



Business Council of Australia

30 April 2021

Catherine de Fontenay and Jonathan Coppel
Commissioners
Productivity Commission
4 National Circuit
Barton ACT 2600

Dear Commissioners

The Business Council welcomes the opportunity to make a submission to the Productivity Commission on vulnerable supply chains. We appreciate the Commission's engagement on the content of the interim report.

The impact of the COVID-19 pandemic has brought into focus global supply chains and their vulnerabilities. While the pandemic has impacted supply chains (particularly initial PPE shortages and disruptions to Australian perishable agricultural exports), Australia's open trade and market-based settings have generally weathered the upheaval well. In considering how to make supply chains more resilient, it is important neither to overstate the challenge nor understate the vitality of open trade and the responsiveness of free markets.

The Business Council supports the interim report's analytical framework to identify vulnerabilities and proposed strategies for managing supply chain risks. In particular, we support the Commission's findings that where supply chain vulnerabilities are present, firms are best placed to manage risks given their understanding of the markets they operate in and specific products.

We acknowledge there may be rare instances where government intervention to address vulnerabilities may be warranted. In this context the Commission's four-level framework for assessing intervention is a useful guide for governments and business. Implementation of additional regulation should be a last resort and only undertaken where the benefits of intervention exceed the costs of living with a residual level of risk. Flexibility in applying regulation, and removal of barriers of a regulatory nature, should be equally considered in the prevention and treatment of disruptions to supply chains.

Drawing on engagement with members and the Commission, the Business Council further highlights some themes and issues to consider in understanding and addressing supply chain vulnerabilities:

Analytical framework and information management

A sophisticated understanding of supply chain risks would benefit from a common framework of leading indicators and data modelling. Presently, industry have a wide variety of data to draw on. However, pulling this together can be highly labour intensive. The Commission's high-level analytical framework is a useful starting point and can be used to build out a common understanding to support industry-led information and analytical tools to prioritise risks, so at times of disruption, essential goods and services can be

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identified. Solutions that encourage collaboration across industries to developing common analytical tools and shared risk mitigation warrant further investigation.

Data

Understanding vulnerabilities may require deeper sectoral analysis. The Commission's analysis, beginning with the 8-digit Harmonized System-level, may not sufficiently capture vulnerabilities in specific critical imports that fall into more generic classifications. Certain product classifications may inaccurately reflect vulnerabilities of imports, such as telecommunication componentry. Product suppliers at this level can be highly concentrated, and in some cases may have only one manufacturer. Interruptions of a third-level supplier of a piece of componentry can have the effect of taking out end-point suppliers for a range of goods and services that support several industries in Australia.

The exercise of market power in highly concentrated product markets (e.g. such as telecommunications componentry above) when an external risk emerges could be further explored. The ability of larger multinational firms to compete on price where the number of suppliers is severely limited can significantly disadvantage smaller Australian firms, driving up the cost of critical inputs.

Services

Offshore services are highly important to functioning supply chains. This includes data processing and storage services, accounting and back-office services for financial institutions and communications, and call centre and other client services. In some cases, COVID-19 revealed business continuity planning may have overestimated the ease with which service suppliers based in one country could be substituted by another. Compliance with Australian laws and regulations – for example ensuring data protection and managing cyber security risks – were in certain cases more complex and time consuming than originally planned for.

The economy is also shifting away from large capital purchases to enable the production and provision of goods and services, with critical functions now being purchased on a consumption basis and provisioned by a third party. This changes the risk exposure in supply chains, as production may be vulnerable to disruption to the supply of a service, not just loss of access to physical goods. This risk will become increasingly widespread as 'traditional' sectors (such as manufacturing) digitise processes and production lines. Further qualitative research on vulnerabilities for offshore services by the Commission may help understand and mitigate this risk in future economic shocks.

