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SERVICING AUSTRALIA'S FUTURE

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FOREWORD

'Servicing Australia's Future' is the seventh instalment in the ANZ Research In-Depth series. We began the work for this paper, by asking "what will Australia, and Australians, look like in 2030?" Beyond confirming the things that many of us already suspect, such as an older and heavier population, we were struck by the projections for a more demographically balanced workforce and higher levels of education. This led us to look more closely at the service sector, which we now believe will be an even more dominant force in the Australian economy than it is today. Crucially, we found that the services-driven economy of 2030 will be one where workers are in strong demand for the first time in several generations.

While the dominance of Australia's service sector is well covered in recent papers, a number of aspects of that story have been neglected to date. In particular, the industries with the strongest growth prospects, such as health and education, are very labour-intensive, but relatively capital 'light'. When viewed in light of Australia's ageing population, this means there could be significant shortages of skilled labour by 2030. It also means financial service providers and investors may have to adapt to a world with lower funding requirements.

In fact, the early signs of this new paradigm are already evident. Some commentators have been wondering how to reconcile Australia's resilient GDP growth, weak investment, and falling inflation with strong employment numbers. But in our view this is consistent with an economy transitioning to a new set of drivers – one where traditional goods industries like mining, which until recently drove out-sized growth and required high levels of investment, are now being eclipsed by large employers of skilled labour.

Despite the challenges of the new service economy, there will still be opportunities for investors. Services companies will still need investment to develop their service offerings and the platforms via which they are offered. And there will be many advantages to this new world, including the fact that service jobs will drive higher education levels in Australia and many of these jobs could be considered more fulfilling jobs than those in mining, construction, and manufacturing.

This In-Depth paper is the result of six months of collaboration between ANZ Research and the University of Queensland's Australian Institute for Business & Economics (AIBE). It is a good example of the partnerships between universities and businesses which we advocate in this paper – partnerships which will be needed to produce the knowledge workers of 2030. Toby Roberts and Daniel Gradwell from ANZ worked closely with Paul Gollan and Chris Henderson from AIBE to review the literature and data, refine the modelling outputs, and prepare the report.

We hope you enjoy 'Servicing Australia's Future'. It is our intention to spark a debate about the steps that businesses and governments can take to prepare themselves, and the rest of us, for the Australia of 2030.

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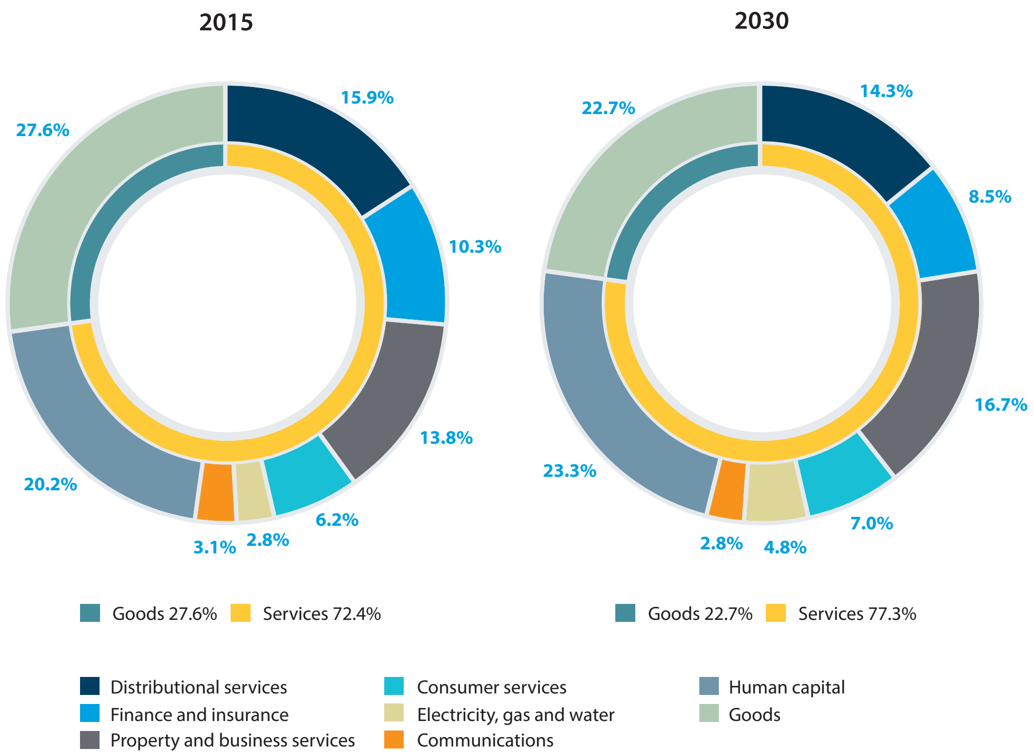
SERVICING AUSTRALIA'S FUTURE

