

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

**Excerpt: ICT**

## 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.

### ***Information and Communications Technology (ICT)***

- Firms in the ICT sector require fast and reliable internet connections in order to supply their services to the domestic market and overseas. Currently, many firms suffer from an insufficient broadband connectivity. Upgrade and expansion of Australia's broadband network is essential for these firms in order to obtain higher connection speed, particularly in currently underperforming regions, such as outside of central business districts and in rural areas.
- Moreover, ICT providers could benefit from national award programs as an effective means for the international and national promotion of innovative businesses. A strong commitment from the government, as well as the active participation of multiple stakeholders from the private sector is required in order to raise the visibility of such awards.

### **Insights into strategic sectors: ICT and digital trade in services**

Information and Communications Technology (ICT) is important throughout the Australian economy. Developments from the ICT sphere are of wide applicability and may overturn business models in other sectors, offering enormous potential for profitable ventures using technologies like artificial intelligence, machine learning, block chain and distributed ledgers, or sensor technology. The sector is labour-intensive, offering high-paid jobs, and compared to other sectors, it relies less on geographic proximity to its customers. Hence, a thriving ICT sector must be a priority for a healthy, modern economy.

More than other industries, this sector benefits from foreign talent. Australian businesses have made extensive use of the 457 visa in order to bring the most talented workers into the country. Occupations like developer/programmer, ICT business analyst, software engineer and ICT project manager are consistently among the occupations with the most 457 visa grants, jointly accounting for more than 12% of the total number of 457 visas granted (DIBP, 2017). Therefore, a liberal visa regime for this sector is important in times when ICT skills are not sufficiently available domestically.

Consultations with businesses from the ICT sector revealed a group of successful firms in this field that do not feel restricted by horizontal barriers to services trade mentioned by firms in other sectors. Whether in the area of app development, business intelligence or digital transformation, these firms find it easy to offer their services to clients worldwide through cross-border trade in digital services and occasional business visits to their most important markets.

The relative ease with which Australian ICT business participate in digital trade also results from Australia's progressive inclusion of digital trade aspects in its most recent FTAs. For example, under the Peru-Australia FTA (PAFTA), Australia and Peru guarantee the free flow of data across borders and are committed not to impose any localisation requirements on data. Requirements on the transfer of technology or other proprietary information, like source codes, as well as customs duties on electronically transmitted content are ruled out by this agreement. In order to facilitate consumer access to digital services, the agreement establishes rules that allow smaller firms to compete with dominant providers in the telecommunications sector, using technologies like co-location, interconnection or resale of services.

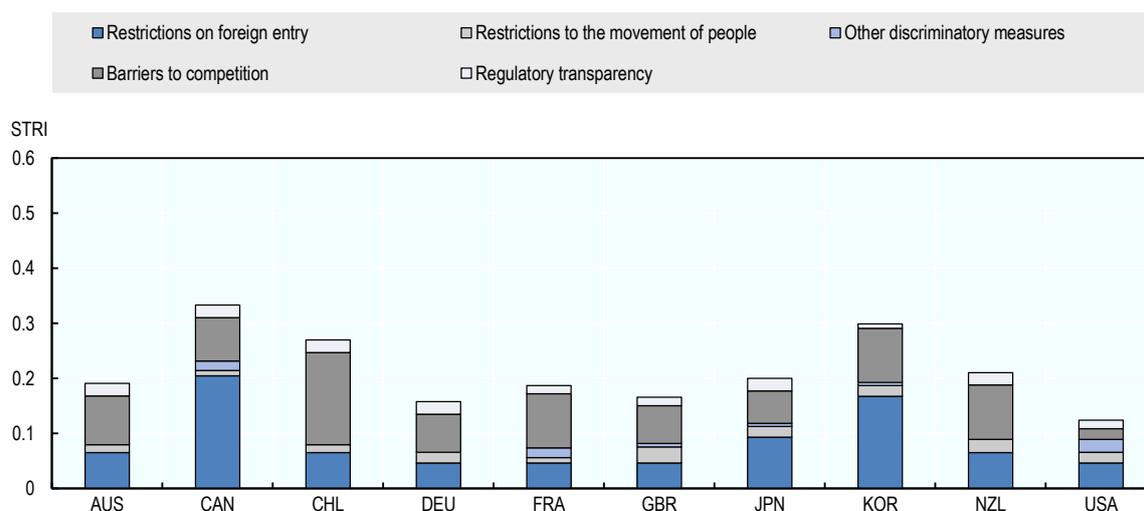
Nevertheless, some ICT businesses expect more support from the Australian Government than they currently receive. Larger ICT businesses mentioned the importance of long-term public procurement contracts for attracting multinational enterprises to establish a commercial presence in Australia. In those MNEs, subsidiaries from different countries often compete against each other in order to attract new business functions to the country. Inward foreign direct investment of this type may help to create a significant number of well-paid jobs in the Australian economy. While public procurement contracts should, in general, be given to the bidder offering the best terms, including second-tier considerations like job creation in public procurement contracts can help to make commercial establishment a viable option for international businesses and secure more inward FDI. On a different front, several ICT interviewees mentioned the existence of national award programs for successful businesses. The main motive for such programs is not monetary reward but the resulting national and international attention and the associated gain in reputation. These programs do exist in Australia, yet businesses feel that their profile is too low and that the awards do not promote innovative Australian businesses adequately. Moreover, businesses mentioned that the selection criteria for export awards are often targeted towards manufacturing firms and do not reflect the reality of services businesses, for which concepts like productivity are much more difficult to measure. Consequently, services businesses feel excluded from these award schemes and suggest a revision of the selection criteria to facilitate an equal treatment of firms in different sectors of the economy.