As the trade in services constitute an increasing portion of our economy, domestic efforts to manage supply chain risks and build resilience need to be balanced with maintaining Australia's position as an attractive location for foreign investment. Unnecessarily intrusive or onerous powers can deter investment, particularly when the interactions with trade obligations or existing laws in other jurisdictions (such as privacy statutes in the US or EU) are not accounted for. This may have a negative effect on business investment decisions. This includes on key components of the supply of modern digital services, such as investments in data centres or cloud services, particularly those necessary to support markets in Asia. While Australia will not lose access to the services hosted in these centres, it may be that Australia increasingly becomes an importer of these services and thereby increases supply chain exposure to international digital markets.

Skilled workforce

Australia's swift closure of the international border at the onset of the COVID-19 pandemic was vital to slowing the spread of the virus and Australia's overall success in managing the health and economic implications. However, an initial blanket ban on non-residents resulted in skills shortages across medical, engineering and mining, telecommunications and IT, aged care, agriculture, food and maritime sectors among others. This has highlighted the critical importance of long-term investment in a skilled workforce to prepare for and minimise the impact of supply chain disruptions. It also points to the need to continue to provide for the movement of people where critical skills shortages exist in a crisis. Consideration should be given to greater flexibility in visa conditions and managing visa extensions where retaining a workforce would minimise supply chain vulnerabilities during a crisis.

Freight and logistics

Knee-jerk and inconsistent actions by governments pose significant challenges for the freight and logistics sector's ability to maintain supply chains. The opening and closing of state borders is an example of government decisions that can have significant supply chain effects. Moreover, there is real risk these actions will be repeated as international borders re-open in line with the vaccine roll-out and COVID outbreaks potentially occur. Measures that would support the freight and logistics sector include upgrading port infrastructure and ensuring sector personnel are included as priority industries for government support, such as the phasing of the COVID-19 vaccine roll-out.

Major reforms to enhance trade facilitation would also boost supply chain resilience, including the introduction of digital trade compliance and seamless single-point contact for traders. A 'Single Trade Window' concept facilitates faster and simpler trade and streamlining regulation, reduces red tape at the border, improves certainty in export markets and expedites the flow of cargo which facilitates access to market. A Single Window After introducing the Single Window in Singapore, the time to process trade documents was reduced from 4 days to 15 minutes. Although this initiative has been on the government's agenda for several years, progress has been slow. A challenge for government to move to a Single Trade Window is grappling with the scale of change required. Important to this process will be identifying the high impact measures by building on the Trusted Trader scheme that realised benefits incrementally and quickly.

Digital services

There is a role for government to work with business to minimise cyber risks that affect supply chains. Current changes to the *Security of Critical Infrastructure Act 2018* (Cth) seek to address these risks. Some of the new powers are a substantial increase in the government's ability to intervene in what are global assets and services. New powers will potentially open access to user, commercial and system data of citizens and businesses located in other countries. Given these powers will affect users in jurisdictions outside of Australia, it is not clear how these powers will interact with requirements under relevant US and European laws, such as privacy statutes and similar regulations. This may have a negative effect on business investment decisions on where to locate data centres or cloud services, particularly those necessary to support markets in Asia.

Exports: future research

We understand the Commission's research into export supply chains will take a longer-term view of risks than the six-month time frame examined for imports. Although there are a multitude of possible risks that could be considered over longer period, we encourage the Commission to consider current trends that are most likely to continue, focusing on geopolitical and trade tensions, accelerated decarbonisation measures globally, and technological changes.

We recommend the Commission examine the extent to which Australia's exports are integrated into global value chains. Notwithstanding the increased concentration of Australia's trade flows, Australia's exports are reliant on more markets than people imagine. For example, while we may sell iron ore to China, this may be driven in part by US demand for cars using Chinese produced steel. Although only 4.3% of Australia's exports are sold directly to North America, when Australia's contribution to the value chains of global exports is taken into account, 9 per cent of Australian exports eventually end up being consumed in North America. Hence, the North American market is more important to demand for Australian exports than would be assumed by looking at traditional trade statistics which only look at direct sales between countries. A deeper understanding of Australia's enmeshment in these complex value chains would enhance risk assessments and help identify opportunities to broaden and diversify Australia's value add in the global economy.

We appreciate the opportunity to provide feedback and look forward to continuing to engage with the Commission on this important issue.

Yours sincerely

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