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State of South Australia

STATE of SOUTH AUSTRALIA

From Crisis to Prosperity?

Edited by John Spoehr

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Preface

State of South Australia: From Crisis to Prosperity?

JOHN SPOEHR

After enjoying a period of strong economic and employment growth, Australia is being buffeted by the deepest global recession since the Great Depression. The global economic crisis is unwinding recent gains, fuelling rising unemployment and underemployment.

Typically, South Australia lags behind the national economy by around six months or more. It was late to experience the full impact of the 1990s downturn, but once the ripples of recession turned to waves, unemployment ratcheted up faster here than in all other mainland states. It rose from 6.7% in April 1990 to 11.5% in April 1992, pushing the number of unemployed up from around 47,000 to 81,000. Nationally, the 1990s recession added more than 400,000 people to the ranks of the unemployed in just two years.

It is difficult to remain optimistic when recession envelops the nation. This was the challenge the South Australian Government's Economic Development Board (EDB) faced in framing its 2009 Economic Development Statement. The result was a refreshingly honest assessment of the difficulties the present crisis is generating. There is no attempt to hide the fact that South Australia will suffer hardship from the global economic crisis in the short term. Beyond this EDB remains optimistic about the state's future.

The statement provides some important insights into transformational changes taking place in the South Australian and global economies, with EDB arguing that, thanks largely to the prospect of the expansion of Roxby Downs, South Australia is well positioned to emerge from the current global economic crisis as a national economic leader rather than a laggard.

Changes in the industrial structure of the South Australian economy and the rise of China and India as the economic powerhouses of the twenty-first century are the main reasons for EDB's optimism. The expansion of mining, in particular Roxby Downs, will add significantly to South Australian economic output. There is little doubt that global demand for mineral resources will reach new heights once the economic crisis subsides. Equally it is true that recent defence expenditure commitments, including the air-warfare destroyer contract and the submarine expansion program, underpin the development of a resilient form of manufacturing that won't rise and fall on the back of the fluctuating fortunes of currency markets like the vehicle industry.

The Economic Development Board estimates that the total investment associated with major projects coming on stream will boost state economic growth by around 1.24% over the next three years. EDB sensibly acknowledges that this outcome will be subject to the duration and severity of the global economic crisis. On the other hand, it is optimistic that the industrialisation of China and India will boost demand for South Australian exports over the medium term, adding to growth. But will all of this be enough to bridge the gap between South Australia and the nation's rate of growth? It may well be over the medium term, but it is not likely that we will exceed Australia's growth rate unless we manage to implement a green transformation of our manufacturing sector. EDB agrees that such a transformation represents an historic opportunity for South Australia, as the pressure to adopt a low-carbon path to development increases.

While narrowing the gap between South Australia and the nation's growth rate is an important objective, we shouldn't become obsessed by it. Many of the determinants of state economic growth are out of the control of state governments. What is more important is ensuring a high and sustainable standard of living for all. The Economic Development Board is mindful of this, but more will need to be done to assess the social impact of different growth paths on particular population groups. For example, there is a risk that over-reliance on mining may lead to a widening of income and wealth differentials. Mining is not as labour-intensive as it once was, but it is extremely lucrative for those who work in it or own it. For this reason it is important that mining royalties be maximised for the benefit of the wider South Australian community and that value-adding be a prominent feature of any new mining ventures. EDB shows an awareness of the danger of over-specialisation, arguing that South Australia must focus more attention on developing the services sector as an engine for growth.

EDB's growth projections indicate that it expects the lion's share of new growth to come from the expansion of the South Australian mining industry. Annual growth is projected to double in this sector by 2014–15, pushing South Australia's economic growth rate to 3.2%. On the back of a mining boom, major contributions are expected from other sectors, including construction, finance and insurance, and property and business services.

The Economic Development Board's conclusions on growth in South Australia are as good as can be expected in the current climate of instability. Economists, as they attempt to come to grips with the severity of the current downturn, but failing miserably to do so, continue to revise down their estimates of growth on a monthly basis. The point in relation to EDB's projections is not when they come to pass but if they will come to pass. There is a good chance that they will when the global economic crisis passes and the industrialising giants of China and India once again reveal their insatiable appetites for our mineral resources. As we fuel the global engines of economic growth, we must also contribute to their transformation to a low-carbon economy. While EDB does not discuss the growth dilemma in these terms, it demonstrates a good understanding of the carbon implications of particular growth paths. One of the disturbing features of this analysis is that mining is associated with relatively high greenhouse gas emissions – a point that EDB doesn't skirt around. Just how we reconcile increasing our reliance on mining with ambitious greenhouse reduction targets will be a challenge for EDB and policy-makers.

