Australian Government
Department of Industry, Innovation and Science

Office of the Chief Economist

Australian Industry Report 2015

The *Australian Industry Report 2015* is the second report in this series to be released by the Department of Industry, Innovation and Science's Office of the Chief Economist.

Last year, the *Australian Industry Report 2014* told the story of how the economy was responding to structural change — particularly as the mining investment boom was coming to an end — and where the economy was heading in the future.

This year's report continues that narrative. The mining investment boom, which buoyed the economy throughout most of this millennium, has all but passed and the resources sector is shifting its focus to production.

The economy is in a state of transition, and how this transition will unfold is unclear.

While 2014–15 marks the 24th year of consecutive economic growth, growth is slowing and is now a full percentage point below its long-run average. Productivity remains a concern. Global market, demographic and technological forces continue to challenge Australia's competitiveness.

Australia's future economic prosperity requires an environment that supports resilience and adaptiveness and facilitates innovation and entrepreneurship. The *Australian Industry Report 2015* takes a look at some core facets of that environment. Specifically, the report examines:

- the role and importance of enabling services
- how regulatory settings impact on firm performance
- the role of research and development (R&D) in securing long-run economic growth

The Australian economy will benefit from a greater diversification in the drivers of growth. An effective and competitive enabling services sector, appropriate regulation and increased R&D are all key contributors to realising that objective.

Australia faces challenges in establishing new drivers of economic growth

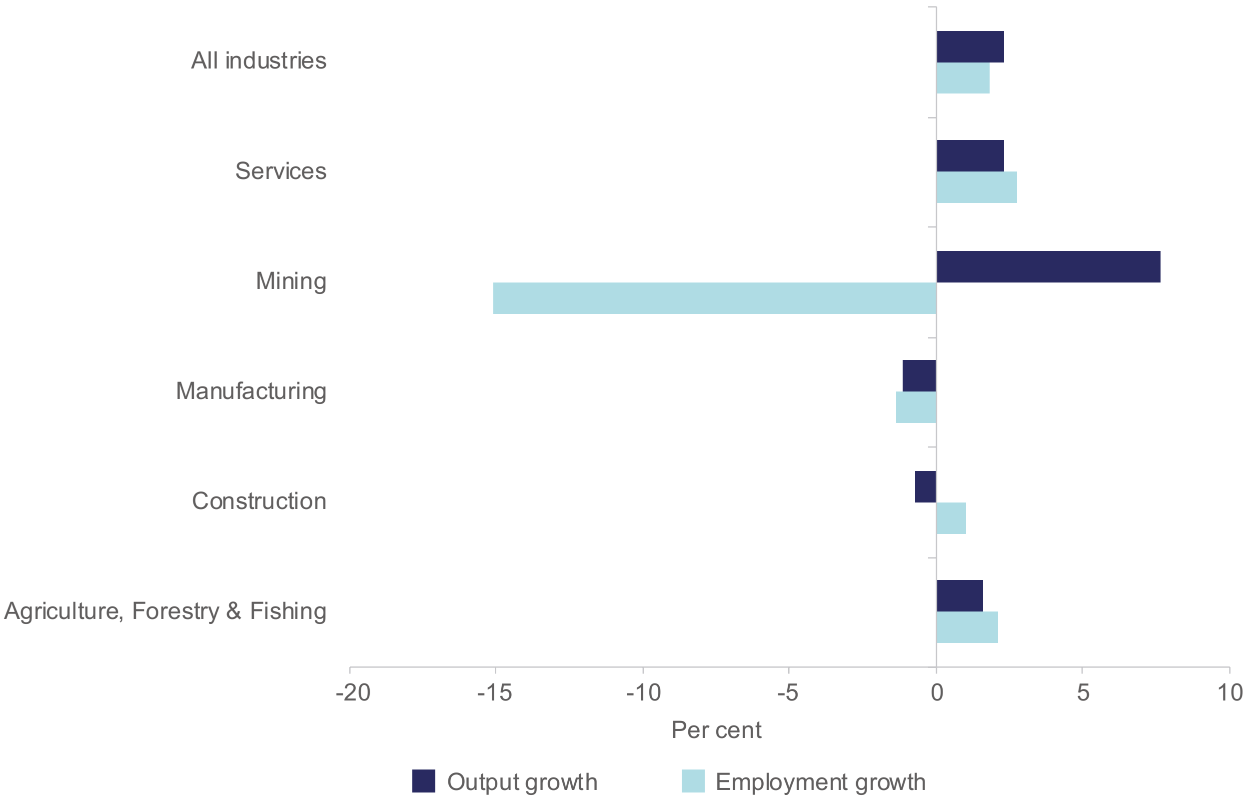
Chapter 1 of the *Australian Industry Report 2015* provides a snapshot of the international, domestic and sectoral developments affecting the Australian economy over the past year.