In recent years Australia's service sector has grown at nearly double the rate of its goods counterpart and now makes up 72.4% of the Australian economy. **We expect the service sector will comprise an even greater proportion of the Australian economy by 2030 (up 5% to 77.3%).**

FIGURE 1
The service sector is set to be even larger by 2030



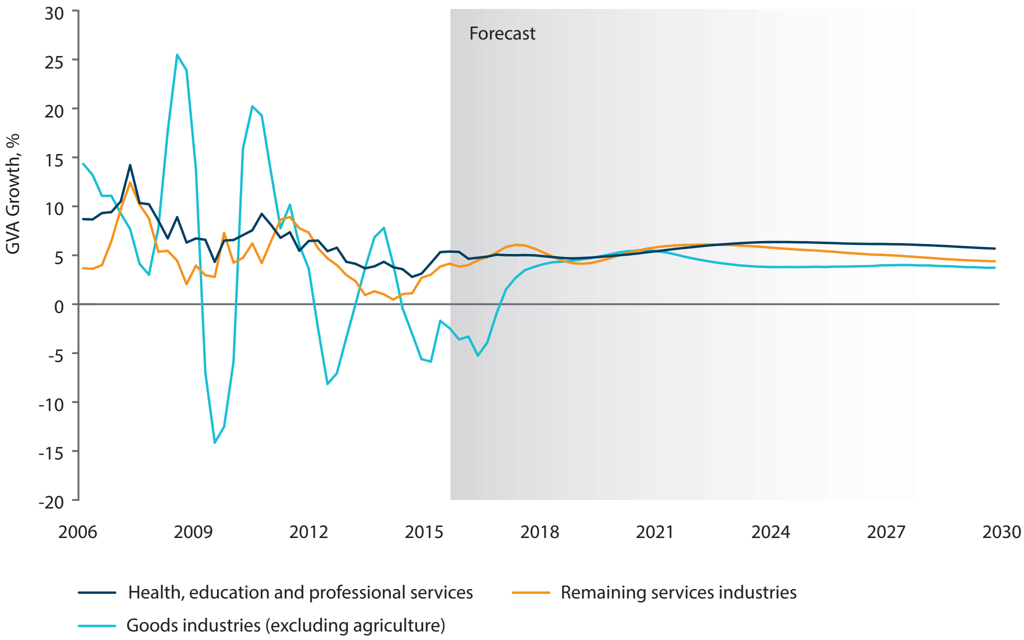
Source: ABS, Outlook Economics, ANZ Research

The healthcare industry will expand as a result of an ageing population and demand for new medical technologies, while the **education and professional services industries are set to benefit** from growth in Asia. We expect these industries to expand at an average rate of 6.0% a year (in nominal terms) through to 2030 – significantly faster than the traditional goods industries of mining, manufacturing and construction.

Australia's exports profile will continue to shift towards education, tourism and professional services. It is becoming easier to enter foreign markets due to digital opportunities and new free trade agreements, and a range of Australian service providers are now achieving greater scale and wider reach through the clever application of technology. Our projections indicate that service exports will on average grow solidly at about 3% a year between now and 2030.

