Address by Ai Group Chief Executive, Innes Willox
to the South Australian Centre for Economic Studies (SACES)
at the University of Adelaide Corporate Business Lunch

Friday 30 June 2017

South Australia in Transition - Where to Next?

It’s a great pleasure to be here in Adelaide at the University of Adelaide’s South Australian Centre for Economic Studies.

Thank you for the opportunity to meet with you today and for giving me this very good reason to get out of the office on the last day of the financial year and be back in Adelaide, where I spent some of my formative years.

Our topic today is South Australia in Transition – Where to Next?

I will get the ball rolling by putting forward a view from my standpoint as the leader of the Australian Industry Group. I very much hope that my remarks will prompt a conversation that brings out other perspectives from around the room.

To give you high-level preview of what I plan to cover:

First, I think SA has the clear potential to make great economic and social progress over the period ahead. There are wonderful opportunities for businesses, for employees, for governments, for educators and researchers and for the public sector to make very important contributions in the well-being of the state and its citizens.

Second, I want to put forward some of the proactive steps that my organisation – Ai Group – and our members see as being fundamental to the future success of the state.

And lastly, I want to look at some of the barriers and obstacles that need to be removed or navigated around if the strong potential is to be realised as fully as it ought to be.

I came to Adelaide when I was one – in an age when half the town came out to see the Beatles. The state was a manufacturing powerhouse and Adelaide was the country’s third biggest city. There was a palpable sense of optimism and dynamism.

Of course, since then a lot has changed. Material living standards and the broader quality of life in SA have improved markedly. The state – and particularly Adelaide – is now considerably bigger. However, other states and other cities have grown more rapidly. Other industries – particularly in the services sector - have grown more than manufacturing. And the sense of optimism and dynamism does not seem to be as much at the forefront.

Before talking about South Australia in transition I would like to firstly give you a sense of where I am coming from in a broader sense by talking about Ai Group and then make some remarks about transition more generally.

While I’m sure you know about Ai Group, many may not know that our organisation’s roots go back to the 1870s and we have been providing services to and earnestly representing our small, medium and large businesses membership continuously since then.
Throughout our history of more than 140 years, we have always had a strong focus on industrial relations. As the Metal Trades Industry Association (MTIA) we were a cornerstone of what used to be called the IR club.

Of course, a lot has changed since those days including us broadening our focus to include not just manufacturers but also other industrial segments including construction, logistics, defence and industries closely linked to these areas of the economy.

The broadening of our own focus, as well as the ever-greater blurring of the boundaries between different sectors sees a membership that now includes ICT and telecommunications companies; food processing and cosmetics businesses; technical and scientific service companies just to name a few.

While our membership has broadened, we continue to have a very strong focus on the manufacturing sector.

Our membership also includes several fast food chains and in fact we successfully represented this industry before the Fair Work Commission in the recent and now controversial penalty rates case.

We often get questions about how well fast-food businesses fit with our organisation. I see it as just another example of the blurring of the boundaries between industries and I find it very easy to view a fast food restaurant as a manufacturing business. Of course, they are also retailers. And real estate players I understand.

Our membership has broadened and we have also extended our focus beyond Industrial relations. What we now call Workplace Relations remains core business of course and we have a large national team of lawyers and workplace relations professionals assisting members and advocating on behalf of industry.

We also house teams of trainers, business advisors and trade advisors providing a range of capability development services to members and other businesses.

And we have a small but very active internal economics and research team whose work includes our well-known monthly business performance measures of the manufacturing, services and construction sectors. The team also does a snap shot of how the various states are going. The latest of these was only yesterday. This is how we summarised the SA economy:

In South Australia state final demand grew by 1.4% q/q in the March quarter of 2017 to be up 3.3% p.a., its best quarter of growth since 2012. Ai Group’s Australian PMI® and Australian PSI® point to mildly positive conditions in manufacturing (with automotive assembly shrinking but stronger activity in food processing and other sectors) and improving conditions for services in 2017.

Construction activity is slow, but capital expenditure appears to be increasing. Growth is relatively slower than other states for population, employment and retail sales. Unemployment remains elevated.