The international economy is gradually expanding, supported by record low interest rates and lower oil prices. However, global growth remains uneven. Instability in the euro area and economic volatility in China pose risks for the Australian economy. Falls in the Australian dollar over the last year will assist Australian industries increase their competitiveness in export markets in this uncertain environment.

Gross Domestic Product (GDP) grew by 2.3 per cent in 2014–15 — a result largely driven by the retreat from record levels of mining investment.

Domestically, all sectors saw an increase in output with the exception of Manufacturing and Construction. The biggest change occurred in Mining, where output grew by 7.6 per cent, but employment contracted by over 15 per cent (see Chart ES.1). Within the services sector, growth was strongest in Information, Media & Telecommunications, Accommodation & Food Services, Financial & Insurance Services and Health Care & Social Assistance.

Chart ES.1: Growth in output and employment by industry, 2014–15



Source: ABS cat. no. 5204.0, table 5; ABS cat. no. 6291.0.55.003, table 4

Notes: Original data and chain volume measures for growth in industry value added (i.e. output).
Original data and a four-quarter average are used for employment growth.

Australia needs reforms that improve productivity and reduce business costs to remain competitive. The immediate challenge is to successfully manage the transition from the commodity price boom to new and broader drivers of economic growth. While a lower Australian dollar is supporting this adjustment, business confidence and investment remain weak. Australian industry must act on opportunities, such as expanding into new areas and capitalising on the potential of emerging markets in Asia. The service sectors in particular will play an important role in ensuring that Australia remains a modern dynamic economy.

Enabling services provide vital intermediary business services

In 2014–15, the Australian economy produced services worth around $970 billion, representing approximately 60 per cent of GDP.

Only about a third of services produced in 2012–13 were sold to households. Indeed, the majority of services produced are intermediates — provided to support other businesses in the production of final products.

The enabling services are a vital part of the economy, a key requirement for businesses to get their products to market. It is highly important that this sector is competitive and productive.

