

# Tasmania's economic recovery: is it the 'Real McCoy?'

## Presentation to Tasmanian Economic Forum

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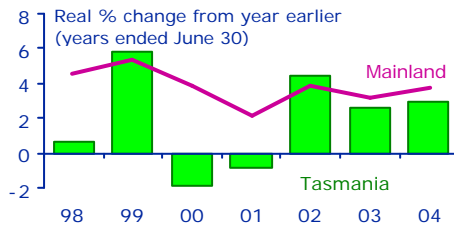
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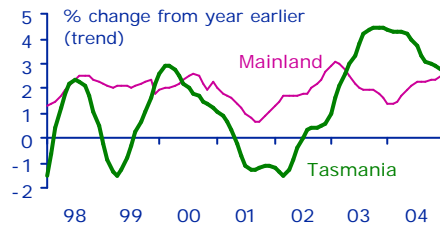
- I came to study economics as a 17-year old in much the same way that Sherlock Holmes used to arrive at the truth – when you've eliminated the impossible, whatever remains, however improbable, must be the truth (*The Sign of Four, The Blanched Soldier, The Bruce-Partington Plans*).
- I eliminated all the things I didn't want to do (law, medicine, science); the things I didn't think I could do (engineering); and the things I wanted to do but suspected I couldn't make a living at (history, geography) and was left with economics and accounting. It only took one year of (compulsory) study of accounting for me 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 enjoy it so much – 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 90s was largely the result of bad economic policy – failure to recognize and respond to significant and predictable changes in the economic environment; and incompetent management of State's finances.
- The improvement in Tasmania's economic performance since 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 ...

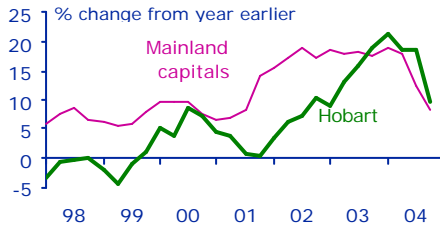
### Gross State product



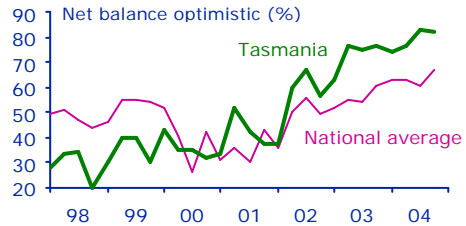
### Employment



### Established house prices



### Small business confidence



Sources: ABS; Sensis; Economics@ANZ.

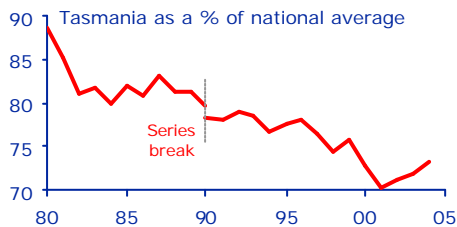
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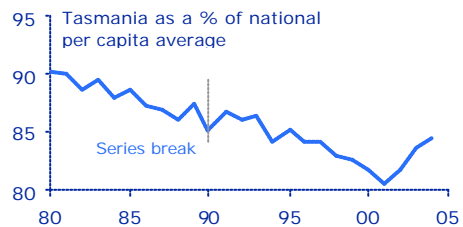
- Tasmania's economic growth performance has much improved so far this decade.
- After growing by an average of just 1.6% pa in the 1980s, and 1.5%pa in the 1990s, Tasmania's real gross State product has grown by an average of 3.3% pa over the three years to 2003-04
- This is the best three-year growth performance Tasmania has sustained since the three years ended 1985-86.
- Incidentally, I acknowledge Tasmanian Treasury has many reservations about ABS' GSP estimates for Tasmania, but since they don't publish details of, nor any history of, their 'underlying economic activity measure – (cf. Queensland Treasury which publishes detailed estimates of State product) – this is all we have to go on).
- 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.
  - Hobart house prices up 44% on average over the past three years, nearly matching the all-capitals average of 49%
  - 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

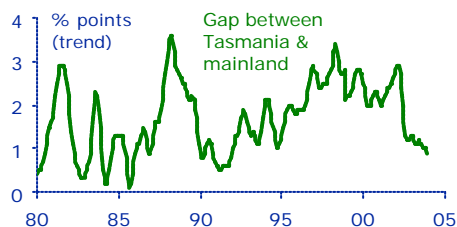
### Per capita State product



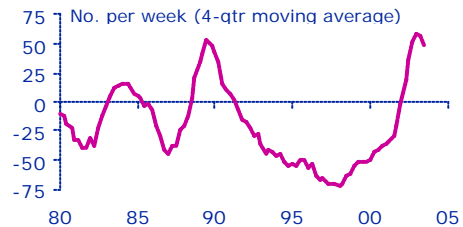
### Household disposable income



### Unemployment rate



### Net interstate migration



Sources: ABS; Economics@ANZ.

