

The International Perspective: South Australia's Economy – Local, National and the Global Context

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Introduction

Good morning and thank you for inviting me to participate in today's seminar addressed to the outlook for the South Australian economy. I would like to acknowledge the traditional owners of the land we are meeting on, the Kaurna people.

I want to congratulate the Governor's Leadership Foundation for organising the program and all of you here present for your commitment to the program and your intention to contribute to the future of the broader South Australian community.

The Institute for International Trade is a part of The University of Adelaide and is dedicated to the advancement of study in support of those who work in today's global economy, whether they are in business, government or academia. We specialise in trade related training programs for developing countries, advanced research for the public and private sector and in specific academic courses in trade, corporate responsibility and poverty reduction.

In my remarks this morning, I will try to give you an overview of the challenges of globalisation and international trade for South Australia; our strengths and potential, some of the key obstacles we face and some of the ways forward.

Globalisation and Australia's Terms of Trade

Generally speaking, Australia's position in the global economy is a good one – filled with promising opportunities more so than difficult challenges. First let's glance at the world economy and Australian economy before summarising the state of economic play for various industry sectors in South Australia and their export potential.

The world economy grew by 5.4 per cent in 2006 after growing 4.9 per cent in 2005, with growth becoming more balanced across regions. The United States experienced a slowdown in the second half of the year, reflecting a weaker housing market and the lagged effects of interest rate rises. The Euro area experienced its highest rate of expansion since 2000, while Japan's recovery consolidated. China recorded its fourth straight year of double digit growth, driven by

investment and supported by strong consumption and net exports, particularly mineral resources. The Indian economy grew strongly, supported by strong domestic demand.

On balance this augured well for Australia and South Australia given our proximity to the robust growth of trading partners in our region of the world. China's growth in particular has led to a surge in demand for the secure supply of Australia's mineral resources with China now replacing the United States as our second largest export market. Japan however remains our largest trading partner receiving a third more of Australian exports than any other country.

Australia is in its 16th year of uninterrupted economic growth, the longest period of growth since 1901, largely a result of our economic reforms and trade liberalisation efforts over the past 20 years enabling us to take full advantage of the strong growth in neighbouring Asian markets. In fact in 2006, Australia's export businesses achieved their best sales ever of \$210 billion.

The Chinese – Japanese Connection

The integration of the Japanese and Chinese economies over recent years is by the way, providing substantial opportunities for Australian and South Australian exporters, for example:

- As Japan supplies much of the advanced machinery parts and technology to Chinese factories, these products are made mostly from Japanese steel which was originally Australian iron ore exported to Japan.
- Japanese companies are buying Chinese mines which have major operational and structural problems. Australian mining technology suppliers are beginning to provide such services to the Japanese owners and Chinese operators.

The South Australian Economy

The South Australian economy can best be characterised at the moment as having reasonable growth given the constraints of a prolonged drought. It experienced moderate growth in 2006-07, with the drought having a particularly negating impact on growth in the farm sector. Gross State Product was \$65.7 billion in 2006-07, an increase of 0.8% from the previous year.

Encouragingly, the non-farm sector grew by a strong 3.1% in 2006-07, demonstrating the growing diversity of the State's economy and the positive impact of major projects.

Growth in the non-farm economy has provided a timely balance to the severe impact of the drought and a stronger Australian currency on exports. The construction as well as the finance and insurance industries made the largest contributions to state economic growth in 2006-07 while the mining industry grew by 3.6% (Gross Value Added) over the same period and manufacturing by 0.2%, a reasonable result considering the strength of the dollar and increasing international competition in this sector. While manufacturing remains important to South Australia's economy, we are in a period of transition, with services now contributing increasingly to Gross State Product.

With respect to South Australia's trade performance, the nominal value of South Australia's overseas merchandise exports increased by 6.6% in the 12 months to September 2007 compared with the 12 months to September 2006. South Australia's merchandise exports were worth \$9.5 billion in this period. The two most valuable commodity groups and largest

contributors to goods exports during that time were in metals and metal manufactures and in wine. Services exports are slowly growing and in the same period were worth about \$1.83 billion.