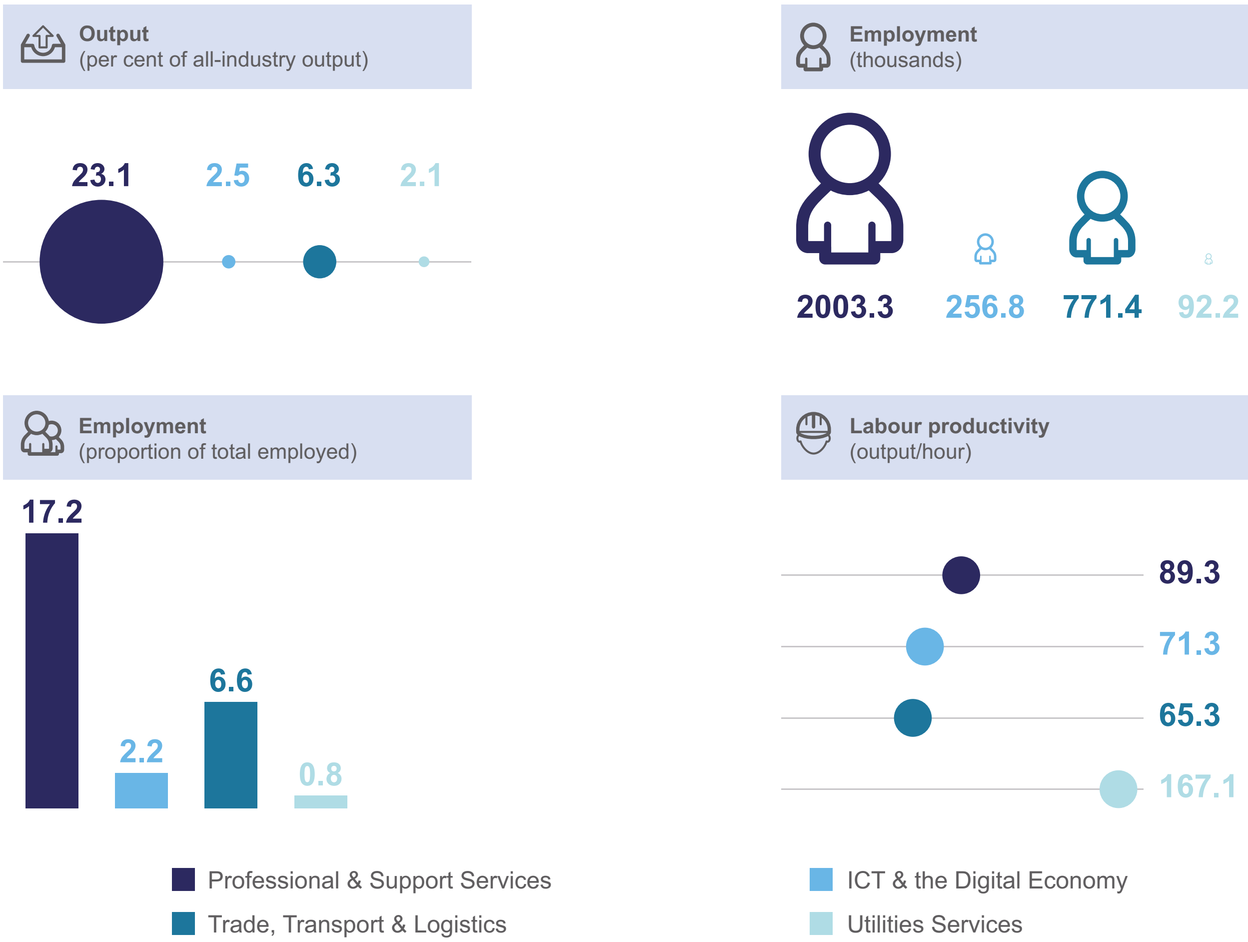
Whereas conventional methods of industry analysis typically focus on *what* is being produced, the analysis in Chapter 2 focuses on *who* the production is for. Shifting the focus to the who provides an alternative approach to examining the services sector. Chapter 2 of this report looks at services in terms of the function they offer other businesses. It shows how enabling services are used by a range of other industries and how they help those industries create their final products.

This analytical approach identified four enabling services groups:

- Professional & Support Services
- Information & Communications Technology (ICT) & the Digital Economy
- Trade, Transport & Logistics
- Utilities Services

In 2014–15, these enabling services produced approximately $465 billion of output (29 per cent of GDP) and employed approximately 3.1 million workers (27 per cent of total employed). Professional & Support Services are the largest of the four enabling services groups, employing the most people and making up around 20 per cent of GDP in 2014–15. The other three groups are much smaller, collectively producing around 9 per cent of GDP. Chart ES.2 presents some key information about each of the enabling services groups.

Chart ES.2: Enabling services groups and key statistics, 2014–15



Source: ABS cat. no. 5204.0, table 5; ABS cat. no. 5209.0.55.001, table 5; ABS cat. no. 6202.0, table 21; *ABS Census of Population and Housing 2011*; ABS Special Data Request from Labour Force Survey; and Department of Industry, Innovation and Science (2015) calculations

