



6. Best practice in the global economy

Dynamic and indirect effects of an FTA

The direct gains of trade liberalisation and the benefits of economy of scale were considered in the previous chapter. These advantages are enhanced by other dynamic and indirect benefits. Measuring the dynamic benefits of trade liberalisation is a challenge. Although attempts may be made using dynamic modelling that takes account of the interdependence of nations, impacts such as the influence of best practice remain in the realm of the anecdotal.

However they are calculated, the benefits are distinct. They derive from more robust competition and absorption of best practice in both policy and business management. They can be deduced from those aspects of a business and economic relationship in which there is already a notable strength. In this chapter, the benefits of greater competition, and the benefits for adaptation to the Information Economy, for business culture and pursuit of sound policy are considered.

The enhancement of competition

Improved competition should be one of the longer-term benefits of a closer relationship with the US. The removal of trade barriers brings an immediate improvement in competition in the markets affected. The effects of increased competition are lower prices to consumers and improved productivity.

In addition to the direct stimulus to competition resulting from the greater price competitiveness of trade resulting from liberalisation, the presence of an agreement should encourage greater market entry by companies from many industries into each others' domains with resulting heightened competition. Although that competition can bring discomfort to incumbents that may have hitherto enjoyed some margin of protection, the benefits are felt throughout the economy.

The hallmark of US markets is their competitiveness. Infrastructure is highly advanced, so there are few internal markets protected by the kind of geographic boundaries that have rendered Australian capital city markets prone to oligopoly. The level of competition in the United States has encouraged firms to focus tightly on their points of maximum strength, an attribute that has assisted their global expansion.

Many of the Australian firms that went to the United States in the wake of the dismantling of exchange controls in the mid-eighties believed that with strength of management they could turn around assets bought cheaply in America, only to find that the problems were more intractable. Industry over-capacity, cut-throat competition and an unequal relationship with customers made a turn-around impossible, even with the highest calibre management. The margins that Australian businesses expected had never prevailed in the US. The Australian companies that have performed in the US have done so with careful appraisal of markets and by matching US practice.

The competitiveness of US markets gives US firms some advantage when they enter international markets. A.T. Kearney finds that Australia is the fourth most desirable destination for foreign investment by US multinationals, and the most favourably viewed destination in the Asia Pacific Region.¹ However, these preferences do not flow through to actual investment because of the restraints posed by market size and remoteness. To the extent that an FTA encourages US firms to see Australia as a natural extension of the US market, it will bring more US entrants to Australian markets.

The effects of this will vary greatly from one market to the next. There is no greater guarantee that US firms entering Australia will find success than there is for Australian business moving to the US. The Australian funeral parlour industry is an example where US entrants believed they could bring greater efficiency benefits but found the synergies in their global model were not effective. On the other hand, one US entrant has made a significant difference in the level of competition in the event management business.

The United States, like Australia, has a highly developed competition policy regime. There are sufficient examples in the recent history of both administrations to provide reassurance that easier access to markets will not be used in an uncompetitive manner. The Australian Competition and Consumer Commission, for example, was instrumental in curtailing the scope of a proposed merger of Coca Cola and Cadbury Schweppes world-wide.

The power of best practice

Companies learn from each other as much as they draw from the lessons of their own experience. They observe their competitors, suppliers and customers and modify their own strategies to keep abreast of the latest developments. The growth of trade and investment therefore amplifies the opportunities for businesses to raise their productivity and hence profitability. The impact of this process may already be seen in Australia's relationship with the US through the prisms of its adoption of information

1 AT Kearney, *Foreign Direct Investment Survey*, 2001

technology as a business tool and of management techniques more generally. In both areas, it is a process smoothed by Australia's cultural affinity with the US.

Learning from best practice also takes place at the level of government. It has been noted in both Europe and other regions that a process of economic integration between nations can generate a 'policy reform effect' that can enhance the benefits of the process both for internal participants and for businesses from third countries. For example, if a country's competition policy were strengthened by regional integration, it would in turn enable companies outside the area to gain profits within the area so long as a principle of non-discrimination were maintained.

