



**Submission to the  
Commonwealth-State Inquiry into  
the Tasmanian Economy**

**Australia and New Zealand Banking Group Limited**

February 1997



## Executive summary

### *Tasmania's economic performance in the 1990s*

- Tasmania's economy has continued to grow more slowly than that of the rest of Australia in the 1990s, even after allowing for its slower rate of population growth.
- The gap between Tasmania's performance and that of the rest of Australia has arguably widened during the current decade. Tasmania's unemployment rate has exceeded the national average by a wider margin since the beginning of 1993 than during the 1980s. Even this masks the full extent of the deterioration in Tasmania's employment performance: since the beginning of 1993, consistently less than 2 in every 5 Tasmanians over the age of 15 have been in full-time employment.
- The relative wages of Tasmanians in employment have also continued to decline. As a result, Tasmanian household incomes have in recent years averaged around 15% below the national per capita average, compared with around 12% below the national average in the mid-1980s.
- Tasmania's poor economic performance has led to, and reflects, an accelerating exodus of population from the State. Interstate migration has distorted Tasmania's population structure, leaving it with a below-average proportion of 20-35 year olds and an above average 'dependency ratio'. Tasmania's inability to attract migrants from non-English speaking backgrounds, and in particular from Asia, has also detracted from its economic performance.

### *Explanations for Tasmania's poor economic performance*

- There is a widespread perception that Tasmania's relatively poor economic performance reflects deficiencies in the structure of its economy. In fact the composition of output and employment in Tasmania is not vastly different from that of Australia as a whole, and Tasmania's economic performance owes more to slower growth in output and employment in a majority of the State's industries, relative to their counterparts on the mainland, than it does to having a preponderance of 'slow-growth' industries.
  - Tasmania's poor economic performance is, at its most fundamental level, a problem of productivity: the *level* of productivity in Tasmania is well below the national average and the *rate of growth* in productivity is the lowest in the nation.
  - Tasmania's poor productivity record in turn largely reflects low levels of investment in both physical and human capital over long periods of time. The share of State product devoted to business investment over the past twelve years has been below that of any State or Territory except the ACT; while educational outcomes and participation in higher education have generally been lower in Tasmania than in anywhere else in Australia except the Northern Territory.
  - Although the impact of Commonwealth policies on Tasmania has not always been benign - and in particular there is evidence that Commonwealth public enterprises have invested less per capita in Tasmania than other States - in general the
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Commonwealth has helped to moderate the adverse effects of other influences on the State's economy.

- Policies pursued by State Governments, especially during the 1980s, have left Tasmania with a heavy burden of debt, which is now inhibiting the State's ability to promote economic growth and respond to demands for community services. Tasmania, uniquely among the States and Territories, imposes above-average taxes and charges (relative to its capacity to raise revenue) whilst spending less than the average on the provision of public services (relative to the unit cost of service provision). The difference is absorbed by debt servicing charges.

#### *Options for a brighter economic future*

- The State Government needs to develop and pursue a strategy which will improve the climate for investment and employment in Tasmania. Within the limitations imposed by the Australian Constitution this essentially requires a more competitive regime of State taxes and charges whilst maintaining an appropriate level of investment in both education and physical infrastructure.
  - Privatization of the Hydro-Electric Commission would radically transform the budgetary options open to the Tasmanian Government. While there are number of complex technical and legal issues to be resolved, sale of the HEC into a competitive electricity industry structure could yield the State proceeds of \$4-5 billion - enough to leave a cash surplus of \$½-1½ billion after extinguishing the State's debt. This would in turn improve the State's annual budgetary position by between \$130 million and \$205 million per annum.
  - A transformation of the State's budgetary position of this order would enable Tasmania to (for example) reduce payroll tax to 4%; substantially reduce land taxes; abolish a range of other State taxes; employ (say) 500 additional teachers; purchase one new PC for every five government school students over a five year period; and pay HECS charges for 1,000 additional Tasmanian tertiary students. Alternatively, a 'Tasmanian Infrastructure Fund' could be established to invest in projects such as Basslink and bringing Yolla gas to Tasmania, subject to appropriate prior analyses.
  - The State Government could further contribute to improving the climate for investment and employment in Tasmania by following Victoria's lead in referring its industrial relations powers to the Commonwealth.
  - Tasmania should seek to build closer links with Asian countries by actively promoting the State's educational facilities to Asian students and attempting to increase the share of immigrants from Asian backgrounds who settle in Tasmania.
  - Tasmania can lay credible claims to (or could develop) comparative advantages in a number of areas of economic activity, including horticulture and viticulture; fishing and aquaculture; food processing; wood and paper products; 'niche' manufacturing with a technology orientation; marine engineering and research; tourism; and particular elements of telecommunications services such as customer call centres. These industries should provide the focus of Tasmania's industry
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development and promotion efforts, and of government policies in relation to research, education and infrastructure development.

## Tasmania's economic performance in the 1990s

In his 1977 *Inquiry into the Structure of Industry and the Employment Situation in Tasmania*, Sir Bede Callaghan presented a relatively pessimistic outlook for Tasmania's economic performance:

“In many respects I expect Tasmania to continue its historical (economic) decline, relative to the rest of Australia ... The expected relative decline should be seen as the continuation of a long-term trend which stretches back prior to Federation and is likely to continue unless there are major positive structural changes to known resource levels or the state of technology in Tasmania”<sup>1</sup>.

Tasmania, in Callaghan's view, was “heading towards another Newfoundland or Ireland situation” - that is, having substantially lower living standards than the continent to which it is economically and politically linked - “albeit moderated by ... the political muscle the State gained through Federation”<sup>2</sup>.

Callaghan's assessment has been largely vindicated by subsequent trends.

### *Slower economic growth*

Tasmania's economy underperformed that of Australia as a whole during the 1980s expansion. Tasmania's real gross State product (GSP) grew at a trend<sup>3</sup> rate of 2.2% per annum between the September quarter 1984 (the earliest point at which estimates of real GSP are available) and the June quarter 1990 (the peak of the national business cycle). This compares with a trend growth rate for Australia as a whole over this period of 4.1% per annum (see Chart 1).

The 1990-91 recession hit Tasmania harder than any other State except Victoria; trend real GSP fell by 3.7% between the June quarter 1990 and the June quarter 1991, compared with a decline in trend real GDP for Australia as a whole of 2.1%. However, whereas Victoria has experienced above-average growth following its worse-than-average downturn during 1990-91, Tasmania's growth performance has continued to lag the national average by a wide margin. Over the five years to the June quarter 1996, Tasmania's real GSP grew at an average rate of just 1.8% per annum, compared with 3.7% per annum growth in (the trend measure of) real GDP for Australia as a whole over the same period. Indeed, over the 1993-94 financial year, when the national economy expanded by 5.1% in real terms, Tasmania lapsed back into recession, with trend real GSP declining by 1.9%.

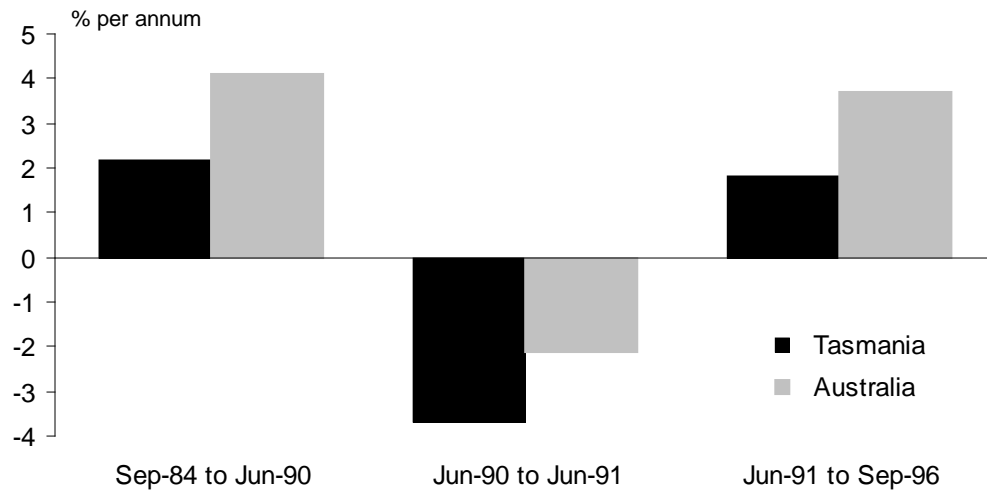
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<sup>1</sup> B.B. Callaghan, *Inquiry into the Structure of Industry and the Employment Situation in Tasmania*, AGPS, Canberra, 1977, p. 102.

<sup>2</sup> *Ibid.*, p. 103. Newfoundland's per capita GDP is about 35% below that of Canada as a whole; while Ireland's is about 23% below the European Union average. Tasmania's per capita GDP is around 19% below the Australian average.

<sup>3</sup> The Australian Bureau of Statistics advises that “given the qualifications regarding the accuracy and reliability of the quarterly national accounts ... trend estimates provide the best guide to underlying movements, and are more suitable than either the seasonally adjusted or original data for most business decisions and policy advice” (ABS *State Accounts*, catalogue no 5242.0, September quarter 1996, p. 59).

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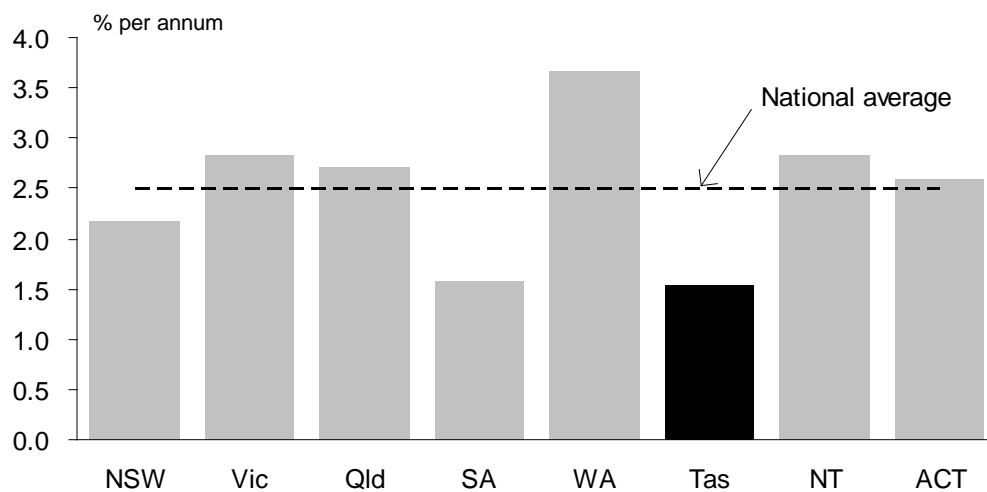
**Chart 1: Real gross product growth : Tasmania vs Australia**

Note: Data are trend estimates. Source: ABS 5242.0.

Even in per capita terms (ie, after allowing for the effect of Tasmania's slower rate of population growth), Tasmania's economic growth rate has been consistently below the national average. Over the five years to the June quarter 1996, for example, Tasmania's trend real GSP per capita has grown at an average annual rate of 1.5%, as against 2.5% per annum growth in per capita real GDP for Australia as a whole (see Chart 2).

Cumulatively, this amounts to a difference of 5.4% between Tasmania's per capita growth rate and that of the nation as a whole over the five years since the end of the last national recession.

It is possible that ABS estimates of real GDP overstate the margin by which Tasmania's growth rate has fallen short of the national average.

**Chart 2: Real per capita gross product growth since the end of the 1990-91 recession: Tasmania vs other States and Territories**

Note: Data are trend estimates. Sources: ABS 5242.0; 3101.0; ANZ calculations.

This arises from the fact that the price deflator used to convert estimates of Tasmania's current-price or nominal GSP into constant-price or real terms appears to have risen somewhat faster than that used for other States. Over the five years to the June quarter of 1996, for example, the implicit price deflator of Tasmanian GSP rose at 3.1% annual rate, whereas the corresponding price deflator for Australian GDP increased at a 1.8% annual rate over the same period. By contrast, the consumer price index for Hobart rose at a 2.7% annual rate over the same period, only marginally higher than the 2.5% annual rate of increase in the eight-capitals CPI.

Had the Tasmanian GSP deflator risen at a rate similar to that for Australia as a whole, the growth rate of Tasmania's real GSP would have been much closer to the national average.

Even so, however, most other indicators also suggest that Tasmania's economy has significantly underperformed that of Australia as a whole.

### *Weaker employment growth and higher unemployment*

Nowhere is this more apparent than in relation to employment.

Tasmania suffered a proportionately larger loss of jobs during the early 1990s than any other State except Victoria, with employment falling by 5.3% between June 1990 and January 1993 (the pre-recession peak and post-recession trough, respectively, in employment), as against a 3.5% decline nationally.

Since January 1993, trend employment has risen at an average annual rate of 2.5% nationally, but by only 0.8% per annum in Tasmania - a difference of 1.7 percentage points. Put differently, had trend employment growth in Tasmania matched the national average since January 1993, there would have been an additional 10,400 jobs in Tasmania by December 1996 (Chart 3a). Over the same period, trend full-time employment has risen at a 2.0% average annual rate nationally, but by only 0.4% per annum in Tasmania. This difference is equivalent to an additional 8,200 full-time jobs by November 1996.

A small consolation is that, over this latter period, Tasmania's employment creation record has been marginally better than that of the ACT (Chart 3b).

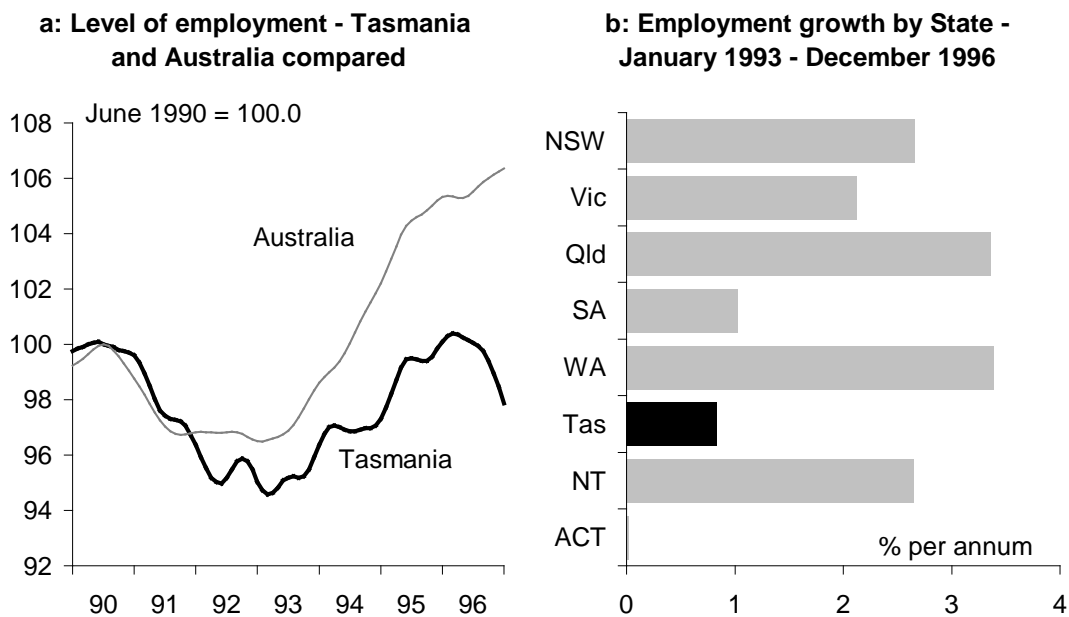
As a result of Tasmania's poor performance in creating jobs, Tasmania's unemployment rate has remained above the national average. Since January 1993, Tasmania's trend unemployment rate has averaged 11.1% of the labour force, 1.7 percentage points above the corresponding national average of 9.4% (Chart 4a).

