event transcript

CEDA
COMMITTEE FOR ECONOMIC DEVELOPMENT OF AUSTRALIA

Launch of the Competing from Australia Project Report

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In my talk, I'm going to give you a quick outline through the paper I have in the CEDA publication, and I guess in doing that, I'll provide I guess some supporting economic data behind the sort of discussion that we've had from both David Byers and from Graeme Kraehe. Graeme gave a very good illustration of how global supply chains operate in a number of companies that he's worked for, and particularly corporate strategy of Bluescope Steel, which is one of our leading companies in taking advantage of these new opportunities.

So basically, what I'm going to talk about is multinationals, and their global economic impact. Global supply chains are really just the other side of the coin to multinationals; they're the companies that supply multinationals. I'm going to talk about the research we've done within the department, and elsewhere over the last 7 or 8 years on the role of multinationals in the Australian economy, and also how we can better realise opportunities through global integration and through getting more Australian firms engaged in global supply chains, and I'm also going to touch on the government's policy response to this that the Prime Minister announced on the 1st May, and that's the $1.4 billion global integration industry statement.

So multinational firms dominate world trade, investment and technology flows; I guess we probably appreciate that. Foreign direct investment which I show here, is really a measure of the activity of multinationals. Foreign direct investment is about investment in overseas productive assets, and that has exploded enormously as you can see over the last 15 years. Down the bottom, we've seen world trade has tripled over this time period, world GDP has doubled, but there's been a 6-fold increase in foreign direct investment. And so when we look at how Australian investment offshore has increased enormously, it's really

increased in the context of a world-wide explosion in overseas investment by firms, and this is really reflecting the improved global conditions for foreign direct investment.

Traditionally, firms invested offshore to chase markets, and that's still very important, but also we've seen a lot of investment going offshore to seek specialist skills, centres of innovation and also of course, low cost labour, particularly in places like China and Asia broadly.

Both Graham and David talked quite a bit about global supply chains, and I will also try and give you some of the macro trends that we're seeing in global supply chains, or direct global value chains. There has been quite a bit of consolidation at the peak of a lot of the supply chains. That's because the cost of developing new products in a whole range of industries; automotive, pharmaceuticals, defence industry, aerospace and so forth, is really becoming huge, and the cost of failures are often catastrophic for firms at the peak of these supply chains. Lexus and Toyota are a big sponsor of today's event. Toyota has now sold over 1 million hybrid vehicles. None of their rivals have really been able to come up with a competitive vehicle in that product space. So this gives you an idea of the sort of...and this same sort of thing happens in pharmaceuticals, and the aerospace industry and the defence industry in chemical production. So the challenge to remain at the peak of the supply chain has become enormous for firms and the consequences of failure to keep up with that global technology leadership can also be catastrophic.

And so in response to this, what firms have been doing, is they've been trying to find partners to share the risk of new product development. And so while we've seen consolidation at the very peak of the supply chains, we've also seen the opening up of a lot of opportunities for people to be technology partners. If you take the joint Strike Fighter program, which is building the new generation aircraft for a lot of the world's defence forces, or the Boeing Dreamliner aircraft, we've seen the peak companies in those supply chains building partnerships with dozens, maybe even up to 100 companies who are actually doing innovations on sub-systems within that major product development space. And so it's in that sort of space that we're seeing a lot of opportunities for Australian firms. So the old model of vertical integration where everything is made by this one large company where you had the R and D facilities very much centred in the home country of the multinational, that sort of model has split up, and you're seeing a much more dynamic space in this, as a result of global supply chains and the sort of logic, I guess, the business logic being driven into the way modern business is being conducted.

So here I have a sort of slightly funny chart which I got from the Taiwanese, so this explains the slightly Asian looks of this chart, it's a sort of smiley-face, and it was actually

used by the chairman of Acer computer when he was talking to the president of Taiwan. And the president of Taiwan was very worried, because he'd been hearing messages from his industry department that Acer computer was going to move a lot of its computer manufacturing offshore to China. And so Stan Shih was called in to explain what was going on to the president; this was in the early 2000's. And essentially, he said to the president "What you have in the manufacturing of computers is a fairly low-grade, low-value added activity and the future for Acer computer is often this innovation, R and D design and also in the brand, and the marketing side. And that's where Acer computer want to move its resources; we want to use contract manufacturing so we can lower the cost of our PC's in the US market, and we can only do that through contract manufacturing in China".