That is a quick overview, but I would now like to look briefly at the export potential in each of the four main sectors of mining, manufacturing, agriculture and services in South Australia to assess just how well placed we are to be globally competitive in the future.

Mining

The South Australian economy is undergoing a period of great change and diversification away from agriculture and towards mining. Extensive investment in mining exploration is being driven by new technology which allows increased measurement of underground mineral and metal deposits. In the year to the September quarter 2007, mineral exploration expenditure was AUD\$ 297 million, up by 73 percent from the previous year.

It is expected that production of uranium, iron ore, copper, gold and silver will increase significantly in the near future. In fact, South Australia has been upgraded from the world's thirty-third largest exploration site to the world's fourth. South Australia has also gained market share from interstate investment in mineral exploration, increasing its share from a mere 3 percent of the national rate to a very healthy 16 percent.

The investment and expansion of Olympic Dam at Roxby Downs, which produces copper, uranium and gold is driving the resource boom. It is the world's largest known uranium deposit, the fourth largest copper deposit and the fifth largest known gold deposit. This project provides potential for significant increases in uranium and copper exports and export potential for gold.

At present BHP Billiton directly employs in total approximately 3,500 people in addition to another 1,000 – 1,200 full-time contractors. With the expansion of Olympic Dam in the future these numbers will increase significantly to as many as 25,000 people. BHP-Billiton will contribute to State Government plans to build and expand infrastructure in support of the mineral resources boom in South Australia contributing to the development of port facilities in the Upper Spencer Gulf while building an airport at Olympic Dam large enough to take a 737 jet.

The challenge for the state is to harness this mining boom over the next 10 years as a 'once in a life-time opportunity' to build a sustainable economic basis for our future. This means government providing clear incentives for productive investment into the state; cooperative ventures between private and public sectors such as the BHP-Billiton measure mentioned above, so we can meet the infrastructural and workforce challenges this mining boom will present. Most importantly, there will need to be incentives to attract technology and further diversification that builds on the mining boom, for no matter how long the mining boom might last, ultimately mineral resources are finite.

The other big issues for mining companies and the state are to ensure sufficient skilled labour can be found either through increased permanent and temporary migration or in the medium to longer term through education and training in South Australian universities. This will require our tertiary institutions to be more engaged than they are at present with the industry in identifying and meeting future labour market demand. Adelaide University for example is now in the process of appointing a mining ombudsman to ensure much closer integration between educational requirements and the needs of the mining sector.

Huge potential has been identified for the mining equipment and mining services sector in South Australia as Free Trade Agreements are developed with countries such as Chile. Chile itself has a large number of mining projects coming on line over the next ten years alongside of our own mining boom. Impending FTAs with Japan, South Australia's most important trading partner, and South Korea, our third largest trading partner, will also ensure the continued growth in demand for a secure source of supply for South Australia's mineral resources.

Manufacturing

Manufacturing accounts for approximately 15% of Gross State Product and employs around 13% a figure which will no doubt decline as a result of the closure of Mitsubishi manufacturing capacity. The manufacturing sector has faced a number of tough challenges over recent years in particular the high value of the Australian dollar, rising oil prices and in particular the massive increase in competition from low cost manufacturers in Asia.

In a recent survey of the Australian Industry Group, the vast majority of firms rated China as the most critical issue affecting their business – and this if before any free trade agreement might affect the reduction of tariff and non-tariff barriers between the two countries. China's abundant, low cost workforce has made it ultra competitive with Australia's with the Chinese manufacturing sector contributing to 35 per cent of China's GDP and constituting 86 per cent of Australia's imports from China.

In South Australia we rely on Chinese imports such as machine parts, video cameras, the clothes that most of you are wearing, toys, televisions, leather products, furniture and so on.