Tasmania's unemployment rate would have been even further above the national average but for its relatively low rate of participation in the labour force. Tasmania's labour force participation rate has averaged 60.3% since January 1993, 2.9 percentage points below the corresponding national average. As of December 1996, Tasmania's participation rate was, in trend terms, 4.0 percentage points below the national average (see Chart 4b).

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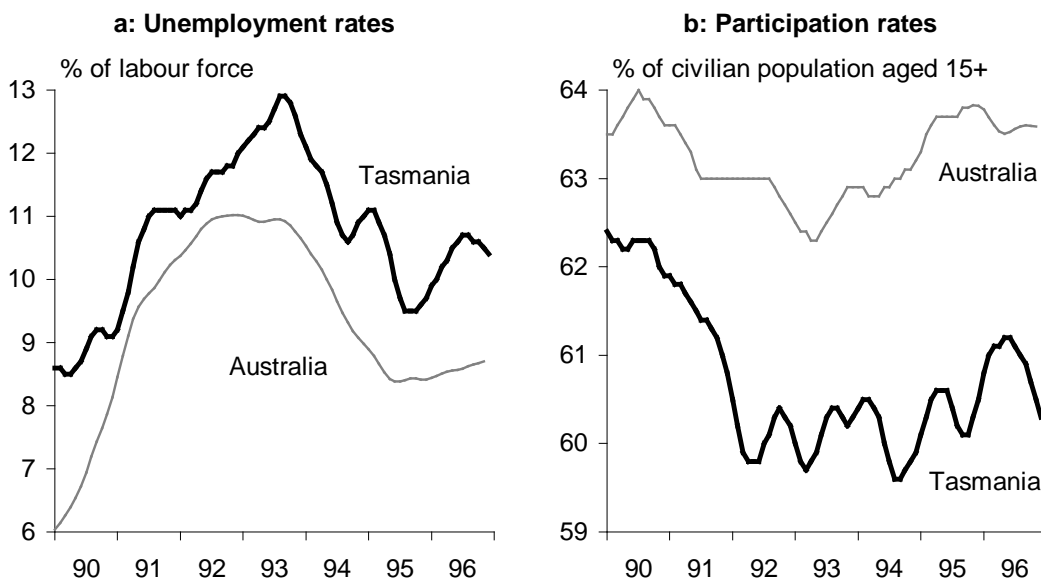


### Chart 3: Employment growth in the 1990s



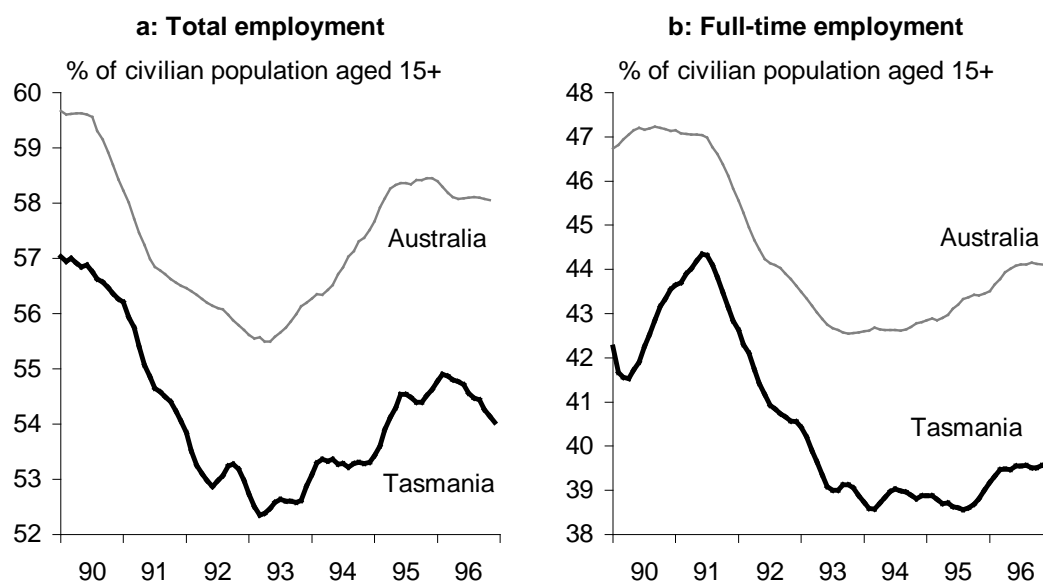
Note: data are trend estimates. Sources: ABS 6201.0 and ANZ calculations.

### Chart 4: Unemployment and participation rates



Note: data are trend estimates. Sources: ABS 6202.0 and ANZ calculations.

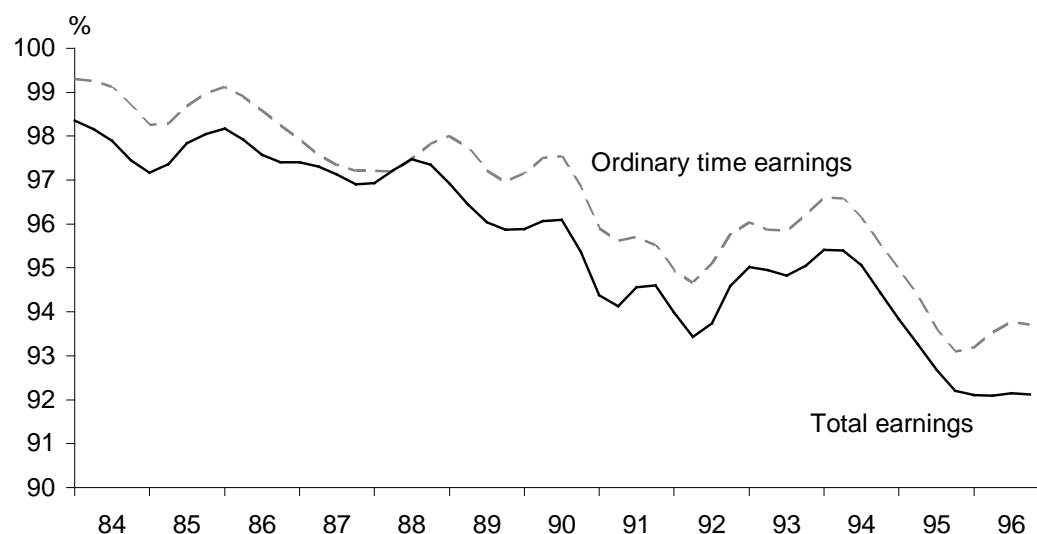
Combining the unemployment and participation rate data shows that, on average, the proportion of Tasmania's working age population in employment has averaged 53.7% since January 1993, 3.6 percentage points below the corresponding national figure of 57.3%, and well below that for any other State (the average for South Australia, the next lowest after Tasmania, was 55.4%). As of December 1996, Tasmania's employment ratio was 4.8 percentage points below that for Australia as a whole (Chart 5a). The discrepancy is even more marked in relation to full-time employment. On average since January 1993, 39.1% - less than two in every five - Tasmanians of working age have been in full-time employment - compared with 43.2% of working-age Australians.

**Chart 5: Employment-to-population ratios**

Note: data are trend estimates. Sources: ABS 6202.0 and ANZ calculations.

### Lower average wages and salaries

The average earnings of those Tasmanians in employment have continued to decline relative to their mainland counterparts. Average weekly total earnings of full-time Tasmanian employees declined, in trend terms, from 94.6% of the corresponding national average in August 1991 to 92.1% by August 1996, continuing a trend which was apparent through the 1980s (Chart 6). The decline in relative average earnings over this period has been more marked for men than for women, in large measure because of a sharp decline in Tasmanian male overtime earnings relative to the national average; by contrast, Tasmanian female overtime earnings actually rose relative to the national average (albeit from a very low base).

**Chart 6: Average weekly earnings: Tasmania relative to national average**

Note: data are trend estimates. Sources: ABS 6302.0 and ANZ calculations.

### Lower living standards

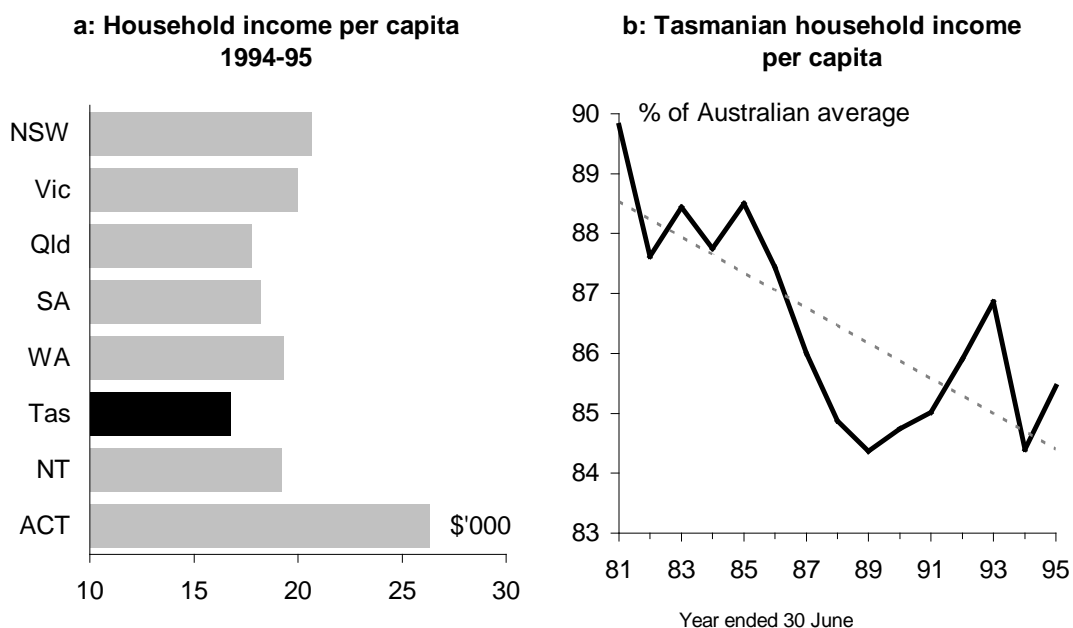
Average household incomes have traditionally been lower in Tasmania than in other States, reflecting not only the smaller proportion of Tasmanians in employment and their below-average earnings, but also the typically lower level of business and other income per head of population in Tasmania than elsewhere in Australia (Chart 7a).

However, despite the declines in both the employment-to-population ratio and in average labour earnings, relative to the corresponding national averages, in recent years, Tasmanian per capita household incomes have apparently levelled out at around 85% of the Australia-wide average (Chart 7b).

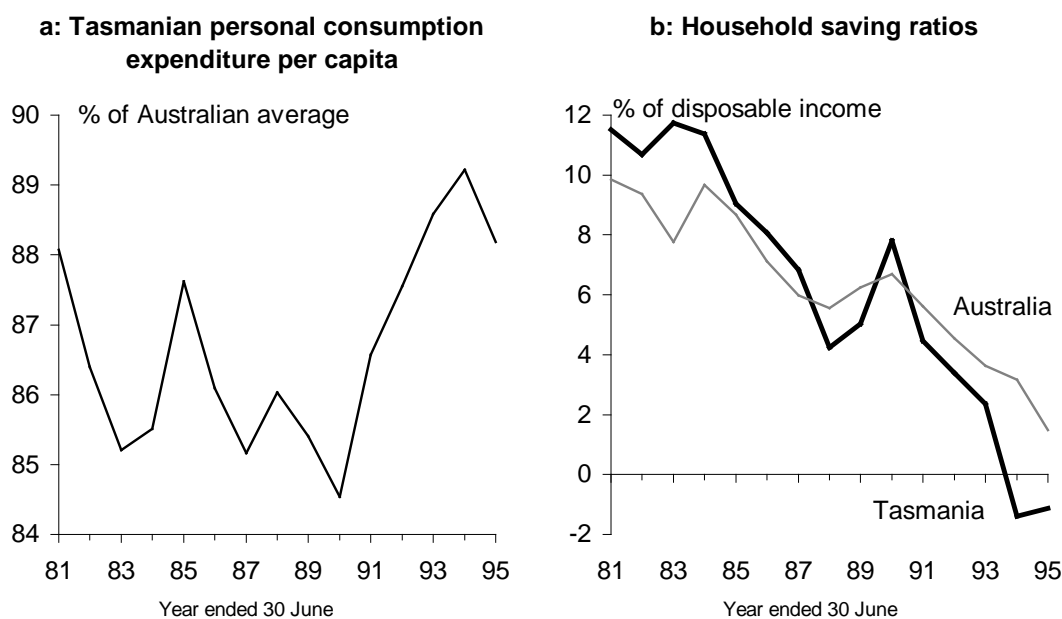
This reflects increases in per capita incomes from non-farm unincorporated enterprises (small businesses) and income from dwellings, relative to the corresponding national averages, which since the end of the 1980s have roughly offset the decline in relative per capita labour incomes. These components of household income rose by less in Tasmania than in other States during the late 1980s, presumably because Tasmania did not participate in the boom in property and other asset prices to the same extent as other States. The decline in Tasmanian per capita incomes relative to the national average was thus to some extent exaggerated during the late 1980s, and it is probably more realistic to regard the data depicted in Chart 7b above as indicating an on-going trend decline in per capita household income in Tasmania relative to the Australian average.

Tasmanian households have, understandably, sought to maintain living their living standards - as measured by per capita personal consumption spending - in the face of this decline in relative per capita incomes. In recent years, per capita consumption spending by Tasmanian households has been higher, relative to the Australian average, than at any time during the 1980s (Chart 8a).

### Chart 7: Per capita household income



Sources: ABS 5220.0, and ANZ calculations.

**Chart 8: Personal consumption and household saving**

Note: Household saving is calculated as the difference between household disposable income and personal consumption expenditure. Sources: ABS 5220.0, and ANZ calculations.

This has been possible only because Tasmanian households have reduced their saving even more rapidly than Australian households in general. Whereas, in the early 1980s, Tasmanian households' saving rate was above the national average, the Tasmanian saving rate has been below the national average in all but one year since 1987-88; and in the two most recent years for which data are available, the Tasmanian saving rate has actually been negative<sup>4</sup>.