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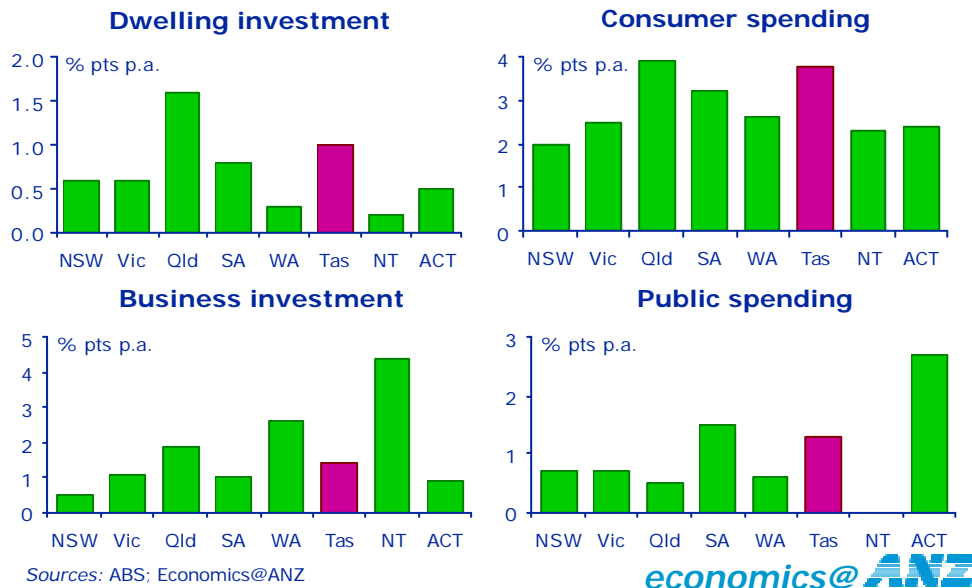
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This has produced some very encouraging developments in Tasmania's standing relative to the mainland –

- 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 (6.2% in Nov) is the lowest since October 1980, and the gap between Tas's u-rate and the mainland's has fallen to less than 1 pc pt for the first time in 12 years (though note because of Tas's lower participation rate, the gap b/w employment/ population ratios is still 4.8 pc points)
- 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

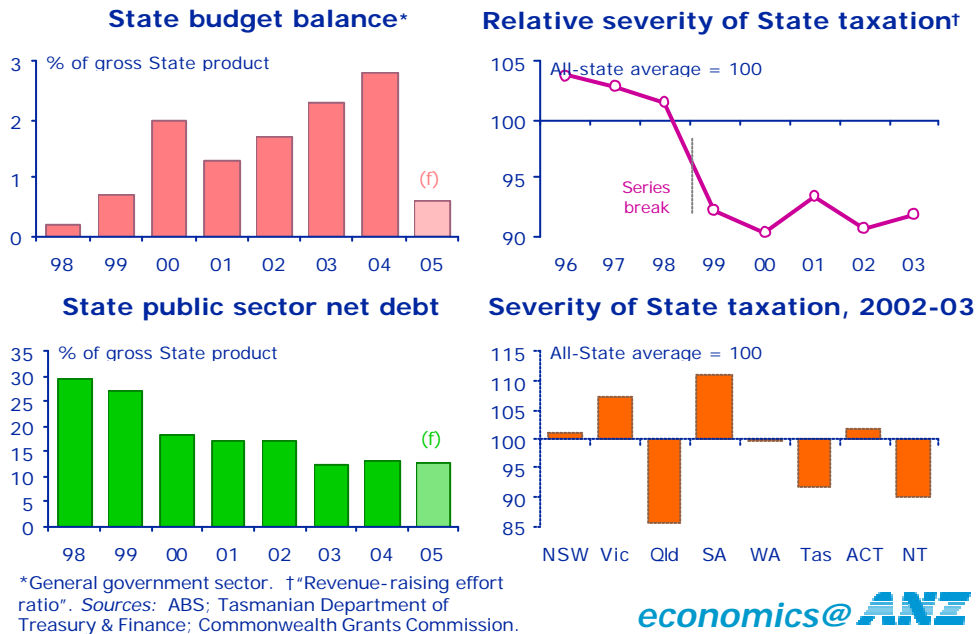
## P.c. point contributions to real GDP growth, 2000-01 to 2003-04



