

Sustaining Tasmania's Economic Performance

Address to the

Northern Tasmania Leaders Luncheon

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Introduction

Thank you for inviting me to speak to you at this luncheon today.

It's a pleasure to be able to address such a significant group in Launceston and has given me a good excuse to visit both my Launceston staff and my parents.

I plan to talk about the Tasmanian economy and some of the drivers that are important in sustaining Tasmania's economic performance.

Many of you here today are involved with industries that play a significant role in the Tasmanian economy. You will know that many factors that influence our State's economy are outside the control, or even the influence, of the State, and the Australian Government.

Among these are national and global economic conditions, including activity in the financial markets around the world, and, in the longer term, the rate of technological progress. The investment decisions of our vast range of large and small businesses in the State, as well as potential new investors are also quite hard for governments to influence. Those investment decisions are strongly influenced by the 'animal spirits' that John Maynard Keynes referred to over 70 years ago. Animal spirits are as important now as they were in the 1930s, the only difference being that with the international mobility of capital, our animals are much more globally mobile than they were in Keynes' day.

Yet, investment is a major driver of economic performance. Ultimately, no economy can enjoy sustained economic growth without strong investment, most of which is within the private sector.

As well as being an important component of Gross State Product in its own right, investment enhances the quantity of Tasmania's capital stock. Investment also improves productivity, and in turn Tasmania's competitiveness as a State. Improvement in competitiveness leads to increased employment and higher real wages.

Slide 1

This first chart shows the history of private investment in Tasmania over the past 15 years in real terms. The chart shows that investment in Tasmania has been much higher over the past five years or so, compared to the previous decade.

Slide 2

As you can see, in the past five years, we have also had much stronger economic growth, compared to the previous decade. The higher investment has been the major contributor to this improved economic growth and has helped to sustain it.

Slide 3

The benefits of this improved economic performance, which has involved jobs growth of over 30,000 since 2002, are reflected in Tasmania's steadily declining unemployment rate, especially for long term unemployment, as this chart shows. The jobs growth and reduced rates of unemployment have occurred at similar rates in all regions of the State.

While the gap has closed between our unemployment rate and that of the rest of Australia, our labour force participation rate remains almost five percentage points below the national average. That feature of our labour market is long-standing but it is of concern. It means we have a potential labour pool, of perhaps ten to fifteen thousand people, who are currently outside the labour force.

Our average wages appear competitive, at around 90 per cent of the national average. However, our average labour productivity is only 85 per cent of the national average. This suggests that, per thousand dollars that employers spend on labour in Tasmania, employers may be getting a lower return, on average, than in mainland states, due to our lower average productivity. In terms of value adding per employee, therefore, Tasmania still has some more catching up to do.

However, industries in Tasmania have been moving in the right direction. My next few charts measure the performance of Tasmania's industry sectors against the same sectors nationally and show that there has been an underlying improvement.

Slide 4

The horizontal axis on this chart shows the relative size of each sector in Tasmania compared to Australia as a whole. If we take the property and business services sector in Tasmania, for example, it is relatively under-represented in Tasmania, accounting for around 8 per cent points less of total private sector activity in Tasmania, compared with the same sector nationally, as a share of national private sector activity. As you can see, we have a higher than national representation in agriculture, forestry and fishing.

The vertical axis shows the difference in the rate of growth of these sectors between Tasmania and Australia as a whole, using a five year average up to the date on the chart. Property and business services in Tasmania, therefore, had been growing well below the national rate in the late 1990s, but more recently has been growing at a faster rate.

As you can see, the finance and insurance sector in Tasmania, another high value sector, also has been growing at a faster rate in Tasmania in recent years.

Slide 5

My next chart shows that the performance of mining, as a sector in Tasmania, has improved significantly over the past decade – although relative to the very rapid growth of mining nationally, we are still a bit behind. It also shows that accommodation, cafes and restaurants - the tourism industry - has become a strongly growing sector in Tasmania.

In the case of manufacturing there has been little change. However, some major changes have occurred within that sector, including reduced production of woodchips and greater reliance on higher value manufacturing output, such as catamarans, other vessels and also mining equipment.

Slide 6

Personal and other services has also been growing faster than nationally in recent years. This has also been the case for the remaining private industries which includes wholesale and retail trade, and transport.