The sharp decline in Tasmania's saving rate does not hold the same risks for Tasmania's economic prospects as the decline in the national saving rate may do for those of the Australian economy as a whole, since Tasmanians' ability to borrow from nationally operating financial intermediaries is not restricted by perceptions of 'State debt' in the way that Australia's foreign debt is sometimes cited as a factor which could (at some point) potentially limit Australians' access to international markets. And it could be argued that, because Tasmanian house prices are much lower than in other States, Tasmanians do not need to save as much as other Australians.

Nevertheless, the fact that Tasmanian households apparently now need to draw upon previously accumulated savings in order to maintain current levels of current consumption spending must cast some doubt on the sustainability of those levels of spending. Less obviously, the lower level of personal saving in Tasmania may also restrict the availability of finance for small businesses through informal networks.

*Slower population growth*

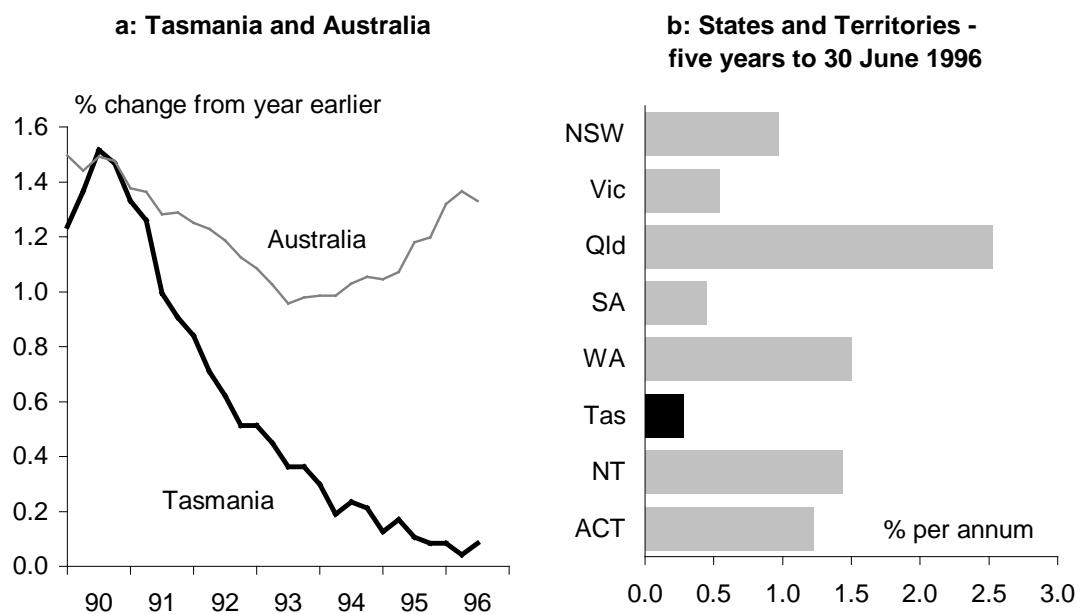
<sup>4</sup> The household saving rate was also negative in Queensland in 1993-94 and 1994-95.

Perhaps the starkest illustration of Tasmania's poor economic performance is the decline in the growth rate of its population, both in absolute terms and relative to that of other States and Territories. Over the five years to June 1996, Tasmania's population grew at an average annual rate of 0.3%, compared with 1.1% for the population of Australia as a whole. Over the past two years, Tasmania's population growth rate has slipped to just under 0.1% per annum, whereas the national population growth rate has accelerated to 1.3% per annum (Chart 9).

Only a very small proportion of the differential between the growth rate of Tasmania's population and that of Australia as a whole can be attributed to 'natural' influences. Tasmania's fertility rate is consistently higher than that of any other State or Territory except the Northern Territory<sup>5</sup>. Against this, women of child-bearing age account for a slightly smaller proportion of Tasmania's population than of Australia's; and Tasmania's mortality rate is also higher than that of any other State or of the ACT. The net result is that the natural increase in Tasmania's population has accounted for just 0.11 of a percentage point of the 0.86 percentage point margin by which the State's population growth rate has fallen short of the national average over the five years to June 1996.

Tasmania's below-average population growth is instead overwhelmingly the result of conscious choices by individuals as to where they wish to live. Migration from overseas has added an average of less than 0.1% per annum to Tasmania's population over the past five years, compared with an average of 0.4% per annum to the national population.

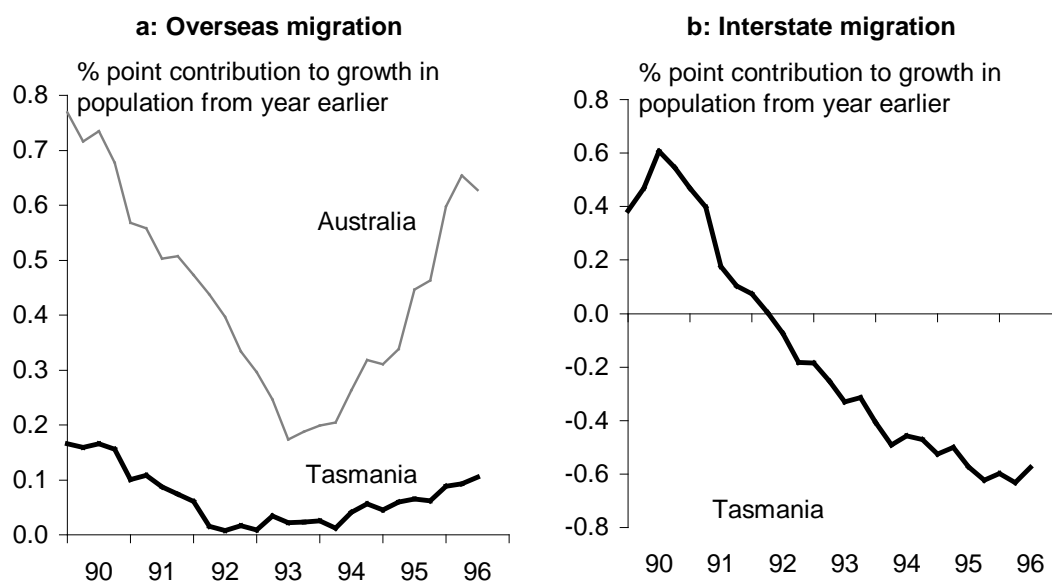
### Chart 9: Population growth



Source: ABS 3101.0

### Chart 10: Net overseas and interstate migration

<sup>5</sup> ABS, *Projections of the Populations of Australia, States and Territories 1995-2001* (catalogue no. 3222.0), p. 10.



Sources: ABS 3101.0 and ANZ calculations.

Net interstate migration has subtracted 0.4% per annum from Tasmania's population growth rate over the same period.

Chart 10 suggests that the proportion of overseas migrants choosing Tasmania as a destination is declining, while interstate emigration from Tasmania appears to be accelerating.

### Summary

Tasmania's decline, relative to the rest of Australia, has continued apace in the years since the Callaghan Report. Between the 1961 census and the June quarter of 1977, when the Callaghan Report was published, Tasmania's population declined from 3.3% of the national total to 2.9%. Over the ensuing 19 years, the State's population has fallen to just under 2.6% of Australia's total. Although data on the size of the State's economy are not available on a consistent basis over the same period, the relative decline in Tasmania's economy is likely to have been even more marked. Between 1980-81 and 1995-96, Tasmania's gross product declined from 2.5% of the national total to 2.1%. This is reflected in the decline in Tasmania's per capita gross product - a broad gauge of living standards - from 85.8% of the Australian average in 1980-81 to 80.9% in 1995-96.

That is not to suggest that material living standards should be the sole gauge of well-being; nor is it to deny that in many respects Tasmanians do enjoy superior lifestyles to other Australians, let alone citizens of other nations. Nonetheless, persistently poor economic performance carries broader social implications: as Callaghan put it, "rich people (rich States) can afford things that others can't"<sup>6</sup>.

<sup>6</sup> Callaghan, *op. cit.*, p. 123.

## Explanations for Tasmania's poor economic performance

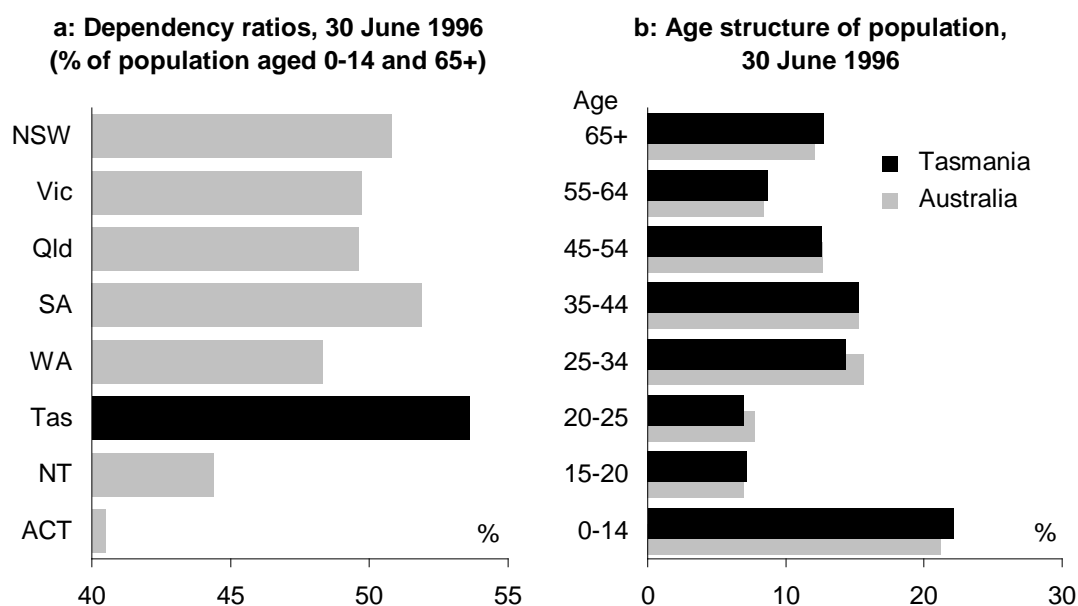
Tasmania's persistently poor economic performance reflects a combination of structural features inherent in the Tasmanian economy, State and Commonwealth government policies, and global factors affecting peripheral regions in many parts of the world. This section examines some of these factors in more detail, with a view to discerning what options might be open to the State and Commonwealth governments in order to arrest, or even to reverse, Tasmania's on-going relative economic decline.

### *The structure of Tasmania's population*

A particularly noteworthy aspect of Tasmania's population losses through interstate emigration (referred to in the previous section) is its impact on the State's population structure. A higher proportion of Tasmania's population is aged under 20 than of any other State or Territory except the Northern Territory. Tasmania also has higher proportions of its population aged 55-64, and 65 or over, than any other State or Territory except South Australia. Tasmania's 'dependency ratio' (the proportion of the population aged under 15 or 65 and over) is higher than that of any other State or Territory, a factor which adds to the demands for government expenditures (eg for education and health services).

On the other hand, the proportion of Tasmania's population aged 20-34 is more than 2 percentage points below the Australian average (Chart 11). This is almost certainly because this age cohort accounts for a disproportionate share of interstate emigrants from Tasmania. Since individuals in this age group have relatively high rates of employment, higher-than-average educational qualifications and are the major source of net new demand for housing, their relatively fewer number in Tasmania represents a significant economic loss to the State.

**Chart 11: Age structure of Tasmania's population**



Sources: ABS 3101.0 and 3222.0.

Tasmania's inability to attract large numbers of overseas migrants is also apparent in the ethnic make-up of its population. 87.5% of Tasmania's population, compared with 77.1% of Australia's, is Australian-born; and only 6.4% of Tasmania's population were born other than in Australia, New Zealand, the UK or Ireland, compared with 14.1% of the population of Australia as a whole.

Given the growing importance of language skills and personal connections in developing export markets, especially in Asia, this lack of ethnic diversity also represents an economic (as well as, arguably, a social) cost to Tasmania.

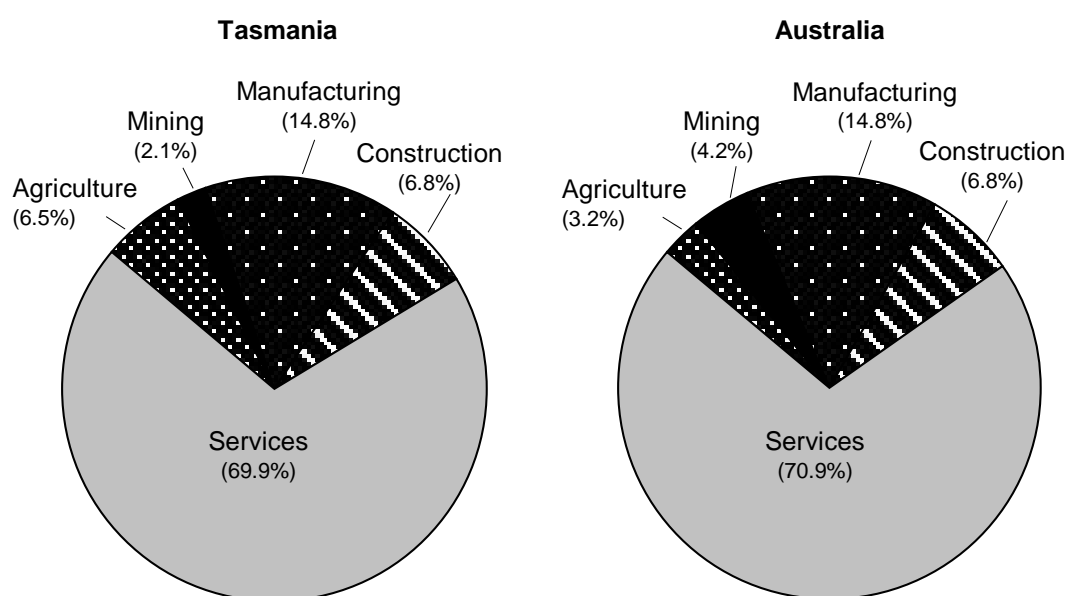
### *The industry structure of Tasmania's economy*

The structure of Tasmania's economy is different in several respects from that of Australia as a whole. Agriculture, forestry and fishing account for a larger share of both output and employment in Tasmania than in Australia as a whole, while mining and services account for smaller shares of Tasmania's output and employment than they do of the corresponding national totals (Chart 12).

These differences in industry structure are part of the explanation for the slower growth in Tasmania's economy during the 1990s.

Table 1 shows the composition of gross product at factor cost by industry in Tasmania compared with Australia as a whole in 1989-90 (the peak year of the 1980s cycle) and 1994-95 (the latest year for which these estimates are available), and the growth rate of each sector in Tasmania and nationally over the four years to 1994-95 (ie, since the last recession). The various sectors are ranked according to their national growth rates over the period 1990-91 to 1994-95. Those sectors whose growth rates at the national level over this period exceed the average for all industries by at least half of one percentage point per annum are grouped as 'fast-growing industries', while the remainder are grouped as 'slow-growing industries'.

**Chart 12: Composition of gross product at factor cost, 1994-95**



Source: ABS 5220.0.



