

# Tasmania's economic recovery: how sustainable is it?

Presentation to a luncheon hosted by the  
Launceston Chamber of Commerce

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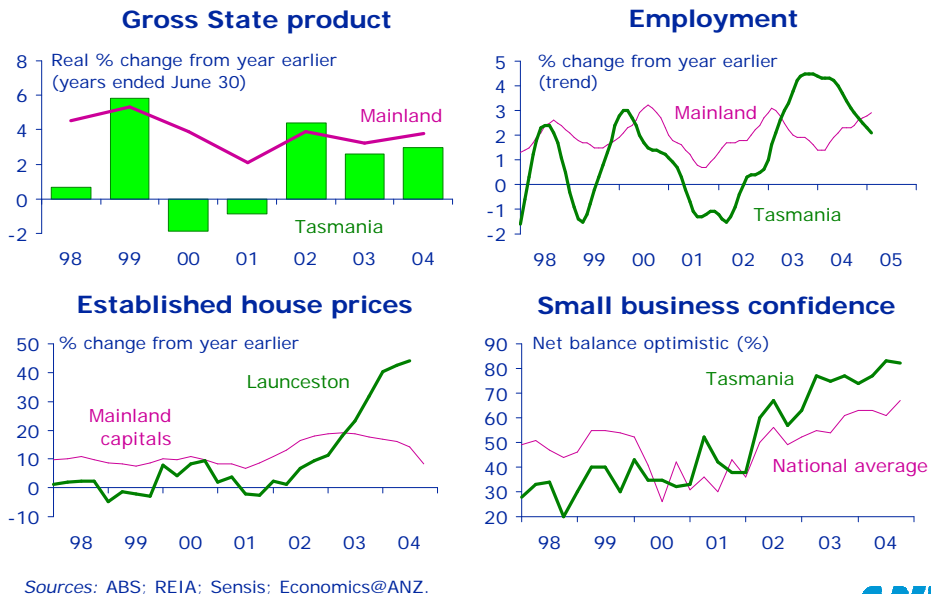
Hotel Grand Chancellor  
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- I came to study economics as a 17-year old in much the same way that Sherlock Holmes used to arrive at the truth – ‘when you’ve eliminated the impossible, whatever remains, however improbable, must be the truth’.
- I eliminated all the things I didn’t want to do (law, medicine, science); the things I couldn’t do (eg engineering); the things I wanted to do but didn’t think I could make a living at (history); and was left with economics and accounting. And one year of (compulsory) study of accounting was enough to reach the conclusion that economics was ‘it’ for me.
- But from that perhaps inauspicious beginning, I’ve stuck with economics because – apart from the fact that I’ve always since found it enjoyable and intellectually stimulating – as Nobel Laureate James Tobin said, “economics offers the hope ... that improved understanding could better the lot of mankind”
- Tasmania’s experience over the last 30 years or so illustrates Tobin’s point very aptly. Tasmania’s poor economic performance over the 1970s, 80s and most of the 90s was largely the result of bad economic policy – the failure to recognize and respond to predictable changes in the broader economic environment (such as Britain’s entry into the EU and the long-term downtrend in commodity prices); and incompetent management of the State’s finances.
- Conversely the improvement in Tasmania’s economic performance since the late 1990s is at least in part directly (though not entirely) attributable to good economic policy – and it’s this improvement in economic performance, the reasons for it, and whether it can be sustained, that I want to talk about today.

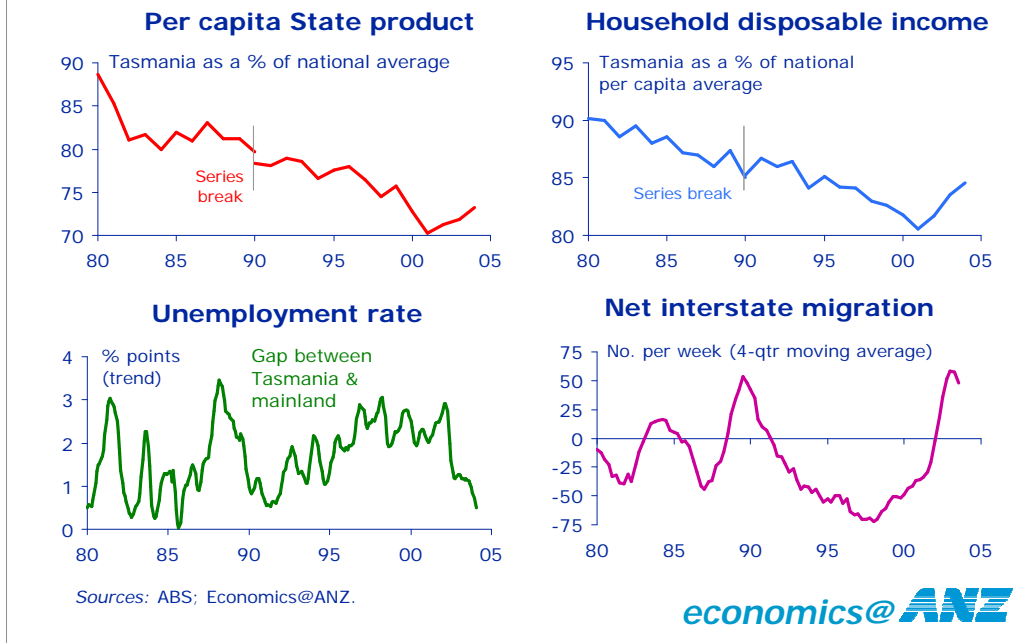
## The Tasmanian economy has performed very strongly over the past few years ...