When I refer to ‘sustaining Tasmania’s economic performance’, I see this in terms of further improvement after a period of strong performance, in our state economy compared with the overall national economic performance. This further improvement in our economic performance requires four things:

- sustained high levels of private investment in Tasmania;
- economic growth rates around the levels of recent years;
- improvements in productivity; and
- increased labour force participation.

Generating high standards of living through strong economic performance is an important part of improving the wellbeing for the whole community. How this improved wellbeing is shared around is another issue, but most importantly there has to be something to be shared before any debate on who gets to have a share in it.

All governments of Tasmania have shared in this goal of strong economic performance. We in Treasury see one of Governments’ most important roles as creating the right business and regulatory environment to encourage private investment and employment growth.

However, Governments often face strong business and community pressure to intervene in some sectors of the economy, when the economy will actually be stronger, in the long run, if governments do not get involved.

At other times, governments can face strong criticism if they actively initiate change and the easier path is to not get involved, or to pass the responsibility for taking action to a subsequent government. I believe that, at times, governments do need to take strong action, to sustain long term economic growth.

If governments give in to these pressures, we place at risk the improvements in economic performance that so much effort and energy of governments is devoted to.

Before I expand on these two points, I would like you to first consider two factors:

First - lobby groups and other interest groups can be successful in promoting narrowly focussed private interests, but there is rarely an equivalent body to represent the broader public interest.

Secondly - Governments are, more often than not, put under pressure to secure immediate short term results, rather than create an environment that can generate longer term benefits.

So when do Governments face strong pressure to intervene in the economy when we consider that they should not?

The first case is about managing a changing economy. As economies develop, industries emerge and expand, such as call centres and financial advisory services; while other industries contract as their market shrinks. Governments find themselves under pressure to retain jobs in these declining industries. This invariably means subsidies, grants or favourable loans, or even in some cases government ownership, as part of a 'rescue plan'.

These contracting industries tend to be low productivity, low wage and uncompetitive in the global market place. Nationally, the footwear, clothing and textile sector is one that has faced increasing difficulties in remaining competitive.

Actions of Governments to retain jobs in such industries often only slow, rather than prevent, their decline – they just put off the evil day – and sometimes at great cost to taxpayers.

More importantly, such action does no favours to employees in these industries, especially in times of low overall unemployment. The workforce in these low productivity, low-paying industries would be better encouraged to move over to expanding industries, with superior long term prospects. This is how economies develop and overall productivity levels can be improved.

I accept that the transition, in itself, can often cause dislocation and hardship, but addressing these issues is a different task and involves quite different considerations.

Currently, for example, the unemployment rate in Tasmania, for those unemployed for one month or more, is around three per cent. The bulk of employees in an ailing industry therefore have options to secure employment elsewhere if they wanted it.

Given the inevitable decline of these industries, it makes very little sense to delay the release of these employees until later, when employment conditions may not be so favourable, and other businesses may not be so willing or able to invest in skills and re-training.

In fact, in some cases, these 'rescue plans' provide more benefits to the equity owners and financiers of these businesses, than to the employees. While it is easy to see good reason for Governments assisting employees affected by a transition, it is hard to see why taxpayers' dollars should be devoted to benefit equity owners and financiers.

Finally, towns and regions are generally much more resilient than doomsayers would have you believe. The history of Burnie after the closure of the pulp mill, which employed 3,500 at its peak, and Tioxide is a good example. Burnie has emerged as a vibrant, regional city where the unemployment rate is around the same level as in Tasmania as a whole. Newcastle has been the same, after the close of the BHP steel works in 1999.

As I will discuss later, the economic performance of the State is likely to be far better served by State Government investment in necessary public infrastructure, than directly supporting ailing industry sectors.

Of course, there are examples of very successful support for individual firms encountering difficult periods. Incat is a good case in point where transitional support from Government made possible a transition to a long-term viable operation. The support provided to our call centre industry is another example. Here, Government has assisted with subsidies in the establishment years without which these operations would have gone to other locations, likely overseas.

The challenge for Governments is to confine their support to those industries which have a long-term sustainable competitive advantage and good growth prospects. Faced with calls from sections of the community to support declining industries and failing individual firms, that can be a very difficult challenge indeed.