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 GDP 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 GDP over this period (clearly, other components, in particular net exports and the 'balancing item', subtracted from GDP growth) – cf. just under 70% of the increase in mainland GDP
  - 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 GDP 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 GDP growth (cf. mainland 20%)
  - as we shall see most of this was State government spending, not Commonwealth

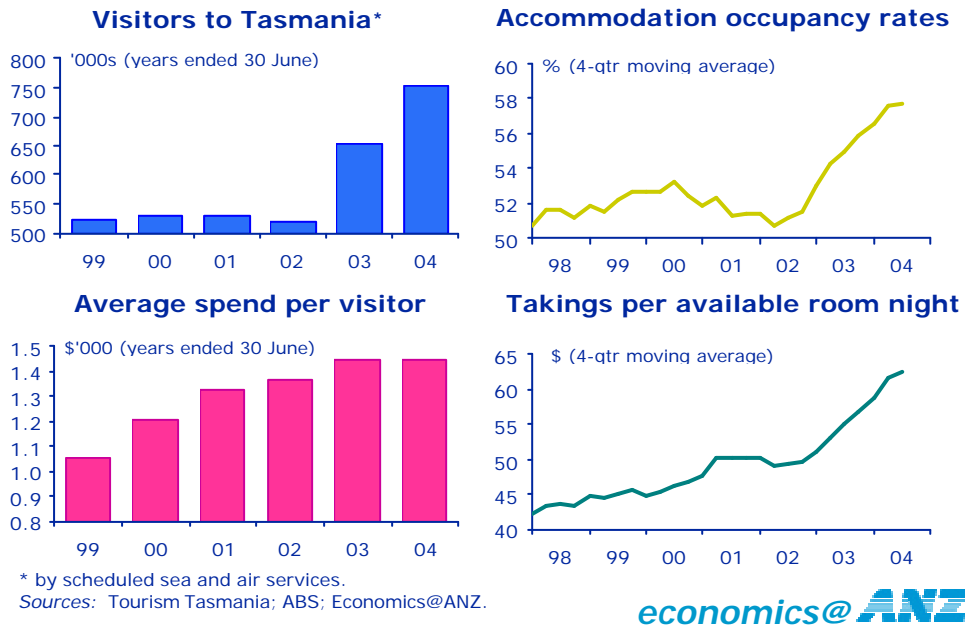
## Good economic policy at the State level has played an important role in these results



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
- 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)

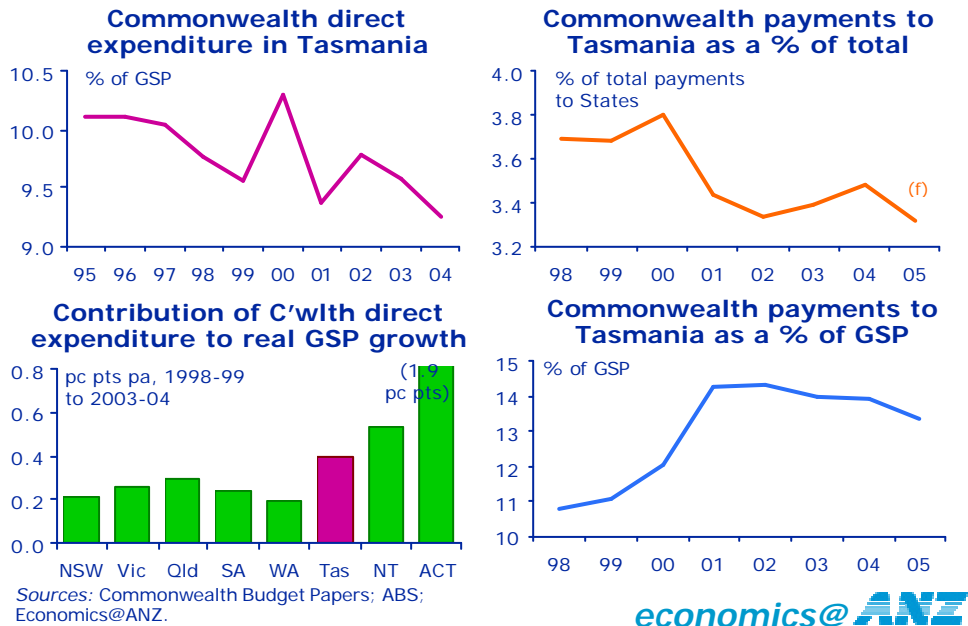
- Visitor numbers to Tasmania up by nearly 45% over past two years.
- Average spend per visitor up by 5½%
- Tourism industry has benefited from improved occupancy rates (now about 94% of the national average, cf. 89% in the late 1980s) and average takings (now around 84% of the national average, cf. 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.