FIGURE 2

Service industries likely to drive Australia's growth

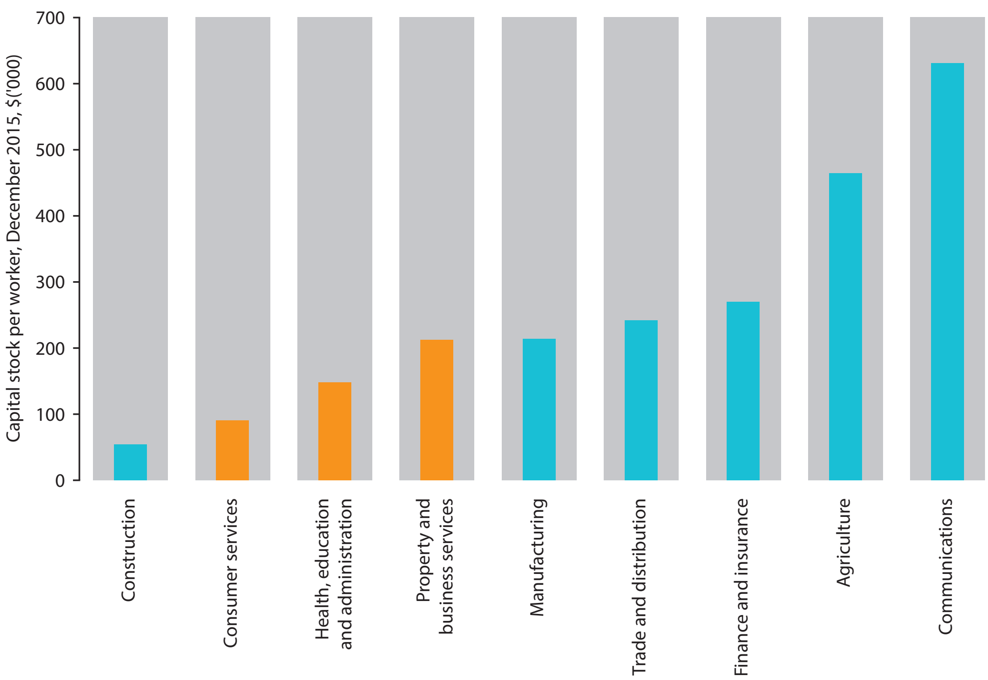


Source: ABS, Outlook Economics, ANZ Research

This expansion of the service sector will also require some adjustment on the part of businesses. Service industries are relatively less capital intensive (see Figure 3) and rely more upon skilled workers, which will prove challenging for Australian businesses given the ageing population and changing workforce composition.

FIGURE 3

Service industries are less capital intensive

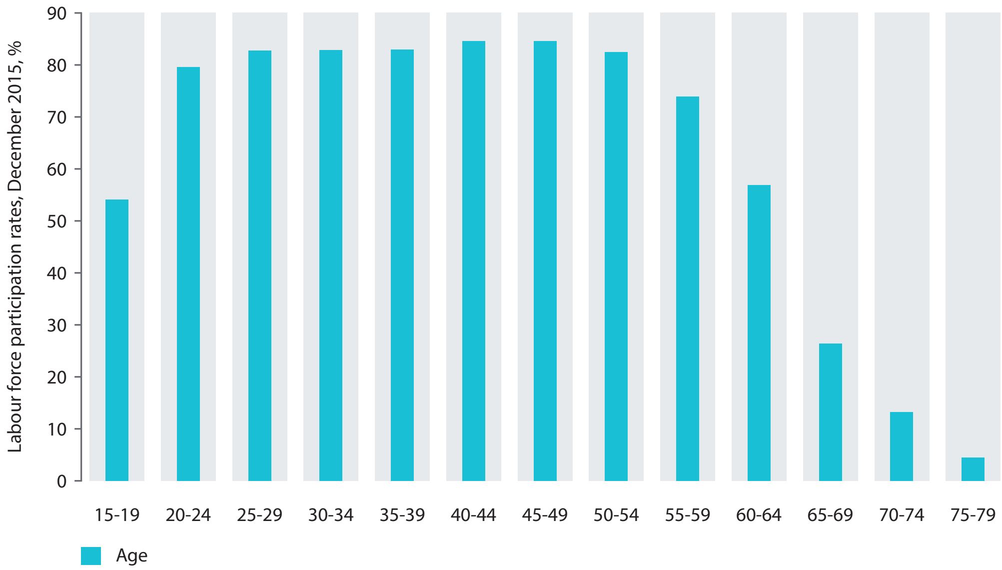


Source: ABS, Outlook Economics, ANZ Research

The industries with the most intensive demand for labour, such as health and education, are also those with the strongest growth prospects. As a result, we project that **demand for labour will continue to rise at a solid average pace of 1.6% per year** over the next 15 years.

