

HUMAN CAPITAL AND TASMANIA'S ECONOMIC FUTURE

Keynote address to HR Week Conference

Organized by the Australian Human Resources Institute

Wrest Point, Hobart

24th August 2005

by

Saul Eslake

Chief Economist
Australia & New Zealand Banking Group Ltd

For the first time in as long as anyone here today can remember, Tasmanians can look at the recent performance of their economy with some pride and satisfaction. Not for one minute do I wish to deny that there are still many challenges facing this island, its government and its people. Indeed most of my remarks today will be around that theme. But my point of departure in talking about some of those challenges is that Tasmania is now better-placed to deal with them than it has been for a very long time.

- Over the three years to 2003-04 (the latest for which the figures I am about to cite are available), Tasmania's economy has grown at an average annual rate of 3.3%, the best performance over any three-year period since that ended 1985-86;
- Over the three years to June this year, employment in Tasmania has grown at an average annual rate of 3.4%, $\frac{3}{4}$ pc point faster than on the mainland, cutting Tasmania's unemployment rate from over 10% during the late 1990s to under 6% this year;
- Average Tasmanian per capita household disposable income has risen from 80.6% to 84.6% of the national average over the past three years – reversing almost all of the decline which occurred over the second half of the 1990s;
- Having been the third most heavily indebted government (relative to the size of its economy) in Australia, after the Northern Territory and South Australia, in the mid-1990s, Tasmania has now joined Queensland, WA and the ACT as one of only four jurisdictions whose 'general government' is a net creditor;
- Over the same time Tasmania has gone from being a relatively high-tax State – indeed, having had the most severe tax burden of any State or Territory in the late 1980s and early 1990s according to the Grants Commission's calculations – Tasmania's State taxes are now the lowest of any jurisdiction in Australia apart from Queensland and the Northern Territory; and
- Tasmania's improved economic position is being recognized by people voting with their feet, with more people moving south across Bass Strait than in the opposite direction since the second half of 2002, for the first time in over a decade – making Tasmania one of only three States, along with Queensland and WA, to be attracting net immigration from the rest of Australia.

Moreover these achievements are overwhelmingly the results of Tasmanians' own efforts. For all the persistent complaints by the Governments of New South Wales and Victoria about having to 'subsidize' other States – and there is something ironic, is there not, about Labor Treasurers complaining about the redistribution of income from the rich to the poor – Tasmania's share of Commonwealth grants to the States and Territories has fallen from a peak of 3.8% in 1999-2000 to an estimated 3.37% in the current financial year. And direct spending by the Commonwealth Government in Tasmania has fallen from a most recent peak of 10.3% of Tasmanian gross State product in 1999-2000 to 9.3% in 2003-04.

However none of this can obscure the undeniable fact that, in most respects, Tasmanians are on average paid less, worth less, less well educated, less likely to make it to 70 years old, less likely to be connected to the internet, and less likely to be in a job; but more likely to be dependent on welfare, more likely to have a disability, and more likely to commit suicide than residents of any other State¹.

¹ The Northern Territory has a lower proportion of its population surviving to aged 70, and a higher suicide rate among males (though not females) than Tasmania. In order to make the point simply I have fallen back on the pedantic point that the Northern Territory is not a State. Apologies to my friends in the Northern Territory. Data are from ABS, *Social Indicators*, 2005.

So there remains much to be done. The good news is that Tasmania is much better placed to do what needs to be done than it has been in a long time.

A number of the things which need to be done if Tasmania's recently improved economic performance is to be sustained, and if the benefits of sustained economic growth are to be translated into improvements in the quality of life for all Tasmanians (as they need to be, not least in order to ensure on-going public support for the policies required to sustain economic growth) can be grouped together under the heading "improving the quality of Tasmania's human capital". And it is those things which I want to concentrate on for the rest of my remarks today.

For some years now, I have been saying that Tasmania's future cannot possibly lie predominantly in the volume production of essentially unprocessed commodities at lower prices than competitors with better access to larger and cheaper resources of labour and capital, or better access to markets (for geographical reasons or by virtue of membership of trade blocs); but, rather, depends on its capacity to produce and market highly differentiated goods and services embodying a high intellectual content and for which customers are willing to pay premium prices.

