

CHAPTER ONE

INTRODUCTION

Background to the inquiry

1.1 Australia's trade in services has grown strongly during the 1980s and 1990s. Trade in services accounted for 20.5 per cent of total trade in 1984-85. By 1995-96 this had increased to 22.7 per cent. Exports of services have grown at almost double the rate of service imports.¹

1.2 In 1994-95 service exports were valued at \$20.4 billion² and in real terms contributed 21.3 per cent to total exports of goods and services.³ The percentage increases to some 40 per cent when embedded services (ie, those bundled in with goods) are taken into account. In 1994-95 the deficit in Australia's services account was \$749 million, or 1.8 per cent of total trade in services. In comparison, in 1984-85 there was a deficit of \$3,734 million, or 24.2 per cent of total trade in service. For 1995-96 Australia had a services deficit of A\$101 million.⁴

1.3 The service sector makes a critical contribution to the domestic economy and economic development. Services directly comprise some 70 per cent of GDP and employ more than 70 per cent of the workforce.⁵ Continued employment growth is predicted in service industries.⁶

1.4 While the Committee and many others applaud these international trade achievements by the service sector, there is little room for complacency. The *Intelligent Exports: "...and the silent revolution in services"* report⁷ launched in September 1994 by the then Prime Minister, and jointly commissioned by the government and private sector, revealed that only a small percentage (1.2 per cent) of Australian service companies export. This represents only about 5 per cent of Australia's total service capability.⁸ The report noted:

The proportion of services exported does not compare well with some of our key competitors. For example, Singapore exports 69% of its services, Hong Kong 19%, the Netherlands 17%, France and the UK 10% and New Zealand and Germany 9%.

-
- 1 Department of Foreign Affairs and Trade, 1995, *Trade in Services Australia 1994-95*, Canberra, Trade Analysis Branch, p. 1; and DFAT, Submission, p. S892.
 - 2 Unless otherwise specified, all dollars are in Australian dollars.
 - 3 DFAT, *Trade in Services Australia 1994-95*, op.cit. p. 2.
 - 4 ibid. p.1.
 - 5 ibid. pp. 1, 13-14 & 73.
 - 6 Department of Employment, Education and Training, November 1995, *Australia's Workforce 2005: Jobs in the future*, Canberra, AGPS.
 - 7 *Intelligent Exports: "...and the silent revolution in services"*, report by the LEK partnership to a Steering Committee of 10 organisations convened by Austrade, Australian Trade Commission, 1994.
 - 8 ibid. pp. 15 & 40-41.

Australia's service export proportion rate equals Canada's (5%), and is slightly ahead of the United States (4%) and more than double that of Japan (2%).⁹

1.5 By comparison with many of these economies, the potential for improving Australia's export performance is significant. The *Intelligent Exports* report revealed business's high expectations for growth, with service exports likely to create some 109,000 jobs and \$18 billion in extra revenue to 1998.¹⁰ Paralleling this is the push for Australia to become a pre-eminent regional service centre based on competitiveness, technology, skill and creativity. The Australian Coalition of Service Industries (ACSI) stressed that 'There has been an explosion of interest in attracting international business to locate regional services centres in Australia'.¹¹

1.6 As the above figures reveal the importance of the service sector in the world trade market is not a new issue. '...Transportation and travel for example, have always been important economic activities. What is new is the rapid expansion of international service transactions over the last decade and the advent of new modes of supply, as in the case of services transmitted over electronic networks...'.¹²

1.7 However, as the Department of Foreign Affairs and Trade (DFAT) pointed out, service's:

...contribution to the emergence of an efficient economy has been given full recognition only recently. The decision in 1986 to negotiate for the first time towards a multilateral framework agreement on trade in services ...[General Agreement on Trade in Services - GATS]... underlined the importance of this sector of economic activity.¹³

The GATS spurred substantial interest and research in services in Australia.

1.8 The *Intelligent Exports* report was an important study. The principal achievements of that report were to bring service export issues to a wider audience, heighten the profile of the service sector, improve the understanding of the structure and performance of services and create a data base on some 8000, and in more detail some 1300, service exporters. However, while the report was a catalyst for some good activity, the work was disappointing in that it was not sufficiently strategic nor demand driven. In addition, its results can only be taken as indicative, being largely based on a once-off, small survey. The Australian Bureau of Statistics (ABS) found respondents had difficulties with the definitions of goods trade and services trade and not all of those included in the survey were involved in services.¹⁴

1.9 The Committee, aware of the importance of the service sector to the Australian economy, particularly its potential to enhance Australia's export performance, deferred

9 ibid. p. 40.

10 ibid. p. 14.

11 ACSI, Submission, p. S714.

12 Hoekman, B and Primo Braga, C A, July 1995, 'Trade in services, the GATS and Asia'. Paper presented to the *International Trade in Services Conference, Brisbane, 12-13 July 1995*, Unpublished, p. 3.

13 DFAT, Submission, p. S209.

14 ABS, Transcript, 13 June 1995, pp. 363-364.

seeking a formal reference on the subject until the *Intelligent Exports* report was released in late 1994. Believing that the service sector was still not well understood by many in government and business, the Committee felt it could play a useful role in not only improving understanding generally of the service sector, but in highlighting the role of Australia in 'clever exports' to Asia and beyond.