And of course, we also develop and promote policy initiatives in the areas that are of most importance to our members. These include in the areas of industrial relations; education and training; industry policy; taxation and fiscal policy; workplace, health & safety; and energy policy.

1 The Australian PMI®, the Australian PSI ® and the Australian PCI®
I will come back to a couple of these areas in a little while.

Of course, many of our members have operations around the country including in SA but until relatively recently Ai Group itself did not have a strong separate South Australian presence.

This was due in no small part to the very excellent job the Engineers Employers’ Association of South Australia did on behalf of its members.

And the MTIA and then Ai Group had a very close affiliation with EEASA. We worked closely together. We exchanged staff. And there were common threads to our cultures - we were both down to earth; we were both pragmatic rather than ideological; we fought hard but respected our adversaries in the IR world; and we had an enduring belief that the business sector has a central role in the broader community and its development.

So with these shared values it was an easy relationship and our organisations decided to come together more formally with a merger and with Ai Group establishing a separate South Australian branch in 2009.

And it is a very vibrant and successful branch. We are very fortunate having Stephen Myatt steering the ship for us here. He is a quiet achiever. He knows just about everything there is to know about industry and particularly South Australian industry.

So that is us. We provide services to our members and we represent our members’ interests in industrial tribunals and in the world of public policy.

Transition

Before turning to the specifics of South Australia’s transition I think it is worth making a few more general points about the transitions in the world around us.

Wars aside I can't think of a time of more fundamental transitions than the present.

Over the past few decades we have lived through the world’s largest-ever industrial revolution. India may be on the verge of something of the same order of magnitude but to date it is China that has the bragging rights.

With an eye to the dynamic nature of industrial and post-industrial economies, Economic History text books used to talk about the industrial “take-off” phase of economic development.

We have not only seen China’s take off: we have felt and continue to feel the ramifications and reactions both globally and in Australia and across the economic, social and political spheres.

We are very familiar with the economic ramifications. China has become Australia’s largest two-way trading partner as we sell iron ore, coal, tourism and education services as well as a wide range of manufactured goods and services. At the same time, we have found new and intense Chinese competitors across a wide range of our domestic and export markets – particularly, though not only, in manufacturing. South Australian manufacturers have certainly not been immune to this injection of competition into the global economy.

And as the world’s second largest economy continues its own transformation and maintains its determination to lift the standards of living of its own citizens towards the sorts of levels
we have had the good fortune to enjoy for some time, the reverberations will continue to be felt around the world and here in Australia.

But wait there’s more. Other countries look to be following suit. I mentioned India. We could also look at Indonesia, Bangladesh, at Brazil and to Africa to find other candidates for take-off in the next half-century. Some are already on the runway. So hold on.

The rise of the emerging economies is occurring at the same time as very profound technological changes.

I am not going to go into any depth here but we see all around us digital disruption and transformation. We see more data and more uses for data than we ever imagined. We see an exponential dissemination of robotics and automation and we glimpse - half in fear perhaps - at artificial intelligence.

We can be - and I think we should be - excited at the potential for these developments to underwrite substantial improvements in material living standards and associated social progress.

However, and not for the first time in the past 250 years, there are growing and clearly justified concerns about the displacement of people by machines; about the adverse occupational and regional fallout; and about economy-wide distributional ramifications of these developments.

We can all draw links between these fundamental transformative forces and contemporary political developments both around the globe and at home.

Some of these are purely reactionary: anti-globalisation; anti-free trade; anti-neoliberalism; anti-establishment.

Others are little more than the opportunistic exploitation of discontent and displacement for narrow political ends.

But in others we are now - belatedly - hearing much more about the need to manage transition. We hear many more questions about steps that can be taken so that people and regions are not simply left to fend for themselves in the face of these fundamental transformations.

Left to themselves in much the same way that hand-loom weavers had to respond to water and later steam-powered industrial textile manufacturing or as the horse and buggy industry had to respond to cheap mass-produced cars.

And so to contemporary South Australia.

**SA’s Potential**

There should be no doubt about the very strong potential for South Australia to have a prosperous future full of opportunity and characterised by economic and broader social progress.