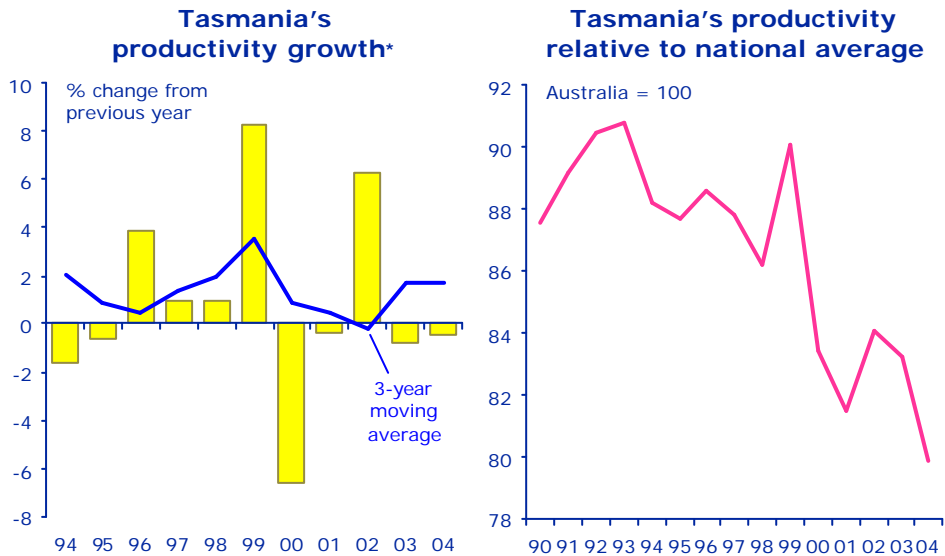
So the strong growth enjoyed by the Australian economy as a whole over the past 13 years has provided a constructive environment for Tasmania.

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)
- 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**

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"

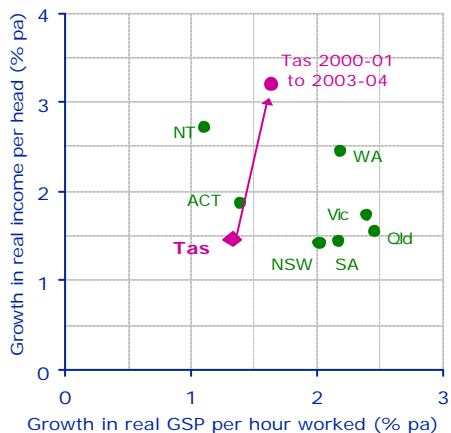
Similarly prominent management theorist Michael Porter, in the book that first made him famous, highlights the critical role that productivity growth plays in underwriting improvements in standards of living and in a society's capacity to provide public services, meet rising social aspirations, care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

Incidentally the phrase 'the real McCoy' is an allusion to the African-American inventor Elijah McCoy (1844-1929), who in 1872 invented an automatic oil cup for lubricating steam engines, and which significantly improved railway productivity by reducing the number of stops trains had to make for re-oiling. His inventions spurred a number of cheaper imitations, but engineers became aware of their inferior performance and insisted on 'the real McCoy'.