Governments are often put under pressure to introduce, or retain, anti-competitive legislation. This is usually dressed up as promoting the particular industry and the State as a whole.

This amounts to legislative protectionism, the equivalent of setting up tariffs on imported goods. Just as tariffs discourage innovation and improvements in efficiency, so too does anti-competitive legislation.

Since National Competition Policy was introduced in 1995, all Governments in Australia have unwound a very large amount of anti-competitive legislation that has been assessed as being against the broader public benefit.

Tasmania's record here is among the best in the country. Some examples of the reforms that have been introduced, all with strong opposition from vested interests at the time, include:

- the removal of restrictions on shop trading hours
- the removal of the monopoly on conveyance services that legal practitioners enjoyed;
- the end of licensing of tourism accommodation; and
- the programmed issue of new taxi licences throughout Tasmania.

In all these industries, businesses were protected by legislation and did not have the same drivers to be efficient, and to invest in productivity improvements, or to innovate, as they have now.

As one example, the independent supermarkets fought strongly against the deregulation of shop trading hours, with claims that this would lead to a large number of closures and job losses in the retail sector. Since deregulation, however, many of these same independent supermarkets have flourished, and their services have improved significantly as they have sought to retain their customers, through better service and other innovations.

The most significant pro-competitive reforms underway at the moment are in the electricity industry. Aurora Energy is losing its monopoly retail franchise under a timetable which extends to July 2009 or 2010, depending on whether the final tranche of the smallest retail customers is made contestable.

Already Aurora is in competition with three other retailers for the retail business of the larger electricity consumers. Aurora's capacity to hold on to its customers, in the face of competition from other retailers, will depend on its competitiveness.

Hydro Tasmania, too is facing major on-island competition for the first time, with Alinta now owning the three gas turbine units at Bell Bay and preparing to build a large new gas-fired power station as well. Even the Gunns pulp mill next door is being designed to export some 60 MW into the grid, which is around half the electricity consumption in the greater Launceston area.

The electricity industry is also in competition with natural gas, where there has been full retail contestability from the start.

Perhaps the most important outcome is that businesses today know that their prospects for survival rely more on their competitive advantage in the market place and less on their capacity to lean on Governments for protection.

For each of these reforms, the broader public interest was shown to be greater than the narrow private interests of certain stakeholders. As you might have gathered, Treasury has been a very strong supporter of National Competition Policy from the start and we are convinced that this program of microeconomic reform is leading to continued improved economic outcomes for the State as a whole.

I would like to say that the task has been completed. However, there are some areas, such as the retail pharmacy sector, where I'm convinced (along with my State and Federal counterparts, the Productivity Commission and the National Competition Council) that more micro-economic reform is needed. The Australian Government, in whose hands this issue lies, is not persuaded.

Furthermore, we still see proposals for new restrictions, such as against supermarket-owned petrol stations for their shopper docket petrol price discounts, or recently in Tasmania, to prohibit new abalone processors.

This is why we have strict 'gatekeeper' arrangements in place in Tasmania to examine all proposals for new legislation and advise the Government accordingly.

This task is performed by my Department, and it is designed to prevent a drift back to earlier times when anti-competition legislation was more widely accepted, and no rigorous assessments of costs and benefits across the whole community were undertaken.

The final area where no action can be better than action is perhaps the most contentious issue. This is where Governments face requests for ever tougher environmental and safety regulation.

Those who call for increasing levels of regulation, and appear happy to impose ever increasing compliance burdens on businesses, rarely seem to weigh up the additional benefits of this new regulation against the additional costs.

The intent is to remove the risk of certain outcomes, even if a risk-averse person considers that some risks might be worth wearing, given the costs of removing them.

Governments are told that it's the height of irresponsibility to allow these risks to remain, and that Government will be pilloried if one poor outcome emerges. (That much, regrettably, is probably true.)

We live in a world where individuals and households manage and accept a level of risk, businesses do exactly the same, and yet Governments are expected to impose a regulatory framework that operates on a different plane, almost regardless of the costs.

The outcome can be that other important objectives, such as economic growth, are put in jeopardy due to the very low risk threshold Governments are expected to adopt in regulation and other areas.