The position in which Tasmania's potato growers have found themselves following the loss of a major proportion of their sales to competitors from New Zealand aptly illustrates the point I have been making.

Let me emphasize, since it is easy for it to be portrayed otherwise, that I am not indifferent to the difficulties which potato growers and their families, and the communities which depend on them, are now confronting. Nor am I unsympathetic to their call for more information to be made available to consumers regarding the origin of the products which they buy – although I am skeptical that this will make much difference in practice to the vast majority of shoppers who, every day, demonstrate by their behaviour that price and convenience are much more important influence on what they buy, and where they buy it, than country of origin.

But it needs to be said, I believe, that emotional appeals to the patriotism of Australian consumers are no substitute for objective analysis; and that frequent re-iteration of the assertion that one is not a protectionist does not constitute evidence that the propositions one is putting forward are not, in fact, protectionist.

The facts, as I understand them, are that Tasmania's potato-growers have been content to rely on a single customer to purchase most, if not all, of their crop; that they have not made any serious effort either to develop other customers or to give customers any reason to think that Tasmanian potatoes have characteristics which make them sufficiently distinct to warrant them commanding a higher price than potatoes produced elsewhere.

Like all too many other businesses, they appear to have made the fatal mistake of assuming that consumers exist to serve the needs of producers, rather than the other way round.

Much as they and other producers wish it were otherwise – although of course they never say so explicitly, since to do so would contradict their assertions that they are not 'protectionists' – this is no longer the case, if indeed it ever was.

Like other Tasmanian commodity producers, Tasmanian potato growers have very little prospect of survival unless they are able to persuade consumers that Tasmanian potatoes do indeed have distinctive characteristics which mean that consumers will willingly pay higher prices for them than for potatoes produced by growers from elsewhere who are able to sell at lower prices because they have lower costs, pay lower taxes or wages, or are willing to operate on thinner profit margins than Tasmanian growers.

This should not be an impossible task.

In the small Central American republic of Costa Rica, banana growers have faced a problem that is remarkably similar to that now confronting Tasmanian potato growers². Small-scale producers accounted for 58% of the crop. They employed 40,000 people, whom they paid wages averaging US\$18 per day plus housing, health and social security benefits. They sold most of their crop to three multi-national companies, who in turn exported them to markets in North America and Europe. They were paid US\$5.20 per box of bananas, and also had to foot an export tax of US18¢ per box.

By 1999 they were beginning to face intense competition from banana growers in Uruguay, in South America, who paid their workers US\$2-3 a day, with no fringe benefits, and were able to export bananas for US\$2.18 a box.

Costa Rican banana growers responded to this competition, not by taking their trucks and their passions to San Jose (the Costa Rican capital), or by making emotional appeals to the nationalism of Costa Rican housewives, but rather by:

- diversifying their sales away from the three multi-national buyers;
- undertaking research into new varieties – and finding a cure for a disease which caused bananas to ripen too quickly;
- marketing bananas to consumers in rich countries as being 'environmentally friendly', involving 'ethical work practices' and 'paying reasonable wages'; and
- developing a brand name to differentiate Costa Rican bananas from those produced in other ways.

If Costa Rican banana-growers can do this, why can't Tasmanian potato growers?

Other Tasmanian agricultural producers have demonstrated that such strategies can be successfully pursued in Tasmania. The "three 'w's" – wool, wine and wasabi – in addition to onions, cheese and salmon, are all examples of Tasmanian primary producers who have established a brand identity and successfully convinced consumers in Australia, Germany, Japan (whose consumers are the most discerning and demanding in the world) and elsewhere to pay premium prices for their product, thereby enabling them to overcome the disadvantages associated with small scale and large distance from major markets.

And what goes for potato chips goes also, I believe, for wood chips and silicon chips; and for any other undifferentiated commodity.