And so I guess the message really that Acer computer, Stan Shih gave to his president, was in a fully employed economy, which Taiwan was and still is, if you want to move up the value chain, if you want to get into this higher value-added activity up here, in the sort of top end of the smile, then you have to give up something and what you need to give up in the case of Acer computer at least, and this will vary depending on what supply chain you're in, but what they wanted to give up was the low value manufacture associated with putting together PC's.

And so this diagram illustrates a lot of the elements of the supply chain, so we have the standardisation, sometimes it's a regulatory role, or liaison with government; particularly important in say the pharmaceutical industry where you get approvals, and pricings from government, then you've got the innovation, R and D design elements of the supply chain right through to this brand marketing and logistics. And I guess the big innovation in supply chain theory has really been that you don't need to do all this; you can just do bits and pieces of the supply chain and be quite a valid company. Dell and Cisco in the United States perhaps were the early exponents of this. Dell's a very interesting company, because it's never manufactured; it concentrates its effort all in this area, the brand marketing and logistics and a little bit of design. It does no R and D, it does no innovation. It purchases all its components from specialist manufacturers in those areas. All it does is organise logistics and the support of the brand to its customers. And so it's not a...we might think of Dell computers as a manufacturer, but it's not actually a manufacturer; it's a wholesaler. And so this illustrates the very changing nature of industry and indeed for us, people like myself working in industry policy, the complex nature of modern industry policy, where some of the highest value-added companies in the world operating and supplying products are no longer manufacturers.

Cisco is the most successful telecommunications company in the world, and it does manufacture and it does do R and D, but relative to its competitors, it does a lot less R and

D & innovation, and its novelty was to say “The whole space of telecommunications is just so complex, it’s impossible for us to keep track of everything. If we invest a lot in R and D, we inevitably start trying to sell this R and D to our customers, and we get focussed on what we make, and we want to be focussed on what our customers want, and then go to these people who are specialists in R and D and so forth, and get what we need for the customer”.

And so that kind of logic has driven a lot of business strategy over the last 10, 15, maybe 20 years amongst the advanced companies and it’s something at a national level we need to take into account in our policy setting. And in my report, I use the illustration of government support for the textile, clothing and footwear industry, where we put $1.3 billion over the last 10 years into supporting the textile, clothing and footwear industry, and we supported it all down this end. Our largest and most profitable clothing company is Billabong, and it operates in this space and in this space, but it doesn’t operate in Australia in that space. And as a consequence, of the $1.3 billion handed out to that particular industry, none has gone to our most successful company. So it does show that this logic, I mean we talk about global supply chains, we talk about these trends happening, they actually have a real implication for how we allocate our scarce, relatively scarce industry funds.

Alright. I just want to talk briefly about what all this means for Australia; about productivity, global integration, distance, the administrative heritage we have and also the challenge we have in Australia with SME’s. The global supply chain paradigm is in fact a major innovation in its own right, and it’s something that Australian industry needs to adopt and move to, and of course the most advanced companies in the economy have done so, but it is something that we need to do more of, and part of that paradigm is global integration. And we’ve already touched on, and Jeffrey’s given us a good overview of the history and thought about distance in Australia, but distance has been and the CEDA papers illustrate the fact that distance has been a hindrance to Australia in being as globally integrated as I think an economy of the sophistication we have in Australia should be. And I mean, I think as Professor Blainey did say, it’s certainly a puzzle when you consider the cost of transport, the improvement in telecommunications has been enormous, and so I want to touch a little bit on why that’s the case.

We have done some significant things in Australia to try and improve our global integration. We’ve probably had the most significant reduction in tariffs of any developed economy over the last 15 years. They’re now down, with the exception of the TCF industry, which is a pretty small part of the Australian economy, they’re now down to insignificant levels. So that has been a major change over the last 15 years.