Scope of the inquiry

1.10 On 15 November 1994 (37th Parliament) the then Minister for Trade, Senator the Hon Bob McMullan referred the reference into the implications of Australia's exports of services to Indonesia and Hong Kong to the Joint Standing Committee on Foreign Affairs Defence and Trade for investigation and report. The inquiry was re-referred on 16 July 1996 (38th Parliament) by the Minister for Trade, the Hon Tim Fischer, MP. The terms of reference of the inquiry were the same in both instances and are set out on page xiii.

1.11 In seeking the reference the Committee chose the Indonesian and Hong Kong markets for investigation for a number of reasons. Both markets have strong growth rates in the service sector and are attractive markets for Australian exporters. These two markets provide a contrasting challenge for Australian businesses in service exports. The Committee also felt that there may be lessons that could be learnt from the Hong Kong experience which could assist Australian exporters to Indonesia.

1.12 Hong Kong is a mature service market with services being the fastest growing sector of the economy, accounting for 83 per cent of its GDP in 1995.¹⁵ In looking at Hong Kong, to a large extent, one is also looking at China since a substantial part of Hong Kong's trade is entrepôt trade. The transition to Chinese sovereignty of Hong Kong in July 1997 also places Hong Kong in an entirely different context in terms of its relationship with China. There are also important links between Hong Kong and Taiwanese service trade. However, little evidence was sought nor received on this matter.

1.13 Indonesia is an emerging service market. While its service sector is experiencing strong growth, Indonesia is a net service-importing country. The potential for service exports to Indonesia from Australia is significant. More generally, Indonesia is recognised as one of Australia's most important trading partners.¹⁶

1.14 The *Intelligent Exports* report noted that the service exporters surveyed anticipate '...that by 1997-98, China and Indonesia will...become the most important new markets for their services'.¹⁷

1.15 From the outset of the inquiry the Committee recognised the importance of its definition of services to its work. It also noted the absence of an agreed definition of services both nationally and internationally. Some debate on the issue of definition was provided by the Department of Industry Science and Technology (DIST) and the Australian Chamber of Commerce and Industry (ACCI);¹⁸ in publications such as *Liberalizing international*

15 DFAT, *Country Economic Brief: Hong Kong*, June 1996, p. 21.

16 An additional factor for looking at Indonesia was that in 1993 the Committee had presented a major report, *Australia's relations with Indonesia*, and therefore had considerable subject knowledge on which to build.

17 *Intelligent Exports*, op.cit. p. 39.

18 ACCI, Transcript, 6 April 1995, pp. 82-84; DIST, Submission, pp. S486-S488.

transactions in services: A handbook by the United Nations and World Bank;¹⁹ and under the GATS.²⁰ Some less helpful definitions are highlighted by Don Mercer in his opening address to the *International Trade in Services Conference*. He noted:

...Adam Smith described services as, "things which perish the very instant of their performance". In 1985, the Bank of England contributed the view that services are, "anything that can be bought or sold which changes the mental or physical condition of the consumer"...Karl Marx's description of services as the, "unproductive labour of lawyers, clergyman, and men of letters of all kind"...

The Northern Territory Exporters Council (NTEC) reminded the Committee that a definition some economists suggest is '...it really is anything that you cannot drop on your foot. It is a wide range of items essentially that are not goods'.²²

1.16 The GATS negotiators agreed on a definition of trade in services based on four modes of delivery:

- cross border supply (eg accountancy services delivered via telecommunications networks);
- consumption abroad (eg tourism and education);
- commercial presence (eg subsidiary/branch of a bank in another country); and
- presence of natural persons (eg delivery of engineering services in another country).²³

1.17 ABS pointed out the difficulties in defining services and noted that it defines them as:

...everything other than goods, income and unrequited transfers - according to the international statistical standards. It is very much a residual category. We do not try to identify any services that might be bundled in with goods; they are covered in our merchandise trade statistics.²⁴

1.18 The Committee took a very broad definition of services including those conducted both onshore (eg, education and tourism) as well as offshore, and likewise embedded services as well as those traded in their own right. The Committee also recognised the very substantial 'knowledge' component of much of the manufacturing, agricultural and mining sector's work and with rising living standards, the increasing importance of the health, education and finance sectors.

19 United Nations Conference on Trade and Development, Programme on Transnational Corporations in association with The World Bank, International Economics Department. 1994. *Liberalizing international transactions in services: A handbook*. New York and Geneva, United Nations, pp. 1-3.

20 DFAT, Submission, p. S218.

21 Mercer, D, CEO ANZ Banking Group Limited, July 1995, 'Meeting Australia's potential in the export of services'. Keynote Speech to the *International Trade in Services Conference, Brisbane, 12-13 July 1995*, Unpublished, pp. 1-2.