On the labour supply side, **by 2030 almost 20% of the Australian population will be older than 65, so businesses will need to adopt more flexible work arrangements** as labour becomes harder to find. See Figure 4 for the impact of ageing upon workforce participation rates. Businesses will also need to focus on attracting and retaining female workers. While participation rates have been rising for women, there remains significant upside potential.

FIGURE 4
Workforce participation drops sharply for older Australians

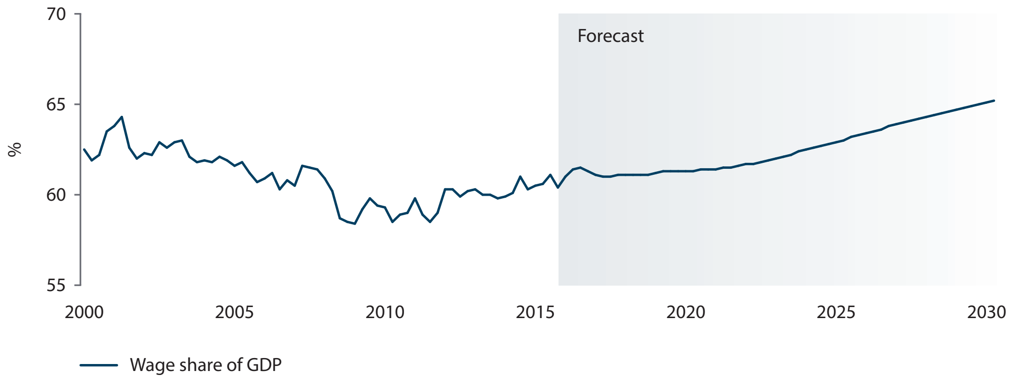


Source: ABS, Outlook Economics, ANZ Research

The growth sectors such as **healthcare, education, and professional services, all require high levels of education**, which presents another challenge – funding the tertiary education sector. In order to meet the growth in demand for tertiary qualifications, **Australia will need to explore more effective ways of securing private sector investment**. Better partnerships between business and the education sector could help bridge the funding gap.

A growing service sector could change the distribution of wealth in Australian society too. The overall demand for labour in services, coupled with a contraction in the more capital-intensive industries like mining, should support **a recovery in the labour share of income** (see Figure 5). As a result, some of the consequences of a falling labour share which we have seen in recent decades, such as growing income inequality, may begin to unwind. A reduction in Australia's income inequality will mean a fairer society and less wasted potential.

FIGURE 5
Australia's labour share may have troughed already



Source: Outlook Economics, ANZ Research

A rising labour share would also have implications for the broader economy as lower income earners could be expected to consume more. **But on the downside, the lower demand for, and lower return on, capital could result in lower rates of investment.**

Projects associated with the mining boom had very high capital requirements. With many of these projects now complete, and with lower commodity prices meaning fewer new projects, investment is being redirected to areas like computer software and R&D. We expect that to continue. **Investment in these areas will be smaller in scale in comparison with mining, but also more frequent,** so financial services providers will have to adapt to this new landscape.

Infrastructure is the one sector which is likely to be an exception to this new pattern, and one where there is no shortage of opportunity because Australia's infrastructure requirements continue to grow. Transport infrastructure will probably remain the primary focus, but **hospitals and universities will require substantial investment** too, particularly given the strong growth outlook for these sectors.

In summary, by 2030 the service sector will be playing an even greater role in the Australian economy than it already does, providing new export opportunities for businesses and many more new jobs than the goods industries. Moreover, many of these jobs could be regarded as more satisfying - requiring higher levels of education and human judgment of the kind which cannot be automated. The higher labour requirements of an expanding service sector, colliding with a demographic wave of ageing, means businesses and governments will have to work harder to secure Australia's future workforce.

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