Building economic resilience in regional Australia

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Ai Group is proud of our regional links. We have several vibrant regional offices – including in Ballarat, Bendigo, Newcastle, Wollongong, and here in Albury-Wodonga.

Some of our best people work in these offices and we find some of the best ideas generated in our national organisation come from our regional offices.

In my comments on building resilience in regional Australia I want to explore these four areas:

- I would like to start by making a few comments about economic resilience and touch on its links with economic diversity and growth – particularly in the context of regional economies.

- I then want to underline a key role that the private sector has in building economic resilience.

- I will then give a quick outline of some of the substantial challenges and opportunities we face.

- Then I want to focus on the sorts of things my organisation argues should be done – by businesses, governments, employees, universities and others – to boost our chances of success.
Economic resilience

“Economic resilience” has a meaning distinct from that other economic ambition of economic growth. Whereas growth is about the pace of expansion – the rate of growth of output, employment or investment – economic resilience is about something else.

If I look for synonyms of “resilience” – by right-clicking in Windows – words like “flexibility”, “suppleness” and “pliability” have been selected for us. And if I look to its etymology, I get a Latin word closer in meaning to “rebound” or the property of returning to an original form after being stretched or bent.

So there is a range of meanings with important differences between them.

I have a hesitation about dwelling too much on the idea of returning to an original form – or equilibrium – when we are talking about regional economies. Clearly this is an important property in the face of natural disasters or other external shocks – we want our regional economies to be able to bounce back as smoothly as possible.

But, more generally, the idea of returning to an equilibrium position might be taken to suggest that there is some desirable static-state in the first place. This seems to me to be at odds with the reality that regional economies are best seen not as static, but as dynamic systems.

And regional economies are not isolated systems but are part of, and shaped by, other dynamic systems – not the least of which are the national and global economies.

So by “resilience” I am thinking of something closer to “robustness” or “durability”. But by that I do not mean “rigidity” but rather an ability to change and adapt to change
successfully. And so I guess I come back to *Windows’* synonyms like “flexibility” and “suppleness” which are, I think, key to being robust and adaptable at the same time.

While I am dwelling at this conceptual level, I want to inject the important connections between the economic resilience of regions and the idea of economic diversity.

In a number of fields diversity is associated with resilience – bio-diversity and the strategy of diversifying a portfolio of investments are important examples. The connections with resilience relate to complementarities between different parts of systems and, in the case of investment portfolios, to management of risk.

However the associations are far from linear – there comes a point where further diversification or the wrong pattern of diversification will weaken rather than strengthen systems.

Before winding up this preliminary section, I would like to underline that there is a range of tensions between diversity, resilience and growth in economic systems. A key reason for this is that economic growth is also often correlated with specialisation and economies of scale.

Often, taking full advantage of the opportunities available from specialisation will involve a sacrifice of diversity. This is all but inevitable as resources are channeled into areas of specialisation and away from the diversifiers or potential diversifiers.

And here I think it is very important that we give a good deal of attention to building resilience in the sense of ensuring high degrees of flexibility and adaptability in our regional economies so that advantage can be taken of specialisation and diversification systems as circumstances change.
The role of the private sector

It will not surprise you to hear that, as a Chief Executive of a national business organisation, I am going to give considerable weight to the role of the private sector in building the economic resilience of regional economies.

Private sector businesses – in their many forms – have a critical role to play in regional economies. They are investors, they employ people, they build our houses and offices; they build and run our shops, they operate distribution centres, communications infrastructure, trucks, banks, factories, farms and they provide an incredible range of services.

Clearly, the private sector has a very big role to play across a very wide variety of activities that are central to the strength and resilience of our regions.

Perhaps paradoxically, however, I want to particularly highlight the disruptive attributes that the private sector can bring.

That is not because I take for granted the very strong qualities that business managers and business systems bring to the routine organisation of production and distribution. Although I think this is something that often is taken for granted.

And it is also not because I underestimate the importance of the efficient organisation of production and distribution to economic growth and resilience.

Far from it, I think there is plenty of very good evidence around that private sector organisations – particularly in a competitive environment – excel at these sorts of activities and are more likely to keep a focus on outcomes and have an eye to making constant improvements than public sector organisations. (Of course there are plenty of excellent public sector organisations too.)
But the features of the private sector economy that I want to highlight this morning are its disruptive qualities. Features such as experimenting with new products and services; of trying out new ways of doing things; of taking risks; of testing, and crossing, boundaries.

At first glance these disruptive attributes may not seem to fit readily with the idea of resilience. And certainly if by resilience we mean the property of returning to an original form, these attributes are likely to be viewed more as destabilising and detracting from, rather than contributing to, resilience.