**Table 1: Industry composition of gross product, 1989-90 to 1994-95**

<i>Industry sector</i>	<i>Tasmania</i>			<i>Australia</i>		
	<i>Share of GDP at factor cost (%)</i>		<i>Growth over 4 years to 1994-95</i>	<i>Share of GDP at factor cost (%)</i>		<i>Growth over 4 years to 1994-95</i>
	<i>1989-90</i>	<i>1994-95</i>	<i>(% pa)</i>	<i>1989-90</i>	<i>1994-95</i>	<i>(% pa)</i>
Finance & insurance	1.5	2.1	7.3	2.8	3.8	10.7
Culture & recreation	1.5	1.5	5.7	1.5	1.7	7.9
Communications	2.0	2.3	6.0	2.5	3.0	6.9
Transport & storage	5.1	4.7	4.1	5.3	5.6	6.5
Personal & other services	2.0	1.9	1.9	1.8	2.0	5.9
Education	5.4	4.1	2.7	4.6	4.9	5.6
Gov't administrn & defence (a)	4.4	4.5	4.6	3.6	3.9	5.6
Accommodn, cafes & restrnts	2.4	2.7	2.2	2.1	2.3	5.6
Health & community services	7.0	7.3	5.0	5.5	6.1	5.4
Retail trade	8.9	10.1	5.9	8.0	8.1	5.4
<i>'Fast-growing' industries</i>	<i>40.1</i>	<i>42.3</i>	<i>4.6</i>	<i>37.7</i>	<i>41.5</i>	<i>6.3</i>
Manufacturing	17.1	14.8	1.8	15.5	14.8	4.7
Property & business services	5.9	4.9	0.1	8.9	8.8	4.7
Ownership of dwellings (b)	7.0	9.5	9.3	9.4	9.5	3.5
Wholesale trade	4.6	4.6	1.5	6.1	5.9	3.3
Agriculture, forestry & fishing	6.6	6.5	5.7	4.3	3.2	3.1
General government (b)	3.1	2.9	1.8	2.0	1.9	2.7
Construction	6.5	6.8	5.6	8.0	6.8	2.1
Electricity, gas & water	5.5	5.6	4.2	3.6	3.3	1.6
Mining	3.5	2.1	1.8	4.5	4.2	0.7
<i>'Slow-growing' industries</i>	<i>59.9</i>	<i>57.7</i>	<i>3.8</i>	<i>62.3</i>	<i>58.5</i>	<i>3.4</i>
Total	100.0	100.0	4.1	100.0	100.0	4.6

(a) Wages, salaries and supplements only. (b) Gross operating surplus only.

Source: ABS, *State Accounts* (5220.0), 1994-95, and ANZ calculations.

Table 1 shows that industries which have experienced above-average growth nationally since the last recession actually account for a larger share of Tasmania's economy than they do of the national economy - although the top four industries ranked by their national growth rates (finance and insurance, cultural and recreational services, communications, and transport and storage) are 'under-represented' in Tasmania.

Perhaps surprisingly, those industries which, based on their national performance, can be considered 'slow-growing', represent a smaller proportion of Tasmania's economy than they do of the national economy.

Table 1 also indicates that, of the nineteen industry sectors, thirteen - including all but one of the 'fast-growing' sectors - experienced slower growth in Tasmania than they did nationally over the first four years of the current business cycle. Only six sectors recorded faster growth in Tasmania than across Australia as a whole during this period.

Table 2 shows the sectoral composition of employment in Tasmania and in Australia, and the growth rate of employment in each sector over the five years to 1995-96. As in Table 1, the sectors are ranked according to their national employment growth rate over the past five years. Note that the industries recording the fastest growth in employment over the five years to 1995-96 are not identical with those recording the fastest growth in output: for example, the finance and insurance sector recorded the fastest growth rate of output of any industry over the five years to 1994-95, but the second-smallest increase in employment over the five years to 1995-96.

By 1995-96, a smaller proportion of the Tasmanian than of the national employed labour force was employed in industries in which, nationally, employment had increased at an above-average rate over the preceding five years. This reflects Tasmania's particularly small share of employment in the two sectors with the fastest national employment growth rates, property and business services and cultural and recreational services, which accounted for 11.9% of Australia-wide employment but for only 7.5% of employment in Tasmania. In three of the five other sectors with above-average employment growth, employment actually grew more rapidly in Tasmania than in Australia as a whole.

**Table 2: Industry composition of employment, 1989-90 to 1995-96**

Industry sector	Tasmania			Australia		
	Share of total employment (%)		Growth over 5 years to 1995-96 (% pa)	Share of total employment (%)		Growth over 5 years to 1995-96 (% pa)
	1989-90	1995-96		1989-90	1995-96	
Property & business services	5.9	5.5	0.1	7.7	9.6	5.6
Culture & recreation	2.0	2.0	0.6	2.0	2.3	4.7
Accommodn, cafes & restrnts	4.0	5.2	4.9	4.0	4.6	3.4
Personal & other services	3.5	3.5	0.3	3.5	3.8	2.9
Retail trade	13.5	15.9	2.9	14.3	14.8	2.3
Health & community services	10.6	10.8	1.9	8.2	9.1	2.2
Education	7.7	7.9	2.8	6.7	7.1	2.2
<i>'Fast-growing' industries</i>	<i>47.3</i>	<i>50.8</i>	<i>2.3</i>	<i>46.4</i>	<i>51.3</i>	<i>3.1</i>
Gov't administrn & defence	5.9	7.6	6.7	4.4	4.6	1.0
Communications	1.5	1.3	-2.6	1.9	1.9	1.0
Construction	5.8	6.5	1.4	7.7	7.2	0.9
Transport & storage	4.2	3.8	-2.4	4.9	4.7	0.2
Wholesale trade	4.6	5.3	-1.4	6.5	6.0	-0.5
Manufacturing	14.9	12.0	-4.0	15.4	13.4	-0.6
Agriculture, forestry & fishing	8.6	8.2	-1.1	5.5	5.1	-0.6
Mining	1.5	0.9	-11.6	1.3	1.0	-2.1
Finance & insurance	3.5	2.5	-8.7	4.6	3.8	-2.3
Electricity, gas & water	2.0	1.0	-10.8	1.4	1.0	-4.8
<i>'Slow-growing' industries</i>	<i>52.7</i>	<i>49.2</i>	<i>-1.8</i>	<i>53.6</i>	<i>48.7</i>	<i>-0.3</i>
Total	100.0	100.0	0.1	100.0	100.0	1.3

Source: ABS, *The Labour Force* (6203.0), various issues, and ANZ calculations.

Conversely, a slightly higher proportion of Tasmania's workforce than of the Australia's as a whole is employed in sectors with below-average employment growth nationally. More striking, however, is the substantially weaker growth in employment in all but two of these sectors in Tasmania than in Australia as a whole. Employment in the manufacturing, agriculture forestry and fishing, mining, finance and insurance, and electricity gas and water sectors declined by an average of 4.4% in Tasmania over the five years to 1995-96, as against 1.1% nationally.

Thus, while the *structure* of Tasmania's economy - the small share, relative to Australia as a whole, of a number of industries which have experienced high growth in output or employment since the last recession - partially accounts for Tasmania's relatively poor growth rate, the *performance* of many Tasmanian industries relative to national benchmarks has also been an important factor.

### *The occupational composition of employment*

A different perspective on the factors responsible for Tasmania's relatively poor employment growth record is provided in Table 3, which sets out the relative importance and growth rates of different occupational categories of employment in Tasmania and for Australia as a whole.

Managers and administrators, professionals and (to a lesser extent) tradespersons are under-represented in the Tasmanian workforce compared with that of Australia as a whole. Of these groups, however, only professionals have enjoyed above-average growth in employment at the national level. This suggests that the occupational structure of employment in Tasmania is not a major contributor to the State's relatively poor employment growth performance.

**Table 3: Employment by occupation, 1989-90 to 1995-96**

Occupation group	Tasmania			Australia		
	Share of total employment (%)		Growth over 5 years to 1995-96 (% pa)	Share of total employment (%)		Growth over 5 years to 1995-96 (% pa)
	1989-90	1995-96		1989-90	1995-96	
Managers and administrators	10.3	8.8	-2.8	10.9	10.6	0.4
Professionals	11.9	12.3	1.3	12.5	14.1	3.1
Para-professionals	7.8	6.4	-2.0	5.8	5.7	0.6
Tradespersons	15.1	14.1	-0.9	15.7	14.4	0.3
Clerks	15.4	16.8	1.2	17.2	16.4	0.3
Salespersons and personal service workers	13.7	16.9	3.7	14.7	16.9	3.8
Plant and machine operators	10.4	8.6	-3.5	7.5	7.0	0.4
Labourers and related workers	15.4	16.1	0.5	15.6	14.9	0.6
Total	100.0	100.0	0.1	100.0	100.0	1.3

Source: ABS, *The Labour Force* (6203.0), various issues, and ANZ calculations.

Rather, this reflects significantly weaker growth in employment in Tasmania among those occupational groups which might broadly be regarded as ‘higher-skilled’ - managers and administrators, professionals, para-professionals (technicians, nurses, police etc.), tradespersons, and plant and machine operators. Taken together these occupation groups actually accounted for a higher proportion of Tasmanian than of national employment in 1989-90 (and 1990-91); yet whereas employment in these groups rose at an average annual rate of 1.1% over the five years to 1995-96, in Tasmania it declined at an average rate of 1.4% per annum.

The growing centralization of many business activities in Sydney or Melbourne - as a result of both technological change (especially in the communications field) and changes in management emphasis (for example the decline in ‘middle management’ positions in both private and public sector organizations) - has undoubtedly had an adverse impact on the number of management and higher-skilled jobs within Tasmania. The declining availability of these types of jobs has, in turn, contributed to the exodus of 20-35 year olds noted earlier.

The decline in employment among these ‘higher-skilled’ occupation groups in Tasmania is also likely to have contributed to the decline in Tasmanian average earnings relative to the national average noted in the previous section.

#### *Low levels of productivity and rates of productivity growth*

There is a widespread recognition that productivity is a key determinant of living standards. In *The Competitive Advantage of Nations*, Professor Michael Porter observes that

“productivity is the prime determinant in the long run of a nation’s standard of living, for it is the root cause of national per capita income ... A rising standard of living depends on the capacity of a nation’s firms to achieve high levels of productivity and to increase productivity over time”<sup>7</sup>.

Or, as the well-known US economist Paul Krugman puts it, “productivity isn’t everything, but in the long run it’s almost everything”<sup>8</sup>.

The *level* of productivity - defined as gross product per hour worked - in Tasmania was nearly 12% below the national average in 1995-96, the lowest of any State or Territory except Queensland (Chart 13a). Moreover, the *rate of growth* of productivity in Tasmania over the five years to 1995-96 was only 1.2% per annum, the lowest of any State or Territory (Chart 13b). Tasmania’s level of productivity was 3.6% higher than Queensland’s in 1989-90; by 1995-96 it was only 0.8% higher.

Chart 14 illustrates that, in general, States with higher levels of productivity have higher per capita household incomes; and that households in those States which have achieved more rapid growth in productivity during the 1990s have also, in general, achieved more rapid growth in real incomes.

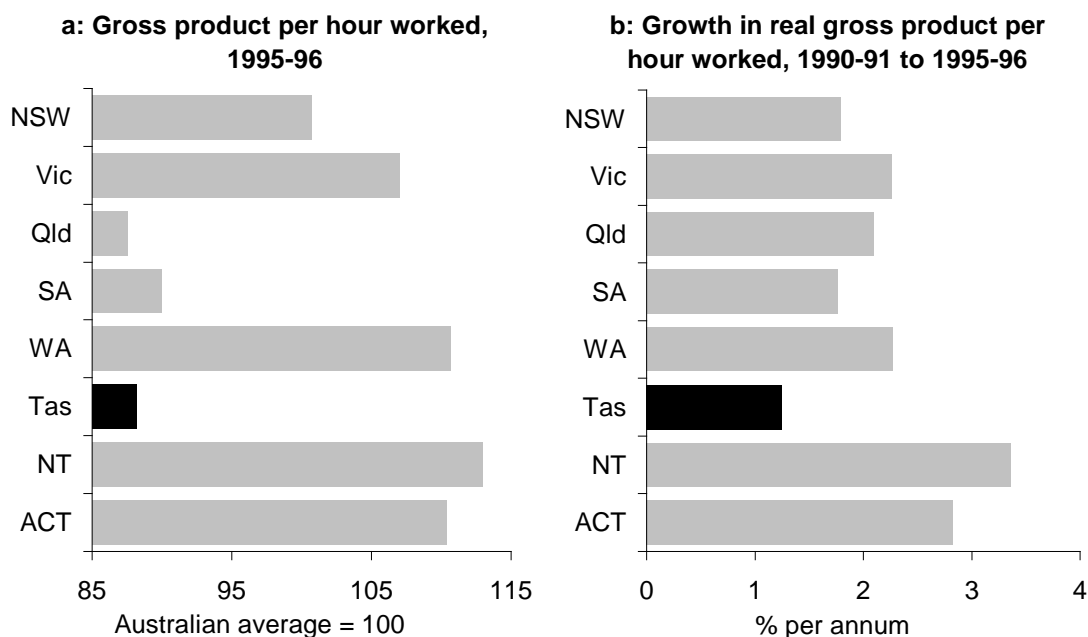
#### **Chart 13: Productivity levels and growth**

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<sup>7</sup> Michael Porter, *The Competitive Advantage of Nations*, The Free Press, New York, 1990, p. 6.

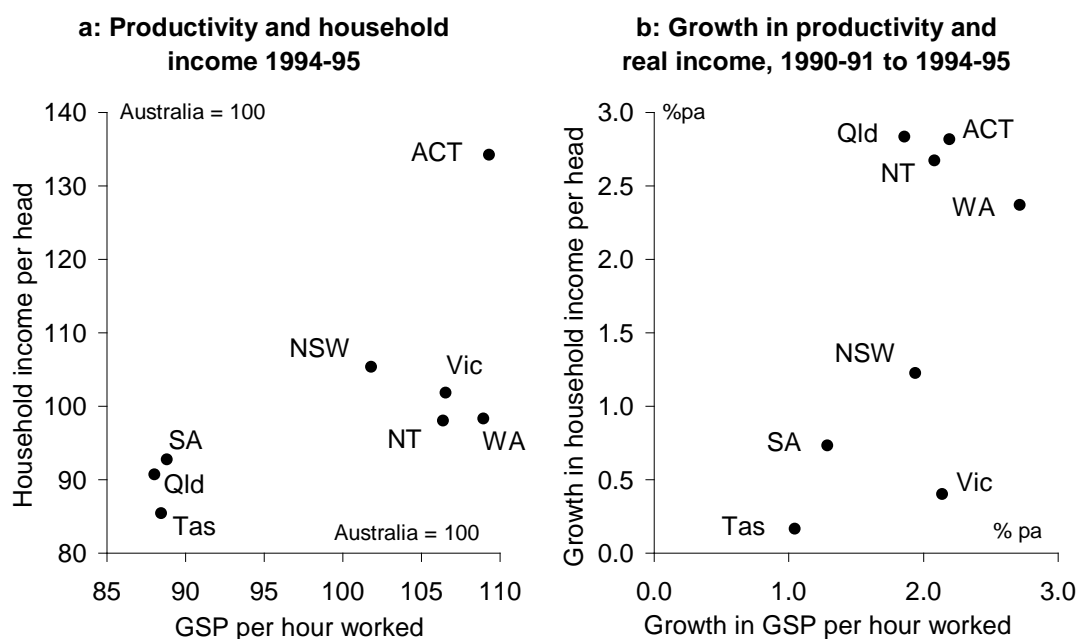
<sup>8</sup> Paul Krugman, *The Age of Diminished Expectations*, MIT Press, Cambridge, 1994, p. 13.