Just imagine a large meteorite plummeting to earth and slamming violently into the arid lands near Roxby Downs. It would instantly scar the landscape leaving a crater kilometres wide and hundreds of metres deep. What took seconds for an astral body to create will take BHP Billiton 40 years to dig at Olympic Dam – a mining pit over four kilometres long and three and a half kilometres wide and deeper than Mt Everest is high.

The scale of the proposed expansion of mining operations at Olympic Dam detailed in the draft Environmental Impact Statement (EIS) is astounding. Total production of copper, uranium, gold and silver is set to triple from around 235,000 tonnes per annum to 750,000 tonnes, adding around $56 billion to South Australian economic output over 30 years. Construction of the new operation will require more than 4000 workers on site over 10 years. Around 8000 permanent employees will be required to run the facility, generating thousands of flow on jobs in other parts of the economy. The industries to gain most from the expansion include rail transport, electricity, water transport services, chemical production and road transport.

Governments dream about projects like this one. Tax revenue flowing to the State Government from the expansion is expected to be around $2.1 billion over 30 years. Mining royalties paid to the State Governments are projected to increase by around $190m per annum when the new mine is operational. Because any substantial change in state revenue affects the formula for distribution of GST, this additional income will result in some decline in South Australia's share of the GST. Despite this the net effect is that South Australia is projected to be around $4.7 billion better off over 30 years than it otherwise would have been.

Just as all booms end in bust, a recovery from the depth of recession will come in due course. When it does, South Australia will benefit greatly from the inevitable recovery in global demand for mineral resources, and recent investments in defence manufacturing will bolster an otherwise sluggish manufacturing sector. South Australia will continue to be a major exporter of educational services, water resources technologies, wine and grain. The key to South Australia's future prosperity and sustainability, as elsewhere, is how rapidly the state is able to make the transition to a low-carbon economy. We must not lose sight of this as we grapple with the global economic crisis.

It is against a backdrop of global economic turmoil that this edition of *State of South Australia* examines recent social, economic, political, environmental and cultural trends and policy challenges. As well as revisiting the issues dealt with in the 2005 edition, *State of South Australia* contains a number of new chapters dealing with urban development, infrastructure, industrial relations and the media.

A fully revised edition of *State of South Australia* will be published every three years. Updates of selected chapters will be available at http://www.aisr.adelaide.edu.au.

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Adelaide, 2009

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Finally thanks to Jane for her love and friendship.

John Spoehr
Editor

CHAPTER 1

South Australia: The Economic Outlook

FRANK GELBER & MATTHEW CIRCOSTA

After a long period of low growth, South Australia will perform well over the next five years.

In the past, the problem for South Australia was low growth and population leakage. The consequence of this was a state unable to provide sufficient jobs for its people and the loss of population interstate as a result.

The high Australian dollar this decade and extreme competition from Asia affected competitiveness of domestic tradeables (in particular, manufacturing). Meanwhile, the centralisation of services to Sydney and Melbourne was saved by one-off major projects (including the Submarines and Alice Springs–Darwin rail).

The reversal of those negatives that have weighed down on state economic growth are now expected to underpin a strong period of economic growth for South Australia.

For now, we need to navigate the current shock from the global financial crisis, the recession in the developed world and the collapse of Australian discretionary spending (on cars, whitegoods and restaurants). The Air Warfare Destroyer (AWD) Warships project will provide a boost. To some extent, South Australia has been protected by its lack of exposure to the finance and business services sectors, with most financial businesses and the head offices of major companies situated in Sydney and Melbourne. Meanwhile, the mining investment downturn will impact more heavily on Queensland and Western Australia.

However, South Australia is not immune from the global financial crisis. The downside risk is the possibility of the financial crisis and its impact on credit, the recession in the developed world and the fall in minerals prices affecting major projects (in particular, the Olympic Dam expansion). Output and employment growth would be considerably lower if the Olympic Dam expansion did not proceed.

But the seeds for strengthening are already there: higher population growth, driven by net overseas migration, and Adelaide's relatively attractive housing affordability will boost state employment, housing construction and economic activity going forward. The previous problem of young and skilled people moving interstate in search of better opportunities led to a net