But if by resilience we are thinking more in terms of flexibility and adaptability, I think the disruptive qualities the private sector can generate, have very important roles to play. This is particularly the case if we take a dynamic and system-wide view of regional economies.

This is because, when we are talking about resilience in the face of continuous change in the national and global economies around us, we need to be constantly looking for, and developing, potential new opportunities. As any businessperson worth his or her salt will tell you, if we just try to do the same thing year-in and year-out we will find ourselves with less and less to do as the years and months go past.

In the absence of what I am characterising as disruptive we will see less resilience and more secular decline.

And these disruptive roles – let’s call them innovation – are best done by the private sector where the incentives for private gain are at their strongest.

We need private sector opportunists on the look-out for the next big thing, to take a hare-brained scheme and run with it while
those who see themselves as older and wiser are shaking their heads.

Perhaps only one in a hundred will succeed and there will be plenty of heartbreak along the way but despite it being inherently tumultuous we need this under-class of disruptive entrepreneurial activity.

It does sound paradoxical but if we are to build stability and success – resilience – we need to be taking risks and failing.

Challenges and Opportunities

I’m a big fan of “think global and act local”.

I want to start out by looking at some major global developments that set the scene for the local actions that might be taken to meet what are some pretty significant challenges and to grasp what are no less impressive opportunities.

The big global themes are:

- The steady onset of pressures from the ageing of our population that we face – like other developed countries and indeed like China among the emerging economies; and,

- The strength of the large emerging economies and the closely related surges in our terms of trade, our currency and in the expansion of the capacity of our resources and energy sectors.

A strong record

According to the way economists identify a recession – as two consecutive quarters of decline in output – Australia’s last
recession was in the first half of 1991.

We are now into the 24th straight year without a recession.

That is a major achievement especially since it has occurred while we have seen the tech wreck, the Asian economic crisis, the terrorist attacks of 2001 and the GFC. Through all this Australia avoided one R word – recession by displaying plenty of another – resilience.

This resilience has seen us get through this global turmoil while delivering across a range of indicators:

- In the middle of 1991 the unemployment rate was 9.8% whereas today it is 6%;

- Over the past 22½ years, the workforce has grown from a bit shy of 8.5 million to almost 12.1 million – an increase of about 44%;

- The value of what we produce – our GDP – has increased by 110% in real terms;

- And, on average, an hour spent in the workforce is yielding about 50% more in output than in 1991.

**Challenges to a repeat performance**

There are substantial benefits from continuing to improve our economic performance. Not the least of these is to raise our ability to further improve education attainment, health outcomes and the range of choices people have.

And if we can get it right there are tremendous opportunities to help us meet these objectives. We are after all on the cusp of the largest ever surge in the global middle class.
One popular projection\(^1\) is that the global middle class will increase from 2 billion now to 5 billion by 2030. Asia's share set to rise from 30% to about 65%: from 600 million people to 3\(\frac{1}{4}\) billion people.

There are tremendous opportunities for Australia to capitalise on our skills and expertise across a range of areas that are well worth pursuing. These include our manufacturing skills and expertise.

We will be poorer if we do not nurture and take advantage of these opportunities.

But first to the challenges.

*Demography*

The first is demography. The die has been well and truly cast on the directions of our demographic development for the next twenty years and more.

- A rising proportion of the population will retire from the workforce and a falling proportion of the population will enter it.

- Our birth rate fell to below replacement levels some time ago and at the same time life expectancies have continued to rise.

- In the past few years the proportion of the population in the workforce has begun to fall. While part of this is due to the slow growth in employment opportunities, this has coincided with another proportion that is structural and reflects the movement of baby boomers into retirement.

\(^1\) [http://www.reuters.com/middle-class-infographic](http://www.reuters.com/middle-class-infographic)
• Often this is exacerbated in regional economies by the movement of younger people to the larger cities.

• More of this is to come: people born in 1945 turned 65 in 2010 and those born right at the end of the baby boom – say in 1960 – are now well into their 50s.

There is only so much that anyone can do about this.

• Governments can lift the age at which people become eligible for the age pension and they can raise the age at which people can access their superannuation;

• We can increase child care places so that more working age women can spend more time in the workforce; and

• We can maintain an immigration program where immigrants are younger on average than the resident population. This is important – particularly for the inland regions – where a disproportionate share of population inflow comes from immigration.

All of these can take some of the pressures off and they are therefore important. But still they will only slow the pace of the ageing of the population rather than alter the basic direction: the size of our workforce relative to our population is going to fall from now on.

Apart from the sorts of policy directions I just mentioned, the other answer is to lift productivity. If, as a population, we are going to be working less, we can make up ground by working smarter and more productively.