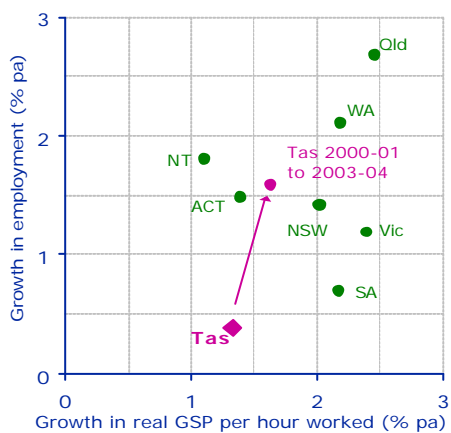
That's why I chose the title for this talk – because sustained growth in productivity is 'the real McCoy' when it comes to sustaining economic growth over long periods of time.

# 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.



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.

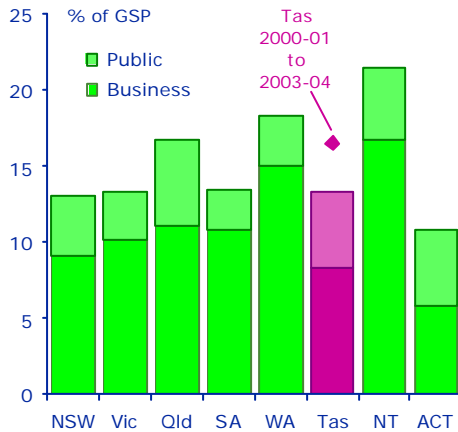
Of course correlation doesn't necessarily imply causation, as this audience would be well aware, but the relationships are nonetheless highly suggestive, and in accordance with what our training in economic theory would lead us to expect.

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

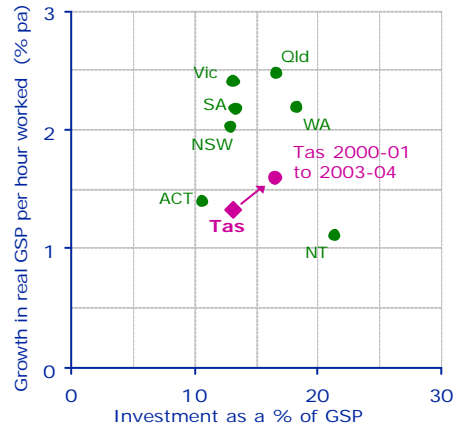
Tasmania's performance has clearly improved quite a lot over the past three years – but not too much of it can be attributed to movements across the horizontal axes (ie to a pick up in productivity growth)

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

**Investment as a share of GDP**



**Investment as a share of GDP and productivity growth**



Note: Investment shares and productivity growth are averages over the period 1990-91 to 2003-04.

11 Sources: ABS; Economics@ANZ.

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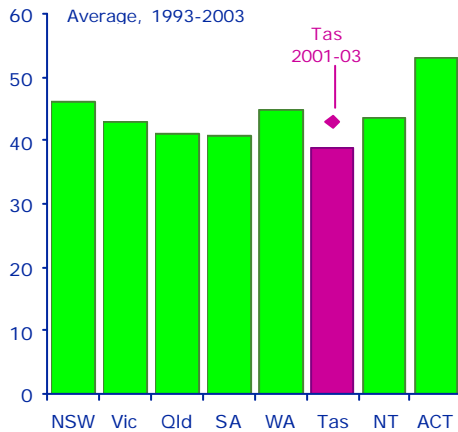
One of the main drivers of productivity growth is investment in physical capital – buildings and structures, plant and equipment, and (especially these days) information technology and software.

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.

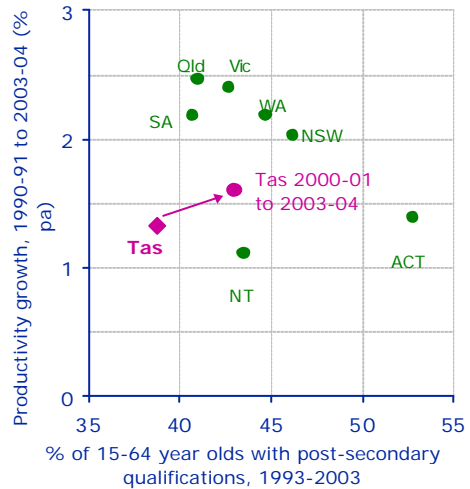
## ... and so is investment in human capital

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



Sources: ABS; Economics@ANZ.

**'Human capital' and productivity growth**



Productivity growth, 1990-91 to 2003-04 (% pa)

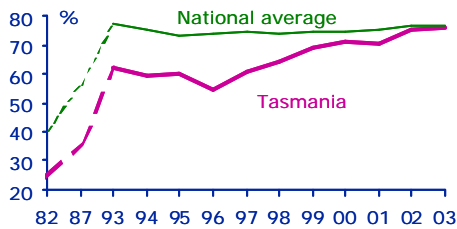
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The other key driver of productivity growth is investment in human capital.