However, this graph shows the trade to GDP level, and I think David put up earlier a chart saying that we were relatively low compared to the rest of the world in our trade to GDP. Now you would imagine, and I think most economists would have thought, that the massive change in tariffs would have had a very significant impact on our trade to GDP level. But in fact, you can see, we've really had not a great change at all. In fact relative to the rest of the OECD who didn't do the same level of tariff cuts, our trade to GDP level hasn't changed much. And of course, our treasury economists have analysed this quite extensively, and that was reporting my paper and elsewhere, and the reason for this they argue is distance.

Here we've got some data showing Australia's trade, GDP, foreign direct investment outwards and foreign direct investment inwards relative to the rest of the world. And so some earlier slides today have shown how this is being in absolute numbers and as a percent of the Australian economy, this is really placing us in the world context, and I think when we're talking about global integration, this is the right context for us to put ourselves in; this is how we rank and how we've changed relative to the rest of the world. Of course, you recall the earlier data I gave you which showed that foreign direct investment has increased enormously, five-fold over the last 15 years. So when we stay the same, that's in the context of a huge increase worldwide. But it is important for us to say well, how do we sit on the radar screen; where do we sit relative to the rest of the world, and that's why I give this graph.

So in terms of GDP and trade, we've bagged around 1 percent of the world's over the 25 years or so. In terms of foreign direct investment outwards, that's companies like Bluescope Steel investing in Asia, we had a rapid rise towards the end of the '80's and we've remained around 2 percent of the world ever since. So that's twice our performance on a trade basis in outwards foreign direct investment. And again, you should recall this is in the context of massively increasing worldwide investment flows. On FDI inwards, that's foreigners investing in Australia, there's been a...we were up around about the 4 percent level, and now we've sort of dropped down to somewhere around 2 to 3 percent level, so there has been a drop in foreign direct investment into Australia. And I guess that's relatively understandable; most of the foreign direct investment in this period here, an awful lot of it was associated with manufacturing in Australia. It came here because we had high tariffs and if you wanted to supply the Australian market, you needed to invest here and so a lot of companies did that.

Now that hasn't been such a driver and I think part of the challenge for us is to say well, what can be the new driver for foreign direct investment into Australia in the forthcoming

period? But the broad thing about...I suppose the broad message from this is that investment is a lot more important to Australia than trade. We do 2 to 3 times better in the world of investment than we do in the world of trade, and I guess that is a measure of distance in a way; it's easier for us to integrate with the rest of the world through the investment flows. And we need to be thinking more about using that and perhaps stretching our advantage more in that investment space than we have in the trade space, where we've tried. It doesn't mean we shouldn't keep trying in the trade space but possibly the investment space is more promising for us.

So on the administrative heritage, there's actually been a recent book put out by Professors at Melbourne University in their international business school, David Merritt and Howard Dick, which is an excellent overview of Australia's administrative heritage. We've had a domestically oriented industry in Australia; we have very few firms exporting relative to other developed countries, only a little over 4000 firms exporting more than $1 million, which is staggeringly low on a world basis. Australian firms were slow to globalise, and there weren't many until the last 1980's, and when we first did so, we had a whole string of failures. And Professor Howard Dick really say that was a sort of...we had to try it and do a bit of learning by doing, and learn from our failures. But we certainly did have failures. I think now, and certainly Graeme Kraehe's presentation illustrated that, there were also a whole string of successes. And I think underlying a lot of the successes is a much better understanding of where Australia's competitive strengths lie, and much better understanding of the role of intellectual capital, the critical nature of that for competitiveness.

A lot of these firms are more in specific niches; so they're taking advantages of the niches developed in global supply chains. So if we look at some of these firms; like Fisher Technology supplies 20% of the world's steering technology. They don't manufacture much of that, although increasingly they are beginning to look at manufacturing in places like China. Bluescope Steel we've heard from. Animal logic is the special effects production house that did the special effects in Happy Feet, 300, the big beer ad. SG Analytical Science is a Melbourne company which provides components for all of the world's mass spectrometers and Billabong we've already discussed. So these are firms that are making sophisticated use of the new advantages available through global supply chains.