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Source: ABS 5242.0, 6203.0, and ANZ calculations.

### Chart 14: Productivity and real per capita household incomes



Source: ABS 5242.0, 6203.0, and ANZ calculations.

Tasmania's economic problems are thus, in a very fundamental sense, problems arising from a relatively poor *level* of productivity and a relatively poor *rate* of productivity growth, compared with other States and Territories.

#### *Investment in physical and human capital*

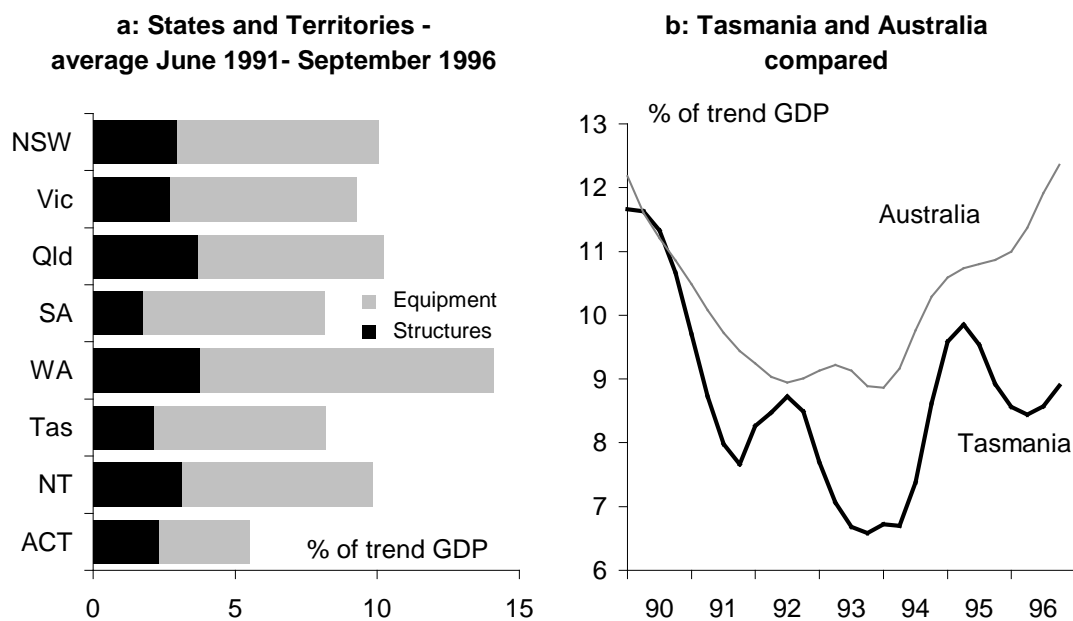
Economists generally accept the notion that there is a strong link between high levels of investment and high rates of growth. Paul Krugman summarizes this viewpoint thus:

“There are three main things that an economy can do to raise the productivity of its workers. It can raise the quantity and quality of its business capital; it can improve the public capital that supports the private economy; and it can improve the quality of its work force, what is sometimes called human capital”<sup>9</sup>.

The proportion of Tasmania’s gross product devoted to business investment is substantially below the Australian average. Since the end of the 1990-91 recession, business investment has accounted for an average of 8.2% of gross state product, lower than for any other State or Territory except for South Australia and the ACT, and compared with a figure of 10.0% for Australia as a whole (Chart 15). The proportion of Tasmanian gross product accounted for by investment in equipment is lower than in South Australia. Business investment has grown at an average annual rate of 3.7% in Tasmania since the end of the recession, compared with 8.5% nationally.

Put differently, Tasmania accounted for 1.5% of Australia-wide business investment expenditure in 1995-96, compared with its 2.0% share of Australia-wide output. This pattern seems set to be maintained in the future. The Delta Electricity-Access Economics *Investment Monitor* records that only 1.2% by value of investment projects under construction or committed as of September 1996 were located in Tasmania. The proportion of projects ‘under consideration’ or ‘possible’ located in Tasmania was considerably higher, at 2.3% by value of the national total; however, 48% of these (compared with 11% of such projects Australia-wide) were subject to ‘environmental or aboriginal constraints. This includes the mooted Taiwan pulp mill which accounts for nearly half the value of projects ‘under consideration’ or ‘possible’ in Tasmania.

**Chart 15: Business investment as a share of gross product**

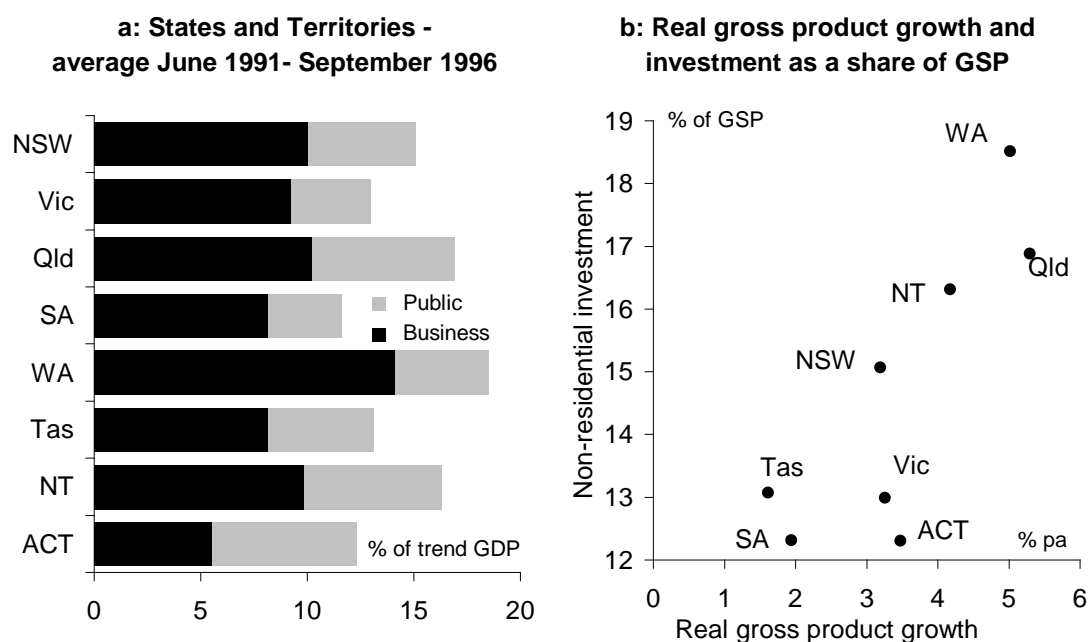


Source: ABS 5242.0.

<sup>9</sup> Paul Krugman, *Peddling Prosperity*, Norton, New York, 1994, p. 125.

Public sector investment has accounted for 4.9% of Tasmania's gross product over the past five years, in line with the national average (and substantially higher than in Victoria). Even taking this into account, however, total non-residential investment has accounted for a smaller share of gross product in Tasmania than in any other State or Territory except for South Australia and the ACT (Chart 16a). This is likely to have had an adverse impact on Tasmania's overall growth performance (Chart 16b).

**Chart 16: Non-residential investment and real GSP growth**

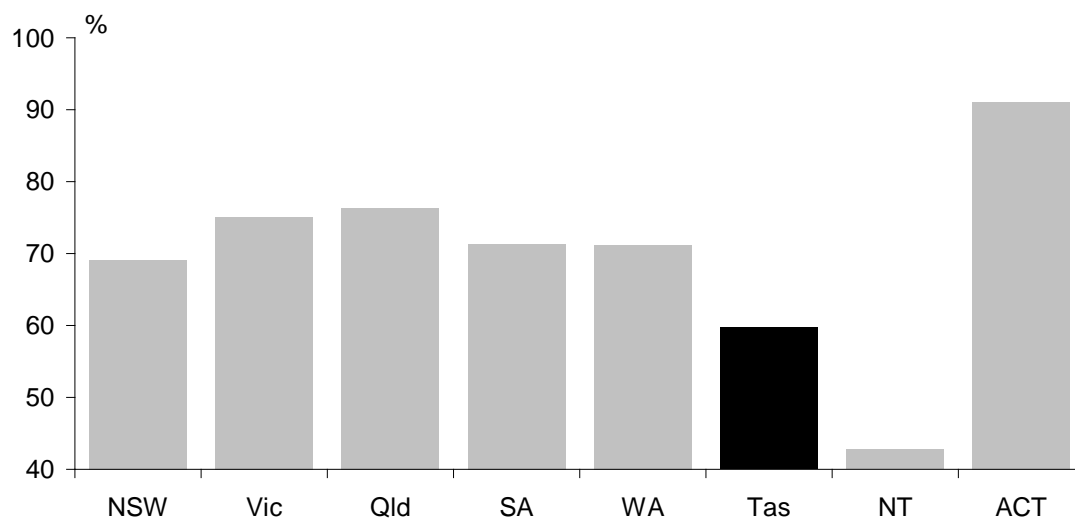


Source: ABS 5242.0 and ANZ calculations.

Tasmania also under-invests in 'human capital' by comparison with the rest of Australia. The proportion of secondary school students continue their education up to year 12 in Tasmania is more than 12 percentage points below the national average. Only in the Northern Territory (where there are particular problems in providing upper secondary education to remote Aboriginal communities) is the retention rate to year 12 lower than in Tasmania. (Chart 17). Moreover, of those who do continue to year 12, the proportion enrolled in English, science and (even more strikingly) mathematics is substantially smaller than for Australia as a whole, while the proportion enrolled in 'society and the environment' is considerably above the national average (Table 4).

Only 19% of Tasmanians aged 15-24 participated in TAFE or higher education in 1995, a lower proportion than in any other State or Territory (Chart 18). The proportion of women among 15-24 year old Tasmanian tertiary students is also significantly lower than in any other in any other State or Territory.

As a result of these relatively low rates of participation in higher secondary or tertiary education, Tasmania's workforce is less skilled (at least in terms of formal certification) than that of other States and Territories (Chart 19). Only 36.4% of Tasmanians aged 15-64 had post-school qualifications in 1995, compared with a national average of 40.6%; whereas 40.6% had not completed the highest level of secondary school (as against a national average of 36.3%).

**Chart 17: Apparent retention rates of full-time secondary students to year 12, 1995**

Source: ABS 4221.0.

**Table 4: Year 12 student enrolment index by key learning area, 1995***Enrolments in key learning areas (per cent)*

	<i>English</i>	<i>Maths</i>	<i>Society &amp; environment</i>	<i>Science</i>	<i>Arts</i>	<i>LOTE</i>	<i>Technology</i>	<i>Health &amp; PE</i>
NSW	17.7	19.1	23.6	13.3	6.5	2.8	12.0	5.0
Victoria	21.0	15.0	18.6	15.8	9.0	3.1	13.3	3.9
Queensland	17.3	18.2	10.5	16.4	9.2	1.3	18.7	8.4
SA	13.3	17.3	27.3	17.4	5.6	2.7	12.2	4.3
WA (a)	18.8	17.6	12.2	16.6	6.9	1.2	16.0	10.5
Tasmania (a)	16.2	12.5	24.5	14.8	7.1	2.2	13.9	6.1
NT	17.4	17.8	24.4	13.7	8.5	1.2	13.1	3.9
Australia	18.3	17.4	18.9	15.3	7.7	2.4	13.2	6.8

(a) 0.4% of WA enrolments and 2.6% of Tasmanian enrolments not classified.

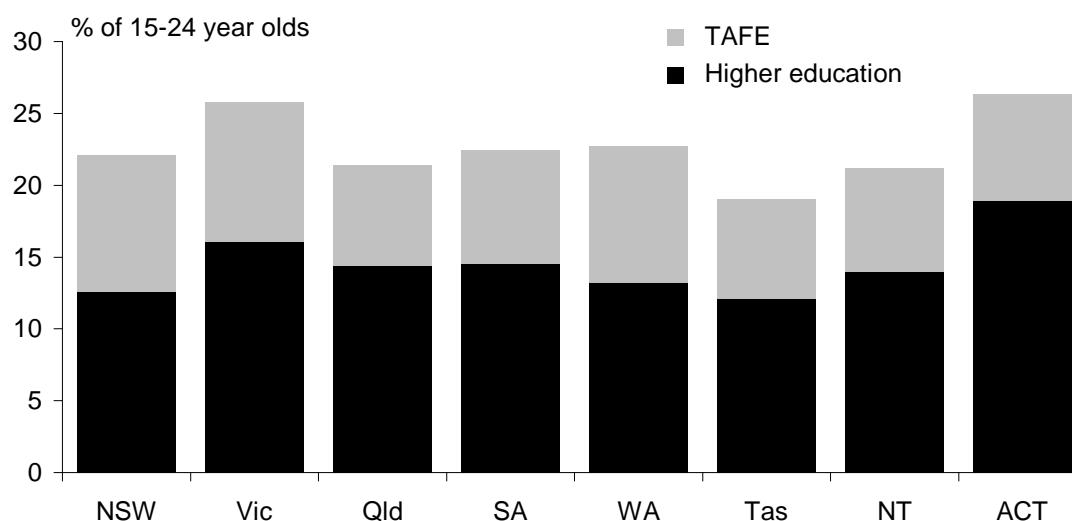
Source: Steering Committee for the Review of Commonwealth/State Service Provision, *Report on Government Service Provision*, 1997, Volume 1, p. 30.

Tasmania performs better than the national average in terms of employment outcomes for, and employer satisfaction with vocational education and training (VET) graduates<sup>10</sup>. However, participation by Tasmanians in VET programs (as measured by annual curriculum hours per person) is lower than in any other State<sup>11</sup>, and the proportion of the Tasmanian workforce with TAFE qualifications is nonetheless below the national average (Chart 19).

<sup>10</sup> Hon. Tony Rundle, MHA, *Operations of Government Departments 1996-97*, Budget Paper No. 2, pp. 36-37.

<sup>11</sup> Steering Committee for the Review of Commonwealth/State Service Provision, *Report on Government Service Provision*, 1997, Volume 1, p. 121.



**Chart 18: Participation of 15-24 year olds in tertiary education, 1995**

Source: ABS 4102.0, 1996.

**Chart 19: Post-school qualifications of 15-64 year olds, 1995**

Source: ABS 4102.0, 1996.

