

Address to the Trans Tasman Business Circle

Mike Smith

Speaking Notes

Good afternoon and thank you for the warm welcome.

About 10 days ago, I attended the annual meeting of the IIF in Washington and what I want to do in my address today is to share with you my perspective on the global economy.

I'm also going to talk the movement of economic power to Asia and about Australia's place in this new 'post-western' world and about the importance of leadership and policy reform which supports an open economy and deeper engagement with the region.

Last month of course, marked the second anniversary of the high water mark of the GFC with the collapse of Lehman Brothers and the near failure of AIG.

Today, while there's reason to think the worst of the crisis in the financial system is over, it's worth remembering that a further 120 US banks have already failed this year.

And the number of "problem institutions" in the US is at an all time high. There were over 800 in the most recent quarter compared around 400 a year ago and just 60 three years ago.

This year the crisis also spread from private to sovereign entities.

Five months ago, the market lost confidence in Greek Government debt. Now Greece doesn't really matter unless you're Greek that is the Greek economy is tiny, accounting for just 3 percent of the EU's output.

The concern of the market was about contagion among other European countries with unsustainable levels of government debt – in particular, a group which are unflatteringly described as PIIGS – Portugal, Ireland, Italy, Greece and Spain.

While the worst might be over for now, we've continued to see how nervous markets are about the amount of debt with implicit or explicit sovereign guarantees.

Even France and Germany have rising deficits. In the UK, budget cuts have started and eventually the US will need to cut its deficit as well.

Today, with Europe's creditworthiness sliding and the US economy drifting, if you look at 10-year bond yields, markets consider Mexico and Peru to be safer than Portugal or Ireland, and Brazil safer than Spain.

The recent goings on in France however provide a striking contrast between the flexibility of the US economy to recover compared to Europe.

With average unemployment stuck at around 10 percent in the European Union, French workers are protesting the government's plan to increase the retirement age by two years from 60 to 62.

In the United States however, where unemployment has now reached French levels, the best-organised protest movement is the Tea Party. Its most prominent spokespeople want to eliminate unemployment benefits.

Right now we are in a financially and politically unbalanced world and the outlook is quite uncertain.

The US and European economies are continuing to demonstrate just how fragile they are, while Asia continues to grow.

The recent talk of 'currency wars' reflects an underlying need for both the emerging and advanced economies of the world to recalibrate policies.

Re-balancing global growth requires the US to keep up its newfound interest in saving more and China needs to keep creating reasons for its consumers to spend more although not for the moment on property.

At the same time, the growing tide of protectionist rhetoric - particularly in the US where even the traditionally free-market Republicans are getting in touch with their inner populist - risks drawing governments into impulsive, uncoordinated and ultimately counter-productive responses.

We need to remember that globalisation and free trade has underpinned economic growth and prosperity for 60 years.

And although the trade links which bind countries are undoubtedly under some strain, I hope that the world has learnt the lessons of the past that economic nationalism actually exacerbates economic contractions.

For us in Australia, we're very fortunate that our open economy and our strengths in natural resources and agricultural commodities have aligned us with Asia – particularly with China.

Today, China and India account for approximately 18% of global economic activity and in July, China edged ahead of Japan as the world's second largest economy.

Direct investment overseas by Chinese companies has increased ten-fold from around US\$5.5 billion in 2004 to over US\$56 billion last year. And last month Chinese officials predicted that it would reach US\$100 billion in three years time.

These investments are part of a slow but hugely important trend in which China is becoming the anchor for a new cycle of self-sustaining economic development between Asia and the rest of the developing world – one that is bypassing the economies of Europe and the US.

For Australia, we also need to remind ourselves that the Asia story is not just a China story.

For example, our linkages with South Korea, Japan and India are continuing to deepen.

And over time the emerging nations of Vietnam and Indonesia are going to become increasingly important to us.

Nor is the Asia story just about emerging markets – Singapore and Hong Kong were recently ranked first and second as world's most competitive countries, overtaking the US for the first time which slipped to number three.

And although London and New York are still the world's leading financial centres, Hong Kong is now breathing down their necks according to the latest Global Financial Services Index.

The five financial centres named as likely to become more significant in the next few years, are all Asian – Shenzhen, Shanghai, Singapore, Seoul and Beijing.

This fundamental shift in the world's economic and political tectonic plates has been greeted in some quarters – particularly the US - with surprise and sometimes with denial but for others the emergence of Asia from the crisis is a wake-up call.

In Australia, there's no question that our geographic position, the size of our resources and agricultural sectors, our trade, our cultural and educational linkages with Asia give us an absolutely unique opportunity.

There's also no question New Zealand also has the same opportunities and John Key's government has clearly recognised this.

Let me say however that Australia is not just a "lucky country" because of these linkages and they don't guarantee our future success.

We need to remember that the foundation for Australia's current success was in fact put in place through the process of reform that began in 1983 with the floatation of the Australian Dollar.

The uninterrupted economic growth of the past 20 years, and our resilience through the global financial crisis, is directly related to the reforms in competition and industry policy of the 1980s and 1990s.

These saw business become more outward-looking, more competitive and more flexible – and in the process, they allowed our most competitive sectors to realise their potential.

In the current political environment, it's even more important than ever for the Australian community to remember that continued policy reform to support an open, competitive economy – created by successive Hawke, Keating and Howard Governments and fostered by the Rudd Government's engagement with Asia - is the key to our national prosperity.