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- Tasmania's economic growth performance has much improved so far this decade.
- After growing by an average of just 1.6% pa in the 1980s, and 1.5%pa in the 1990s, Tasmania's real gross State product has grown by an average of 3.3% pa over the three years to 2003-04
- This is the best three-year growth performance Tasmania has sustained since the three years ended 1985-86. Other indicators also shown favourable trends –
  - Employment growth of 2.6% pa over the past three years (incl. 1.8% pa growth in FT employment) cf. 2.3% pa on the mainland.
  - Launceston house prices up 89% over the past three years (and Hobart 98%), compared with the average increase for all State and Territory capitals of 58%/
  - Business confidence significantly higher in Tasmania than across Australia as a whole

## ... resulting in a number of improvements in Tasmania's standing relative to the mainland

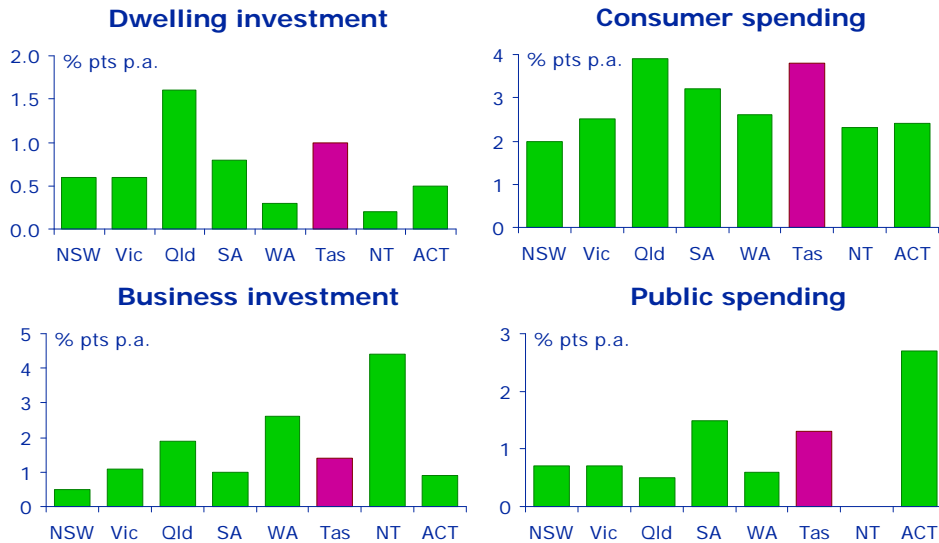


This has produced some very encouraging developments in Tasmania's standing relative to the mainland –

- Tasmania's per capita State product has risen, as a proportion of the mainland's, by nearly 3 pc points (from 70.3% to 73.2%) – the first time this has occurred over a three year period since the three years ended 1988-89 – and by the largest amount since the three years ended 1986-87
- Per capita household disposable income per head has risen, relative to the mainland's, by 4 pc points over the past three years – from 80.6% to 84.6% - the largest increase over any 3-year period in the last 24 years, and reversing nearly all of the decline that occurred between 1994-95 and 2000-01
- Tasmania's trend unemployment rate (5.6% in Jan) is the lowest since monthly data were first published in 1978, and the gap between Tas's u-rate and the mainland's has fallen to less than ½ pc pt for the first time in 19 years (though note because of Tas's lower participation rate, the gap b/w employment/ population ratios is 5.5 pc points, a decline of only 1.2 pc points from the peak reached at the end of 2002)
- And of course as has been well recognized, State's population is growing again – at fastest rate since 1991 – with Tas no longer suffering a population drain across Bass Strait
  - though note, interstate immigration appears now to be peaking
  - and it would appear that inward movements are dominated by over 50s while outward movements dominated by people in their 20s and 30s

## The housing boom has made an above-average contribution to Tasmania's recent economic upturn

P.c. point contributions to real GSP growth, 2000-01 to 2003-04



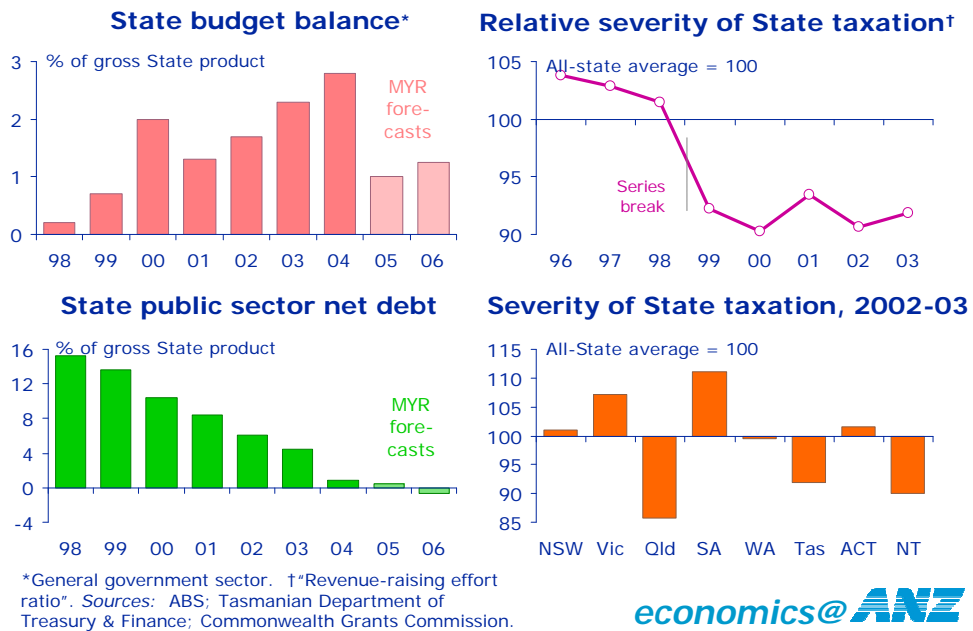
Sources: ABS; Economics@ANZ

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Improved performance of Tasmania's economy over past three years has owed a good deal to the strength of the housing boom:

- Growth in housing investment accounted for 31.5% of the increase in real GSP over the three years to 2003-04 – a higher proportion than for any other State (though slightly less than for the ACT) and compared with 21.0% for the mainland.
  - Obviously partly reflects the turnaround in population flows – but clearly is unlikely to be repeated in the same magnitude
- Consumer spending more than accounted for the entire growth in GSP over this period (clearly, other components, in particular net exports and the 'balancing item', subtracted from GSP growth) – cf. just under 70% of the increase in mainland GSP
  - obviously driven by faster population growth, tourism boom and impact of rising house prices on Tasmanian's wealth – Tasmania's household saving rate (lower than any other State except Qld) fell by 4.5 pc points b/w 2000-01 and 2003-04 cf. 3.2 pc points on the mainland.
- Business investment accounted for 43% of the growth in real GSP cf. 34% on the mainland – this is an encouraging development
- Public spending grew at a faster rate in Tasmania (4.4% pa ) than any other State except SA (cf mainland 3.3%) and accounted for just under 40% of total GSP growth (cf. mainland 20%)
  - as we shall see most of this was State government spending, not Commonwealth