Anecdotal evidence suggests that those leaving Tasmania for other States (especially the 20-35 year olds who, as noted earlier, account for a disproportionately small share of Tasmania's population) are more likely to possess post-school qualifications than those who remain. Interstate migration has thus detracted from the average educational attainment of the Tasmanian workforce. Nonetheless, the relatively low retention rates to year 12 suggest that the problem is largely 'home-grown'.

Low levels of investment in both physical and human capital, relative to other States, are both a symptom and a cause of Tasmania's comparatively poor economic performance. Low investment over long periods has contributed to poor productivity growth, and hence to below-average economic growth. This has in turn discouraged additional capital investment, reduced the State's ability to generate 'high-skill' jobs and further encouraged emigration of skilled Tasmanians to the mainland.

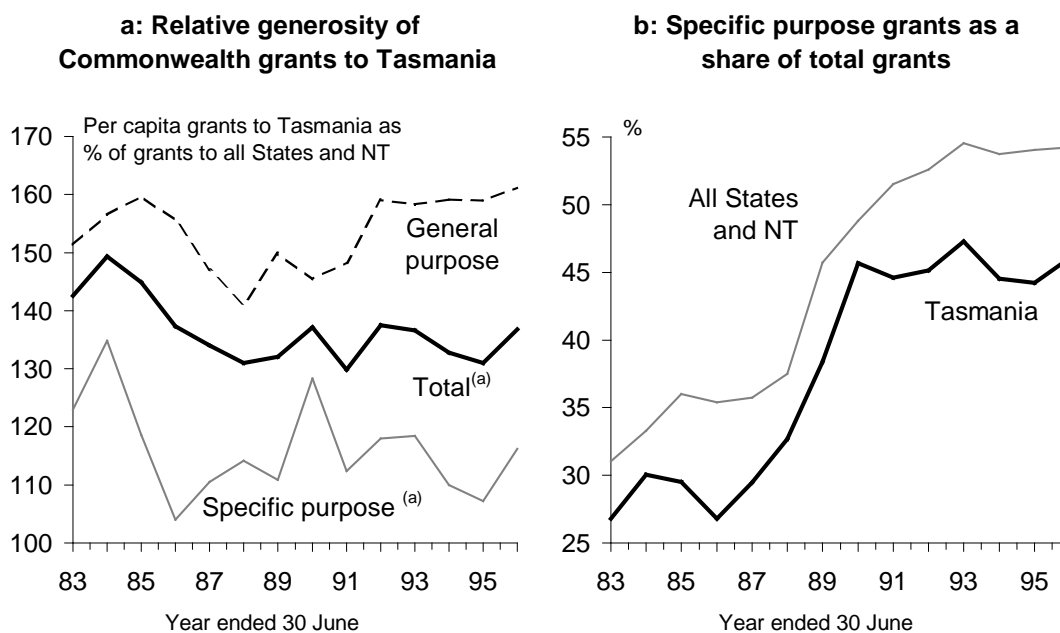
### *Commonwealth Government policies*

Tasmania has been a primary beneficiary of the long-standing policy of ‘horizontal fiscal equalization’, under which poorer States receive higher per capita levels of financial assistance from the Commonwealth Government than more affluent States. Fiscal equalization has been taken much further in Australia than in most other federations, both because of the greater degree of vertical fiscal imbalance in Australia (so that all the States are more dependent on the national government than in other federal systems) and because Australia, uniquely, takes account of differences in revenue-raising capacity as well as in the demand for, and costs of providing, government services in determining the distribution of Commonwealth payments.

Payments to Tasmania have traditionally been considerably higher, in per capita terms, than those to other States. Commonwealth assistance to Tasmania has nonetheless become relatively less generous since the early 1980s. Since 1984-85, when the Commonwealth first began restricting growth in payments to States and Territories, grants to Tasmania have risen by 51% (37% in per capita terms), as against an increase of 72% (56% in per capita terms) in grants to all States and the Northern Territory.

As a result, per capita payments to Tasmania in the last three years have exceeded the average for all States and the Northern Territory by around 34%, down from around 45% in the early 1980s (Chart 20a). This is despite the fact that financial assistance grants (the general revenue payments whose distribution is based largely on the recommendations of the Commonwealth Grants Commission) have, apart from a brief period in the second half of the 1980s, tended to become more generous to Tasmania. This trend has been more than offset by the growing relative importance of specific purpose grants (Chart 20b), which are usually not distributed along fiscal equalization lines and hence are less generous to Tasmania than financial assistance grants.

### **Chart 20: Commonwealth grants to Tasmania**



Note: Excludes \$40mn grant to Tasmania for 'public sector restructuring' in 1989-90.

Source: ABS 5501.0, Commonwealth Budget Papers and ANZ calculations.

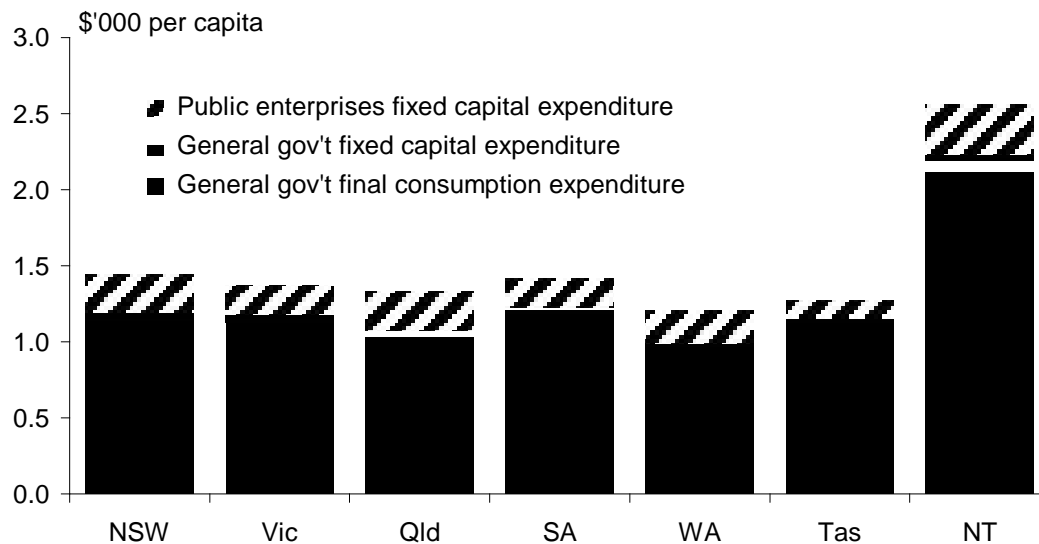
The growing importance of specific purpose payments partly reflects the fact that payments 'through' the States and Territories - that is, payments which the Commonwealth makes to the States and Territories for on-passing, mainly to higher education institutions, non-government schools, and local governments - have grown more rapidly than payments 'to' the States and Territory governments (both general purpose and other specific purpose payments). These now account for over 20% of total Commonwealth payments to the States and Territories, compared with less than 17% in the second half of the 1980s (and for nearly 15% of Commonwealth payments to Tasmania, compared with 11½% in the second half of the 1980s).

Significantly, Commonwealth payments 'through' the Tasmanian government are typically 2-4% lower, in per capita terms, than the average level of payments 'through' all States and Territories.

While assessments of the impact of Commonwealth budgetary policy on Tasmania usually focus on the distribution of grants, this is not the only channel through which Commonwealth expenditures affect the State. The Commonwealth incurs significant expenditures on its own account, through the employment of Commonwealth public servants, purchases of goods and services for its own needs, and the activities of Commonwealth-owned enterprises.

In recent years, direct expenditures by the Commonwealth and its agencies in Tasmania have been lower, in per capita terms, than in any other State except Western Australia. This is largely due to a substantially lower per capita level of fixed capital expenditure by Commonwealth public enterprises (principally Telstra) in Tasmania than in any other State or Territory (Chart 21).

#### **Chart 21: Commonwealth government expenditures per head of population, by State, 1991-92 to 1994-95**



Note: 'expenditures' does not include transfer payments such as pensions, grants etc.

The below-average per capita level of direct Commonwealth expenditures in Tasmania does not, of course, offset the substantially above-average per capita level of Commonwealth grants to the Tasmanian government. Overall, the effect of Commonwealth budgetary and spending policies has been to moderate the impact of other negative influences on living standards in Tasmania relative to the rest of Australia. Indeed, the 'cushion' thus provided may have lessened many Tasmanians' awareness of the underlying deterioration in the State's economic position.

In other areas, the effect of Commonwealth policies on the Tasmanian economy has not always been so benign. For example, the long-standing Commonwealth 'cabotage' policy (under which coastal shipping is restricted to Australian-owned and crewed vessels) has clearly imposed additional costs on Tasmania, for which the various freight equalization schemes have provided an incomplete offset. As a net exporter, Tasmania (along with Western Australia and Queensland) has borne a disproportionate share of the costs of tariffs and other protectionist policies, which only in recent years have begun to be dismantled. Labour market regulation, especially the enforcement of national minimum wages through Federal awards, has inhibited Tasmania's capacity to create employment, especially for the (relatively more numerous) less-skilled members of its workforce. Again it is only in the last few years that Commonwealth policy in this area has begun to change.

Tasmania's economy has also been affected by Commonwealth environmental and heritage policies. This effect has not always been adverse: for example, the blocking - at the Commonwealth's instigation - of the construction of the Gordon-below-Franklin dam can legitimately be said to have saved Tasmania from the construction of an expensive and unnecessary addition to its hydro-electricity system, and has added another dimension to Tasmania's tourist industry. On the other hand, it would be difficult to deny that Commonwealth-imposed restrictions on woodchip exports, and on mineral exploration and quarrying in various areas of the State - however

justifiable on environmental and other grounds - have been at some cost in terms of economic activity and employment.

### *State Government policies*

For most of this century, and especially in the decades following the Second World War, successive Tasmanian Governments sought to foster economic and industrial development through the progressive expansion of the State's hydro-electric system. There can be little doubt that 'hydro-industrialization' made a substantial contribution to the growth of economic activity and employment in Tasmania in the post-war period, both in the construction of the system itself and in the industries which were enticed to the State by the availability of relatively cheap electricity.

The reliance on 'hydro-industrialization' as the major plank in Tasmania's economic development strategy nevertheless left the State particularly vulnerable to two major global trends which developed during the 1980s:

- First, the significant rise in real interest rates added substantially to the costs of servicing the debts incurred in the construction of earlier stages of the Tasmanian electricity system, and made further expansion of the system less economically viable.
- Second, the downward trend in commodity prices adversely affected the profitability and prospects for expansion of the predominantly resource-based industries which had been attracted to Tasmania in earlier decades. New investment - even by companies which operated facilities in Tasmania - tended to be directed to 'greenfields' sites embodying new technology elsewhere in Australia or overseas, in many instances leaving the Tasmanian operations diminishingly efficient by evolving international standards.

It would be unfair to criticize previous Tasmanian governments for failing to foresee these trends. However, Tasmanian governments during the 1980s were slow to realize their implications for the State's long-standing economic strategy. The impact of high real interest rates on the cost of HEC-related borrowings was instead compounded by a string of substantial deficits in the State 'general government' sector - that is, in the 'core' non-commercial operations of the State government, funded largely through the budget (Chart 22). Apart from Victoria, Tasmania was the only State which consistently incurred recurrent deficits in its general government sector during the 1980s - a practice correctly identified by the Victorian Commission of Audit as 'the opposite of good financial management'<sup>12</sup>.

The net result was a significant increase in Tasmania's public sector net debt, and in the State's net debt servicing burden (Chart 23). Not until 1990-91 - when credit rating agencies first began to accord different credit ratings to the States<sup>13</sup> - did Tasmania begin to implement a strategy explicitly aimed at restoring the State's public sector finances to a more sustainable position.

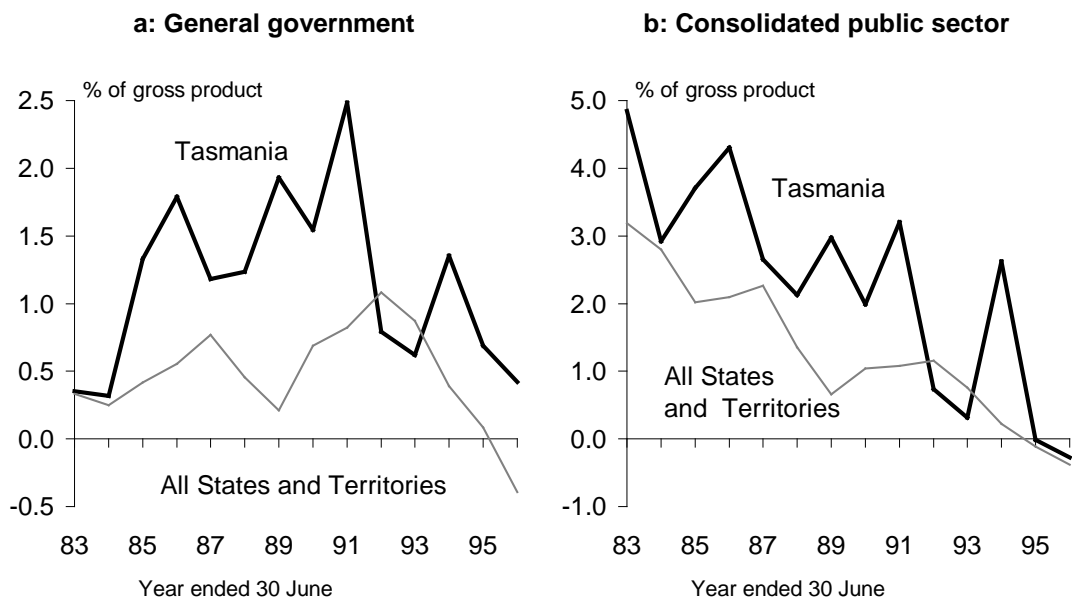
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<sup>12</sup> Victorian Commission of Audit, *Report*, Volume One (Melbourne, 1993), p. ii.

<sup>13</sup> Prompted by the Commonwealth Government's decision to cease issuing debt on behalf of the States, instead requiring them to issue debt in their own names.