What advantages it has!

- It is a great place to live. Adelaide was ranked the world’s fifth most liveable city in The Economist Intelligence Unit’s liveability index for 2016.
No doubt I will offend some followers of other codes, but it has a couple of highly-ranked teams in the national football competition as well as vibrant local competitions.

It has very strong universities and a great tradition of primary, secondary and vocational education.

It has considerable research expertise including globally well regarded organisations such as the DST Group [formerly the DSTO], the Waite Institute and the Ian Wark Institute, which is now part of the University of South Australia’s Future Industries Institute.

It has an enviable base of natural resources.

It has a very strong wine-making industry.

It is attractive to domestic and international visitors and it has a positive record in innovative public policy.

SA is part of a vibrant and growing national economy and it enjoys the relative proximity of Australia to the region that is already and is set to continue to be at the centre of growth in the global economy.

This is all high-level, so let me get to some specifics. I will limit myself to some comments about the state’s manufacturing sector; the defence-industry outlook; and at some of our member’s businesses in South Australia.

Manufacturing

SA punches above its weight in the manufacturing sector that is core business for Ai Group.

- It accounts for about 6% of total national output and 6.9% of our national manufacturing output.

- Similarly, of its 50,619 employing businesses (which was 6% of all employing businesses nationally in June 2016), there are 3,282 manufacturing businesses with employees. This is 6.9% of all Australian manufacturing businesses with employees.

- SA has 817,000 employed people or 6.7% of all employed people nationally. This includes 75,500 manufacturing workers which is 8.3% of our national total of 900,000 manufacturing workers.

- Interestingly this tells us that the average manufacturing business in SA is larger and more labour intensive than the national average (measured in numbers of employees).

South Australia is currently seeing the last stages of the exit of large-scale car assembly in Australia.

- This sector still employed around 24,000 people nationally as of June 2016, with 12,400 in motor vehicle manufacturing and 11,600 in motor vehicle parts manufacturing.
• Up to 10,000 people are still working in South Australia’s auto industry. Whilst some in the supply chain will transition to new opportunities and others will continue to provide global expertise out of South Australia and Victoria, there will be other supply chain companies that exit the industry and Australia altogether. It will be a challenge for South Australia and Victoria to successfully transition displaced workers.

There are other manufacturing segments that are growing to help fill the gap, assisted by our lower dollar and expanding export markets - particularly in Asia. These are grouped around several ‘growth clusters. And SA is well positioned in all of them:

• Processed food, beverages and groceries. Food processing now accounts for about 28% of manufacturing output nationally and is the fastest growing segment. Packaged foods, confectionery, whole-foods, health-foods are all finding strong export demand.

• Related to this are the growing ‘niches’ of pharmaceuticals, toiletries, cosmetics and health supplements.

• Packaging for these areas is also receiving a boost, as a key part of the associated supply chains.

• Building materials and household furnishings, related in part to the surge in housing investment, but also related to the lower dollar and the generally high quality of Australian product amid real concerns about ‘non-conforming’ products from other countries.

• Specialist and advanced equipment and machinery in areas ranging from personal medical equipment to industrial irrigation and mining applications. Engineering ingenuity at its best.

This means SA has been well-placed to benefit from the recovery that has been evident in these sectors since early 2016. This is roughly since the domestic dollar dropped to a more reasonable trading range of around its long-run average of 75 US cents.

This recovery has been evident nationally in the return of manufacturing businesses, employment numbers, export earnings and most recently, capital investment.

Defence

We can't talk about the strong potential of SA without mentioning the defence industry.

As you know, the federal Government has launched the largest investment in naval shipbuilding since the second world war.

It amounts to an estimated $89 billion over the next decade. I'd like to say that number again: $89 billion.

Adelaide is poised to begin a lion's share of this naval activity incorporating full build of two new Offshore Patrol Vessels (OPVs), 9 Future Frigates and 12 regionally superior, large conventional submarines.