So is the manufacturing sector in South Australia doomed to extinction? Well the following points might be instructive.

- GM Holden has recently announced it will be exporting its Holden's VE Commodore Ute to the United States in the second half of 2009. The move should cement Holden's position as a key cog in the broader General Motors world and could add tens of thousands of vehicles to Holden's export program. According to Managing Director, Mark Reuss, the addition of the new Commodore Ute to Holden's export program further enhances GM Holden's position as the centre of global rear wheel drive expertise in the GM organisation. Holden has reaffirmed that it aims to be part of a sustainable, long-term home based automotive industry in Adelaide and points to their recent investment of a further \$500 million in their Elizabeth plant to upgrade and more fully automate their plant.
- In addition to motor vehicle manufacturing, South Australia has well recognised strengths in resource based manufacturing in areas such as processed food and beverage products, wood, paper and pulp products, industrial machinery, electronics, scientific equipment, optical goods and pharmaceuticals. Elaborately Transformed Manufactures or ETMs are a quiet growth industry receiving little publicity but may be the key to the future of South Australia's manufacturing survival. An ETM is a finished or near-finished good with high added value for example, automotive component parts.
- For example, Visiocorp, a firm specialising in the production of rear-view mirrors employs over 730 workers in this state and exports significant quantities to Korea, India and China where they also have subsidiaries or joint-ventures. Visiocorp has built a competitive base

in a specialist area enabling it to employ almost as many people as have just been laid off at Mitsubishi.

- So, products in both the resource-based and technology intensive categories are likely to drive the future export growth for South Australia's manufacturing sector. Our manufacturing sector will always be able to compete with Chinese and Asia neighbours so long as we are specialising and differentiating our products, especially where the production process is capital intensive rather than labour intensive.
- A final point here on tariffs - the Institute for International Trade is a strong advocate for a more open, liberalised and transparent rules based multilateral trading system. If Australia hadn't reduced tariffs for passenger motor vehicles for example, Australian families would now be paying an additional \$10,000 on a \$30,000 family car – and cheaper imports are good for working families. However given both the tariff barriers and behind the border trade barriers many of our manufacturing exporters continue to face, we believe it would be wise for Australia to maintain a gradual phasing out of our manufacturing tariffs to ensure competition in the future is on a level playing field with our competitors.

Agriculture

We have mentioned processed food but it is of course worth briefly restating here the importance of South Australia's wine and seafood export industry in the face of future global challenges. Export volumes of wine have risen steeply in recent years with about 12,500 Australians – a large percentage who live in this state – relying on exports of wine for their livelihood. The future looks bright assuming we can deal with the water conservation issues and improve our marketing expertise and penetration.

The South Australian seafood industry is worth around \$400 million to the state annually and employs approximately 15,000 people. Free trade agreements with Japan, Korea and China in the not too distant future will increase the already considerable demand for our exports of tuna, lobster, abalone and prawns with a major issue being the sustainability of our fishing industry. The biggest constraint to increasing seafood exports into the future will not be trade barriers but domestic restrictions on production, essential to the sustainability of the industry. An increase in seafood output will likely need to come from aquaculture which is able to meet the strict health and safety requirements of overseas markets.

Services

South Australian overseas services exports were valued at \$1.83 billion in 2006-07, up 8.5% from 2005-06 and equating to 16.9% of our total state overseas exports. Services is the way of our future for most Australians. The services sector accounts for 78 per cent of Australia's GDP and employs 85 out of every 100 Australians. However a major challenge for South Australia is to increase its services exports.

Currently our education services exports are worth more than \$250 million and generate about 2,000 jobs. Transport services are our next most important sector followed by tourism. Services exporters are spread throughout the South Australian economy in sectors such as professional services, finance and insurance, engineering and mining, agriculture, environmental services and creative services such as in film making and the arts.