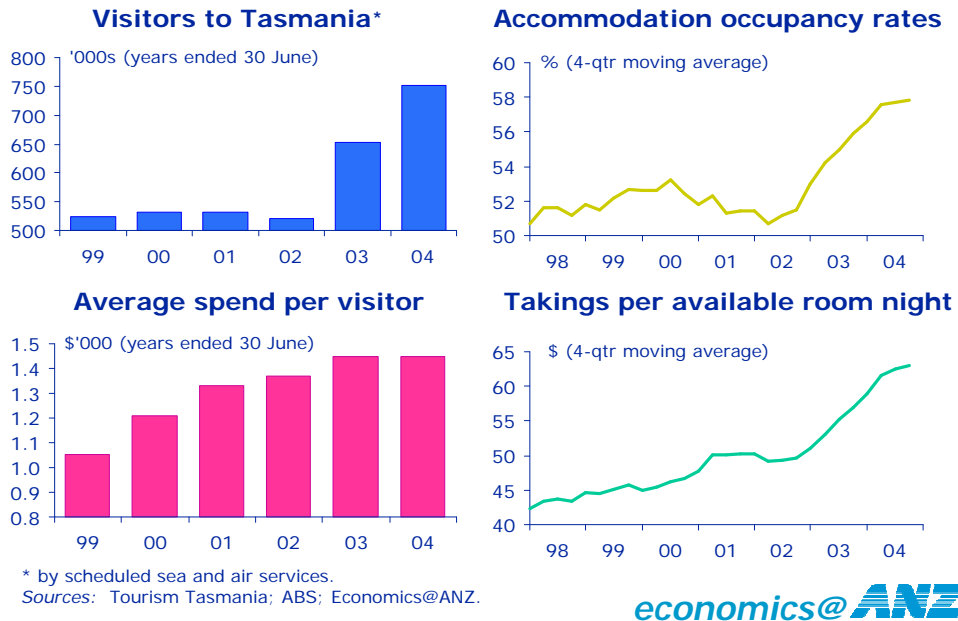
## Good economic policy at the State level has played an important role in these results



Good economic policy at the State level has played an important role in the improved performance of Tasmania's economy

- the State's finances have been well-managed, as highlighted by the improvement in Tasmania's credit rating
- the Budget has been kept in surplus and debt has been reduced – in marked contrast to the 1980s, when Tasmania ranked second only to Victoria for fiscal incompetence – and
- Among other benefits, this has meant that less than 2% of the Government's revenue is now being absorbed in interest payments, cf. a peak of over 10% in 1993-94
- Surpluses for 2004-05 and beyond were revised up in last week's mid-year review of the Budget, with the result that 'general government' net debt will be paid off before 30 June next year – a year ahead of schedule
- Importantly, good budget bottom lines have been achieved without raising State taxes – rather, the relative severity of Tasmania's state taxes has declined, and after taking account of differences in each State and Territory's capacity to raise taxes, Tasmania's tax burden is the third lowest of all the States & Territories, bettered only by Qld and NT.
- I think I'm right in saying that Tasmania is the only State not to have raised the rate of any State tax, or introduced any new State taxes, in the past four years.
- However good economic policy isn't only about good house-keeping. It also entails promoting economic growth through micro-economic reform, nurturing the economy's competitive strengths, removing impediments to economic growth, and ensuring that the benefits of economic growth are widely shared.

## The tourist industry provides a specific example of the benefits of good policy at the industry level



The tourist industry provides a specific illustration of the benefits of good economic policy – in this case, in particular, the acquisition of the first two “Spirits” (it may be that the acquisition of the 3<sup>rd</sup> “Spirit” was, in hindsight, a mistake, though I don’t want to go there)

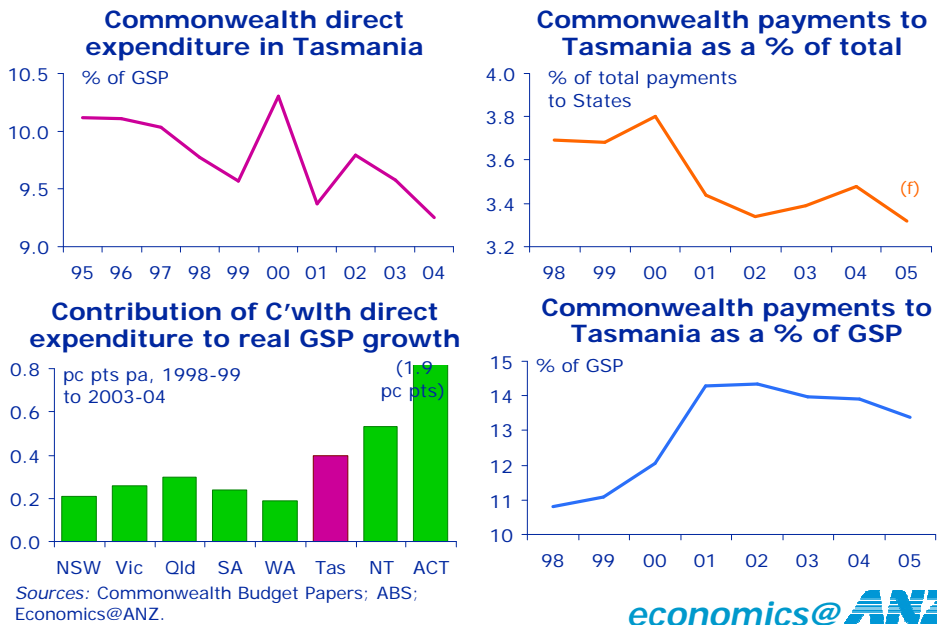
- Visitor numbers to Tasmania up by nearly 45% over past two years.
- Average spend per visitor up by 5½%
- Tourism industry has benefited from improved occupancy rates (now about 94% of the national average, cf. 89% in the late 1980s) and average takings (now around 83% of the national average, cf. less than 73% in 2000-01).