The Prime Minister and Defence Industry Minister, Christopher Pyne, have acknowledged the important contribution which this national shipbuilding endeavour will make to national growth.
Beginning next year, the first steel for the OPVs will be cut at Osborne Park, with frigates due to commence in 2020 and submarines from mid-2022. Local defence industry companies, many of which are members of Ai Group, can confidently predict orders flowing progressively over the next 5 years and beyond. And those with proven credentials in naval sustainability will be invited to begin a journey encompassing three to four decades and beyond.

A major challenge for all of us, principally through the lead contractors for each part of the program, is to ensure that the highly skilled workforce is in place to begin the work. Ai Group, through its extensive experience in skilling and training naval shipbuilders over many years, intends to play a leading role in this challenge.

Importantly, the opportunity for new companies to enter the supply chains for each platform design and build will be assisted by the Federal Government's commitment of $1.6 billion to encourage and foster innovation in advanced technologies and skills.

The South Australian Government is playing its part as well, recognising the importance of the world-class defence industry sector to the state's long term health.

**Great Businesses**

And South Australia has some outstanding businesses and business people. And I hope I don't need to elaborate on why successful well-run businesses are critical to our broader economic prospects.

I risk offending more than I have time to mention here but I'd like to single out some home-grown and SA-headquartered companies such as Redarc; Korvest; Haighs; Nova Professional Services; Badge Constructions; Jurlique; Seeley International; Beerenberg and Philmac.

I'd particularly like to highlight Jurlique and Beerenberg who have invested heavily in South Australia in new state-of-the-art manufacturing facilities.

And while I'm in the business of offending by omission I'd also like to mention businesses in traditional industries in transformation such as Electrolux (in ovens and cook tops) and ZF Lemforder (in electric buses).

In short I think there are more than enough reasons to think that SA has a great potential before it.

Much of what I have said aligns with the five key growth industries singled out in last week's state budget. As you know, the Government's Future Jobs Fund identifies five key growth industries:

- Shipbuilding and defence
- Renewable energy and mining
- Tourism, food and wine
- Health and biomedical research
- IT and advanced manufacturing

I have no argument with this list of industries - I think they all have strong potential and I know they have been thoroughly researched.
But I would caution that so much business success and the associated job creation and export growth depends on serendipitous elements: the peculiar characteristics of the individual entrepreneur; the chance meeting and the happy coincidence. SA is just as likely to find that its potential opportunities lie beyond this very worthy group of industries.

Of course, potential is one thing. Realising it is another. And I would like to spend the rest of my comments first on the proactive steps that can be taken to secure this potential and on the obstacles and barriers that we need to overcome.

**Proactive Steps**

I plan to touch only briefly on the proactive steps and in doing this I want to concentrate on what I see as the most fundamental: our workforce and business capabilities. I know there are other areas and I am sure we will hear more about them in the open session.

We need to equip our workforces and our businesses not just to lift their productivity and therefore their ability to compete but also to be ready to adjust, often in very substantial ways, to the challenges of global competition and technological change that I spoke about earlier.

This means making our education and training systems fit for purpose; flexible; adaptable; responsive to changes in the opportunity set.

It means equipping students with the foundation skills that will enable them not only to find a job but also to adapt and to upskill as they progress through their careers.

It also means providing opportunities for the existing workforce to upskill. This itself will lift productivity and it will better equip them as individuals to manage the risks of the various sources of disruption around us.

For some members of the workforce we are too late and we need to step into the breach after the event and equip them to take advantage of new opportunities. Of course, while this is a nation-wide challenge it is particularly important in South Australia.

- SA has the distinction – if that is the right word - of the highest unemployment rate of any state, at 7.1% versus 5.7% nationally.

- It also has more of its workforce on part-time hours (35%) than any other state except Tasmania (36%) compared with a national average of 32% and it has a comparatively high rate of under-employment.

And just as we need to work to lift the capabilities and the adaptability of the workforce in general, the same goes for business people and managers. They too need to build their capabilities and their business skills. This includes greater skills in the management of the businesses along their supply chains; greater trade-related capabilities and greater innovation capabilities.

I don’t think we can simply leave this to the market alone. That said, markets can be tapped to help deliver the ends that are required. But we can do a lot better by combining markets with well-designed interventions.