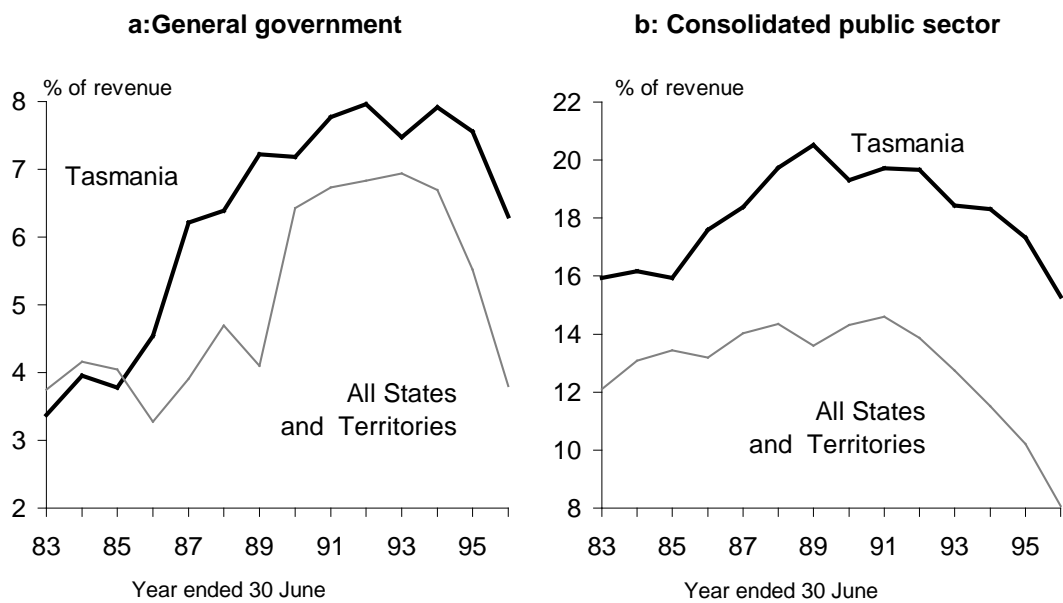
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**Chart 22: 'Underlying' State public sector deficits**



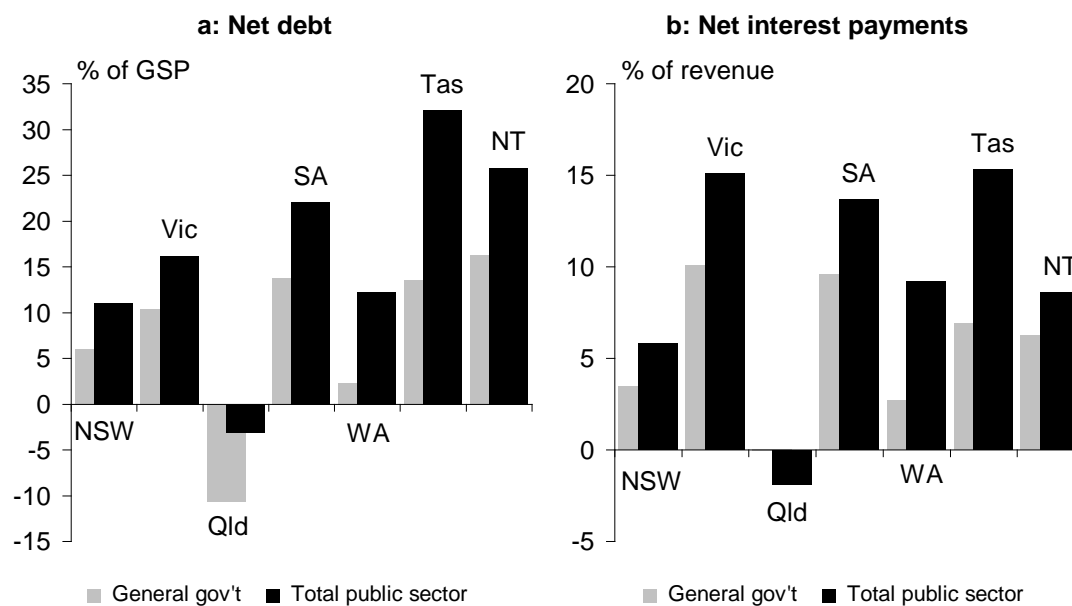
Note: 'Underlying' deficit excludes net advances and asset sales. 'All States and Territories' includes the ACT from 1989-90 onwards. Sources: ABS 5501.0, 5242.0 and ANZ calculations.

**Chart 23: State-debt servicing burdens**



'Revenue' excludes interest received. Source: ABS 5501.0

**Chart 24: Public sector debt and debt-servicing by State, 1995-96**



'Revenue' excludes interest received. Sources: ABS 5513.0, 5501.0 and 5242.0.

This strategy has succeeded in stabilizing, and in more recent years reducing, Tasmania's net debt-to-GSP and net interest-to-revenue ratios - an achievement which has in turn resulted in some narrowing in the interest rate premium on Tasmanian government borrowings.

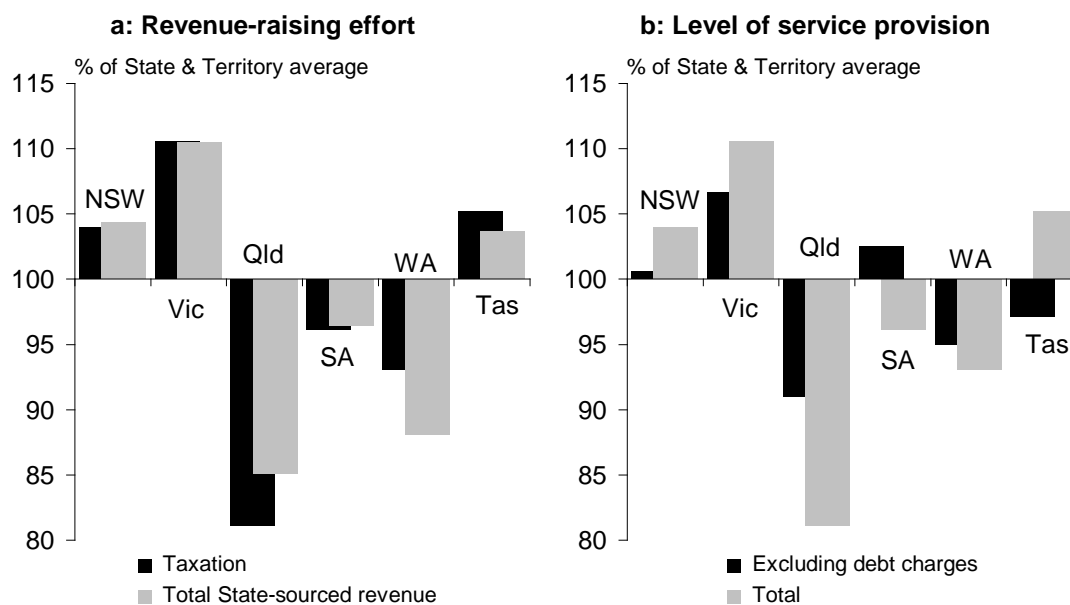
Despite this, however, Tasmania's public sector debt-to-GSP and net interest payments-to-revenue ratio remain the highest of any State or Territory (Chart 24).

Unlike Victoria, Tasmania has eschewed privatization as a major element of its financial strategy, its only asset sales to date being those of the TGIO and the TDA housing portfolios in 1993-94 (the effects of which on the State's debt position were offset by the purchase of *Spirit of Tasmania* for \$155mn). This essentially reflects the fact that the Hydro-Electric Commission accounts for the overwhelming majority of the State's assets. Privatization of all or part of the HEC raises a number of complex technical as well as political issues, some of which are considered in the next section.

The financial strategy pursued by Tasmanian governments since 1990-91 has therefore, of necessity, required stringent control of expenditures and increases in State taxation. State public sector outlays (excluding net advances and asset sales) fell by 1.8% in real terms (or by about 2 percentage points of gross State product) between 1989-90 and 1995-96; while State taxation revenue has risen by 21% in real terms (about  $\frac{3}{4}$  of a percentage point of GSP) over the same period.

As a result, Tasmania is the only State in which taxpayers are paying above-average levels of State taxation and receiving, in return, below-average levels of State services (Chart 25). This conclusion is based on estimates compiled by the Commonwealth Grants Commission as a by-product of its annual reports on the distribution of Commonwealth financial assistance grants among the States<sup>14</sup>.

<sup>14</sup> The Grants Commission estimates the 'standardized revenue' which each State or Territory would raise, if its regime of State taxes and charges were the same as the average of all States and Territories,

**Chart 25: State taxation and service provision, 1994-95**

Source: Commonwealth Grants Commission, *Report on General Revenue Grant Relativities*, 1996 Update.

Chart 25 shows that:

- Tasmanian State taxes and charges in 1994-95 were 5% higher, in per capita terms, than if Tasmania's State tax regime had been of the same severity as the average of all States and Territories - the second-highest 'revenue-raising effort' ratio of any State (after Victoria);
- per capita spending on State-type services by the Tasmanian government was about 2% higher than required to provide these services at the same standard as the average of all States and Territories;
- this 'above-average spending' is however wholly attributable to debt charges. Once these are excluded, per capita spending on State-type services in Tasmania was nearly 3% below the level required to provide these services at the same standard as the average of all States and Territories;
- while taxpayers in NSW and Victoria pay above-average State taxes and charges, even after allowing for their greater revenue-raising capacity, those taxes fund above-average spending on public services. The other small States have below-average State tax burdens.

Although the Grants Commission methodology attracts some criticism (usually from Treasury officials in the larger States seeking to reduce the generosity of

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after allowing for differences in each State or Territory's revenue-raising capacity; and the 'standardized expenditure' which each State or Territory would need to spend in order to provide public services at the standard of the average of all States and Territories, after allowing for differences in the unit cost of providing each type of service. The ratio of revenue actually collected to 'standardized' revenue (the so-called 'revenue-raising effort' ratio) and the ratio of actual to 'standardized' expenditure (the 'level of service provision' ratio) thus give an indication of the relative severity of the tax burden and of the relative generosity of public service provision in each State or Territory, after making allowances for differences in the capacity of each to raise revenue and the cost in each of providing services.

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Commonwealth payments to the smaller States), these conclusions are broadly consistent with more direct observations. For example, Tasmania's 7% payroll tax rate is higher than that of any State except Victoria (which also has a 7% rate). Additionally, Tasmania's tax-free threshold of \$565,000 is lower than any State except Victoria, South Australia and the Northern Territory. Tasmania's land tax on properties valued up to about \$1½ million is much higher than in other States. \$1 million of taxable land attracts land tax of around \$21,100 in Tasmania, compared to between \$11,380 and \$14,450 in the other States. At higher values, Tasmania's land tax regime is still significantly more onerous than those of NSW, Queensland and Western Australia.

The Government's current budgetary strategy is expected to produce a decline in the State's net debt-to-GDP ratio from 32% at the end of 1995-96 to 22% by 2000-01, while the ratio of net interest payments to revenue should decline from 15.3% to just under 12%<sup>15</sup>. Despite this, Tasmania will still have the highest such ratios of any State in five years' time, and will remain especially vulnerable to any sharp rise in interest rates or unexpected downturn in economic activity. Victoria will experience a much sharper decline in its debt and debt-servicing ratios, thanks largely to its substantial privatization program. This will give Victoria - the only State, at present, with a higher tax burden than Tasmania - much more leeway to reduce State taxes and charges.

The downside of the current strategy is that it requires the maintenance of relatively high State taxes and stringent control over expenditures. Under these circumstances, Tasmania will continue to experience considerable difficulty in attracting new investment and in improving its relative economic performance - especially if Victoria does pursue a more aggressive tax-cutting policy over the next few years.

### *Summary*

The conventional wisdom seems to be that the structure of Tasmania's economy, together with its 'natural' disadvantages of scale and isolation, are the major causes of the State's on-going economic decline relative to the rest of Australia.

In reality these are but a small part of the story. Fundamentally, Tasmania's poor economic performance reflects its low levels of productivity and rates of productivity growth, relative to the rest of Australia, across a wide range of its industries. This, in turn, results primarily from relatively low levels of investment in both physical and human capital over long periods of time. Although some specific national policies have adversely affected the State's economy, the general effect of Commonwealth policy has been to prevent the gap between material living standards in Tasmania and the mainland from becoming even wider.

The State Government's ability to address the causes of Tasmania's economic difficulties is severely hampered by its heavy burden of debt. While the State budget is now on a much more sustainable footing, the policies which (largely of necessity) have been required in order to achieve this result will accelerate Tasmania's relative economic decline if maintained for any length of time.

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<sup>15</sup> Access Economics, *State and Territory Budget Monitor*, December 1996.

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Tasmania's slow rate of population growth, and the unusual features of its population structure (in particular the below-average proportion of 20-35 year olds, and of persons of non-English speaking backgrounds) are both a symptom of and a contributor to its economic underperformance.

Indeed, all of the characteristics identified in this section are inter-related. Low levels of investment in physical and human capital beget low rates of productivity growth, which in turn represents a disincentive to further investment and growth. Low rates of economic growth encourage emigration from the State, especially of those who perceive greater openings for their skills elsewhere, reducing Tasmania's pool of human capital. Low population growth adversely affects perceptions of future growth in demand for goods and services and thus acts as a deterrent to investment. The relatively small proportion of the workforce possessing post-secondary qualifications reduces the likelihood of attracting businesses which require special skills. Low economic and population growth undermine the State's revenue base (requiring higher rates of taxation in order to raise a given amount of revenue, adding a further disincentive to investment), and increases the demand for welfare services.

In the absence of fundamental change, these trends are likely to continue. In all probability, Tasmania's share of national population and economic activity will continue slowly to decline, and the gap between material living standards in Tasmania and on the mainland will continue to widen gradually. Tasmanians could, of course, choose to accept such an outcome. There is little reason to expect in the foreseeable future a single, cataclysmic crisis to compel a radical change of direction.

There are, however, options which would, at the very least, slow the rate of relative decline, and perhaps reverse it. It is to some of these which this submission now turns.

## **Some options for a brighter economic future**

Tasmania's economic problems are by no means unique. There are many regions whose long-term economic performance compares poorly with their immediate neighbours, or with that of the larger entity with which they are affiliated - New Zealand, Ireland, southern Europe, Canada's Atlantic Provinces, the southern States of the United States, and the inland provinces of China come readily to mind. Closer to home, many of Tasmania's difficulties can also be seen in South Australia.

Not all of these regions have succeeded in stemming, or reversing, their relative economic decline. Where some success has been achieved (New Zealand, Ireland, some of the southern US states) governments have been able to pursue policy options which are not available to the Tasmanian government - such as changes in income tax rates and concessions, foreign investment rules, and labour market regulation.

Nevertheless, it is open to Tasmania to develop an economic strategy with two distinct major strands:

- at the *macro* level, improving the climate for investment in Tasmania by lowering State taxes and charges and, where necessary, increasing expenditure on education
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and infrastructure provision. This can be achieved in the context of responsible and sustainable budgetary outcomes through the privatization of the Hydro-Electric Commission; and

- at the *micro* level, by encouraging and facilitating the growth of what are likely to be small firms in a range of industries in which Tasmania can lay a credible claim to some comparative advantages.

Indeed, it can be argued that Tasmania is actually slightly better placed than South Australia to pursue strategies along these lines.

### *Improving the climate for investment and employment*

As noted in the previous section, Tasmania is unique in levying above-average rates of State taxes and charges (after allowance is made for the State's revenue-raising capacity) whilst spending less per capita than average on State public services (after allowing for the higher unit cost of providing most services in Tasmania) - the reason for this being the very high level of debt-servicing charges with which Tasmania is burdened. This in turn acts as a disincentive to additional business investment in the State, by existing firms or by new ones, and inhibits Tasmania's ability to upgrade the educational attainments of its population. Moreover, it enables at best a fairly gradual reduction in the share of the State's budget absorbed by debt-servicing charges.