We find this in several areas within the building industry, such as the energy efficiency requirements for new buildings in the Building Code, which can add substantially to building costs. In the primary sector, the regulation of security sensitive materials has imposed very large costs on agriculture, and on horticulture in particular, in Tasmania. There are less onerous restrictions in some other states (not all have banned ammonium nitrate as a fertiliser, for example). We have also recently introduced a mandatory accreditation scheme for commercial egg producers, even though there is no history of serious illness or disease spread by eggs.

Other cases are in regulation of the professions. In addition to extensive regulation of pharmacists, for example, we separately regulate pharmacy premises through a registration scheme.

From my perspective, there is a strong case for Governments to allow more risks to remain, rather than attempt to virtually eliminate them all, at the expense of other objectives.

I now turn to the other case, where Governments **should** intervene when the easier course is to lay low.

Governments are, or at least should be, in the business of making popular as well as unpopular decisions. In some cases, unpopular decisions need to be made because the longer term benefits outweigh the short term costs. A good example here is the implementation of fiscal strategies to bring down net debt levels and create greater Budget flexibility.

Tasmania has been fortunate in recent years in having a Government that has announced and stuck to its fiscal strategies. Within those fiscal strategies has been a strong commitment to eliminate core government debt and maintain Tasmania's tax competitiveness. This has had huge payoffs in terms of business confidence and, more recently, enabling Governments to wind back taxes, especially business taxes. It has also been rewarded with a series of ratings upgrades – to AA+ with Standard & Poor's, and Aaa with Moody's which themselves improve business and community confidence.

At times Governments should take a pro-active stance to address long term issues. Two recent examples, where our Government is being admirably proactive, come to mind.

The first relates to the State's water and wastewater assets. The quality of the State's water and wastewater infrastructure is unacceptably low, due to past underinvestment. Our initial estimate was that expenditure of between \$650 million and \$825 million is needed to bring those assets to an acceptable performance level. It now looks as if the true cost will be higher again.

We find ourselves in this unsatisfactory position for a number of reasons – including that the balance sheets of some local Government Councils are not strong enough to handle the borrowing needed to fund these long-lived assets.

However, it is also evident that some councils have under-charged for water and wastewater services, with the result that there has been insufficient revenue generated to maintain these assets and fund the necessary new investment.

The second example where our government has pro-actively addressed long-term issues deals with Hydro Tasmania. The community, especially the business community, expects a high level of reliability and quality of supply from Hydro Tasmania. However, electricity users are less keen to contribute, through higher electricity prices, to the investment Hydro needs in order to maintain its generation and other assets at the level of reliability the community expects.

Setting low prices for Hydro generation might well be popular – at least in the short term – but it is not a smart strategy for the medium and longer term. The consequence of artificially low energy prices is that Hydro receives insufficient revenue to meet its operating costs and fund the capital expenditure necessary to maintain the service potential of its assets. This would lead to increased risk of service failure and an erosion in confidence of businesses and the community generally in the reliability of our electricity supply.

On policy grounds, therefore, it is important that the Government as owner is pro-active in ensuring that its businesses, which provide essential services to the community, are set up to operate in a sustainable way, with a tight commercial focus, and with prices at levels that cover all costs and provide the revenue needed to fund required investment.

This is very important for private investment in the State. Publicly owned businesses have an important role in providing infrastructure and services for new private-sector developments. Viable developments should not be prevented merely because these public businesses cannot fund the necessary investment.

Just as important, however, is investors having confidence that these public businesses are being operated in a sustainable way and that the prices charged are not likely to increase significantly as a result of earlier under recovery. Businesses can then plan accordingly, and make investment decisions, with a higher degree of confidence.

The last area I would like to cover is closer to home, for many of you.

For several years, the Government has been working with the Launceston City Council to address the flood risks at Invermay. This has given us an opportunity to have a close look at the public policy issues to do with development in flood risk areas.

Once a new levee system is built, it is tempting to encourage development behind the levees. The level of protection has been increased, investors are itching to get busy, and governments are looking forward to the new economic activity and employment, together with the rates and taxes that will follow. It is tempting to allow all these developments to proceed.

Again, this is an area where I believe Governments at all levels need to make a long-term assessment as to the costs and benefits of these developments.

Businesses and households that settle in flood risk areas impose costs on the broader community. They are the prime beneficiaries of the levees and the emergency planning arrangements. The cost of providing council services is often higher in these areas - around 30 per cent higher in Invermay for example.