² Raphael Kaplinsky, 'How Can Agricultural Commodity Producers Appropriate a Greater Share of Value Chain Incomes?', Paper presented to a Food and Agricultural Organization Symposium on the State of Research and Future Directions in Agricultural Commodity Markets and Trade (Rome, 15-16 December 2003), pp. 17-18.

The common ingredient in all of these success stories – and the missing ingredient in nearly all of the failures – is intellectual input of some form or another: product improvement, enhanced variety, customisation, design, branding, and marketing – with a view to creating something which can be sold at a relatively high price, rather than at a low price.

And it is in these areas that Tasmania can and must do better.

One conspicuous area of economic performance in which Tasmania not shown any improvement is in relation to what economists call 'productivity' – that is, the skill, ingenuity and efficiency with which labour, capital and technology are combined to produce goods and services. Whereas output per hour worked rose at an average annual rate of 2.0% over the five years to 2003-04 (the latest year for which these data are available), in Tasmania output per hour worked actually *fell* at an average annual rate of 0.5%. Thus, as a percentage of the national average, the productivity of the Tasmanian workforce has declined, from just over 90% of the national average in the early 1990s and again in 1998-99 to less than 80% in 2003-04.

As the well-known business strategist Michael Porter of Harvard University pointed out in the book that first brought him to world-wide attention, *The Competitive Advantage of Nations*,

"Productivity is the prime determinant in the long run of a nation's standard of living ... High productivity not only supports high levels of income but allows citizens the option of choosing more leisure instead of working longer hours. It also creates the national income that is taxed to pay for public services which again boosts the standard of living. The capacity to be highly productive also allows a nation's firms to meet stringent social standards which improve the standard of living, such as in health and safety, equal opportunity and environmental impact"³.

Substitute 'state' for 'nation', and this applies to Tasmania as much as it does to any country. And I hope the last sentence won't have escaped your notice: that high productivity also enhances firms' capacities to meet objectives in relation to occupational health and safety, and equal opportunity, which are an important component of your responsibilities as human resources managers.

Years of research by academic economists have made it clear that two of the most important determinants of both the level and rate of growth of productivity are investment in physical and human capital.

Tasmania has consistently devoted a smaller proportion of its 'state income' to investment in physical capital – plant and equipment, office buildings and factories, etc., and software and intangibles – than any other part of the country except the ACT. Tasmania has improved a bit on this score in recent years, largely thanks to the huge energy projects that have been undertaken during this period - but so have other States, and Tasmania remains below the national average. It remains to be seen whether this recent increase in investment spending is sustained after the completion of these energy projects.

³ Michael E. Porter, *The Competitive Advantage of Nations* (The Free Press, New York, 1990), page 6.

Tasmania also ranks poorly, relative to other States and the Territories, on most indicators of the quality of its human capital. In particular, only 44% of all Tasmanians aged 15-64 have acquired post-school educational qualifications, less than those of any other State or Territory and 4½ percentage points below the national average; while conversely, 44% of Tasmanians aged 15-64 have not completed Year 12, more than any other State or Territory, and nearly 12 percentage points above the national average.

Not surprisingly, therefore, an above-average proportion of the Tasmanian work force is employed in the lowest-skill occupations, and a below-average proportion of the Tasmanian workforce is employed in the highest-skill occupations.

Encouragingly, from this perspective, the proportion of Year 10 students going on to complete Year 12 in Tasmania, which 20 years ago was almost 20 percentage points below the national average, is now very close to the national average. That should mean that the proportion of young Tasmanians going on to attain post-secondary qualifications will rise in coming years.

Education contributes to increased productivity and economic growth in several ways:

- by increasing the skills and abilities of individual workers;
- by raising the flexibility of workplace teams;
- by allowing for more rapid utilization and transmission of new skills and production technologies; and
- by fostering the creation of knowledge, ideas and technological innovation.

Research by academic economists suggests that each additional year of schooling in the adult population boosts long-run economic growth by between ¼ and ¾ percentage points per annum, or by anywhere between 6 and 19% in total. The Australian National University's Professor Steve Dowrick suggests a figure of 8%⁴.