During the recent election many commentators remarked there was disappointing lack of appetite on both sides of politics for policies that would reinvigorate the reform momentum of the Hawke, Keating and Howard years.

Right now in Australia, as we begin a new era of politics with a minority government and, from next year a Green Senate, it's timely for business – especially those of us with businesses that are outward looking - to provide a reminder of the bigger picture that's before us.

The bigger picture for Australia is this – our geographical position, our natural endowments, the capabilities of our people with the strength of our institutions give us a great starting point but we need to re-launch ourselves with a new platform of consensus around sustaining national competitiveness.

When I think back to the time I first lived in Australia in the mid-1980s, I remember the reform consensus of the time and the elements that built it – some related to common ground on the problem, some concerned the solutions.

What they had in common however was leadership – political leadership, policy leadership, union leadership and above all, business leadership that welcomed the pursuit of policies that would expose businesses to competition.

The result was that – in financial services for example – bankers, regulators and customers found themselves in a vastly different world, with new opportunities to exploit and new challenges to manage.

I can't say the outcomes were perfect – we saw that all too well in the early 1990s.

But we also saw a sustained wave of innovation directly in response to the de-regulation of financial services whose outcome was major productivity improvements and a new level of competitiveness and service for customers - new non-bank players emerged; new products were developed.

Innovation in our sector involved adopting a more outward looking approach. It was the time for example that ANZ really began its international expansion and its focus on Asia.

The relationship is clear. Innovation and productivity improvements grew from creative business and political leadership, sensible policies and from more open markets.

New enterprises were created, old enterprises were renovated and banking - a sector that had been a dead-weight on the Australian economy - became a much more vital, effective and resilient enabler of the economic growth we have enjoyed for the past 20 years.

I also remember how the opening of Australia's markets created new enterprises led by a new generation of outward looking leaders even in the sector most vulnerable to offshore competition - textiles, clothing and footwear.

While tariff cuts saw the end of much of Australia's textile, clothing and footwear production it did, for example, give rise to an entirely new group of innovators.

These were the surf-loving entrepreneurs who created internationally competitive, outward looking businesses on platforms of innovation in design, materials and customer utility.

Now although these companies are very different to innovators in other markets – for example, global companies like Infosys and Wipro in India – they do demonstrate how reforms spur innovation in a national economy.

And just to be clear – I won't be encouraging our senior executives at ANZ to knock off at 4pm when the surf's up although my Chief Of Staff has roof racks on her car for this very purpose presumably as a reminder of this fantasy when I'm not around

But more seriously, I'm observing that at the time Australia de-regulated and lost some uncompetitive companies as a result, it also created great companies like Billabong, Quicksilver and Rip Curl – all of them innovating enterprises – doing business around the world having begun their beach-side corporate lives as internationally competitive innovators.

Before the reforms of 1980s, none of this would have been possible.

Clusters of competing enterprises are often characterised by shared cultures of innovation. You see it not just in the mining sector in Australia, but also in the support businesses which provide contracted project and supply services to mining.

The Australian Stock Exchange is now populated by dozens of companies like United that grew to support the internationally competitive mining industry and are engaged in the export of services to places like Latin America, the Pacific Rim and to Africa.

Innovation in these service businesses is underpinned by sophisticated technology platforms and their knowledge is underpinned by Australia's quality higher education institutions.

So there's a broader message in the reform debate.

At home, these innovating enterprises have emerged as our economy has de-regulated and opened up and, in the current environment, I'm not sure we fully appreciate it as a dividend of reform.

We're inclined to see everything through the prism of the resources boom – the lucky country in the right place at the right time – when in fact the reality is our prosperity is owed to leadership and to reform, and how Australia built more outward-looking businesses.

This is why it is so critical for our economy right now that we re-invigorate the broad consensus for reform that liberalises markets.

We no longer see innovation narrowly as an outcome of R&D or invention – it's actually about new ways of doing business and of thinking. That's what reform creates and what open markets sustain.

Innovation in thinking underpins our productivity and delivers us international competitiveness. It creates enterprises that can succeed offshore - the rewards of good leadership and inspired risk taking.

And it is also the result of good policy and policy leadership. Over-regulation, tax policies that inhibit flexibility, industry policies that reward processes rather than creativity, governance frameworks that inhibit well reasoned risk taking.

These should be the objects of reform in the tradition of the 1980s and 1990s now and for this new decade because these are what help build an innovative economy.

Policies that maximise the pressure on us to innovate in order to compete will make us do it. They will help drive productivity growth and directly contribute to better living standards for all Australians – whether they live in rural and regional Australia or in our major cities.

Now I want to be clear that this is not just nostalgia for the reforms of years past. The issue is very real right now.

Despite Asia's economic growth engine, we need to remember that for the last two years we have been riding the wave of billions of dollars of stimulus spending.

To be blunt, without a renewed commitment to bold economic reform and productivity improvements, Australia's current growth rates will simply not be sustained.

Here in Australia we have to resist becoming too domestically focussed to the exclusion of what the real opportunities are.

While I remain optimistic about what can be achieved by Australia, we need to remind ourselves that prosperity has to be earned, through leadership and through the courage to continue reforms that help unleash our natural advantages, the competitive position of business and the talents of our people.

Many thanks for the opportunity to speak to you this afternoon – and I hope that sets the scene for an interesting discussion with Andrew.