However it’s not only good economic policy that has produced this result. Also good social policy – specifically the abolition of two distinct sets of what were previously ‘victimless crimes’ –

- homosexual acts between consenting adults
- transactions between consenting retailers and consumers on Saturday afternoons and Sundays

Both have significantly altered the State’s image – and have contributed not only to the tourism boom, but I would argue also to the turnaround in population flows.

## The Commonwealth government's contribution to Tasmania's recovery has been fairly small



Good economic management at the Federal level (by the Federal government and the Reserve Bank) has indirectly contributed to the improvement in the performance of the Tasmanian economy. With 30% of Tasmania's output sold on the mainland, and as a peripheral part of the national economy, Tasmania is especially vulnerable to any downturn in national economic growth.

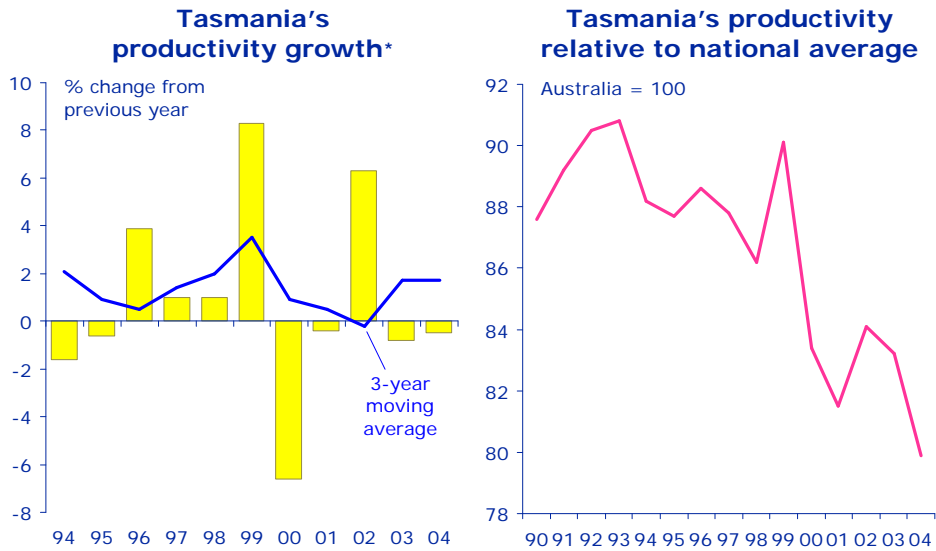
So the strong growth enjoyed by the Australian economy as a whole over the past 13 years has provided a constructive environment for Tasmania.

And as the second most heavily indebted State government (after the NT), the Tasmanian budget has benefited from the decline in interest rates since the early 1990s.

But (for all the complaints by the Premiers of NSW, Vic & WA about the supposed generosity of successive Federal Govts to Tasmania), the direct contribution of the C'wlth to Tasmania's recovery has been quite small.

- Direct spending by the Federal government and its agencies in Tasmania (including Telstra) has actually fallen as a share of the State's economy since the late 1980s (apart from a one-off spurt in 1999-2000 – the Harradine grants) (these figures obviously don't include all the spending in the seat of Bass ahead of last year's election)
- Tasmania's share of total C'wlth payments to all States and Territories (including GST revenues since 2000-01) has declined by nearly ½ pc point since the late 1990s)

## However it's not clear that there has been a trend improvement in Tasmania's productivity



\* Productivity defined as real gross State product divided by an index of hours worked.  
Sources: ABS; Economics@ANZ.

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For all of this good news about the recent performance of the Tasmanian economy, there is however one significant area of concern that goes to the heart of the question of whether this improvement is sustainable.

This is that there has been no apparent improvement in Tasmania's productivity performance – apart from a seemingly isolated spurt in 2001-02.

Indeed, relative to the national average, Tasmania's output per hour worked has declined further in recent years, to less than 80% of the national average – the lowest such figure in at least 14 years.

## **Productivity is 'what you get out for what you put in' - and it matters**

**"Productivity is the prime determinant in the long run of a nation's standard of living, for it is the root cause of per capita national income**

**High productivity not only supports high levels of income but allows citizens the option of choosing more leisure instead of working longer hours.**

**It also creates the national income that is taxed to pay for public services which again boosts the standard of living**

**The capacity to be highly productive also allows a nation's firms to meet stringent social standards which improve the standard of living, such as in health and safety, equal opportunity and environmental impact"**

**– Michael E. Porter, *The Competitive Advantage of Nations* (1991), page 6**

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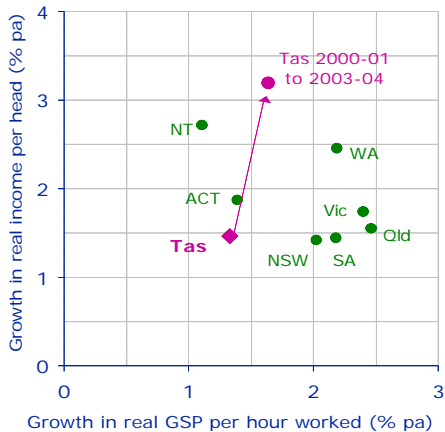
Productivity is important. As one of the foremost contemporary American economist, Paul Krugman, says –

- "Productivity isn't everything, but in the long run it's nearly everything"

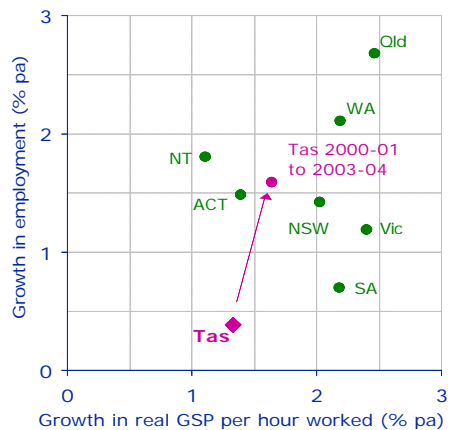
Similarly prominent management theorist Michael Porter, in the book that first made him famous, highlights the critical role that productivity growth plays in underwriting improvements in standards of living and in a society's capacity to provide public services, meet rising social aspirations, care for the environment and so on.