A report by Access Economics for the Victorian Government suggests that raising the Year 12 retention rate in that State to 90% (which would represent an increase of 7 percentage points) would boost Victoria's gross product by 1.1% by 2040⁵.

There is a clear association between age, educational attainment and labour force participation⁶. In particular, male workers with upper-secondary or post-secondary education are much less likely to drop out of the work force once they turn 55 than those who have failed to complete year 12.

⁴ Steve Dowrick, 'The Contribution of Innovation and Education to Economic Growth', Paper presented to the Melbourne Institute Economic and Social Outlook Conference *Towards Opportunity and Prosperity*, April 4-5 2002; available at www1.ecom.unimelb.edu.au/iaesrwww/conf/top2002/pdf/Steve5A.pdf p. 20. Robert Barro, 'Education and Economic Growth', OECD 2003, available at www.oecd.org/dataoecd/5/49/1825455.pdf;

⁵ Access Economics, *The Economic Benefits of Increased Participation and Training* (May 2005).

⁶ David Headley and Steven Kennedy, 'Educational Attainment and Labour Force Participation in Australia', in Commonwealth Treasury, *Economic Roundup*, Winter 2003, Canberra.

There is also a clear association between educational attainment and employment outcomes. Australians with a bachelor's degree or higher are 24% more likely to have a job, and less than half as likely to be unemployed, as those without one; and in employment they typically earn at least 35% more than those without such qualifications⁷.

However, it is not only the *quantity* of education received that matters. The *quality* of that education, while harder to measure, is also at least as important. For example, some researchers have found a significant positive correlation between proxies for quality such as test scores (especially for maths and science) and economic growth⁸.

Data released late last year by the Australian Council for Educational Research⁹ suggests that on three important measures of educational attainment – reading literacy, mathematical literacy, and problem solving ability – Tasmanian students are near the 'bottom of the class' - with only the Northern Territory having a higher proportion of students 'failing to reach level 1' (the lowest level of attainment) in these three areas, and a smaller proportion of students in the highest levels.

Another recently published set of internationally standardized test results¹⁰ suggests that Tasmanian school children do well by national standards in mathematics and science by year 4: their scores are slightly below the national average, but better than those for the other small States. To me, this suggests that Tasmanian kids have the same innate abilities as kids from anywhere else in Australia.

But then something happens – or doesn't happen – over the following four years which leaves Tasmanian school children performing 5.5% and 4.4% below the national averages in maths and science, respectively, by Year 8. Tasmania's Year 8 results are lower than for any other State.

There is, perhaps, some room for argument as to whether these differences are 'significant' or not. For what it's worth I have little doubt that if Tasmania's results were higher than the national average by these margins rather than lower by them, then the Minister for Education would regard these margins as 'significant'.

It may well be that improving the educational attainment of young Tasmanians requires the expenditure of more public money. But before anyone gets too carried away with that idea, it's worth noting that the Tasmanian government already spends more per head of population on education than the national average, and a higher proportion of the State's income than any other jurisdiction except the Northern Territory.

⁷ Australian Bureau of Statistics, *Education and Work* (catalogue. No. 6227.0), May 2003, Table 12; OECD (2002), *Education at a Glance 2004*, Table A.13, available at http://www.oecd.org/EN/document/0,,EN-document-604-5-no-27-32058-604_00.html.

⁸ See, for example, Robert Barro, *op. cit.*, pp. 23-25; and Eric Hanushek, *The Long Run Importance of School Quality*, Education Next, 2002; available on-line at <http://www.educationnext.org/200023/10.html>.

⁹ Australian Council for Educational Research, *PISA in brief from Australia's Perspective*, http://www.acer.edu.au/research/PISA/documents/PISA_Brief_screen.pdf.

¹⁰ Australian Council for Educational Research, *Trends in International Mathematics and Science Study 2002-03*, http://www.acer.edu.au/research/TIMSS/TIMSS_02_03.htm.