No levee system is 100 per cent failsafe – all are designed to cope with a particular level of flood intensity. When floods occur they are costly to Governments, in terms of their own assets in the flood area and in providing assistance to residents and businesses.

By allowing all developments in the flood risk areas, even after a new levee system is installed, the developers and future residents and businesses are effectively receiving subsidies from governments (including the local council).

In turn, these different levels of government, which really means our households and businesses, are incurring future liabilities by allowing these new developments in flood risk areas.

I see the right policy response, therefore, as imposing tough restrictions on new developments in flood risk areas. This is ultimately how future damage arising from floods can be contained.

It's also important that those in the flood risk areas face the right price signals, in terms of the costs they end up imposing on the rest of the community. Those who benefit from flood protection should therefore be required to contribute towards the costs.

In summing up, Governments have an important role in creating the right environment to encourage investment and economic growth, and the private sector is generally best placed to drive this growth.

Some regulation and government intervention can clearly do more harm than good, even if imposed for the best of reasons.

Sometimes, though, Governments do need to get involved and make less than popular decisions, because, in the long run, the benefits outweigh the costs. Many of these decisions do, in fact promote economic growth and development.

Thank you again for the opportunity to share my thoughts with you.

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Northern Tasmania Leaders Luncheon

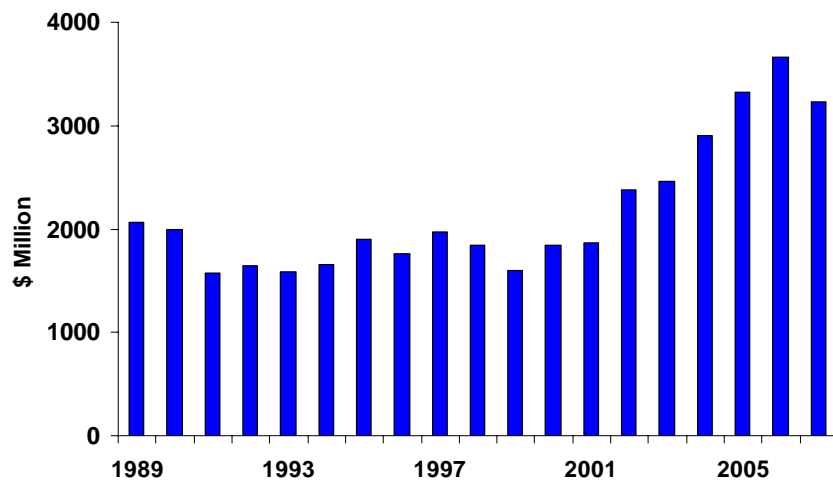
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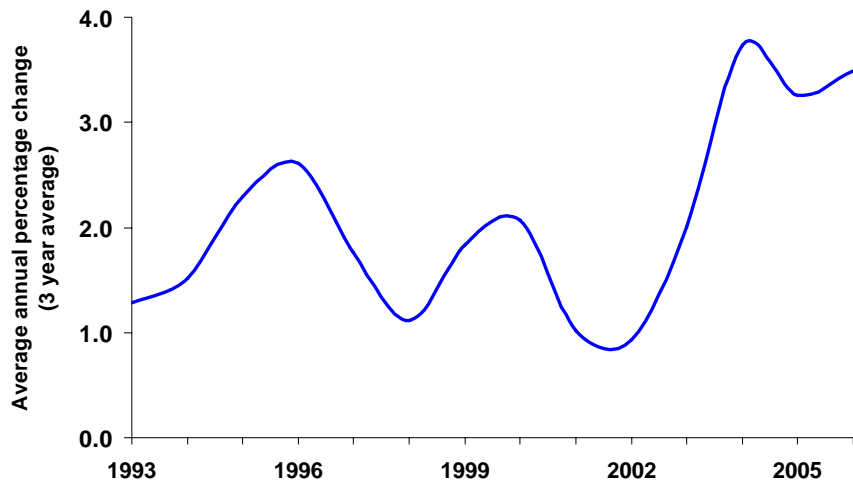
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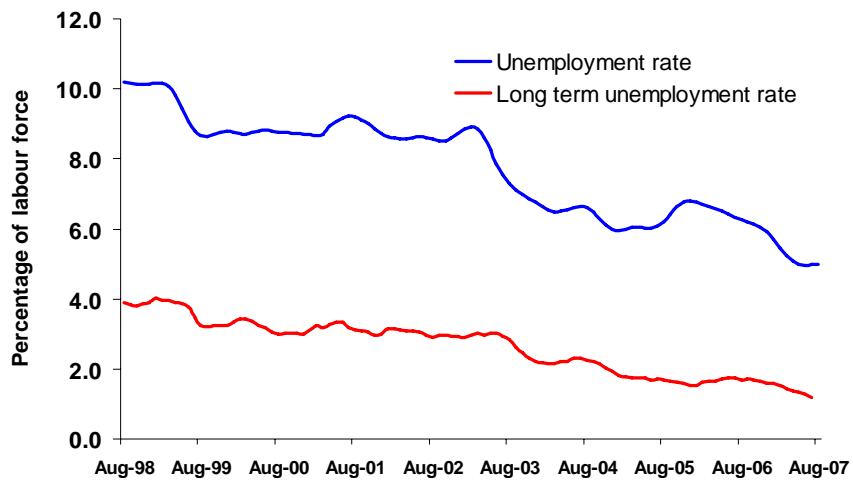
Private Investment - Tasmania



