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The State of the States

How the 'resources boom' is redistributing activity around Australia – but that's not all

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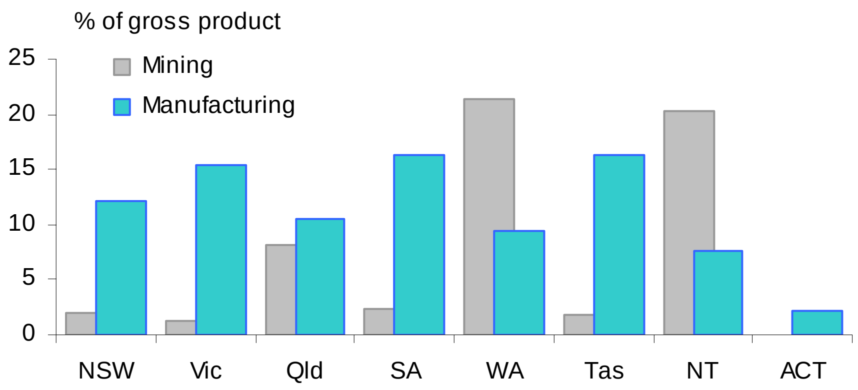
There's no doubt that the transition from the residential property market boom to the China-driven resources boom is altering the distribution of economic activity across Australia. It is heightening talk about jobs, business and wealth moving from Australia's south-east corner (where the majority of the population lives) to the north and west (where the majority of the resources now keenly sought as fuel for China's rapid growth and industrialization are located)[1].

Yet although this picture of a 'two-track Australia' has much substance to it, the reality is more nuanced than the simple assertion that WA and Queensland are gaining 'at the expense' of Victoria and NSW.

Mining and manufacturing - 2004-05



Without doubt **Western Australia** is doing spectacularly well. After experiencing a recession in 2000-01 (for the first time in 19 years), WA's economy has grown at an average annual rate of over 5%, and according to the forecasts underpinning this year's State Budget will grow by an average of 4½% per annum over the next four years. Within the next two years Western Australians will have moved ahead of residents of NSW and Victoria to have the highest average per capita household disposable incomes of any part of the country except the ACT.

Western Australia's unemployment rate has fallen by two percentage points since the end of 2003 to just 4% and is (conservatively) projected to remain below 5% for the remainder of this decade. After remaining in the doldrums for much longer than in eastern capitals, Perth's housing market is now booming, with average prices almost doubling over the past four years.

Not surprisingly, the WA State Government is in a very strong financial position, having become a net creditor two years ago and expecting a budget surplus of nearly $1½bn in the current financial year, even though its operating expenses have risen by over 10% per annum during the past two years.

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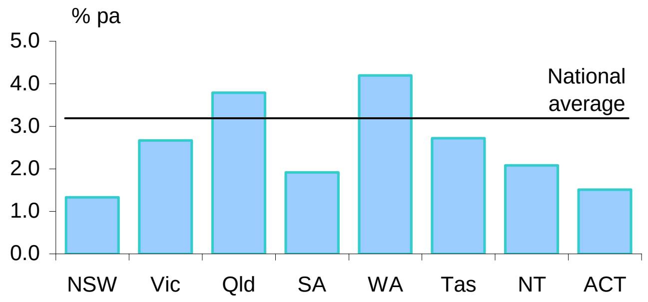
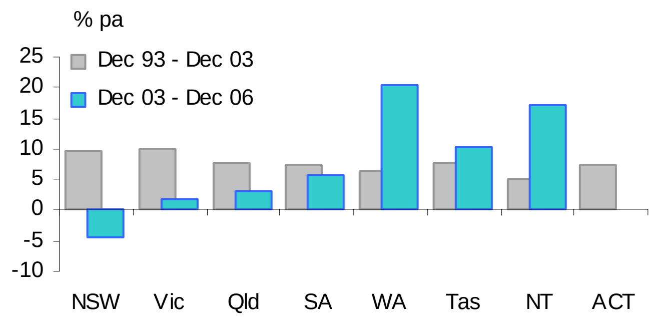
[1] See for example Commonwealth Treasury Secretary Dr Ken Henry's speech to the Australian Business Economists' post-Budget lunch in Sydney on 16 May 2006, *The Fiscal and Economic Outlook;* or the Discussion Paper published this month by the Victorian Department of Treasury and Finance, *A Tale of Two Economies: The Regional Impact of Australia's Resources Boom* (available on the Commonwealth and Victorian Treasury websites, respectively).