An important part of the innovation agenda is encouraging and removing obstacles to closer collaboration between our research organisations and our businesses. There are clearly significant cultural differences and there are disincentives that can be removed.
But the bottom line is that collaboration between research and business runs much more deeply in other countries and if we bridge this gap, we would provide ourselves with a very substantial boost to our economic prospects.

**Avoiding Obstacles and Removing Barriers**

Before I wind up and open to your questions and comments, I would like to look at the importance of avoiding obstacles and removing barriers – particularly the barriers to business investment.

Of course, business investment is not the whole story but it is I suggest a key ingredient for us becoming much more successful and much better equipped to successfully transition our people, our businesses and the state to a more prosperous future.

There is any number of areas on which I could focus attention. I could look at the importance of removing unnecessary barriers and obstacles built into our workplace relations arrangements.

Or I could talk about the importance of reducing the regulatory burden on businesses – particularly small businesses – that absorbs so much time and that distracts effort that could otherwise be directed to working on their businesses. This could also take up more time than we have.

So – perhaps to your relief – I am not going further down these roads. Instead I am going to confine my remarks to two topical areas. They are topical across the country but they are particularly topical here is South Australia.

**Energy**

One of the most urgent and obvious challenges facing SA is energy. The issues are complex, but I can sum them up quickly: how does SA reverse the present situation, where energy is extremely expensive, increasingly unreliable, and a brake on growth? We see reports that SA now pays the world’s highest prices for energy – that is simply unsustainable if you want to attract or keep industry or attract investment or reinvestment.

The whole of Eastern Australia is struggling with energy.
- The growth of LNG exports has pushed gas prices up sharply, with businesses that used to pay $6 a gigajoule now being offered $18 or more.
- The electricity market has become more dependent on gas-fired generation as demand has picked up and old coal generators have closed.
- Pricier gas has seen wholesale electricity futures roughly double over the past year.

In SA these wider challenges are coupled with the reliability issues that come from being a small concentrated market segment at the very end of a long stringy national grid, with a high dependence on variable renewables and therefore a great need for supply to complement that variability.

The reliability challenge intersects affordability too, because the number one source of supply at present is expensive gas-fired generation. So, while prices have risen across the National Electricity Market, futures prices are worst in SA because of the higher reliance on gas-fired generation.
This situation has enormous consequences for industry. Ai Group estimates the costs to industry of last September’s statewide blackout at up to $400 million. The electricity and gas price rises now under way will cost businesses across the country more than $7 billion per year once fully passed through.

In light of all this, low energy intensity businesses are rethinking expansion plans and considering job cuts. High energy intensity businesses are fundamentally reconsidering their viability. Across Eastern Australia we are putting current investment and future opportunities at risk, and SA is at the sharp end.

To respond, we need action on electricity and gas from Federal and State governments, energy suppliers, and energy-using businesses themselves. And we need to look to both supply and demand.

On gas, there is a lot we can do to develop more gas resources and to manage gas demand.

We are going to need a patchwork of new supply options, but none are likely to be cheap and most involve unconventional gas extraction.

Community concern about unconventional gas is genuine and governments need to earn community confidence with credible regulation that requires good engineering when it comes to safeguarding water resources and so on. SA is doing its part to encourage new production, and we hope that persists.

While we can do much better than current gas prices, which are up to double export parity, gas is not going to be cheap again. Helping gas users improve their efficiency or switch fuels is going to help their financial sustainability and take pressure off the gas market. But this will take time and more investment in a flexible electricity system that can meet new demand from gas substitution.

In electricity, we have a fundamental problem: the lack of long term energy and climate policy, and intense political instability around these issues, mean there is very little basis for investment. And we desperately need investment, both to alleviate immediate supply risks and to bring costs down.

Federal difficulties have led States to start to fill the policy vacuum, and SA has done so more coherently and creatively than most. However, we remain convinced that NEM-wide mechanisms and policies have the best prospect to meet industry’s needs, and that we should step carefully in introducing the major changes that most agree are needed.

The broad package of reforms recommended by the Finkel Review looks like a strong basis for new investment in both the lowest cost clean generation, and in the range of security and reliability services that the system needs.