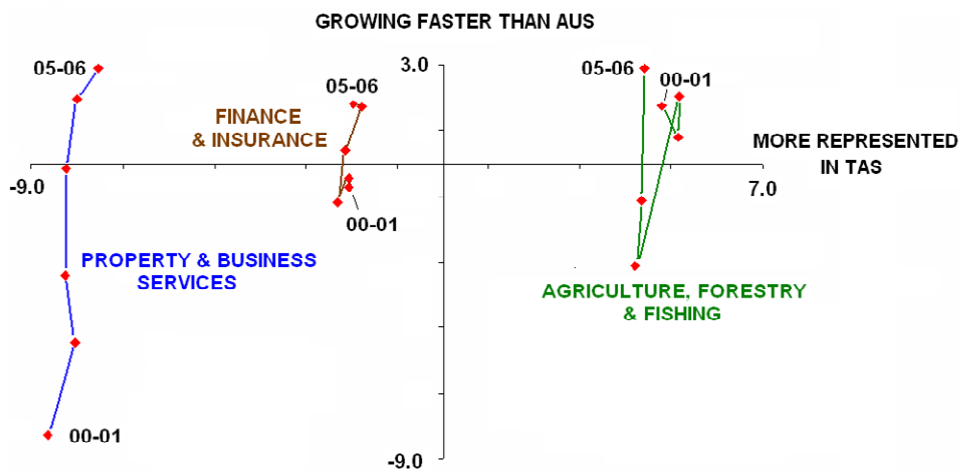
GSP Growth - Tasmania



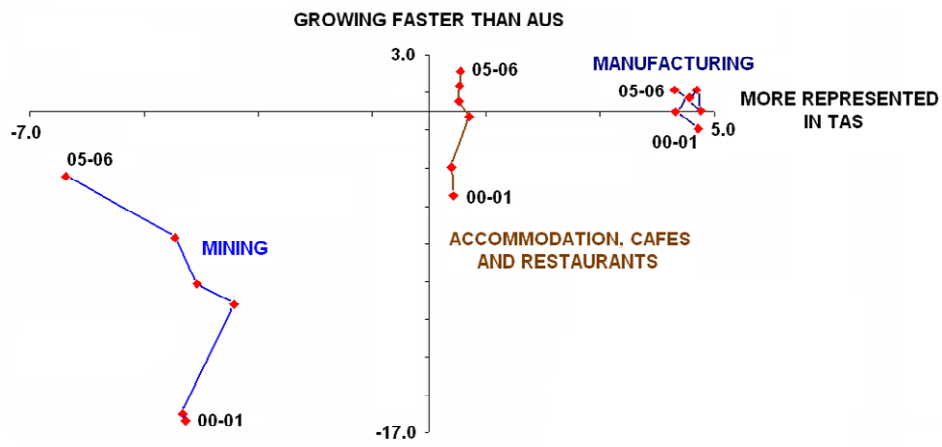
Unemployment - Tasmania



Key Industry Sectors



Mining, Tourism and Manufacturing



Personal Services and all other Industries