Table 1: South Australian key economic indicators table

Year Ended June						Forecasts					Average
	2004	2005	2006	2007	2008	2009e	2010	2011	2012	2013	2013–23
EXPENDITURE ON GDP											
(at average 2006/07 prices)											
Consumption											
– Private	3.5	3.8	1.8	2.6	3.5	4.8	1.5	2.5	3.7	2.8	1.8
– Government	3.4	4.7	2.4	2.2	2.5	2.0	4.6	3.6	3.5	1.5	1.8
Private Investment											
– Dwellings	15.0	4.4	–0.9	5.9	–1.7	1.6	3.4	7.9	3.5	–1.0	1.3
– Real Estate Transfer Exp.	–2.3	–8.3	0.2	6.2	4.7	–15.6	15.2	11.7	4.9	–7.9	–0.1
– New Non-Dwelling Construction (+)	9.0	5.1	–6.3	12.3	–1.8	9.0	–19.8	40.9	15.6	2.8	–3.7
– New Equipment (+)	13.8	8.2	4.5	–5.4	–6.7	11.5	–10.8	3.4	12.3	17.4	3.4
– Livestock	113.3	6.3	–2.9	–33.3	–4.5	14.3	8.1	2.2	–19.0	4.5	–0.2
– Intangible Fixed Assets	–0.6	14.3	23.0	21.7	18.5	–14.3	–7.9	–1.3	9.9	15.5	3.0
– New Business Investment (+)	11.2	7.4	0.8	4.0	–1.8	6.9	–11.7	14.9	12.5	11.1	0.8
Total New Private Investment (+)	11.5	5.4	1.0	3.4	–1.8	4.3	–7.3	12.9	9.7	6.4	1.1
New Public Investment (+)	6.1	11.1	–0.2	9.2	1.3	17.0	23.8	–5.8	–16.1	–6.3	2.6
State Final Demand (SFD)	5.1	4.5	1.7	2.9	2.2	4.5	1.1	4.2	4.1	3.0	1.7
Exports	2.5	–0.7	7.7	–8.3	13.5	nf	nf	nf	nf	nf	nf
Imports	2.1	10.8	1.9	5.4	10.8	nf	nf	nf	nf	nf	nf
External Contribution (*)	0.2	–1.2	1.1	–2.1	0.9	nf	nf	nf	nf	nf	nf
Balancing Item Contribution (*)	–1.0	–2.3	–0.5	–0.2	0.7	nf	nf	nf	nf	nf	nf
Gross State Product (GSP)	4.2	0.9	2.3	0.6	3.8	0.1	1.9	4.5	2.7	2.9	2.1
Population Growth	0.6	0.8	1.0	1.1	1.1	1.3	0.9	0.8	0.8	1.0	1.0
GSP per capita	3.8	0.3	1.5	–0.1	3.1	–0.6	1.2	3.8	2.0	2.2	1.8
– Employment Growth (Yr Avg)	1.9	1.6	2.5	1.9	2.1	1.5	–1.2	2.3	2.4	1.7	1.6
– Unemployment Rate (Yr Avg) (%)	6.1	5.6	4.9	5.0	4.8	5.5	7.2	6.4	5.4	5.4	5.3
GROSS VALUE ADDED											
(at average 2006/07 prices)											
Agriculture, Forestry & Fishing	30.1	–0.8	12.2	–27.0	42.9	2.5	10.0	1.0	–9.5	8.0	1.5
Mining	–1.6	15.0	–6.7	6.6	1.0	2.8	5.2	6.6	3.0	1.8	5.4
Manufacturing	–1.0	–3.3	–3.4	–1.9	–1.9	–4.3	0.4	4.8	3.5	2.1	1.3
Electricity, Gas & Water	11.8	6.6	–0.8	–1.2	0.4	–0.5	–2.2	2.2	2.5	2.5	1.6
Construction	6.1	5.3	3.2	7.8	–0.4	4.4	4.7	17.7	2.7	1.6	–0.8
Wholesale Trade	4.6	1.2	1.8	1.9	0.5	–2.1	–3.1	4.9	3.6	2.3	2.8
Retail Trade	1.1	4.3	–0.2	4.5	4.3	2.2	0.7	3.1	3.2	1.4	2.4
Accommodation, Cafes & Restaurants	0.7	–3.1	2.9	1.8	6.6	–1.0	0.6	3.6	4.2	3.5	3.4
Transport & Storage	9.0	–3.0	–2.8	2.7	3.5	0.3	0.3	3.6	4.8	3.0	3.8
Communication	5.0	3.9	8.1	7.3	6.8	1.9	1.5	4.0	4.7	4.0	3.2
Finance & Insurance	–0.1	–0.1	9.4	10.5	5.1	–1.9	2.0	3.9	4.3	2.5	4.7
Property & Business Services	3.0	–3.2	4.0	2.0	3.7	0.7	–0.2	4.2	4.1	3.2	2.7
Public Administration & Defence	9.4	5.9	–1.3	1.4	–1.1	1.0	3.2	2.3	2.4	3.4	2.6
Education	1.4	0.9	1.6	–0.2	1.7	1.0	2.5	2.2	1.9	1.3	0.9
Health & Community Services	3.6	1.8	4.6	0.2	3.9	2.5	3.1	3.8	3.4	3.2	3.5
Cultural & Recreational Services	10.2	8.5	1.2	1.3	6.7	1.8	–0.8	2.6	3.9	3.1	2.1
Personal & Other Services	3.7	–11.9	–0.2	0.3	6.6	0.9	0.1	3.5	2.7	3.2	1.1
TOTAL – GSP	4.2	0.9	2.3	0.6	3.8	0.1	1.9	4.5	2.7	2.9	2.1

e: estimate ; nf: not forecast Source: BIS Shrapnel, ABS Data, RBA

+ Expenditure on new assets (or construction work done). Excludes sales (or purchases) of second hand assets.