Best practice: the use of technology

The structural changes taking place in technology-intensive industries including those occurring in telecommunications and biotechnology, the Internet, information and communications technology (ICT), and the development of knowledge-intensive industries, are having a profound effect on both the US and Australian economies. The US is leading global change in these areas. Australia is one of the handful of countries where change is occurring at a similar rate.

It is apparent that Australia is tracking closely trends in the US and is among a select group of countries that are similarly following suit. These countries have identified themselves as contenders for economic leadership in the New Economy.²

On the other hand, it is clear that in a number of areas that are key to the New Economy, Australia's position is mid-pack rather than at the forefront. Increasingly the New Economy indicators, such as cost of leased lines and ease of access to the Internet, will be the basemarks for competitiveness in the New Economy.

If Australia is to seize New Economy opportunities in an era of rapid globalisation, it will not be sufficient for Australia to be a middle-ranking competitor in the world economy. Customers are increasingly sourcing products and services globally, making it increasingly necessary to be a world leader with innovative, best-practice technologies, production processes, products and services.

Despite the recent sharp slowdown in growth in the US economy (from an annual rate of nearly 5 per cent in 1999–2000 to a current rate of just over 1 per cent), it is at the

2 The term 'New Economy' is used in this paper in a broad sense to refer to the combined impact on national economies resulting from:

- ┆ globalisation
- ┆ developments in Information, Communications Technologies (ICT) including technological and commercial 'Convergence' of telecommunications, broadcasting and information technology
- ┆ application of ICT to 'old economy' sectors/industries including information intensive industries (such as financial services)
- ┆ developments in so-called 'knowledge-based' industries, including biotechnology
- ┆ growth of services as a percentage of GDP and trade.

forefront of developments in the New Economy. The US is still the world leader in many of the technologies that are impacting dramatically on the world economy, including health, biotechnology, financial services and IT. Moreover, the US possesses the sort of characteristics crucial for success in the New Economy, notably entrepreneurship and innovativeness. The US is likely to remain the global leader of the New Economy.

It is generally accepted that these increases in US productivity, growth potential and growth itself are linked and are explained principally by the surge in investment in ICT.

The US Council of Economic Advisers has estimated that, of the 1.6 per cent annual acceleration in US productivity, 11 per cent came in the ICT industries themselves, 63 per cent came in the rest of the economy (partly stemming from use of better information technology) and the rest came from the capital deepening of investment in ICT by non-ICT sectors. There was strong growth in the capital stock and the capital/labour ratio grew by more than 70 per cent. A parallel estimate is that two-thirds of the economic growth surge in the US in the second half of the 1990s resulted from the production and use of computers.

A recent report by the OECD³ highlights Australia, along with the US, Netherlands, Norway, Finland, Denmark and Ireland as economies that led the way in the 1990s in terms of growth and multi-factor productivity.

Australia has certainly been quick to apply ICT technology. In 1999, expenditure on ICT products and services in Australia exceeded \$US36 billion. This placed Australia in the top 10 countries in the world. IT spending as a share of GDP and per capita ownership of computers was the second highest in the world. As a percentage of GDP, the 'spend' in Australia was the fifth highest in the world. Moreover, the market is expected to maintain average growth rates of 8.5 per cent per year in the next few years.

Australia exhibits the preconditions to quickly adopt technologies and processes developed in the US. By keeping abreast of such developments, Australia will be better positioned to develop products and services that are competitive in various markets.

Despite the rapid uptake of ICT in Australia, Australia is not generally perceived as a New Economy country. An FTA with the US can be symbolically important to help dispel Australia's "Old Economy" image. The closer investment and business linkages which will follow from an FTA will inevitably lead to adoption in Australia of the New Economy benchmarks that apply in the United States. An FTA could anchor Australia's economy to the global reference points for success in the New Economy.

3 OECD, *The New Economy - Beyond the Hype*, Paris 2001.

A Free Trade Agreement between Australia and the US can help boost Australia's prospects for seizing these opportunities. Foreign direct investment will help sustain the flow of state-of-the-art technology and management practices. This will improve competitiveness in Australia and enhance prospects of technology, skills and entrepreneurial innovativeness in New Economy industries being transmitted quickly from the US.