# Productivity growth is a key driver of both household income and employment growth

## Productivity and real per capita household income growth



## Productivity and employment growth



Note: Growth rates are measured from 1990-91 (the trough of the last recession) to 2003-04. Sources: ABS; Economics@ANZ.

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I've argued previously, eg in our submissions to and commentary on the Nixon Report commissioned by the previous State government, that there is a correlation between productivity growth and per capita household income growth, and (contrary to what many non-economists believe) between productivity growth and employment growth.

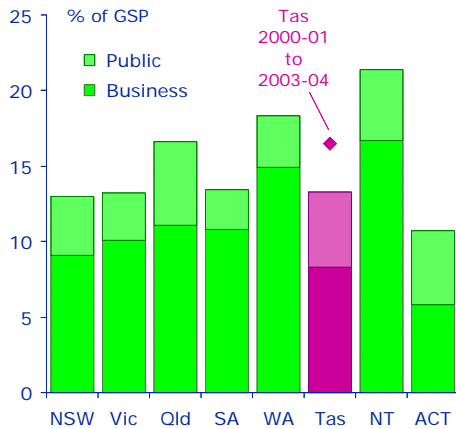
Of course correlation doesn't necessarily imply causation,, but the relationships are nonetheless highly suggestive, and consistent with what economic theory and academic research leads us to expect.

These charts update those I used a lot in the late 1990s.

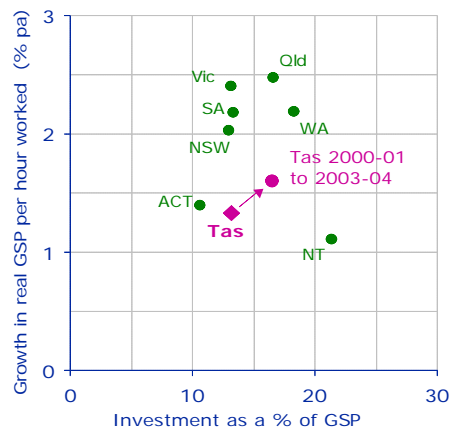
Tasmania's performance has clearly improved quite a lot over the past three years – but not too much of it can be attributed to movements across the horizontal axes (ie to a pick up in productivity growth)

## Investment in physical capital is an important driver of productivity growth ...

Investment as a share of GSP



Investment as a share of GSP and productivity growth



Note: Investment shares and productivity growth are averages over the period 1990-91 to 2003-04.  
Sources: ABS; Economics@ANZ.

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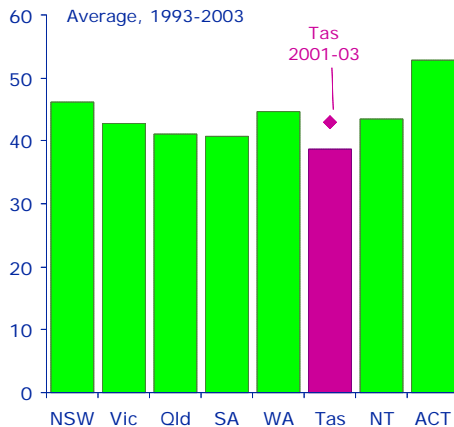
One of the main drivers of productivity growth is investment in physical capital – buildings and structures, plant and equipment, and (especially these days) information technology and software.

Since the end of the last recession, the share of Tasmania's output applied to investment in physical capital has been consistently below the national average – indeed, in most years, the lowest of all States and Territories – especially in relation to business (as opposed to public) investment.

Tasmania's position has improved a bit over the past three years (now close to the national average) – partly reflecting the huge energy investments undertaken during this period. But those projects have now passed their peak expenditure phase and it's not clear whether this recent improvement will be sustained.

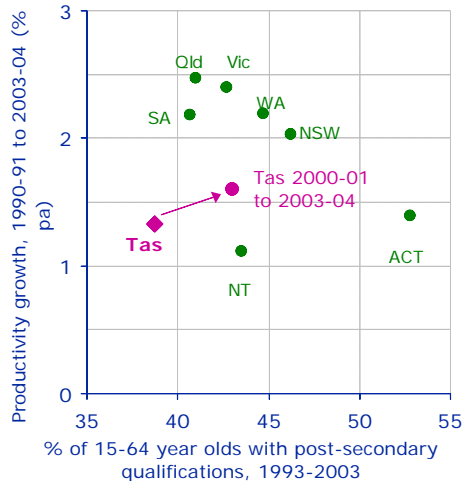
## ... and so is investment in human capital

### % of 15-64 year olds with post-school qualifications



Sources: ABS; Economics@ANZ.

### 'Human capital' and productivity growth



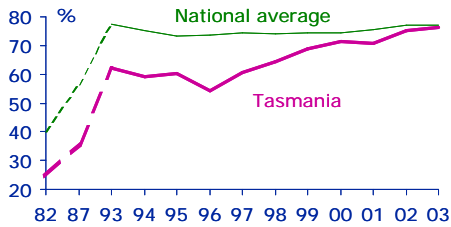
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The other key driver of productivity growth is investment in human capital.

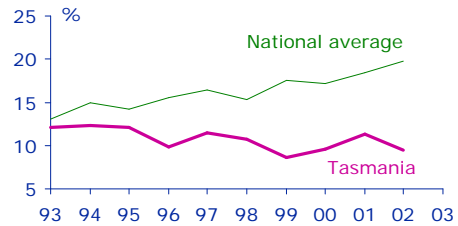
Again, historically Tasmania has performed poorly in this area, with the proportion of Tasmania's working age population possessing post-secondary qualifications (higher education or TAFE) being the lowest of any State, and conversely the proportion of the working age population having not completed year 12 being the highest of any State (or Territory).