Note: Employment (thousands) infographic is not to scale

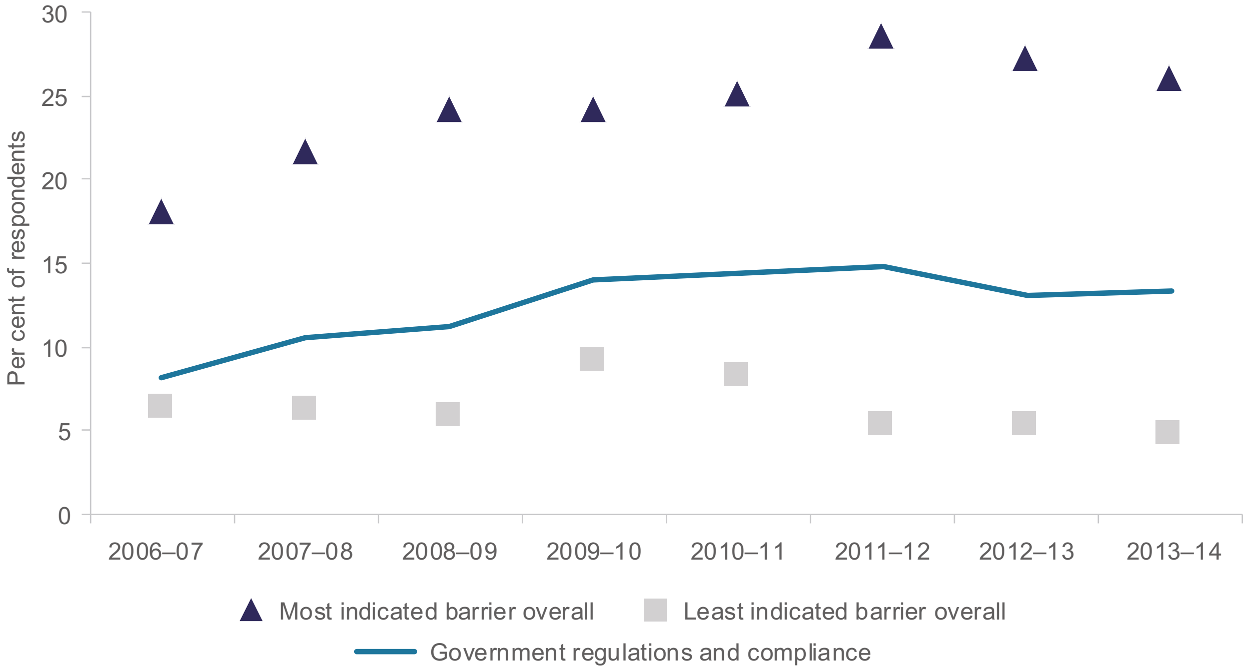
Appropriate regulation facilitates and supports sustainable economic growth

Well-designed regulation can serve to improve productivity and competitiveness within the economy, while also meeting broader social objectives. It is the role of government to ensure that these benefits are not outweighed by the costs.

Chapter 3 shows that while the benefits of regulation are widespread, it is the costs that receive a disproportionate amount of attention. Multiple business surveys indicate that the business community perceives Australia's regulatory burden as high. These perceptions do not align with the favourable rankings Australia receives on international benchmarks such as the *World Bank Doing Business Indicators* and the *OECD Product Market Regulation Index*. Nor do the surveys give us data about the economic and financial impact of regulation or isolate this impact from other effects on business activity or firm performance.

Looking past these measurement difficulties, a key finding based on the Australian Bureau of Statistics' *Business Characteristics Survey* is that regulation is only a moderate concern for firms when viewed in the context of other barriers to performance (see chart ES.3). Barriers that are cited to a greater extent include lower profit margins to remain competitive and lack of access to additional funds. The small size of Australia's underground economy provides further evidence that Australian businesses are not overly regulated.

Chart ES.3: Regulatory and other barriers to general business activities or performance, 2006–07 to 2013–14



Source: ABS cat. no. 8167.0

Notes: The least and most indicated barrier overall does not relate to government regulation and compliance.

Additional insight can be obtained from stocktake measures, such as the analysis of the Australian Business Licensing and Information Service that was conducted for this report. The findings show varying quantities of regulation across industries, though stocktakes are limited given that levels of complexity and impact are ignored.

Well-designed regulatory frameworks can have a positive impact on both the behaviour and performance of firms. While it is often argued that improvements in economic outcomes depend on deregulation, the evidence suggests there is a limit to what regulatory reform can achieve for highly deregulated economies with quality institutional frameworks.