

CEDA Economic and Political Overview

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Speaking Notes

Melbourne – 24 February 2011

Good afternoon and thank you for the warm welcome.

You know I always get a little nervous before I come to speak to CEDA. While I did study economics at university, I am really just a traditional banker.

But as one of my lecturers at university said:

“As you go out into the world just remember one thing: The only thing more dangerous than an amateur economist is a professional economist.”

The objective CEDA has set for this year's Economic and Political Overview is to examine the impact of the minority government and what it means for the reforms that we need in Australia.

I know many of us here today feel disappointed.

Over the past decade, the very real energy that Australia had around economic reform and innovation has slowly dissipated as the focus slowly shifted from economic reform to climate change – a debate that has ultimately become bogged down.

It's also dissipated ... not just because the political priority attached to economic reform has weakened but also because business has stepped away from leading and contributing to a wider reform debate.

Regrettably, this is true of many western economies where the debate has stagnated rather than the approach in Asia and other developing economies where reform has focussed on driving economic growth and national prosperity.

Australia is bestowed with a disproportionate share of the world's mineral resources; the conditions to grow a substantial share of the world's food, and close proximity to what is now the world's fastest growing region.

Naturally it required and still requires, remarkable talent to take advantage of our resources. And we have been very successful at doing that. Indeed, Australia's economic history is driven by a series of mineral and agricultural booms.

But with the economic, political and technological shifts which are occurring around the world, and the emergence of global competitors to many of our major industries I believe it's essential that we stop thinking like the 'lucky country' and that we reinvigorate the reform debate.

And as I'll discuss later, the best way to do this is to remind ourselves that reform must be about something it must have a higher, shared objective if there's going to be agreement about why reform is necessary, and what it must include.

This means the starting point is going to involve going back to the basics and focussing as clearly as we can on the opportunities and the benefits.

I believe this is the pivotal issue for Australia and I commend CEDA for bringing it to centre-stage this year.

To set the scene, I want to start by giving you my thoughts on the global economic climate in which we will be operating in 2011 and what might lie ahead.

There are three key themes that we need to be thinking about.

First, we've moved from a banking crisis to a sovereign debt crisis.

While the recapitalisation of US and European banks, coupled with massive government stimulus, saved the world from a 1930s-style Depression, the bill came due last year in the form of a sovereign debt crisis.

Markets woke up to the fact that risk had simply been transferred from the private sector to the State.... and the EU suffered the most serious crisis in its short history.

What this highlights is that crises ebb and flow in their severity – they rarely hit once and subside – and the vulnerabilities that build up in advance of a major crisis are often systemic - they take time to work through and so we can continue to expect volatility in the global economy.

The second theme is the acceleration of the power shift from west to east, and in particular China's economic and political power is continuing to rise.

China has overtaken Japan as the second-largest economy in the world and it will soon be the world's largest manufacturer.

I understand that Ladbrokes - the British bookmaker - is offering odds of 6 to 4 on China surpassing the US to become the world's biggest economy by 2020.

While Ladbrokes claim this to be based on serious analysis completed in a morning apparently if I ever was inclined to have a bet, they sound like good odds to me.

In Australia we need to bring more systematic thinking to this issue because the rise of Asia led by China and India won't be over in a few short years, it's a long-term shift which will be with us for this century and beyond.

But last year we also saw a backlash against globalisation and free-trade in the US and Europe which means that this shift won't always be smooth.

Finally, we've also seen a continued reassessment of risk.

The earthquakes that devastated Haiti and now in New Zealand, the floods in Australia, the BP oil spill and the recent political changes in the Middle East.... remind us just how quickly and how dramatically the world can change.

While we have seen a recovery in asset prices based on better economic and financial fundamentals, it's also important to be realistic about the rebound in prices for some asset classes. It may be they have risen too fast, too soon.