22 NTEC, Transcript, 31 July 1995, p. 577.

23 DFAT, Submission, p. S218.

24 ABS, Transcript, 13 June 1995, p. 369.

1.19 There is a substantial and expanding volume of literature on Australian services as well as the consideration of services as part of general trade research. Since 1991 several reviews and reports on service industries have been prepared by the Industry Commission. Between 1990 and 1993 ACSI and the predecessors of DIST jointly sponsored the Service Industries Research Program which produced 15 policy oriented reports on services. Several State and Territory Governments, including Tasmania, Western Australia and the Northern Territory, have undertaken surveys of their services area.²⁵ The industry associations now are very active in this field with some of the most prominent players, such as the ACSI, the ACCI, the International Legal Services Advisory Council (ILSAC) and Austmine producing important reports.²⁶

1.20 There is also an expanding literature on particular services issues such as the work done on international benchmarking by the Bureau of Industry Economics;²⁷ DFAT's report on Asia's perceptions of Australia's capabilities²⁸ and its extensive and ongoing work on the GATS; the Karpin report on Australia's management skills;²⁹ and the Australia China Chamber of Commerce and Industry Limited report on Australian executives in China.³⁰ University research projects are also picking up some of this work, for example, research on direct investment in Indonesia by Ms Heij, a Research Fellow at Murdoch University, and work by a student at Curtin University on the marketing of education services overseas.³¹

1.21 Having surveyed the service sector at large, the Committee gave its attention to more specific issues which need to be addressed in more detail. The Committee decided also to focus its attention less on the present, and to look to the future and opportunities for action to promote the development of Australia's service exports.

1.22 In referring the subject in the 37th Parliament the Minister for Trade noted the Committee's intention to refine the focus of its work as the study progressed and suggested that the Committee give greatest attention to those service areas which have not been the subject of extensive study in the past. Accordingly, in June 1995 following the first round of public hearings, the Committee reviewed the issues emerging from the inquiry and decided to focus most of its attention on business and professional services. Education services were also included because of their significant contribution to exports in the two markets investigated. Although tourism is Australia's largest export earner, accounting for over half of Australia's service exports, the Committee decided not to examine tourism in depth. This was because of the extensive work already undertaken in this area and because, at present, relative to the export of other services, there appear to be no fundamental business barriers to the further development of tourism exports. The expansion of the tourism sector is dependent also on the bilateral negotiation of air services, marketing and a range of other factors.

25 Tasmanian Government, Submission, pp. S377-S379; WA Government, Submission, pp. S381-S468; and NT Government, Submission, pp. S562-S575.

26 See Appendix 3 for details of the documents provided by those industry associations.

27 Bureau of Industry Economics, Nov 1995, *International benchmarking: Overview 1995*, Canberra, AGPS.

28 Market Australia, Department of Foreign Affairs and Trade, 1995, *Australia through the eyes of Asia: Adding innovation*, Canberra, AGPS.

29 *Enterprising nation: Renewing Australia's managers to meet the challenges of the Asia-Pacific century: Executive summary*, April 1995, Report of the Industry Task Force on Leadership and Management Skills, Canberra, AGPS.

30 Blackman, C, Asian Studies Unit, University of Ballarat. nd, *Australian executives in China: The management challenge: A survey report*. Presented by the Australia China Chamber of Commerce and Industry Limited, Unpublished.

31 Heij, Transcript, 12 July 1995, pp. 530-544; and Heij, Submission, pp. S102-S110.

1.23 The Committee found difficulty in identifying the current situation on service exports. Much of the available data on service exports was out of date and this was a factor in determining which service areas the Committee examined during the course of the inquiry.

1.24 It is obvious that the nature of the inquiry demanded substantial input from service exporters to Indonesia and Hong Kong. The *Intelligent Exports* report revealed that while most service exporters are small to medium in size, 'About 90% of services export revenue is generated by just 23% of exporting enterprises and organisations classified as medium and larger companies'.³² Because the input the Committee received was mainly from small to medium size exporters that grouping also became a focus of the Committee's inquiry. The substantial contributions from many small to medium businesses was greatly appreciated. However, the Committee was disappointed by the low participation level of many large businesses operating in those markets. The Committee noted, however, that with larger companies, services are predominantly embedded, whereas for smaller sized businesses, the service exports are more easily identified.

1.25 An outline of the conduct of the inquiry is included at Appendix 1.

Structure of the report

1.26 The remainder of the report is structured to reflect the major domestic and external issues arising from the inquiry. Chapter 2 examines the framework for global service trade and Australia's place within it. The success of Australian service exporters depends as much on what goes on in our domestic environment as in the target country for our exports. Accordingly, Chapters 3 and 4 look at the domestic commercial environment for service exporters, firstly in regard to taxation, and then more widely by examining visas, financing and other matters. Chapters 5 and 6 discuss Australia's service exports to Hong Kong and Indonesia respectively.

1.27 With the change of government following the March 1996 election, a number of government departments have been renamed. For instance, the Department of Employment, Education and Training (DEET) is now known as the Department of Employment, Education, Training and Youth Affairs (DEETYA). As the evidence to the inquiry spans the 37th and 38th Parliaments, the departmental name at the time the evidence was given is used throughout the report.

32 *Intelligent Exports*, op.cit. p. 14.

