

Appendix 1. Australia's Comparative Advantage

Introduction

Establishing proper policy foundations now, combined with public support and effective leadership, will better place Australia on a trajectory for national wellbeing. While change is challenging, the benefits of systematic reform and investment in our future to build Australia's comparative advantage will mean higher living standards, increased equity and greater sustainability.

A reform package entailing institutional change and investment could add more than 20 per cent to living standards by 2030 above trends based on current policy settings.

The interdisciplinary report by the Australian Council of Learned Academies (ACOLA), SAF01 *Australia's Comparative Advantage* (<http://acola.org.au/wp/project-1/>) explores how to build and secure Australia's future through comparative advantage. For the report, this means creating and taking advantage of Australia's strengths, and ensuring flexibility and resilience in the pursuit of this ambition. The report provides a national roadmap for decisions about the future and the conditions that can underpin achieving Australia's best.

Rating our performance

We perform strongly against other countries on a range of social measures. For example, Australia is an attractive place to live. Four state capitals are considered among the most liveable cities in the world. We rate as one of the highest on the UN's Human Development Index.

Conversely, several international assessments have found weaknesses. People believe that regulation and taxation, for example, place a high burden on business, and Australia rates poorly on competitiveness against similar advanced economies.

Various rankings rate Australia as competent at basic innovation, but weaker at the next stage of developing or commercialising those ideas.

The Australian education system rates highly at the school, tertiary and vocational stages, and is particularly good at attracting foreign students. Government education expenditure, however, is parsimonious compared to our international peers, especially in pre-school and post-school education.

Australia does well on environmental measures such as health impacts (child mortality), water and sanitation, water resources and air quality. We rank well or reasonably well on key aspects of ecosystem health such as forestry and water resources. However, we rank more poorly on biodiversity and habitat, agriculture, fisheries, climate and energy environmental measures.

Respondents to surveys for the project by the Committee for Economic Development of Australia and the Institute of Public Administration of Australia rated the ability of various industries to innovate. Highly rated were arts and recreation services, retail trade,

transport, postal service and warehousing. Rating low on innovation capability were public administration and safety, and electricity, gas, water and waste services.

There are perceived problems with leadership in industry and government, though research for the study found that we rate ourselves less highly than do overseas executives who know Australia. There is value in government and the public service improving their awareness of global and other country directions.

Sector performance and opportunities

The services sector dominates the economy. In 2013, it accounted for close to 60 per cent of Australia's GDP and for 78 per cent of employment. Education (post-school), health and financial services have the potential to drive productivity growth in all other sectors. The economic rise of Asia provides a significant opportunity for Australia to increase its net trade in the service sectors.

Agriculture is one of Australia's oldest and most important sectors, yet its relative contribution to the Australian economy has steadily declined over the past century. The decline is due in part to a long-term reduction in agricultural terms of trade and an increase in global agricultural production, but also to structural and systemic factors. The ACIL Allen report for this project identified three main ways in which Australia could expand its supply capacity: farming new areas of land; moving from low-input, low-production systems into high-input, high-production systems; and producing more from less by increasing water-use efficiency or employing innovation-based productivity.

Although the mining industry has been a leading contributor to Australia's economic growth and international impact, we do now need to adjust to reduced future reliance on mining. However, proactive policies would allow the sector to move into higher value-added downstream activities and to create value through collaboration with non-mining sectors such as manufacturing and services.

The manufacturing sector itself still plays an important role in our economy but its contribution to GDP has declined. Australia has a growing advanced manufacturing sector, which is poised to build on Australia's comparative advantages and increase its contribution to economic growth and global trade. The focus now should be on collaboration to develop an innovative workforce, and improving entrepreneurship and business management skills, especially in the formerly protected non-traded sectors.

Institutions, investment and society

The long period of sustained income, employment growth and economic resilience in recent decades has been much underpinned by a process of microeconomic reform that began in the 1980s and continued into the current century. Reform entailed substantial review of legislation, regulation and public finances to free up market operations and make the role of government more market consistent.

Australia has an experienced, educated and highly skilled population. Maintaining and enhancing strength across educational skills should be a major national priority. Investment in education and in skills training is a core principle for building comparative

advantage; it is also a key to addressing issues of equity such as Indigenous disadvantage and intergenerational poverty.

The rise of Asia is the biggest economic trend of the 21st century. This presents great opportunities for Australia; modelling shows that, in addition to resources-related business, Asia could contribute an additional \$275 billion to the Australian economy over the next 10 years. A vibrant immigration program can help underpin this and provide wider benefit, as it did in helping Australia weather the GFC better than most countries.

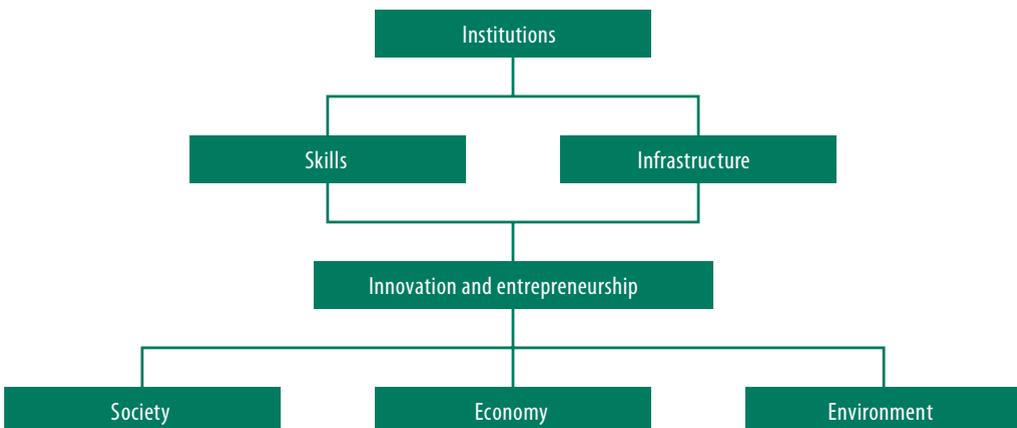
Lack of access to adequate finance is a major contributor to poor innovation outcomes in Australia, and may even be the biggest impediment to innovation in Australian firms, over 90 per cent of which are classed as small to medium-sized enterprises.

Policy directions

Change is difficult for government and society. However, change becomes easier to implement if the benefits can be shown both for the economy and for people's wider prospects and living standards.

Broad policy change and reform as well as increases in investment for the future would have real sustained benefits for the economy and society. They can stimulate private initiative and underpin all of the industry sectors that are crucial to Australia's future. These will provide the foundations for future progress.

Policy reforms require support from the public. People need to be convinced that reforms are necessary and sensible. In 2015, ACOLA commissioned a public opinion study on expenditure, tax and policy reform. All age groups and most educational levels agreed on the following priority areas for increased government spending: health, schooling and tertiary education, transport and communications, social security for seniors, and public order and safety; and were willing to see appropriate tax support.



Foundation for creating advantage.

Conclusion

Building Australia's comparative advantage will require steps that include:

1. ensuring the necessary leadership and partnerships;
2. maintaining and enhancing Australia's strengths, and guarding against emerging challenges that could undermine them;
3. complementing past strengths with opportunities, such as globalisation, Asia links and information technology advances;
4. a more effective taxation and legal system that encourages innovation and risk taking;
5. realignment by institutions, including our federation, to adapt to a changing strategic environment and 21st century imperatives; and
6. boosting investment in our capability to compete.

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