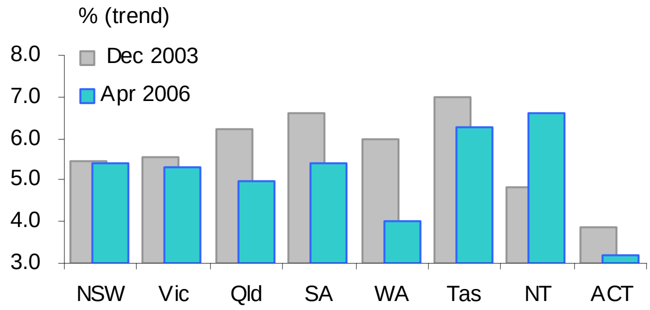
Real GSP growth, 2001-02 to 2005-06



Capital city established house prices



Unemployment - Dec 2003 and April 2006



Queensland is also doing well, with economic growth averaging 5¼% pa over the past four years and expected to continue at close to 4½% pa over the remainder of the decade. Queensland has generated nearly one-third of all of the new jobs created in Australia over the past two years, despite having less than one-fifth of the population; and its unemployment rate, traditionally above the national average, is now just below it at 5.0%.

Yet when Queensland's rapid population growth is taken into account, its economic performance is distinctly less impressive than WA's. Per head of population, its economy has grown by a full percentage point per annum less than that of Western Australia.

Contrary to the impression widely held in the southern States, Queensland is a relatively poor State. Average household incomes remain the second-lowest in the nation. That's because Queensland is still a low-productivity economy, with output per hour worked 13% below the national average.

And while Queensland's mining industries are undoubtedly benefiting from high commodity prices and increased investment, its rural and tourism sectors (which are bigger than WA's) are being hurt by the strong A$.

With operating expenses set to rise more rapidly than in any other State over the next few years, as the Beattie Government seeks to fix serious problems in Queensland's health system, Queensland will see an unusual run of budget deficits (although it will continue to enjoy the strongest balance sheet position of any Government, in no small part due to the financial assets accumulated by the Queensland Investment Corporation).

The **Northern Territory's** economy has been surprisingly weak for much of this decade, with growth averaging less than 1% pa between 2001-02 and 2003-04 and unemployment averaging nearly 6%.

However activity is now starting to pick up in the Territory, with economic growth expected to average nearly 7% in the current financial year and just under 6% in 2006-07. House prices in Darwin are rising almost as fast as in Perth.

As the second-largest exporter of Australia's largest single export – coal – one might have also expected **New South Wales** to be a beneficiary of the resources boom. Yet the self-styled 'Premier State' has in fact become the lead in the nation's economic saddle-bags in recent years.

Its economy has grown by less than 2% per annum over the past four years. Employment has grown more slowly than in any other State during this time, and NSW's unemployment rate is now nearly one-half of one percentage point above the national average. While housing activity in the rest of the country is still running at levels comparable to the 1990s average, in NSW dwelling starts are down to less than two-thirds of the 1990s average.

Although NSW is more adversely affected by rising interest rates than other parts of Australia (because its residents have, on average, bigger mortgages), and it was hurt more by the down-turn in the IT sector at the beginning of the decade, many of its current economic woes have been self-inflicted by the policy mistakes of the government led for a decade by Bob Carr.

The most compelling evidence for this is that most of the distinctive policy stances of the Carr Government – the vendor stamp duty on investment properties, the unwillingness to borrow for infrastructure investments, the refusal to contemplate privatisation of any major assets, the generally unfriendly attitude to property development and, most of all, the anti-growth bias epitomized by Bob Carr's "Sydney is full" mantra – have all been reversed by Carr's successor, Morris Iemma.

Partly as a result, there is now some evidence that Australia's largest State economy is no longer deteriorating as sharply relative to the rest of the country. But NSW seems set to under-perform for some years to come.

By contrast **Victoria** has done quite well, considering that it derives almost no direct benefit from the resources boom, and its traditional strengths in export-oriented or import-competing manufacturing and in export-oriented agriculture (such as wool and dairying) are particularly vulnerable to the strength in the A$ induced by the resources boom.