Victoria's recent experience demonstrates that much more rapid reductions in debt and debt-servicing can be attained through an extensive privatization program. This is not the primary motivation for Victoria's approach - which is instead premised on the expectation that the establishment of competitive markets in areas such as electricity and gas will deliver efficiency gains which will in turn be passed on to consumers in the form of lower prices. Indeed, in pursuit of this objective Victoria has generally been willing to accept lower privatization proceeds than if it had sold its State-owned utilities with their monopoly powers intact.

Nevertheless, the Victorian Government would have had virtually no prospect of achieving its stated goal of restoring its AAA credit rating in the absence of the privatizations already undertaken and those expected to occur over the next few years.

As noted earlier, privatization has not played a major role in the financial strategy of recent Tasmanian governments.

However, the Hydro-Electric Commission is so large in relation to Tasmania's public sector debt that its privatization would transform the State's financial position to a much greater extent than has been possible even in Victoria.

The assets of the HEC had a book value of \$4.58 billion as at 30 June 1996<sup>16</sup>. The HEC's 1995-96 earnings before depreciation, interest and tax (EBDIT) were \$352 million. Since the HEC's payments to the State Budget are expected to rise by some

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<sup>16</sup> Hydro-Electric Commission, *Report for the Year Ended 30 June 1996*, p. 35. This includes \$4.38 billion for the 'assessed recoverable amount' of property, plant and equipment as at 30 June 1996.

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65% over the next three years (from \$54 million to \$89 million)<sup>17</sup>, it seems reasonable to expect that, by the year 1999-2000, its EBDIT will have risen by at least half that proportion, to around \$460 million. Victoria sold its five electricity distribution businesses for multiples of 9-11 times EBDIT, implying that the HEC could be worth a minimum of \$4.1 billion, and possibly as much as \$5.1 billion, even if sold as disaggregated competitive businesses rather than as a monopoly.

The proceeds of such a sale would allow the repayment of the HEC's liabilities (other than those to the Budget) of \$1.72 billion, the State's remaining debt of \$1.86 billion, leaving (roughly) between \$520 million and \$1.52 billion in cash. From being the most heavily indebted State in the Commonwealth, Tasmania would join Queensland in the enviable position of being a net creditor.

Elimination of the State's debt would save the Budget around \$220 million per annum in interest payments. Offsetting this, the State would no longer collect dividends and other revenues from the HEC which, as noted above, are expected to rise to nearly \$90 million by the end of the decade. The Budget would presumably take over the community service obligations currently performed by the HEC (in respect of PHB card holders and the Bass Strait islands) at an annual cost of \$16 million. The net result is a saving to the State Budget of nearly \$115 million per annum. This is before taking account of the interest which might be earned on the surplus cash generated by the privatization of the HEC, which (at current interest rates) would be between \$30 million and \$90 million per annum<sup>18</sup>. Overall, privatization of the HEC could improve the State's budgetary position by at least \$130 million, and perhaps by as much as \$205 million per annum.

There are, of course, a number of complex technical and legal issues which must be resolved before privatization of all or part of the HEC could be considered. In particular, from the standpoint of electricity consumers (both households and businesses) it is important to ensure that privatization does not result in the substitution of a private monopoly for a public one: the HEC should be disaggregated prior to privatization, with a view to fostering competition in the generation, distribution and sales components of the electricity industry, even if this involves some sacrifice in terms of the price received for the HEC. Achieving genuine competition in the Tasmanian electricity industry would almost certainly require the connection of the Tasmanian grid to the mainland via Basslink. Additionally, since the water storages used in the generation of hydro-electricity have other uses as well (in contrast to the coal used in thermal generation on the mainland), legal rights and obligations in relation to water rights will need to be clarified prior to any sale of the HEC.

Subject to the resolution of these issues, privatization of the HEC would dramatically transform the options available for improving the investment climate in Tasmania.

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<sup>17</sup> Hon. Tony Rundle, MHA, 'The Hydro - An Important Issue for Tasmania', Speech to the Tasmania 2010 Forum, 11 November 1996, p. 11.

<sup>18</sup> The logic of this paragraph follows that of the Premier in his speech of 11 November 1996 (see n. 9 above). However the figures used have been derived by ANZ directly from the HEC's 1995-96 Annual Report and the 1996-97 Tasmanian Budget Papers and thus differ in some respects from those used by the Premier.

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Out of the *lowest* estimate of the net annual gain to the Budget of \$130 million, the Government could (for example):

- reduce the rate of payroll tax from the current 7% to (say) 4%, which would be 1 percentage point lower than in Queensland, at an annual cost of around \$60 million (after allowing for lower payroll tax payments by State government agencies);
- abolish land tax on principal residences, costing around \$3 million per annum, or preferably (from the viewpoint of encouraging investment and employment) reduce land tax on business property by (say) one-third, costing around \$9 million per annum;
- abolish the 15¢ debits duty and duty on credit card transactions (which Tasmania, alone among the States, imposes), at a cost of around \$17 million per annum;
- increase expenditure on education, for example by employing an additional 500 teachers at an annual cost of around \$20 million, and acquiring (say) one new personal computer for every five government school students over a five-year period at a cost of around \$9 million per annum. In practice, such additional expenditures would need to be undertaken in the context of a careful review of school curricula; and
- establish a scholarship scheme to pay the HECS charges for 1,000 Tasmanian tertiary students at a cost of \$7 million per annum.

Modelling by the Centre for Regional Economic Analysis at the University of Tasmania suggests that a \$125 million package comprising (say) \$60 million in payroll tax reductions, \$20 million in reductions in other taxes and \$45 million of additional spending would boost real private investment in Tasmania by around 4¾%, Tasmanian real exports by nearly 9%, and both real gross State product and employment by nearly 4% in the long run<sup>19</sup>.

Alternatively, the Government could forego some or all of the annual interest income from the \$½-1½ billion surplus cash which might be realized (after repaying the State's debt) from the privatization of the HEC - in which case the amount available for measures such as those listed above would be reduced by some \$30-90 million - and instead establish a 'Tasmanian Infrastructure Fund' to invest in a range of projects which (in addition to their immediate employment effects) could, after detailed investigation, be expected to improve the climate for private sector investment in the State. Such a Fund might contribute to the costs of establishing the Basslink connection with the mainland electricity grid (which, as noted above, is likely to be required in order to establish a competitive electricity industry structure in Tasmania upon the privatization of the HEC); and to bringing natural gas from the Yolla field to Tasmania.

Whatever the ultimate disposition of the final proceeds, it is clear that the benefits in terms of employment and investment in Tasmania from privatization of the HEC far outweigh those of maintaining what has now become essentially a passive investment

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<sup>19</sup> These estimates represent ANZ calculations based on model results published in *Forum Facts* by the Centre for Regional Economic Analysis at the University of Tasmania for the Tasmania 2010 Forum, November 1996. Note that the 'other taxes' considered by CREA were liquor licence fees, household motor taxes and gambling taxes, rather than land tax and financial transactions taxes.

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on the part of the State Government. Indeed, it is difficult to see any other means by which Tasmania, at its own initiative, can bring about a rapid improvement in its medium-term economic prospects.

Aside from budgetary initiatives, the State Government could make a further contribution to improving the climate for investment and employment in Tasmania by referring its industrial relations powers to the Commonwealth (as Victoria did earlier this year). The recently-enacted Commonwealth industrial relations legislation provides for greater flexibility in negotiating terms and conditions of employment than the State awards system; and referral of State powers in this area to the Commonwealth would reduce the duplication, overlap and complexity inherent in parallel systems of employment regulation.

The State Government should also seek to build personal and business links between the State and overseas markets by actively seeking to entice a higher proportion of immigrants (especially those from Asian backgrounds) to take up residence in Tasmania, and by promoting Tasmanian educational institutions to students from Asian countries.

### *Promoting the development of growth industries*

As a general proposition, the most effective contribution any State Government can make to enhancing growth in economic activity is to ensure that its own policies and actions foster a favourable perception of the State in the eyes of those (within the State and elsewhere) making decisions with regard to the location of investment and employment. Sound and stable public finances; a competitive regime of State taxation (which does not necessarily mean the lowest level of taxation of any State); adequate provision of public services and infrastructure; and transparency, certainty and fairness in the imposition and administration of regulations governing business activity are the key elements of creating such perceptions.

Experience suggests, however, that existing and potential investors and employers also regard favourably locations where governments have a clear and consistent vision of the pattern of economic development which they believe is possible and desirable.

This emphatically does not amount to a strategy of dealing with certain companies or industries on more favourable terms than others, which (among other things) leaves a small economy such as Tasmania's exposed to 'bidding wars' with other jurisdictions. Tasmania is unlikely to attract large-scale industries (other than, perhaps, in the resources area) or corporate head office functions, and there is little to be gained by offering large inducements in pursuit of them. Rather, the approach most likely to succeed in Tasmania's case is one of promoting the State's environmental and lifestyle attractions and - assuming a 'macro' strategy along the lines outlined above is implemented - its competitive business environment to small scale operations in specialist fields.

It is possible to identify a number of areas in which promotion of Tasmania in these terms is likely to be reasonably successful. These include:

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- *Horticulture and viticulture* - based on Tasmania's advantage of cooler climates and 'clean green' image to produce crops and products for small or specialized markets (such as flowers, honey, pharmaceutical and medicinal products and premium wines).
  - *Fishing and aquaculture* - have substantial growth potential based on rising world demand and limited natural stocks. Tasmania's relatively pristine waters and recent technological developments are improving the economics of aquaculture in the State.
  - *Food processing* - building on what should become a more diversified agricultural base and, as with horticulture and viticulture, Tasmania's cooler climate and positive environmental image. With appropriate attention to promoting perceptions of quality and uniqueness, dairy products, vegetables, mineral waters and cool climate wines have particular potential .
  - *Wood and paper products* - still have considerable potential in Tasmania despite high profile environmental concerns which are common to almost all producers worldwide. There is substantial scope for import replacement in the domestic market for paper products, from which Tasmania should benefit. Tasmanian furniture makers have the capacity to create a premium image similar to the State's dairy products and wines.
  - *Specialized manufacturing* - firms such as Incat and Global Lightning Technologies have shown that manufacturing activities employing advanced technology and producing for specialized markets can succeed in Tasmania where transport costs are not a major impediment and where visionary local entrepreneurs have been able to recruit or train a highly skilled workforce. Tasmania's lifestyle and environment may be attractive to entrepreneurs from other locations, but improvements in the 'macro' climate along the lines outlined earlier in this section will be necessary to promote the 'clustering' of small, technically advanced operations which has occurred elsewhere around the world.
  - *Marine engineering, technology and research* - represent a specific example of combined public and private sector activities which can in turn prompt 'clustering' of specialized manufacturing and services firms. Tasmania already has some capacity in this sphere and there is no reason why North Queensland should be the only recognized centre of excellence.
  - *Tourism* - has considerable unrealized potential if sensibly targeted. Resort developments have limited appeal in the Tasmanian context. Rather, promotional efforts should be targeted at tranquility seekers; 'relaxed' tourists to whom history, scenery, fine dining etc. are key points of interest; fringe wilderness tourists seeking to experience natural environments but also seeking 'nightly comfort' and the company of others; serious eco-tourists; and backpackers. Marketing campaigns should also direct greater attention to 'short break' holidays rather than concentrating solely on two-four week vacations.
  - *Telecommunications services* - improvements in communications technology (such as 13- and 1-800 telephone numbers) have dramatically cut the need to be physically present in a given area in order to provide service to customers, enabling national and international firms to centralize customer service, enquiry and billing
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operations. While this has often worked to Tasmania's detriment in recent years, the Ansett's selection of Launceston as the location for its national tele-centre illustrates that this trend need not be one-way. Lower land and labour costs, combined with other enhancements to the business environment as suggested earlier, would represent a significant advantage for Tasmania in attracting this type of activity.

The purpose of identifying activities in which Tasmania may have a competitive advantage is, as emphasized earlier, not in order to provide them with special tax breaks or subsidies, but rather to provide a coherent framework for the State Government's own promotion and development activities, research efforts, infrastructure planning, and the like; and to enable it to articulate a vision which makes sense, in practical terms, to the Tasmanian community and to potential investors.

Thus Tasmania should, through TDR and other agencies, seek to promote the industries mentioned above (and the State's comparative advantages in them) to potential investors; should make representations to the Commonwealth Government on issues affecting these industries; where it undertakes or funds research activities (eg through the Department of Primary Industries and Fisheries) it should focus on these industries; and it should take the requirements of these industries into account when formulating policies in other areas ranging from education curricula to the provision of infrastructure.

There may be scope for TDR to provide assistance for firms in these industries with marketing activities, especially in export markets. Firms should be charged for such assistance; the rationale for state involvement is that, in many cases, firms may be too small to undertake such activities on their own (or the cost of private finance may initially be too great). Similar programs have been successfully pursued by the Irish Trade Board over the past decade.

Another industry-specific initiative which merits further investigation in the Tasmanian context is the Northern Territory arrangement under which the proceeds of a 5% tourism marketing duty imposed on accommodation charges in the Territory are used to fund tourism promotion programs. This appears to have succeeded in lifting the NT's 'market share' of accommodation nights above Tasmania's since the early 1990s, despite the greater cost of travelling to the Northern Territory (from most parts of Australia) and generally higher accommodation charges.

## **Conclusion**

The choices which Tasmania makes over the remaining years of the twentieth century are of critical importance for the performance of the Tasmanian economy, and the living standards of the people of Tasmania, in the century which is about to begin.

Tasmanians can of course choose to continue to on the present path, making small changes of direction at the margins of government policy but otherwise 'muddling through' as they have done for decades. Such a course is unlikely to lead to a crisis in the foreseeable future. Rather, Tasmania would simply continue to grow at a slower

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rate than the rest of Australia; its young people (in particular) would continue to drift to the mainland, probably in increasing numbers; living standards, though unlikely to decline outright, would fall further behind the national average; and the State would be ignored by the rest of Australia to an even greater extent than it is today.

Alternatively, Tasmanians can seize the opportunity to embark on a change of direction; to mark Tasmania out as a place offering a unique combination of lifestyle, environment and opportunities; one where government recognizes the importance of being competitive in a national and global context, but also appreciates the role which it must play in providing the social conditions and business environment in which growth industries can prosper and provide jobs for Tasmanians.

The choices outlined in this submission are *not* ideological. This submission urges (among other things) the privatization of the Hydro-Electric Commission not because of any belief that the role of the state ought to be lessened; but rather because this course will enable the state to play a much more constructive and relevant role in Tasmania's future than if it continues to be burdened by high levels of debt in order to carry what is now essentially a passive investment.

Similarly this submission does *not* argue that Tasmania ought to discard its consciousness of environmental values; indeed that is increasingly part of what marks Tasmania out as 'different' from other places. Rather, these values may become harder to sustain, and may even become a source of tension among different parts of the Tasmanian community, if the State's economy is unable to provide jobs (especially for its young people) and improvements in material living standards reasonably consistent with those obtained elsewhere in Australia.

Tasmania's economic problems have been long in the making. The fact that it is possible to identify solutions to many of those problems should be a source of great hope: the same cannot be said of every other region with similar difficulties. ANZ urges all political parties in Tasmania to work constructively together to ensure that this hope can be realized.

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