Consulting engineering is quite an engineering cluster within Australia. We have 5 firms in the world top 100, and last year, we had $2.2 billion in overseas earnings from those consulting engineering firms, which is really quite a success story. 80 percent of that is from subsidiary sales, so export is a relatively small part of this success. And to give you just an example of this, this is Arab Australia, which is the local subsidiary of the UK

engineering firm, and some Sydney architects have been responsible for this blue cube, which is the national swimming centre for the Beijing Olympics. And so that's a good example of an Australian firm linking in with a multinational; a 100 percent Australian firm, a multinational with substantial activity in Australia linking into some major global opportunities.

We had a discussion about how Australia's doing better in getting income from overseas, and so while over the last 10 years or so there hasn't been a great increase in the amount of Australian...while as a proportion of the world we haven't changed much in the amount of offshore investment, we're certainly getting a lot more income from it. And in my paper I state that this would be a third in the offshore earnings, a third in the list of exports after iron-ore and coal, ahead of automotive, ahead of wine, some of those other famous industries. So earning money from offshore subsidiaries is big business for Australian firms.

There's a whole range of blockers to accessing global supply chains for SME's, and I go into them in a reasonable amount of detail in the paper, and I suggest perhaps you might like to read that. I want to talk briefly about the government's industry statement, which the Prime Minister launched in May. It's $1.4 billion over 10 years. It's got 5 major initiatives; a global opportunities program to help Australian firms access global supply chains, the Australian industry productivity centres to help lift the capabilities so that we can have more than 4000 firms actively engaged in global business, and some changes to the R and D tax concession to EFIC, Austrade and CSIRO, also to better support Australia's global integration.

The productivity centre initiative has got $170 million over 5 years, and essentially involves running a diagnostic over firms to help them address blockers to their global integration. Those of us who've been working with a lot of small firms often see really strong capabilities to work in global business, but also some things which would also simply knock them out of the race. We've seen this in working with Australian industry on the joint Strike Fighter and the Dreamliner programs, where we've done this sort of activity quite a bit.

The global opportunities program puts $122 million over 5 years to facilitate access to global supply chains, and also to encourage reinvestment by multinationals into Australia. Perhaps where a multinational has had a large manufacturing focus and is looking to perhaps downsize it, we want to try and build up say a research focus in that activity.

Another major change has been to the R and D tax concession. Until this was announced, if a multinational undertook research Australia for global markets, they couldn't claim the tad concession. Now that was a sort of bit of protectionist heritage. As I was talking to Professor Blainey before, it was a bit like when we had rules that stopped people from exporting iron-ore unless they processed it in Australia. So we had a rule that said unless you've processed your R and D in Australia, you couldn't export it. Naturally enough, this didn't encourage multinationals to do research in Australia, and we've now got rid of that rule, and the treasury analysts argue that this will encourage an extra $1 billion worth of R and D from multinationals into Australia.

So just in conclusion, there are new challenges as a result of these changes in global supply chains; certainly domestic suppliers are being cut out of jobs which they traditionally won in Australia, but equally there are opportunities globally for capable Australian firms. Most of this is really up to firms to deal with. In Australia there is a lot of discussion about industry policy measures, but it's important to put them in perspective. We have a $1 trillion economy; the total amount spent on industry policy measures is less than $10 billion, so it's less than 1 percent of the total economy. So it's not distortionary; it's not intended to be distortionary, and increasingly we've got to focus in directing industry policy measures in co-investment with groups of firms. So we're looking to industry to set the direction for this money, so that we can address impediments that they have in accessing global opportunities. That's the new focus; it's not about protection from overseas, it's about how you can integrate Australian firms, how you can raise the capabilities of existing Australian firms to tackle these opportunities. And it has been, I think the government statement is really a new phase in Australian industry policy, and the work that CEDA has done over quite a number of years now in global supply chains and integrating with the global economy, I think has been very helpful to the government in making this policy shift.

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