## Tasmania is starting to do better on some human capital indicators, but results take time

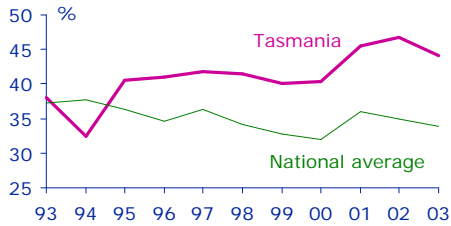
School retention rates to year 12



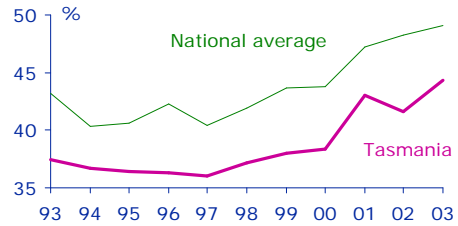
% of 15-24 year olds in higher education



% of 15-64 year olds not finishing year 12



% of 15-64 year olds with post-secondary qualifications



Source: ABS.

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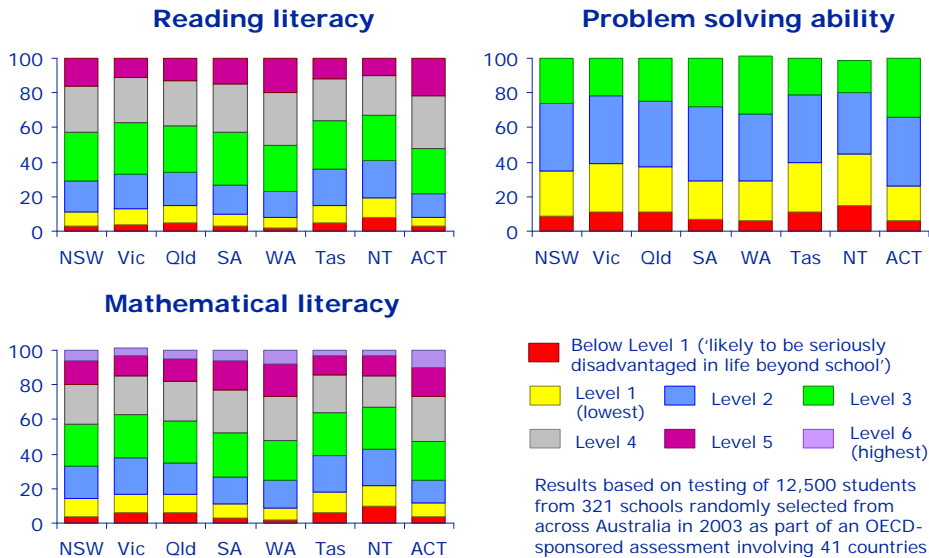
Tasmania is starting to do better on some of the indicators of educational participation and attainment

- in particular, the retention rate from year 10 to year 12 – once (around the time I was at school in Tasmania) nearly 20 pc points below the national average – is now almost equal to the national average
- and an increasing proportion of Tasmanians have acquired post-secondary qualifications – though this is still well below the national average (which is also rising).

However on some other indicators the signs are not so encouraging

- 
- the proportion of the working age population not having finished year 12 is rising – this seems a little hard to reconcile with the rising retention rate, but it may reflect the differing educational attainments of those moving to Tasmania from the mainland, and those moving in the opposite direction.
- the proportion of young Tasmanians participating in higher education appears to be declining – in contrast to the trend in the national average.

## But it's also important to monitor quality of outcomes – where Tasmania isn't doing so well



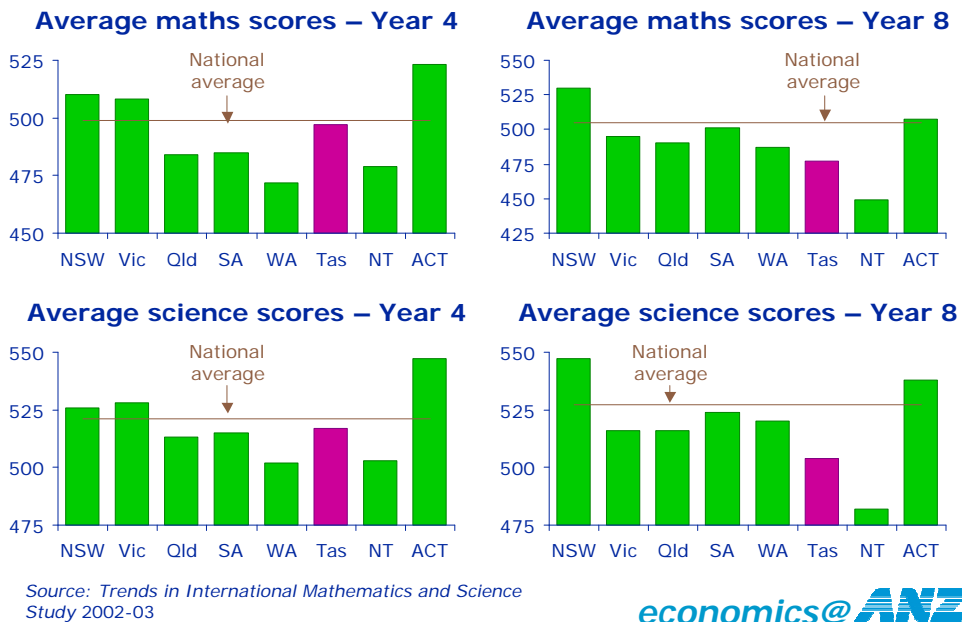
Source: Australian Council for Educational Research; Program for International Student Assessment (PISA).

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It's also important to pay attention to the quality of educational outcomes, as well as to measures of the amount of schooling Tasmanian students are getting.

Data released late last year by the Australian Council for Educational Research suggests that on three important measures of educational attainment – reading literacy, mathematical literacy, and problem solving ability – Tasmanian students are near the 'bottom of the class' - with only the Northern Territory having a higher proportion of students 'failing to reach level 1' (the lowest level of attainment) in these three areas, and a smaller proportion of students in the highest levels.

