals, where the mobility of highly qualified professionals leads to knowledge spillovers across different hospitals belonging to a single corporate group.

In other segments of health services, such as pathology, many Asian countries are characterised by less restrictive regulations than comparable activities in Australia. In Singapore, Malaysia and Viet Nam, pathology services can be advertised directly to

consumers, creating business opportunities in societies with a growing and ageing middle class that is increasingly able to afford modern health care services. For example, expenditure on health care services measured at constant prices doubled between 2006 and 2014 in Viet Nam and between 2005 and 2014 in Malaysia (WHO Global Health Expenditure database). This provides an opportunity for Australian services providers to enter a market via the acquisition of foreign providers and achieve substantial growth through increased operational efficiency.

A second mode of health services trade is the treatment of non-residents within Australia (Mode 2). In many cases, this type of health export results from the treatment of non-residents who did not come to Australia specifically for treatment, such as tourists, business visitors or foreign students. Medical tourism, where people visit a certain country for the purpose of receiving medical treatment in that country, is not yet frequent in Australia. In 2010, only 12 000 visitors came to Australia for medical reasons, accounting for 0.23% of all visitors in that year (TRA, 2011, quoted from Deloitte, 2011).<sup>2</sup>

At first sight, this number seems very small. Data for other countries can set it in context: Hanefeld et al. (2013) report 52 000 patients travelling to the United Kingdom for medical care in 2010, whereas Johnson and Garman (2010) estimate the number of foreign patients visiting the United States annually for medical treatment at between 42 400 and 102 900. Consequently, the Australian figures suggest a market that is still relatively small, and this despite anecdotal evidence of an increase in medical tourism in many developed countries. However, data on the size of the sector are not harmonised across countries and cannot be used for international comparison for a larger number of countries.<sup>3</sup> Crucial determinants of the patterns of health-related travel are, first and foremost, the cost and quality of the treatment. While these two factors are usually considered jointly, more travellers in developed economies seem to seek low cost for a sufficient level of quality while only a minority seek maximum treatment quality irrespective of the price. An increasing number of people are travelling for medical treatment from developed countries to developing and transition economies in South East Asia, Latin America and Eastern Europe since the appearance of facilities targeting foreign consumers with offers of high-quality health services in these countries. Other important factors are geographic proximity and cultural affinity. For specific health problems, ethical regulation prohibiting certain treatments can be another crucial determinant for the patterns of cross-border health travellers.

Table **Error! No text of specified style in document.**1 shows that prices for different types of surgery are comparable in developed economies. A notable exception is the United States with significantly higher prices for all treatments. The table also shows that in Singapore, Thailand and India many operations can be offered at more competitive prices than in Australia. In addition, there are many more competitors than those listed in the table, such as the United Arab Emirates, China, Malaysia, Sri Lanka, Mexico, Costa Rica or Hungary. All these countries have realised the potential of a growing market for health care services and are located closer to other major economies, suggesting that competition for Australia will remain difficult in the future.

A strong area of Australian comparative advantage is related to research and development (R&D) in the health and biotech sectors. For example, clinical trials in Australia benefit from a robust regulatory environment with strong intellectual property protection and legal standards. This is particularly true for early trial stages, for which fewer participants are required. By contrast, later trials with thousands of participants are more often conducted in countries like China or the United States. Moreover, most companies in the segment benefit from the R&D Tax Incentive, helping them to remain competitive in the face of

increasing competition from Asian countries such as Singapore, Korea, and Chinese Taipei.<sup>4</sup>

**Table Error! No text of specified style in document..1. Selected surgery costs by country 2008 (USD thousands)**

	Australia	New Zealand	United States	United Kingdom	Korea	Singapore	Thailand	India
Heart bypass	23.1	30.5	130.0	24.6	34.2	16.5	11.0	9.3
Heart valve replacement	n/a	30.5	160.0	n/a	n/a	12.5	10.0	9.0
Angioplasty	n/a	8.5	57.0	14.9	n/a	13.0	13.0	11.0
Hip replacement	16.5	15.0	43.0	14.0	11.4	9.2	12.0	7.1
Knee replacement	13.9	14.0	40.0	16.6	24.1	11.0	10.0	8.5
Hysterectomy	4.9	6.0	20.0	n/a	12.7	6.0	4.5	6.0
Spinal fusion	n/a	n/a	62.0	n/a	n/a	9.0	7.0	5.5

*Note:* All values in USD converted at 2008 exchange rates.

*Source:* Voigt et al. (2010), Deloitte (2010), Tattara (2010), quoted from Deloitte (2011).

International trained medical graduates (IMGs) must obtain registration at the Medical Board of Australia (MBA) or the relevant specialist medical college in order to practise in Australia. A recent report (Deloitte, 2017) found that specialist colleges mostly comply with the Good Practice Guidelines in the quality assessment process. Assessments and additional requirements for Specialist IMGs are mostly consistent across colleges. Nevertheless, the authors note that some colleges may not be applying a standard assessment and that at some colleges there was a lack of information about additional registration requirements. There are different registration types, which are available for IMGs to practise for periods of supervision or for teaching and training purposes. Even though a number of pathways exist, hospital operators mentioned that they face obstacles when trying to bring in foreign specialist doctors for short-term visits.

Given the lack of a clear competitive edge and its remote geographical location, Australia could try to identify a profitable niche within its areas of comparative advantage. For example, a coordinated strategy for tourism and health services could help to promote a combination of medical treatment and holidays in Australia, increasing the average spending and duration of stay for foreign tourists. Businesses mentioned the difficulty of promoting medical services offered by general hospitals, compared to those of specialised medical centres. Offering a wider diversity of medical institutions, including small and specialised clinics, may help to promote Australia as a high-quality location for specific treatments.



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1. Beijing, Tianjin, Shanghai, Jiangsu, Fujian, Guangdong and Hainan. An additional area of liberalisation in ChAFTA is the possibility for Australian providers to establish age care institutions throughout China.
  2. The Revised System of Health Accounts (OECD/Eurostat/WHO, 2017) was recently established to provide a framework to record trade in health services. However, no data are available for Australia yet.
  3. Definitions of the sector sometimes seem to be inflated by other health services, such as wellness treatment. Numbers based on visa applications only exist in cases where visas are required and when medical reasons are stated as the main reason for travel on the application. Data published by hospitals on the treatment of foreign nationals often do not distinguish between residents and non-residents. Also see Helble (2011).
  4. See Chapter 6 on Governments initiatives for services competitiveness for a more detailed description of this program.