*The resources boom*

The second challenge stems ultimately from the changes over the last decade to the structure of our economy associated with the mining boom.
The central global development over the past decade or so has been the very strong growth of the emerging economies and in particular China. This has eased a bit in the past couple of years but further gains look likely – particularly as India and Indonesia move along their development paths.

Together these three countries make up about 40% of global population. They are industrialising and urbanising and they will use a lot of energy and a lot of steel – which means they will need a lot of LNG, iron ore and coal.

We have already seen major changes to the structure of our economy.

• In 2006 the share of mining in the total economy was 7.8%.

• Now it is well over 10%.

• Over this period mining grew more than 2½ times faster than the economy as a whole.

• And iron ore output increased at close to 6½ times faster than economy-wide output.

And we have more to come over the next few years: many of the new mining expansions are just beginning to ramp up and many of the new gas projects – including the big ones – have yet to come on line at all.

The phenomenal investment boom that is lifting mining and energy capacity so dramatically was fuelled by a very large increase in the prices we received for our resource exports as additional Chinese demand outran available supplies.
And both the surge in prices and the investment boom lifted the value of our currency to very high levels.

A year or so ago, in a statement to the Senate Economics Committee, the Governor of the Reserve Bank said this boom was as big a shock to the economy as the Gold Rushes of the 1850s.

There is no question that the current mining boom has earned Australia considerable income. Largely by lifting the exchange rate, a good proportion of the benefits were distributed to Australian households – by making our consumption of imported consumer goods and holidays abroad considerably cheaper in Australian dollars.

At the same time however, and also largely because of the exchange rate – it has weakened other parts of the economy.

The periods of very high exchange rates either side of the GFC knocked the stuffing out of many other trade-exposed industries such as manufacturing.

• It closed off export markets and undermined their competitiveness against imports in the domestic market.

• It reduced their revenues, slashed their margins and ate away at their reserves.

• In many cases parts of their supply chains have succumbed and there are areas of capability that we just don’t have any more.

These pressures also made energy intensive producers much more vulnerable to the very strong rise we have seen in energy costs.
• These are now more than double what they were at the turn of the century.

It also made them more vulnerable to the unwelcome strength of Australian unit labour costs.\textsuperscript{2}

• Unit labour costs have risen much faster than those in other developed countries.

Even now that the exchange rate has fallen by about 18\% in the past year and a half, at around $US0.87 it is still just under 20\% higher than the post-float average.

For all these reasons, we have become a high-cost country.

We are now paying a price for this. The investment boom in mining is now easing off and is unlikely to contribute directly to further GDP growth.

We need to find other sources of growth. A further lift in mining output will help and I will come back to this in a minute. But we are currently looking around for new sources of growth.

But those sectors that have been adversely affected by the mining boom are in no fit state to fill the void. They have been drained and they have not been investing.

And that is what we currently have: a void. That is why employment growth has been very sluggish and why unemployment is on the rise.

And before I leave this and turn to the points I would like to make about building for the future, I want to touch on another impact of the mining boom that is also relevant to how we think about our economic direction.

\textsuperscript{2}Unit labour costs as measured in domestic currencies to keep exchange rate movements out of the comparison.
I mentioned the increase in mining exports as a share of GDP and that this still has some way to run. This has also increased – and is set to further increase – our exposure to notoriously volatile commodity prices. From now on we will face much higher risks from this source.

And we also face higher exposures to the handful of countries to which we sell our resource and energy commodities. We are now more at risk of downturns in demand from these countries. And the emerging economies in particular are themselves going through major industrial transformations which, historically, come in fits and starts and also bring their share of social and political disruption.

**Building for the future**

So these increased risks bring me to the future.

What can we do to make sure we address our weaknesses, accentuate our strengths and, indeed build new strengths?

At a fundamental level the challenge is no different for the regions as it is for the national economy.

I have already mentioned the importance of lifting the pace of productivity growth in the context of the ageing of our population. If we can make more with less, we can offset the fact that we are going to have relatively fewer people in the workforce.

Productivity is also a large part of the answer to the challenges faced by the trade-exposed industries that have been stifled by the rise in the dollar associated with the mining boom.

- Industries such as manufacturing are going to have to compete at a significantly higher exchange rate than they
enjoyed over most of the period since the last recession. This is particularly relevant for regions such as Ballarat and Albury-Wodonga where manufacturing is a bigger share of the local economy than it is in the country as a whole.

- If the performance of industries such as manufacturing can be lifted, they will be in a strong position to diversify the economy and reduce the additional exposures to commodity price fluctuations and to demand conditions in a handful of countries.

“Productivity” is easy to say but I have just given it three very big jobs to do:

- Compensate for the declining share of the population in the workforce;
- Help overcome the impacts of a higher Australian dollar; and
- Help diversify our economy.