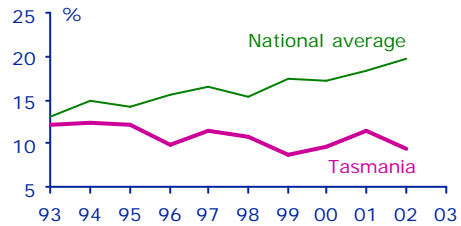
Again, historically Tasmania has performed poorly in this area, with the proportion of Tasmania's working age population possessing post-secondary qualifications (higher education or TAFE) being the lowest of any State, and conversely the proportion of the working age population having not completed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

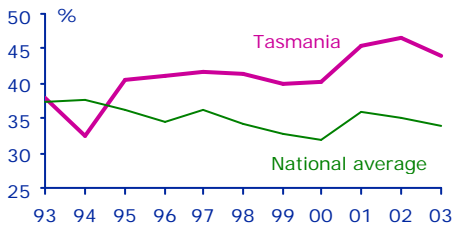
School retention rates to year 12



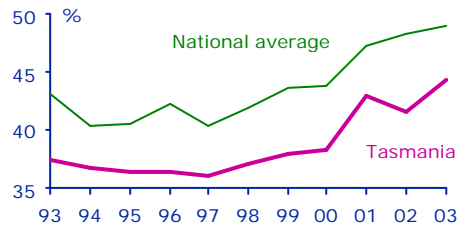
% of 15-24 year olds in higher education



% of 15-64 year olds not finishing year 12



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



Source: ABS.

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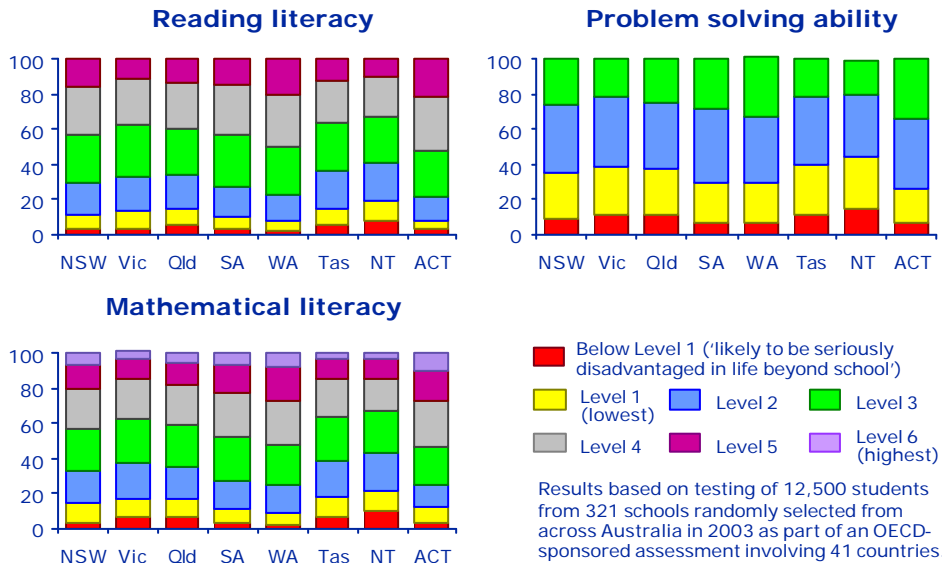
Tasmania is starting to do better on some of the indicators of educational participation and attainment

- 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).