Several of SA’s steps, such as backup generation and a large-scale battery project, will complement this. The proposed SA Energy Security Target, by contrast, has the potential both to conflict with the Finkel mechanisms and to impose significant transitional costs on energy users. We are glad that the SA Government has delayed it for further study and analysis.

**Taxation**

My final area is taxation.
Our failure to improve our tax arrangements after the Henry Review has been tremendously frustrating and this lack of progress nationally has led to aberrations at the State level.

Taxation is now an Alice in Wonderland-like story in which we have come to expect the next chapter to rise to new levels of absurdity. And the SA Budget announcement last week of the new SA Bank Levy in the South Australian Budget certainly did not disappoint in this regard.

Whilst we recognize the State government has the right to manage state issues, we should not underestimate that decisions like this will have consequences.

One of our larger headquartered South Australian members indicated that its overseas owners viewed this decision as “anti-business”. It will have an impact on investment decisions and will also impact on the gradual improvement in business confidence.

Looking at the decision from afar the imposition of a state based tax on the liabilities of national businesses is sadly short-sighted.

If you wanted to pull the rug out from under a business sector that is ever-so-gradually rebuilding the confidence to invest, perhaps this is what you would do.

You would announce without consultation and without an eye to its design or its impacts on activity, on the cost of borrowing, and on investment and employment a new tax to take effect from Saturday week (which is tomorrow). If this was the objective, we would have to rank this SA Bank Levy a clear winner.

Colbert (that’s not Colbert the comedian but Jean-Baptise Colbert the French Minister for Finance under Louis XIV) famously described the art of taxation as “in so plucking the goose as to procure the largest quantity of feathers with the least possible amount of hissing.”

In view of the amount of hissing we have heard over the past week, I think we would have to rate the Weatherill/Koutsantonis Bank Levy an outstanding failure. And rightly so.

Sadly, the typical business does not react only, or even mainly, by hissing. Rather the business reaction is to redo the sums: to recalibrate probabilities; increase risk premia; and adjust investment plans.

If they have opportunities interstate or internationally, they will be more likely to head in those directions.

If they were tempted, instead of reinvesting in the business to withdraw a bit more cash for a family holiday, the family holiday just got a lot more attractive.

On federal Budget night on television, when I was asked about the Commonwealth’s bank levy, I said that if you squinted, it could be justified on the basis that the sector received Commonwealth guarantees and support, such as the maintenance of the Four Pillars policy. But you would have to squint.

I also said that no doubt some of our members would quietly perhaps chuckle at the banking sector getting one in the eye. It would also lead to questions around what sectors would be hit next and the realisation that eventually and inevitably, the costs imposed would be passed on to consumers, including business customers.

But as it turned out it was not which sector was next but which state hit the banks next.
It never occurred to me to think that a state would introduce their own levy. There is no real justification and the potential consequences could be enormous in terms of financial support for and costs for local businesses. You would hope that it will be rethought and that no other state would even contemplate going down this road.

Concluding Comments

So, in conclusion, I do think South Australia has a very strong future. I see no objective reason that should prevent it from being able to build its prosperity and for the benefits of that prosperity to be spread widely across the state.

This is true even though we live at a time of major global and technological transformations. There is much to do to realise that potential and to transition in the face of these upheavals. I have emphasised the particular importance of developing workforce and business capabilities.

And there are important barriers to dismantle. Sadly, most of these are man-made - I've pointed to energy and taxation as topical examples. But of course, if they are man-made, the good news is that we can unmake them.

South Australia needs to become a hub for investment – be it in energy, industry, start-ups, horticulture, tourism or defence. That is its road to success. The state has enormous natural advantages, a ready and able workforce hungry to acquire new skills and a track-record of delivering on major projects for our nation. It needs to attract investment and capability, not drive them away.

There are reasons to be optimistic but if you were being hard-headedly realistic, you would have to say the state sits at the cross-roads and some of its major competitors are leaving it behind in the dust.

This is a state that remains full of promise but it needs action, focus and commitment to deliver.

We should concentrate our efforts on building opportunities rather than on blocking them.

Thank you.