Best practice: management methods

The rise of the United States as the supreme economic power has also seen the rise of American management thinking. A characteristic of American management is its preparedness to put ideas into practice in an effort to improve performance.

This started with the work of Frederick Taylor at the turn of the twentieth century who believed there was a single best method of organising work. His 'scientific theory of management' consisted of breaking a task down to its simplest parts, selecting the most suitable person for each job and devising the right set of incentives. This was translated into practice by Henry Ford with the assembly line and further advanced at General Motors by Alfred Sloan who developed the multi-divisional firm.

Australia is an early adopter of many American management techniques, particularly those that relate to finance or operations management. The balanced scorecard has a strong following among Australian corporations. The total quality movement did well here in the eighties, while technology solutions such as enterprise resource planning are being widely adopted. Both BHP and Coles Myer were working on shareholder value models as early as 1993. The American consulting company that pioneered the concept, Marakon, was formed in Connecticut and put its second office in London and its third in Melbourne.

German companies did not start using shareholder value concepts until 1995, while French companies only started applying them last year. The Japanese are only beginning to talk about shareholder value now, while the Italians have yet to begin.

Australia has been quicker to adopt flatter management structures than has Europe and is seen to share an entrepreneurial approach with the United States, although not to the same degree.

Weaknesses in Australian management practice relate to its market size and its history. Management consultants point to the problems of oligopolistic markets that leave Australian companies very focused upon their direct competition, but less interested in experimenting with niches, or upsetting established supplier or distribution channels.

The fact that Australian companies could not invest abroad until exchange controls were removed in 1984 means that many companies diversified, rather than developing the deep areas of expertise required to compete in global markets. Australian companies are still not as focused on their core competencies as Americans.

The differences are greatest in human resource management. Although there are highly unionised pockets of American industry, it never had anything resembling Australia's centralised industrial relations system, which led business in this country to abrogate large areas of human resource management responsibility to the Industrial Relations Commission and its predecessor.

Recent studies show that US firms in Australia invest much more in human resource management than Australian-owned companies and provide more formal training to all front line managers in employee relations. There are therefore elements of US practice from which Australian companies still have something to learn. To the extent that their implementation is effective, Australian business productivity stands to gain.

Best practice: economic policy contribution to growth

Australia is a powerful advertisement for the power of unilateralism in economic policy. During the last two decades Australian governments have been engaged in an unprecedented process of economic reform. The core infrastructure industries of finance, energy, transport and communications have been opened to local and international competition. The labour market has been partially reformed to improve its flexibility. A number of previously protected manufacturing and primary industries have been exposed to overseas competition.

It is believed that these reforms rather than the application of ICT made the greatest contribution to improved productivity in Australia in the 1990s. No doubt, they would have become mutually reinforcing and ICT would have become more of a factor as the decade progressed and productivity growth accelerated. Nevertheless, those industries that were the focus of reform have had the highest productivity gains. The IMF has estimated that labour productivity in Australia was 15 per cent higher in 1998 than it would have been under the previous growth path, mainly as a result of the structural reforms in trade and competition policy.

A further factor is the successful inflation-targeting monetary policy of the Reserve Bank, which helped to destroy the pre-existing inflation mentality and generate a less volatile growth trend. At the same time a major shift to equity financing in foreign investment eased the concern over the continued current account deficit in the balance of payments.

The result was that the increase in productivity in Australia was evident throughout the decade and was more broadly based than in the US. This growth was sustained through the Asian economic crisis.

Australia has generally been an enthusiastic supporter of the open multilateral trading system. Like many other countries it has had its periods of trade protectionism but has for many years now accepted that such policies lead to lower growth in incomes and poorer choice of products for Australians.

Box 6.1 Australian Reform Measures

Australia has undertaken very substantial economic reform in the past 20 years. The aim has been to improve the working of the economy through more efficient and competitive enterprises producing higher levels of product and incomes.