*Contribution to growth in GDP

interstate migration outflow from South Australia. This outflow saw annual growth in the population average just 0.6% over the five years to 2002–03. In the past five years, population growth has increased to an average of 0.9% and is expected to increase further to 1% over the next five years to 2012–13. This is good news for the future prosperity of the state.

A crucial ingredient is a fall in the Australian dollar, provided it sticks. When the dollar fell to US60c, our hopes were raised that this would underwrite the competitiveness of domestically produced tradeables industries, with South Australia a major beneficiary. We believed that the dollar would settle at around US70c, and that would have suited us. Since then, however, the dollar has risen to the current level of around US0.80c, eroding some of that stimulus. The dollar is volatile. We believe that lower commodity prices will eventually bring it back down towards our medium-term forecast of US75c, but we can't be sure. The level of the dollar will be a primary driver of the competitiveness of, and hence the prospects for, South Australian trade-exposed industry.

The South Australian economy is positioned well for strong economic growth over the next five years, but needs to navigate through the weakness from the economic downturn.

INDUSTRY STRUCTURE

South Australia, given its small market size, reliance on imports of consumer goods and relative isolation, is dependent on domestic demand from the rest of Australia as a driver of economic growth. Indeed, much of South Australia's manufacturing sector services the Australian market, locking the South Australian economy into the Australian cycle.

South Australian industry is concentrated in the agriculture and manufacturing industries (in particular, machinery and equipment, and food, beverages and tobacco), with less contribution from mining and services.

Agriculture makes up 5.4% of the South Australian economy (compared with 2.3% for Australia), while manufacturing is the dominant industry sector, comprising 12.1% of Gross State Product (GSP) (compared with 9.8% for Australia). Within manufacturing, machinery and equipment is dominant, with motor vehicle production (including parts and components) an integral part. The other major contributor is food, beverages and tobacco, driven by secondary processing of agricultural products.

Accordingly, South Australia is more sensitive than Australia overall to the effects of changes in tariff protection and changes in the value of the Australian dollar. The reduction in tariffs and industry protection since the mid-1980s have greatly increased the competitive pressures on South Australia's manufacturing sector. But this decade, the high Australian dollar has become a major problem for the competitiveness of South Australian manufacturing. Competitive pressures are generally only alleviated by periods of exchange rate weakness.

The services sectors in South Australia have a relatively weaker presence than in Australia overall. However, there are a few exceptions. These include health and community services (due to the relatively high median age of the South Australian population); electricity, gas and water; retail trade; accommodation, cafés and restaurants; education; and personal and other services. Wholesale trade plays a weaker role, being particularly affected by the trend towards larger distribution centres servicing several states. The finance and insurance and business services sectors are smaller because of the relatively low number of Australia-wide businesses based in South Australia and the current corporate culture of centralisation of most management activities into head offices.

SOUTH AUSTRALIA'S GROWTH: A MIXED BAG

Many point to South Australia's industrial structure as the reason for low growth, with periods of stronger growth generally a result of one-off large investment projects. Overall, GSP averaged an annual rate of 2.4% over the last five years, compared with the Australian average of 3.4%.

Traditional low-growth industry sectors such as manufacturing and agriculture were weak during this period. Much of the decline in agriculture can be attributed to the droughts of 2002–03 and 2006–07, while an overvalued Australian dollar was a major setback for the manufacturing sector.

Given the aforementioned performances of industries such as agriculture and manufacturing, some argue that South Australia's low growth overall is because the industry structure is concentrated in traditional low-growth sectors. However, upon closer analysis, this is not so. Table 2, which illustrates industry structure and growth, represents the growth South Australia *would have* realised had its industry sectors grown at the same rate as the Australian average. Over the last five years, this figure was 2.7% – only 0.7% per year behind the Australian figure. In other words, it's not South Australia's industrial structure being focused on traditionally lower-growth industries that is mainly responsible for its low-growth performance – it is the under-performance of virtually all industry sectors which is the main problem.

Despite low output growth, South Australian employment held up relatively well, growing just under the Australian average. In previous five-year periods, South Australian employment growth had significantly trailed Australian employment growth. However, during the last five years, employment growth tracked output growth. Employment growth in seven South Australian industries – including important industries such as retail trade, mining and manufacturing – was greater than their Australian counterparts (despite slower output growth compared with Australia in most of these industries). The other side of the coin is that this translates to weaker labour productivity growth and may herald lower employment growth in future.