So bearing in mind the warning my economics lecturer gave me and the shortcomings of economic forecasts and predictions, I think it's possible to at least think about the likely scenario that's ahead of the world for the next 12 months.

The most plausible scenario is that we'll continue to muddle along but with more volatility than most of us are comfortable with.

The monetary and fiscal stimulus in the US and Europe and resilient demand from Asia is going to underpin the slow but uneven recovery from the crisis.

The good news of course is that here in the Asia-Pacific region.... our outlook is brighter than just about anywhere in the world and there's still plenty of room for optimism.

So what does this mean for Australia?

First of all Australia is moving back to a more normal economy. The economy of the decade leading up to the financial crisis wasn't normal although it lasted long enough for people to believe it was.

Growth will be slower and Australia will be a multi-speed economy as it traditionally has been.

Reinforcing the multi-speed economy, are those industries involved in supplying Asia's growth which have formed clusters particularly in Queensland and Western Australia.

This week I visited some of our clients in the resources and agricultural sectors in those States.

It made me think that sometimes we, who are active in the policy and financial debates, sometimes focus too much on the risks, before we start to use our imaginations to picture what is actually possible.

We hear the stream of expansion announcements in coal, in iron-ore, LNG, copper, nickel, rare earths, zinc in fact, just about everything in the resources sector.

But until we look closely, we don't see that the opportunities are not just about the quarry and the farm.

Today, 17 of the top ASX-listed companies have substantial mining services operations, with a combined market cap of over 70 billion dollars.

And there are the smaller services companies in specialist areas like remote housing, mining software, scientific equipment, logistics and labour-hire companies all incredibly successful in their own right.

Of course urbanisation and higher living standards in Asia is not just driving demand for hard commodities – it's also driving the increase in global demand for food.

We're seeing the effects of this in the consolidation of parts of the industry with some of its ownership moving offshore, but with stronger linkages developing to new sources of capital.

In fact, international interest in soft commodities and food production in Australia is continuing to increase across the board.

But some commentators are questioning just how long the boom can last?

Is China's growth sustainable?

How destructive will the exchange rate and demand inflation impacts be?

And as I get around and talk to our clients in other sectors, I'm also hearing about the difficulties being faced in other parts of the economy.

The higher education sector, which is increasingly funded by foreign student fees, is finding it extremely hard to compete.

Tourism is doing it very tough.

Even agriculture is being crowded out as the resource sector absorbs the rural labour force.

But as each of these discussions develop; I wonder if we are yet seeing the wood for the trees.

I'm worried that we aren't grasping the bigger picture issues which Australia needs to address in this changing global environment. For example:

- What would the size of the benefits be if we sought to maximise them, compared to if we muddle through?
- What are the policies and reforms that would enable us to do this?
- And finally, if there were an opportunity to take full advantage of this boom, what would our economy look like and what sort of linkages to the broader global economy would we have to create?

I'll give you an example of the way we might begin to change our thinking.

Yes, the strong dollar is putting the market for international students under pressure. But what about the opportunities?

- Where are the higher education plans for international specialisations in earth sciences?
- Where are the far-sighted engineering and niche technology developments?
- Where are the opportunities for industry and university co-operation on the basis of this incredible expansion and how do we organise them?

Responses like these would seem to be more productive and strategic than to say we should dampen commodity exports and bring the dollar down.

There are also a host of questions on the contrary side of this theme too, which we are also giving too little thought to.

The obvious one is whether a “muddle through” strategy in the belief that we truly are the “lucky country” is viable.

Beyond Australia, there's increasing recognition of the scale of the opportunity presented by the growth of India and China which is creating new competitors.

You only have to visit Mongolia to realise that not only do they have a deep resource base which is cheaper to mine they are also right next door to China.

Guinea and Brazil are planning massive iron ore developments.

Indonesia and Columbia have both driven significant expansions in thermal coal and further expansions are planned.

Mozambique and Canada are competitors for us in coking coal.