Tasmania's relatively small and dispersed population may mean that the unit cost of providing a given standard of education is higher than in larger States; but assessments by the Commonwealth Grants Commission, which take these factors into account, suggest that Tasmania is spending more on education than would be required to provide the same standard as the average of all States and Territories¹¹.

Thus there is probably some grounds for looking at the efficiency and efficacy of current education spending, as well as the level of it.

More important, I believe, is that employers – and as human resources professionals, you as your employers' representatives – should be getting involved in discussions about the content of the school curriculum, and about the measurement of student performance, rather than leaving such matters entirely to teachers and education department bureaucrats.

One other aspect of 'human capital' in which Tasmania performs poorly is in regard to the diversity – or lack of it – in its population and workforce:

- only 3.3% of Tasmanians spoke a language other than English at home at the 2001 census, compared with a national average of nearly 20%;
- only 1.1% of Tasmanians were born in Asia, compared with a national average (in 2003) of 5.5%;
- only 52.4% of Tasmanian women participated in the labour force in 2004-05, 4 percentage points below the national average; and
- less than 1.4% of Tasmanian households at the 2001 census were other than groupings of two or more related persons, compared with a national average of 1.8%.

As human resource managers I am sure you are well aware of the literature demonstrating that diversity is a source of competitive advantage for organizations. As ANZ's Chief Executive Officer John McFarlane says, "Any failure on our part to utilize the unique capabilities and strengths of diversity is a lost opportunity of immense proportion"¹².

Richard Florida's research highlights the importance of a city or region's diversity in influencing its ability to attract and retain members of what he calls the 'creative classes' – meaning not only writers, designers, musicians, painters and artists but also scientists, managers and people in computer, engineering, education, healthcare, legal and financial occupations, in total about 30% of the work force in the US¹³.

This is not because members of identifiable minority groups are inherently more 'creative' than anyone else, but rather because 'creative' people are attracted to cities or regions which welcome and encourage different beliefs, lifestyles, viewpoints, forms of entertainment, modes of expression and the like.

¹¹ In Grants Commission terminology, Tasmania's 'level of service provision ratios' are above 100% for every category of education spending except grants to non-government schools. See Commonwealth Grants Commission, *Report on State Revenue Sharing Relativities – 2005 Update*, page 257.

¹² John McFarlane, message to ANZ staff, 30 March 2004.

¹³ Richard Florida, *The Rise of the Creative Class* (Basic Books, New York, 2002).

A recent study which tested the applicability of Florida's theory to patterns of employment growth in Dutch cities found that indicators of the presence of members of the 'creative classes' (which the authors defined more rigorously than Florida) was a better predictor of employment growth than more traditional measures of human capital such as years of education.¹⁴

I've argued on a number of occasions that Tasmania has many of the characteristics which Florida's research suggests are 'creative class magnets' – including authenticity and uniqueness, historic buildings, established neighbourhoods and ample opportunities for passive recreation. The decriminalization of homosexual acts between consenting adults in 1996, and the decriminalisation of transactions between retailers and shoppers on Sundays in 2002, have further enhanced the intrinsic appeal of Tasmania to 'creative' people.

Yet to my mind Tasmanians are still more suspicious of and resistant to social and economic change, less conscious and supportive of the value of education and of overseas experience, less willing to embrace scientific and technological advances, and in many ways less tolerant of divergent viewpoints and the 'clash of ideas', than many of their counterparts on the mainland. Tasmanians are of course perfectly entitled to such perspectives – and those who do hold them dear are entitled to resent being told by outsiders that they need to change them. Nonetheless, to the extent that such perspectives do predominate in Tasmania I think they will prevent this island and its people from achieving their full potential.

As human resources professionals your task is very much about helping the organizations for which you work, and the people who work for them, to achieve their full potential. I hope today's event, and the other activities which will take place this week, will assist you in achieving those goals.

¹⁴ Gerard Marlet and Clemens van Woerkens, *Skills and Creativity in a Cross-Section of Dutch Cities*, Tjalling c. Koopmans Research Institute Discussion Paper Series no 04-29 (University of Utrecht, October 2004).