Major reforms were:

- Industry protection – tariff and quota protection gradually reduced throughout the 1980s and 1990s with significant changes brought about by the 4 year program commenced in 1988.
- Industrial relations – the introduction of enterprise bargaining and other decentralisation of industrial relations to the firm level, greater scope to customise apprentice and trainee schemes.
- Government business enterprises – corporatisation and privatisation of Government business enterprises at Commonwealth and State levels, including reform of pricing, management, Community Service Obligations and introduction of competition; water supply reform; national gas strategy; rail reform in some States.
- Competition – Competition Principles Agreement 1995 with ongoing review of legislation; introduction of competition into previously monopolised areas such as telecommunications and electricity; dismantling of rural marketing schemes, price supports and buffer stocks; construction of privately operated tollways
- Taxation – GST; removal of transaction taxes such as BAD and FID; reduction of corporate tax rate; reform of Capital Gains Tax.
- Contracting – widespread adoption of contracting out of commercial service by government.

In more recent times, governments have accepted that internal economic structures and markets can also benefit from greater competition. A dramatic series of reforms in labour markets, transport, finance, communications, energy and other sectors reinforced trade liberalisation and helped give Australia an unprecedented surge of new growth. Box 6.1 above summarises the reforms over the past dozen or so years.

The United States has also experienced an active two decades of policy reform. The United States never had the level of government ownership of business assets of Australia or Britain, nor did it have anything resembling Australia's system of centralised wage fixing, nor a body with such sway over international trade as was exercised by the Australian Tariff Board through much of Australia's modern history. The United States has nevertheless embarked upon bold policy reform in numerous areas of public administration, ranging from taxation to regulatory reform, electronic commerce, environment and social welfare.

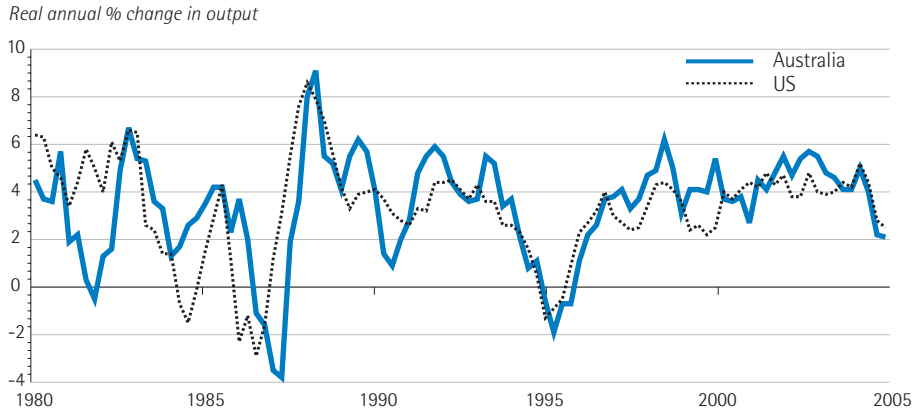
Leading Australian regulators would never embark upon important reform without first appraising what is taking place in the relevant authorities in the United States. Although national conditions and culture render many US solutions inappropriate to shared problems, the US authorities have the advantages that scale brings to policy research and development. The level of collaboration between Australian and US policy authorities means that there is some reverse flow of ideas. For example, Australia's targeting of welfare has influenced US policy debates.

Australia can struggle to register in the thinking of the world's largest economic power on policy issues. An FTA with the US will do nothing to alter the preponderant influence of domestic considerations in American policy decisions that have international consequences, however it may be expected to bring at least a marginal improvement in Australia's profile in American policy making.

It is remarkable the extent to which the Australian economy already parallels the United States. The growth of no other country so closely tracks the United States as Australia, not even Canada or Mexico. Modelling by the Reserve Bank of Australia shows that, compared with a weighted average of the GDPs of Australia's main export markets, US GDP growth is a better predictor. The reasons for this are not straightforward: the Asia Pacific economies (apart from Japan), for example, take four times as many of our exports as the United States. It is suggested, however, that the reasons may include policy coordination with the United States and a cultural affinity that leads the businesses and investors of both countries react to common issues in similar ways.

The economies of Australia and the United States are already pursuing a common path. The dynamic and indirect impacts of an FTA may be expected to bring benefits that cannot be factored in a quantitative method in advance. However the likelihood is that they will bring closer the economic performance of businesses in the two nations.

Figure 6.1 Australia and the US grow together



Source: Thomsen Financial Data Stream