Mongolia, Chile and Peru are planning massive copper projects.

What this highlights is that our success is not a given.

Australia simply has to face up to a reality that we are going to face more and in many cases cheaper competition.

As a nation we need to discuss the reforms and adjustments that are going to make Australia more competitive, make us more innovative, add value, and make us a better place to invest.

It was clear last year – when the Federal Government posed its first version of the minerals tax – that we really hadn't had this discussion.

Our policy debate was the poorer for it and the perception of foreign investors about Australia was the poorer for it as well.

In a world of mobile international capital, we need a sensible debate on these opportunities and greater consistency in the approach to economic and business policy.

Australia can't afford to take for granted the opportunities which are opening up in Asia or to frighten off foreign investors by giving oxygen to poorly thought through, populist policy proposals.

Australia is a net importer of capital and our growth is driven by foreign investors.

Without these investors ... whether they are investing in our growth sectors such as resources, agriculture or funding the balance sheet of banks growth in Australia will stall.

Although the political situation is now more uncertain in Australia with a minority government I'm actually cautiously optimistic about what can be achieved by Australia's political and business leadership.

Looking back to the way the reform debate was established and sustained in the 80's and 90s shows us how this can be done.

Then reform was driven by a well founded fear that Australia was losing its global competitiveness.

We came to understand that our economy was too inflexible and too inward looking to deal with a fast globalising world.

The reforms to financial markets including - the floating of the dollar, the opening up of the banking market and superannuation reforms to industry policy including the deregulation of labour markets and reduced tariffs and the reform of taxation policy including the introduction of the GST these were all built on a clear understanding that the world was moving ahead fast, and Australia was at real risk of falling behind.

And these reforms were carried out by both the major political parties.

In a different way, the world is again moving very fast and this time Australia is at real risk of missing the opportunity ahead of us.

My view is that an economic reform agenda can only be developed and evaluated within a broader economic context, and like the 80s and 90s is only going to gain traction if there is a clear rationale for change.

Once again, we need to convene the policy conferences and forums such as this one today and we need to commission the thought leadership and policy discussion papers.

Importantly business has to find new ways to systematically support and engage with government and with other stakeholders in the community to build a broad-based consensus around reform.

And we need to encourage a frank, open and constructive exchange and avoid shouting-down those with longer-term perspectives that go beyond this year's political cycle.

The big picture here is that the forces re-shaping the world economy present an opportunity to not only fuel growth in the Australian economy for many years to come but to position this country for a sustainable future.

Australia has the natural and human resources and a track record of successful growth.

But Australia needs to adopt a whole new reform agenda if we are to capture this opportunity. The questions we need to ask are:

- How do we provide for a skilled and flexible workforce that meets the needs of all sectors of the economy?
- How can we reform our tax system to be simple, efficient and provide the right incentives for work and investment?
- How can we enable Australian businesses to invest in research and development and develop innovative products and services and create added value?
- How can we allow efficient industries to grow and exploit competitive advantages and trade opportunities?

And we need to be prepared to tackle the more difficult issues such as population, urban development, climate change and energy which are too often diverted into narrow political debates where the full economic trade-off are never aired.

These are some areas where I think we need to have a sensible debate, free from populism and the political cycle, about the best policies to manage this boom, build the next one and increase our national prosperity.

Taking full advantage of the opportunities we have is not inevitable.

Australia has been privileged in its ability to attract global capital for resource developments, but countries in Africa, Asia and South America are all working much harder than we are to improve their positioning.

The required reform agenda needs much work and debate, but opportunities like this are rare, and shouldn't be squandered.

Today, we all need to re-energise our contribution to economic reform and to helping Australia make its own luck just as we have in the past.

Those of us in business need to help engage the nation around a new wave of reform to drive growth and productivity. I urge my fellow CEOs in Australian business to lead the call.

Many thanks for the opportunity to speak to you today.