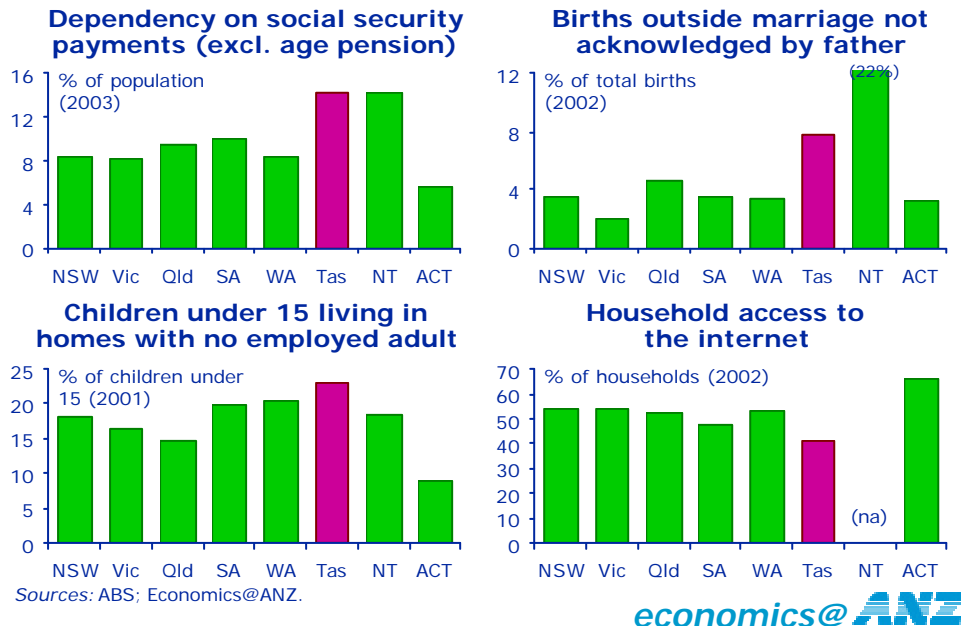
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It's also important to pay attention to the quality of educational outcomes, as well as to measures of the amount of schooling Tasmanian students are getting.

Data released this week 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.

This is something which I think demands careful and close examination by Tasmania's educational authorities – and if these findings are borne out by such an examination – then a very determined strategy to remedy them.

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



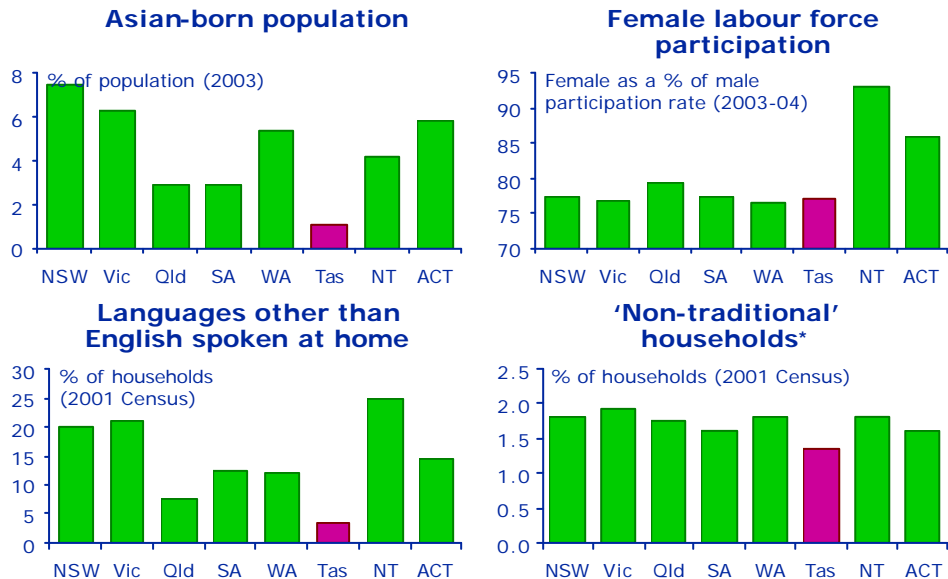
Tasmania continues to score poorly on a range of social indicators (about which I'm sure more will be said by Kelly Madden later this afternoon).

In brief,

- 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:

- "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"**

18 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

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So to summarize -

## 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'

(First dot point – these words, which I notice have been picked up and quoted by a range of different people – have been very carefully chosen to accommodate the commercial interests of my employer, which I have no desire or intention of damaging. I'm not saying that commodity production has no role in Tasmania's future – just that it is unlikely to prove Tasmania's salvation.

## 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

In last week's edition of *The Economist* (Vol 323 No 8403, 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

If it was enough for former Chinese Foreign Minister and Premier Zhou Enlai to say, in response to (depending on which source you believe) the French Ambassador in the late 1960s, Henry Kissinger in 1972, or some un-named journalist) asking what he thought were the effects of the French Revolution, that 'it was too early to tell', then I feel no shame in giving the same answer to the rhetorical question in my title, Tasmania's recovery – is it the 'real McCoy'?