### Sector specific regulation: Telecommunication

*Telecommunication services* comprise voice and data transmission over fixed and mobile networks. Telecommunications are at the core of the information society and provide the network over which other digitized products are traded. Australia's score on the STRI in telecommunication services compared to some of its international peers is presented in Figure 2.6.

Australia's score mainly reflects restrictions on foreign entry and barriers to competition. Most of the restrictions on foreign entry are attributable to the general regulation related to investment screening, restrictions on board members and acquisition of land. In addition, the National Broadband Network (NBN) Corporation, a statutory state-owned wholesale only broadband network, has a strong market position in wholesale broadband services supply. Several of the other countries also have significant restrictions on foreign entry. Canada and Korea cap foreign equity at 20% and 49% respectively; the United States limits ownership by foreign entities in a common carrier radio station licensee to 20%; Japan and New Zealand limit foreign equity participation in a state-owned supplier and all the countries included in the chart, except Chile, screen foreign investment in telecommunications.

Barriers to competition reflect the extent to which best practice pro-competitive regulation is in place. In cases where one supplier or several suppliers jointly have significant non-transitional market power regulated access to the incumbent's network may be necessary. The purpose of such regulation is to lower barriers to entry for newcomers. Imposing similar access regulation on small and new companies could be overly burdensome for them and offset the pro-competitive effect of access regulation. Symmetric access regulation on the NBN and small entrants contribute to Australia's STRI results in this sector.

**Figure Error! No text of specified style in document..1. STRI Telecommunication services**

Source: OECD STRI database, 2017.

**Table Error! No text of specified style in document..1. Australia's regional revealed comparative advantage, 2015**

Vis-à-vis OECD countries

	World	Asia & Oceania	Europe	Americas	Africa
Agriculture and food (HS Chapter 1-24)	2.0	6.1	0.3	1.5	1.1
Mineral and fuel (HS Chapter 25-27)	6.9	21.3	0.5	0.4	0.2
Manufacturing (HS Chapter 28-97)	0.4	1.1	0.1	0.2	0.3
SERVICES	0.8	2.6	0.3	0.6	0.5
Maintenance and repair services n.i.e.	0.1	0.2	0.0	0.0	0.0
Transport	0.5	1.6	0.2	0.4	0.3
Travel	2.1	6.8	0.8	1.3	2.2
Construction	0.1	0.2	0.1	1.2	0.2
Insurance and pension services	0.2	2.6	0.0	0.0	0.1
Financial services	0.4	1.7	0.3	0.5	0.9
Charges for the use of intellectual property n.i.e	0.1	0.1	0.1	0.2	0.1
Telecommunications, computer, and information	0.4	1.1	0.2	1.0	0.1
Other business services	0.5	2.7	0.2	1.4	0.4
Personal, cultural, and recreational services	1.3	14.2	0.5	1.4	1.3

Note: Some OECD countries are not included in the calculations due to missing data. Hence, resulting RCAs might be inflated. Numbers should be considered as upper bound for Australia's revealed comparative advantage.

Source: Own calculations using OECD International Trade in Services Statistics by Partner Country (ITSS), EBOPS 2010, for services trade and World Integrated Trade Solution (WITS) by WTO, UNCTAD, ITC, UNSD and World Bank for goods trade.