The defence services industry warrants special attention, not so much as an exporter at this stage, but for its likely economic multiplier effects. The Government of South Australia is developing Techport Australia, Australia's premier naval industry hub – with a vibrant, internationally competitive shipbuilding and support capability. Investing over \$300 million dollars in state-owned infrastructure at Techport Australia, the precinct will feature a world class common user shipbuilding infrastructure, an onsite Maritime Skills Centre delivering trade and technical skills for a job-ready workforce and a state of the art Air Warfare Destroyer Systems Centre. Apart from direct employment in this industry there are a number of spin-offs for local manufacturing and services such as design and engineering which may act as a spring-board for an increase in defence related services exports.

The services industry is a knowledge-intensive industry and our international competitiveness is not threatened by developing country exporters whose comparative advantage is in low cost manufacturing. Services exports also have nothing to do with tariffs and quotas at the border.

The barriers are opaque behind-the-border industry and government regulations, such as special licenses or requirements for services firms to operate in another country. Here is another clear example of the importance of government and industry needing to work closely together on free trade agreements and on the Doha multilateral round of negotiations to ensure these barriers are reduced or eliminated in the future.

According to one recent estimate, full global services liberalisation could result in welfare gains of US\$1.7 trillion. Even if you discount this by a large amount, the potential gains for a more focussed export oriented services sector in South Australian are clearly apparent. So what does all this mean for South Australia's future from a more global perspective?

Ways ahead and Conclusion

South Australia is fortunate in its endowment of natural resources, its reasonable intellectual and entrepreneurial capacity and its proximity to the booming markets of Asia. Throughout this overview paper we have discussed the potential of the mining boom if we can harness it as a 'once in a life-time opportunity' to plough the seeds of long term investment in our economic diversity as miners, manufactures and service producers. Manufacturing in South Australian can remain globally competitive by specializing in niche market products that are differentiated from those of our competitors.

The challenges facing our agricultural exporters lie as much in sustainability rather than trade barriers so what is needed is environmentally sustainable practices supported by technology and technical expertise to increase our capacity and competitiveness. Finally we saw that there is unlimited potential for services exports but we will need to embrace the so-called education revolution being touted at the moment, increase government-private sector cooperation in working together for the removal of trade barriers overseas.

South Australia is well placed to meet future global challenges if we rise to the formidable challenges required by competitive globalisation. We must re-double our efforts to reach higher levels of educational achievement at technical, vocational and tertiary levels. Education and training hold the key to increases in our future productivity and work ethic that will allow us to create the technology, the entrepreneurs, the well-educated workforce that a climatically-challenged state like ours will require if we are to successfully integrate and compete in the global economy.

A technically efficient, well educated workforce will be needed for us to overcome such issues as our acute water shortage, the need to provide massive power and infrastructure for a burgeoning mining industry and to develop those niche products and services which hopefully will one day make holodec technology on Startrek Voyager look obsolete.

A final point on the importance of growth with equity or if you prefer *more even* growth. South Australia must continue to increase its productivity and grow to increase the amount of wealth to be shared around the community. Openness and competitiveness is a pre-requisite for this growth but trade liberalisation and openness is not the same as government deregulation and an abandonment to market forces.

Our challenge must be to invest in and utilise all of our available talent whether they be in remote Aboriginal lands, young unemployed or in parents trying to get back into the workforce. The recently announced initiative of the state government and mining sector to target Aboriginal employment in remote mining areas is a step in this direction as is the importance of the private sector seriously embracing corporate social responsibility.

I know that the South Australian Government is also supporting broader initiatives overseas such as education and training programs for young people in East Timor in liaison with the Federal Government. South Australians have an important role to play a very important role not only in securing the future of our own children but for all children. We have much to offer to environmental sustainability processes, poverty reduction strategies and to political stability in our own region of the world. Whether for enlightened self-interest or for wider humanitarian motivations part of our challenge for growth much be balanced with the challenge for growth with equity and justice.

Good luck to each of you in your own leadership journeys and thank you very much for your commitment and for your attention.