## Tasmanian students slip back relative to their mainland counterparts between Years 4 and 8



Another set of internationally standardized test results suggests that Tasmanian school children do well by national standards in mathematics and science by year 4: their scores are slightly below the national average, but better than those for the other small States. They suggest that Tasmanian kids have the same innate abilities as kids from anywhere else in Australia.

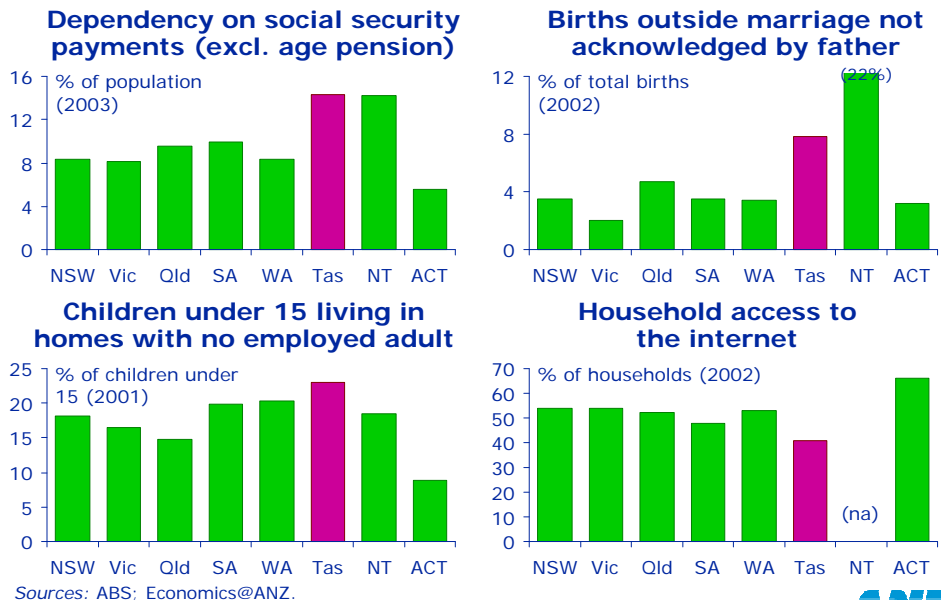
But then something happens – or doesn't happen – over the the following four years which leaves Tasmanian school children performing well below the national average in maths and science by Year 8, lower than for any other State.

I don't pretend to be an educational expert, but as an economist I think results such as these ought to be ringing some alarm bells not only in Tasmania's education department but also in the business community and across the State more broadly. Because if they are representative of the quality of the education received by Tasmanian children relative to those in other States then there is little prospect of Tasmania closing the 'productivity gap' with the rest of Australia.

Part – though I want to stress only part – of the answer is probably spending more money on education. But the good news is that the improved position of the State budget means that the resources to spend more money on education are now available. That's one of the main reasons why getting the State's finances under control has been so important.

But it's also vital that the business community recognizes that education is a business issue – not just a social issue – and gets involved in discussions about the amount of money spent on education in Tasmania, and what is done with what is spent.

## Tasmania still ranks poorly on a range of other indicators of social well-being



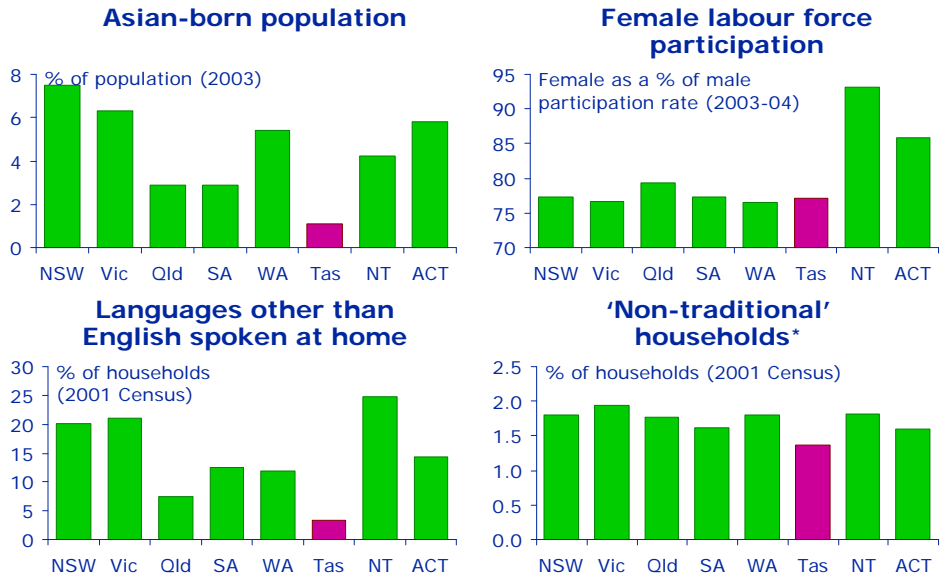
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Tasmania continues to score poorly on a range of social indicators. One could point to a wide variety of statistics which bear this out, but let me confine myself to four:

- 14.4% of Tasmanians are on labour market program payments, disability pensions or single parent allowances – compared with a national average of 8.8%
- 23% of Tasmanian children under the age of 15 are living in households where no adult has a job – compared with a national average of 17.4% (admittedly this was in 2001 and the gap will hopefully have narrowed a bit since then)
- 7½% of all Tasmanian births are to teenage mothers – compared with a national average of 4.6% - and, more alarmingly, the proportion of ‘extra-marital’ births where the father is not acknowledged in Tasmania is, at 7.8%, more than double the national average of 3.8%.
- Finally, the proportion of Tasmanian households having access to a PC or the internet at home is, by a fairly wide margin, the lowest of any State or Territory.

So there is a long way to go before the State’s improved economic conditions are reflected in meaningful progress against some of these social benchmarks.

## Tasmania also ranks poorly on a range of 'diversity' indicators



\* Non-traditional households are groupings of 2 or more related persons (incl. defactos) resident in the same household, excl. couples with or without children and one-parent families. Source: ABS.