Victoria's economy has grown by 3.3% per annum, on average, over the past four years – slightly faster than the national average. Over the past two years Victoria has accounted for one in every four jobs created nationally – more than any other State except Queensland.

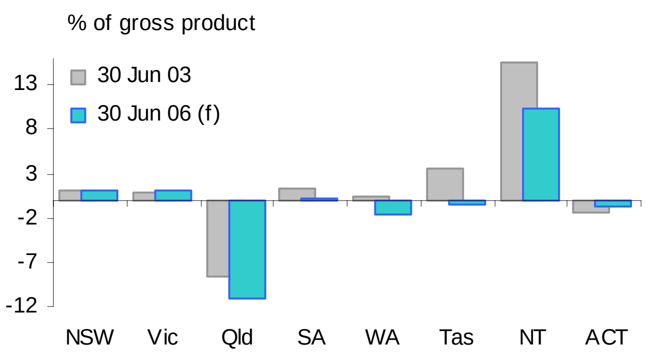
Victoria's economy probably will grow a little more slowly than the national average over the next few years, but by a smaller margin than NSW. Having lost its position as Australia's 'financial capital' to Sydney during the 1970s and 1980s (albeit that it remains the home of two of Australia's four largest banks and a major centre for funds management), Melbourne may now struggle to prevent the loss of mining company headquarters to Perth.

South Australia may have the world's largest uranium mine and Australia's biggest copper mine at Roxby Downs, but otherwise like Victoria it has little to gain from the commodities boom and a fair bit to lose from the boom's impact on the exchange rate. The 'wine glut' and persistent uncertainties over the future of motor vehicle manufacturing in Adelaide haven't helped either.

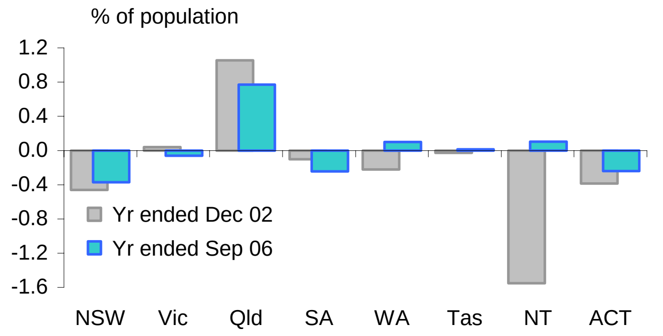
Its economy has grown at about 2½% per annum over the past four years, and its unemployment rate has drifted up by about half a percentage point to nearly 5½% over the past year. The population outflow to other States is accelerating. And South Australia's budgetary position, although much improved from the early 1990s, is also arguably the weakest of any State.

The striking exception to the 'weak south-east versus strong west and north' dichotomy has been the performance of the **Tasmanian** economy over recent years. Tasmania's economy has grown by nearly 3½% per annum over the past four years, exceeding the national average. In per capita terms Tasmania's economy has grown faster than any other State except WA over the past four years.

General government net debt



Net interstate migration



Tasmania has also been the only State, other than WA and Queensland, in which employment growth has exceeded 3% per annum over the past four years. In Tasmania's case, this has prompted many of its above-average proportion of 'hidden job-seekers' to re-enter the labour force, thus keeping its unemployment rate above 6%.

To some extent, Tasmania's strong economic performance has been driven by its 'discovery' by refugees fleeing the stratospheric house prices of Sydney and Melbourne. The traditional population drain across Bass Strait has gone into reverse since 2003, although the normal pattern now seems to be re-asserting itself since the end of the property boom in Australia's two largest cities.

But Tasmania's recovery also reflects a decade of something Tasmania has lacked for the preceding 30 years – namely, good economic management at the State level. Tasmania has paid off what ten years ago was proportionately the highest net debt of any State; and it has done so whilst being the only State not to have introduced any new State taxes, or increased any existing ones, since the introduction of the GST.

Tasmania remains Australia's poorest State – although by a smaller margin now than at any time since the late 1980s – and its challenge is to lift its bottom-of-the-ladder productivity performance and diversify its economy away from commodity-based industries which in most cases lack the scale to be internationally competitive.

For Australia's resource-rich States, the key challenge is to ensure that the fruits of the current boom are not dissipated in wasteful spending. For the rest, a key issue is dealing with the consequences of an exchange rate that will undermine the competitiveness of their traditional strengths.

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