I am not going to go into the full details of all the steps that we need to take to build a stronger and more resilient national economy and stronger and more resilient regional economies. But I would like to touch on the flavour of some of them and what it means for building industry of the future.

*Removing obstacles: red tape and workplace relations*

Part of what needs to be done lies in removing obstacles that stand in the way of business’s own ability to build for the future. This is the case in removing red tape for example and it is also the case in workplace relations reform.
Ai Group has been leading the business case on the need to fix key elements of our workplace relations arrangements for a long time. Our organisation is a hands-on workplace relations advisor to many thousands of businesses and we see first-hand the difficulties they have with the current arrangements.

Their issues are less about nominal wages growth than they are about the ability of managers to manage effectively. Businesses need to be able to make decisions in areas like the employment of casual workers and they need to be able to propose to their employees modifications to enterprise bargaining agreements when business conditions take a turn for the worse.

These are just some of the many workplace relations obstacles confronted by businesses that need to make changes and adapt to new and changing circumstances.

We continue to put to the Government in the strongest terms possible the need to make some key changes as soon as possible. We also seek the support of other parties and independents.

Particularly for businesses in sectors such as manufacturing, we simply cannot afford to wait until the next term of parliament before changes to the current workplace relations arrangements are contemplated.

**Infrastructure**

Ai Group puts a lot of emphasis on investment in infrastructure. Whether that is in road, rail or communications infrastructure, there is a strong case for a significant increase in investment across the country and particularly in the regions.

I think the case is more or less well established now and slowly the ducks are being lined up so that we have or are getting
rigorous processes for assessment and prioritisation; the creation of infrastructure pipelines and we are now entertaining a wider range of financing options than has previously been the case.

Plus the time is now right. With the mining boom unwinding and engineering construction resources being released from the massive investment boom particularly in WA and QLD, we should now really be able to get on with the job of infrastructure investment.

A clear candidate for attention is the investment in communications infrastructure that works for our regions. The potential that high-speed broadband has for regions is astonishing. However we are notoriously slow in getting our act together in this area.

*Workplace skills*

Another part of what needs to be done goes to the topical area of “industry policy”. The Australian Industry Group is not in the business of seeking special favours for particular businesses. But nor are we backing the totally hands-off position of let-market-forces-take-us where-they-will. Rather, we think that governments do have a role in the active building industry of the future.

This is most clearly evident in the case of the need to lift workforce skills. Governments have a role not only in general education and training prior to entry into the workforce but also in encouraging and facilitating education and training for the current workforce.

- This is particularly the case at a time such as this when there is so much restructuring going on across the economy. Jobs are being made obsolete and new opportunities are being created.
• A major emphasis should be on a more proactive strategy of ongoing up-skilling of existing employees.

• This can help lift productivity in their existing workplaces and it can make people less vulnerable in the face of industrial changes.

A particular and very important dimension of this is in the area of foundation skills. There is still a frightening incidence of employees with very low language, literacy and numeracy skills.

**Innovation**

A further policy area which attracts our strong support is in the area of innovation. Of course, the primary responsibility for innovation lies with individual businesses. However, there is much that governments can do to facilitate and encourage business efforts.

One of these is to help address the very low levels of collaboration between Australian businesses and the excellent capabilities in our publically-funded research organisations.

There are exceptions of course and the announcements by the Commonwealth Government yesterday contain quite a few promising initiatives.

If we look around the world: at the US, at Germany and at a range of mainly northern-European countries we see much more close-knit and mutually beneficial relationships between the business community and research organisations.

In contrast, Australian businesses often get the impression that they are a second or third order priority for researchers and that
little effort is made to bridge the cultural divide between the two sectors.

Yet Australia has such tremendous potential from forging much closer and more substantial links between our teaching, research and business communities.

Interestingly, in Australia, many of the best examples of business-research collaboration are found between regional universities and their local business communities. And I think there is very good scope for the lessons from these success-stories to be used to generate results more broadly across the country.

**Concluding Comments**

In winding up I want to re-emphasise the importance of economic resilience in the sense that I have used it – the ability to adapt successfully to changing circumstances.

I think the private sector has a central role in building economic resilience. I think this is the case both in terms of the efficient organisation of production and distribution but, also, and I think critically, because it is the source of the disruptive innovations that are, paradoxically, central to system-wide resilience both at the national and regional levels.

We have a very strong recent record in Australia – both nationally and, albeit unevenly, across our regions and we have very strong opportunities before us.

But nevertheless we face significant challenges and we now have to adapt in the face of them.

We also have to adapt if we are to take full advantage of our opportunities.
It will be a challenge to build another decade without a recession on top of what is getting close to two and a half decades.

And I have outlined what I see as some of the major steps we need to take to achieve this.