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Finally – and I promise this is the last set of inter-state comparisons – Tasmania ranks lower than other States and the Territories on a wide range of diversity indicators –

- by a long way, Tasmania has the smallest proportion of people of Asian extraction among its population
- similarly, a much smaller proportion of Tasmania's population speak languages other than English than any other State or Territory.
- participation by women in Tasmania's labour force is lower relative to that of men (albeit by a fairly small margin relative to the other States) than anywhere else in Australia
- and Tasmania has a smaller proportion of 'non-traditional' households (that is, households other than married couple families with or without children, or single-parent families) than any other State.

I argue that these things matter because, increasingly, diversity is valuable not only for its own sake - but as a positive contributor to economic growth in its own right.

## **Tasmania should be seeking to attract more of the so-called 'creative classes'**

According to Richard Florida, Professor of Regional Economic Development at Carnegie-Mellon University, Pittsburgh (and now at George Mason University in Washington DC)

- "Creativity is now the *decisive* source of competitive advantage"
- "Creativity comes from people"
- "Places that succeed in attracting and retaining creative class people prosper; those that fail don't"
- The creative class is "a fast-growing, highly educated and well-paid segment of the workforce on whose efforts corporate profits and economic growth increasingly depend"
  - it includes people in science and engineering, architecture and design, education, arts, music and entertainment
  - it also includes 'creative professionals' in business and finance, law, health care and related fields ...
  - ... and 'the growing numbers of technicians and others who apply complex bodies of knowledge to working with physical materials' and 'the secretary in today's pared-down offices'

Source: Richard Florida, *The Rise of the Creative Class*, Basic Books (2002).

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Research by Richard Florida highlights the contribution that the so-called 'creative classes' are making to economic growth, and to the success (or lack of it) of different regions within the United States.

## What attracts the 'creative class'?

- "The location choices of the creative class are based to a large degree on their lifestyle interests [which] go well beyond standard 'quality of life' amenities"
- "They gravitate to stimulating creative environments – to places that offer not only opportunity and amenities, but openness to diversity, where they feel they can express themselves, and validate their identities"
- "They favour active, participatory recreation over passive, institutionalized forms ... not once did they mention professional sports as playing a role of any sort in their choice of where to live or work"
- "Places are also valued for authenticity and uniqueness - [which come] from ... historic buildings, established neighbourhoods, a unique music scene or specific cultural attributes"
- "Openness to immigration is particularly important for small cities and regions ... it's important for a place to have low barriers to entry for people - to be a place where newcomers are accepted quickly into all sorts of social and economic arrangements"

Source: Florida.

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Florida's research suggests that diversity is an important factor to members of the 'creative classes' in deciding where to live and work.

I argue that Tasmania has many of the characteristics which are intrinsically attractive to members of this 'creative class'.

But these characteristics have to be valued, nurtured, strengthened and promoted if Tasmania is to succeed in attracting members of the 'creative classes' – and conversely, Tasmania has to be careful to avoid creating impressions that would lower its standing among such people.

## Tasmania now

- Is still a long way behind the rest of Australia on most measures of material living standards and market-based economic activity
- Nonetheless appears to be better positioned for sustained economic growth than at any time during the past two decades
- Is less likely to continue falling behind the mainland on a broad range of economic indicators over the next ten years than it has done over the past twenty
- And indeed has begun to narrow at least some of the gaps with the mainland on some, though not all, important economic indicators

## Tasmania's future ...

- ... cannot possibly lie predominantly in the volume production of essentially unprocessed commodities at lower prices than competitors with better access
  - to larger and cheaper resources of labour and capital
  - and to markets (by virtue of proximity of membership of trade blocs)
- ... but instead depends on its capacity to produce and market
  - highly differentiated goods and services
  - embodying a relatively high intellectual content
  - for which customers are willing to pay premium prices
- Tasmania does have the potential to be a magnet for the 'creative class' - many of the key ingredients are already here
- But Tasmania and Tasmanians also need
  - to be less resistant to social and economic change
  - to be more conscious and supportive of the value of education
  - to be more willing to embrace scientific and technological change
  - to be more tolerant of diversity and the 'clash of ideas'

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I'm not saying that commodity production has no role in Tasmania's future – so, for example, I support Gunns' proposed pulp mill project, provided there are no hidden government subsidies to it and provided it meets all the relevant environmental requirements – I see this as a way of capturing more of the forest products value chain in Tasmania than the export of unprocessed woodchips.

Similarly, I'd be delighted to see an increase in mineral exploration activity, and mining production, in Tasmania

However it would be a mistake to see commodity production as being the solution to Tasmania's economic problems, or as a significant source of employment in the future.

## Three things Tasmania must now avoid

- **Putting all its economic eggs in one basket (or a small number of them)**
  - this is effectively what Tasmania did from the 1950s through the late 1980s
  - and it left – and would again leave – Tasmania vulnerable to economic, technological and political shifts beyond its control
  - in a brand or image-conscious world, perception is as important as reality in this context
- **Monopoly or excessive concentrations of economic power**
  - always a greater risk in a small economy
  - potentially exposes Tasmania to greater risk of individual management failures, shifting corporate strategies and unhealthy influences over public policy
- **Complacency or hubris**
  - Tasmania's economy has performed better than expected over the past two years
  - some of that reflects temporary influences which are passing
  - reversing the cumulative effects of 20 years of bad policy and bad luck takes more than three years

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In *The Economist* of 27 November 2004 one of the editorials observed that 'it took about 20 years to reverse the damage done to the British economy in the 1960s and 1970s'.

- One should hardly expect that the damage done to the Tasmanian economy over at least as long a period can be repaired much more quickly

- It really is too early to tell whether the improvement in Tasmania's economic performance in recent years is truly sustainable.

- what I think is unarguable, is that there is a lot more work to be done to ensure that it is sustainable

- but that the nature of this 'work' is now different from the challenges which have needed to be addressed over the past decade, now that the battle to restore the State's finances to a sustainable position has been won.

There really is no point in State governments building up piles of financial assets by running large surpluses. That's not to say that the State government should now be running budget deficits (that would represent a return to the complacency of the 1980s).

But it is now time for Tasmania to consider revenue and spending measures designed to improve the State's human and physical capital, and thereby lay the foundations for a truly sustainable recovery in Tasmania's economy.